Xero Limited

2019 Annual Report

xero

Beautiful business

From beautifully designed accounting software

Wellington, NZ | John Scully, Product Manager (Mobile), with Anna Curzon, Chief Product Officer, Matt Barnett, General Manager Product and Para Muraleedharan, Product Manager Transactional Tax


xero

London, UK | Gary Turner, Xero Managing Director, UK & EMEA, with accounting partners Stuart Airy, Sylwia Kotarba, and Riaz Kala from Accounts + Legal

to beautiful
accounting
partnerships.

From growing our global presence

Singapore | Lim Wen Ling, The Mindful Company Co-founder, with Kevin Fitzgerald, Xero Regional Director, Asia, and Tessa Khoo, Marketing Director, Asia


xero
Figured
Expensify
GUSTO

to growing our platform connections.

Melbourne, AU | The Xero crew in Australia get together for the year ahead at the annual kick-off meeting

Highlights

Subscribers

Up 432,000 YOY

1,818,000

Total subscriber lifetime value

Up 36%YOY

$4.4 billion

Annualised monthly recurring revenue

Up 32%YOY

$638,179,000

Operating revenue

Up 36%YOY

$552,819,000

Free cash flow

Up $34,964,000 YOY

$6,451,000

Gross margin percentage

Up 2PP YOY

84%

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Chair's review

Dear shareholder

I am pleased to update you on another successful year for Xero. In the year ended 31 March 2019, Xero delivered against its financial and strategic objectives, and continued to expand our community of small business customers and partners around the world.

Graham Smith
Chair

Notably, for the first time, this financial year, while delivering on revenue growth, the business achieved positive free cash flow excluding funds used for acquisitions. More broadly, we have improved our financial performance and operating metrics, while prioritising investment in growth.

This year Xero made strong progress on building a beautiful, world-class platform for our customers and the communities we serve.

We are focused on growing our global subscriber base, and our investment priorities will reflect this. Combined with our ongoing product and technology investments, Xero is well positioned to succeed both in times of global macroeconomic strength and potential volatility.

The Board is pleased that the benefits we anticipated from consolidating Xero's listing on the Australian Securities Exchange (ASX) have been realised.

Liquidity in Xero's stock has more than doubled since announcing the move to a sole ASX listing in November 2017. Combined with Xero's inclusion in a range of equity market indices (including the S&P/ASX 100), the increase in liquidity has been accompanied by significantly higher investor and analyst interest, and a range of new investors have accumulated positions on our share register.

Convertible notes issue builds financial flexibility

Investor confidence in Xero was demonstrated by our successful US$300 million convertible notes issue, completed in October 2018.

In parallel with the convertible notes issue, Xero entered a call spread arrangement that reduces the potential dilution to shareholders that could occur upon conversion. This structure has been used in other geographies, particularly the US, but was the first of its kind for an Australian or New Zealand company not listed in the US.

The Xero Board | Bill Veghte, Graham Smith, Dale Murray, Lee Hatton, Rod Drury, Susan Peterson, Craig Winkler

The funds raised will provide greater flexibility should we choose to execute acquisitions or investments with the aim of enhancing and extending Xero's small business platform and ecosystem.

We have implemented a capital allocation framework supporting the review and pursuit of future organic and inorganic investment opportunities. This is aligned with our strategic priorities, while satisfying our strong focus on financial discipline.

Leadership at Xero

Just over a year ago, we welcomed Steve Vamos as Xero's new Chief Executive Officer, filling the shoes of founder Rod Drury, who moved to a non-executive director role on Xero's Board. The Board is delighted with the progress in Steve's first year and how well the leadership team is delivering on our strategy to achieve positive results.

We have a deeply experienced, highly qualified, international board of directors, and I'd like to thank and acknowledge the valuable contribution of my fellow directors during the year.

On behalf of the Board, I would like to thank the entire team of dedicated and talented people at Xero for their commitment and contributions to our business.

To our valued partners and customers, and to Xero investors, thank you for the trust and confidence you place in us every day.

Graham Smith
Chair

CEO's review

Dear shareholder

It has been just over a year since I became Xero's CEO and each day the extraordinary opportunities for our business are clear to see.

Steve Vamos
Chief Executive Officer

I'd like to thank Xero's founder Rod Drury for enabling a smooth and effective CEO transition and my induction into the business, and for his continued contribution to strategy and innovation. Thanks also to our Chair Graham Smith and our Board, Xero's leadership team, our people, and our partners, customers and shareholders I've met around the world, for your support and for making me feel so welcome.

Communities with purpose

At the heart of Xero are deeply engaged, passionate and diverse global communities of people connected to Xero and to each other. These include small business owners and their customers, employees, accountants, bookkeepers, business advisors, banks and suppliers.

Together, we make planning, managing and running small businesses more seamless, simpler and smarter. Our purpose is to help make life better for people in small business, their advisors and communities around the world. The strength of our business is represented as much by the people in our extended communities as it is by the beautiful products we provide.

Today, Xero is much more than a cloud accounting platform. Our customers are increasingly turning to Xero to help them run their businesses, not just manage their finances.

The Xero platform connects customers with financial services, data insights, and more than 700 third-party apps. To illustrate the scale of activity the platform facilitates in our communities, in the 2019 financial year, $2.8 trillion* in transactions flowed through Xero and $658.6 billion in invoices were raised on the Xero platform. The platform also provides businesses with more than 200 connections to banks and financial service providers around the world.

** Incoming and outgoing transactions, 12-month period*

In the 2019 financial year:

$2.8 trillion*
Transactions through Xero

$658.6 billion
Invoices raised on Xero

Financial and operating performance

During the 2019 financial year (FY19) Xero delivered revenue growth of 36 percent while maintaining strong operational discipline. Notably, we achieved a significant milestone with our first positive free cash flow result in FY19.

Key financial highlights for the year were:

- Operating revenue increased by 36 percent to $552.8 million
- Subscribers increased by 31 percent to 1.82 million
- Free cash flow was positive for the first time at $6.5 million, an improvement of $35.0 million
- The total lifetime value (LTV) of Xero subscribers was $4.4 billion, up 36 percent from the previous year
- EBITDA, excluding impairments, increased by 84 percent to $91.8 million
- Annualised monthly recurring revenue (AMRR) increased by 32 percent to $638.2 million

At the same time as delivering these results, during the year we maintained a strong focus on the strategic initiatives and people and technology capabilities that are key to maximising our long-term opportunities.

Particularly encouraging is our ongoing growth in subscribers across both established and emerging markets and our progress in entering, growing and scaling in new geographies. In FY19, we added 432,000 subscribers globally. Compare this to Xero's total subscriber number of 475,000 just four years ago.

For the first time, this year Xero's International market subscriber additions of 239,000 collectively exceeded our home ANZ markets additions of 193,000.

A highlight of the year was Xero's growth in the UK, where we achieved record subscriber additions for one country in a 12-month period. The UK business added 151,000 subscribers (up 48 percent) with revenues increasing by 50 percent (45 percent in constant currency). We remain well positioned to support small businesses and their advisors in the transition to HM Revenue & Customs' (HMRC) Making Tax Digital (MTD) policy initiative.

Detailed analysis of our 2019 financial performance can be found in the management commentary on pages 19–34.

Acquisitions

While Xero delivered strong organic growth this financial year, we also enhanced our platform strategically through two targeted acquisitions.

The acquisition of Hubdoc in August 2018 expands the Xero platform by providing a leading data-capture solution to help accountants, bookkeepers, and small businesses streamline administrative tasks.

In December 2018 we acquired Instafile, a tax filing and accounts production solution that extends Xero's existing connectivity to the UK's HMRC and Companies House. This acquisition highlights our intent to continue to invest for growth in the UK and to provide the most compelling product experience to both small businesses and accounting professionals.

Culture and human connections

Xero's culture is best illustrated by one of our five values, #human. This value represents our core belief that our business is all about connecting people with people, and caring about each other and those who we connect with.

Technology is at the core of our business, but the human connections and collaboration we support are what underpin our culture. The ability of our people to form trusted relationships with small businesses, partners and advisors is a source of genuine competitive advantage.

It is important to me that we provide our people with an environment where they feel safe to be themselves, are able to openly and honestly question and challenge each other and the way we do things, and are encouraged to think in new ways.

Looking ahead

We are in an exciting stage of Xero's journey. We have the people, partnerships and platform to innovate and grow our business. We remain focused on the significant opportunities ahead for Xero while continuously improving what we do and how we do it.

We will continue to prioritise investment in growing our subscriber base, improving our capability to deliver more services to our customers and partners, and expanding our presence in new markets such as Asia, Canada, and South Africa.

We will remain focused on our highly valued relationships with our accounting and bookkeeping partners as the foundation of our go-to-market and customer engagement strategy. These advisors are helping to improve the productivity of, and provide insights to, small businesses in ways that were simply not possible before the onset of cloud computing.

We will fuel strong organic growth while also pursuing strategic acquisitions and partnerships, which will benefit shareholders, small businesses, accounting and bookkeeping partners, and our ecosystem.

I'm very proud of our team of Xero people around the world for the results they have delivered this year. Thanks to all of you!

Steve Vamos
Chief Executive Officer

Melbourne, AU | Matt Jolley, Head of Customer Experience, AU, with Erin Jetter, People Experience Business Partner, Rachael Powell, Chief Customer, People and Marketing Officer, and Rob Goodwin, Commercial Director

Bringing beautiful business to the world

Xero made strong progress in FY19 towards our strategic priority of driving the adoption of cloud accounting.

During the year, Xero's total subscriber base grew by 432,000 (or 31 percent) to 1.82 million subscribers. It is encouraging to see this continued growth, but the opportunity for Xero from here remains immense. To provide some context around this opportunity, we estimate that less than 20 percent of small businesses currently use cloud accounting technologies, across the English-speaking countries in which we operate.

In Xero's home markets of New Zealand and Australia (ANZ), our small business customers and partners are leading the world in the adoption of cloud accounting technologies. We estimate that over 50 percent of small businesses in the region use cloud accounting, which is more than double the uptake within other markets such as North America and the UK.

We work closely with our partners, advisors and government taxation authorities to help small businesses move to a digital environment and realise the benefits of adopting cloud technologies. Ultimately, the ability to access high-integrity information in real time, like cash flows, tax payments and payroll, benefits the economies in which we operate.

Xero is balancing global focus with local market needs

This is the first year Xero's International markets have collectively added more subscribers than in our foundation markets of New Zealand and Australia. We anticipate this trend will continue, underscoring the increasing international composition of our business and its performance.

UK

A highlight for FY19 was the standout performance in the UK. Xero UK finished the year with 463,000 subscribers, adding 151,000 in the 12 months, a new record for any one country, and UK revenue was up by 50 percent. Xero is well positioned to continue to benefit from the opportunity provided by HMRC's MTD policy initiative and looking to FY20, we see MTD as a continuing growth catalyst for our UK business.

ANZ

During the second half of FY19, we announced total subscribers in ANZ had reached one million. We ended the year with 1.08 million subscribers, further cementing Xero as the region leader in cloud accounting. Xero's revenue also increased strongly in the region by 30 percent from the previous year. Subscriber growth remained the primary driver for this increase in revenue.

London, UK | Trent Innes, Managing Director, Australia and Asia, with Craig Hudson, Managing Director, New Zealand and Pacific Islands, and Gary Turner, Managing Director, UK and EMEA

In New Zealand, where many small businesses already use cloud technologies, we're increasing our presence in the market through the increased use of Xero product add-ons with associated incremental revenue from payroll, expenses, projects and other adjacent products (such as Hubdoc). An increase in prices, combined with a higher feature product mix, contributed to a 5 percent increase in ARPU in our foundation market.

Payday filing became mandatory in New Zealand from 1 April 2019, meaning most businesses are required to file payroll information with the Inland Revenue within two days of processing. Payday filing is easy with Xero. After a one-off connection is established with Inland Revenue, payday filing happens automatically each time a pay run is completed in Xero Payroll.

The digitisation of small business accounting is also accelerating in Australia with the introduction by the Australian Taxation Office (ATO) of Single Touch Payroll, which will be mandatory for all Australian businesses from 1 July 2019. This legislation requires businesses of all sizes to file each pay run electronically with the ATO. This provides Xero with a substantial opportunity to support the changing small business compliance needs in the Australian market.

North America

In North America, subscriber numbers reached 195,000 in the financial year and finished the period up 48 percent. Our US accountant and bookkeeper partner-led strategy continues to deliver positive results. Likewise, Canada is emerging as a key growth opportunity for Xero with an encouraging initial uptake in subscribers, further boosted by our acquisition of Hubdoc.

Rest of World

Xero's Rest of World markets include South Africa, Singapore, Hong Kong, and others. Here, subscriber numbers increased by 43 percent to 83,000, with revenue up 55 percent as Xero continues to build brand recognition and distribution channels in these markets.

Brisbane, AU | Xerocon Brisbane 2018

From New Zealand to the world

Founded more than a decade ago in an apartment in Wellington, New Zealand, Xero was created as a cloud accounting platform designed to revolutionise how small businesses, accountants, and bookkeepers work together. As the needs of small business and their advisors have changed, Xero has expanded the breadth of our offerings to meet these needs building out to a business platform.

Xero's brand tagline changed during the year to reflect our strategic position as a business platform, moving from 'beautiful accounting software' to 'beautiful business'. Combining the two words 'beautiful' and 'business' underscores the ongoing evolution of the business and highlights what our customers love about Xero – automated and easy, intelligent and connected, secure and reliable, creating a delightful and personalised user experience.

Xero delivered a major customer support milestone with the launch in May 2018 of Xero Central – our customer support and community portal where customers engage with Xero and each other.

Xero is delivering on its promise as a small business platform. The launch of Xero's full-featured API for bank feeds in September 2018 is an example of this. The API enables banks, fintechs and other financial institutions of all sizes to connect with Xero, providing small business customers with a clearer view and faster access to their financial data. We have integrations with a range of financial institutions, including leading UK fintechs such as Tide, Starling, and TransferWise, as well as major global banks, including OCBC in Hong Kong and Singapore.

We believe that the Xero brand comes to life with our communities at our signature Xerocon events. The events bring thousands of partners together to connect and learn. Now held in three geographies annually, in FY20 Xerocon will be held in San Diego, Brisbane and London.

Xerocon has become part of Xero's cultural fabric and illustrates the growing scale of the Xero communities. It is about building personal relationships, providing updates on new product developments and contemporary business practices, and working together to support small businesses.

Xero's purpose and people, the human element

Xero's continued expansion and future success depends on building and maintaining trust with our key customers, partners, and other stakeholders worldwide.

At Xero our purpose is to 'make life better for people in small business, their advisors and communities around the world'. This purpose is at the heart of how we build our products and improve our platform, shape our values, build our workforce and keep our team of Xero people engaged.

Over the past decade, our purpose and our people have become intrinsically linked. We believe if we build trust through a clear purpose and direction, and support and equip our people to do the best job of their lives, it has a positive ripple effect on customer loyalty and the long-term strength of our business.

We hire people who are purpose-driven, customer-centric and passionate about small business and our industry. Our people also have a deep understanding of the accounting and needs of our customer base, particularly small business.

As our business grows, our purpose and people will continue to be consciously connected to serve our growing communities of small businesses and their advisors.

Harnessing the power of the Xero platform

The Xero platform provides our 1.8 million subscribers with over 200 connections to banks and financial service providers, and more than 700 apps.

Xero was founded as a cloud-based accounting offering with a revolutionary idea – a secure, real-time system of record on which small business could be conducted anywhere in the world.

Today, the Xero platform truly embodies this idea, by extending well beyond financial record keeping, to providing a full spectrum of tools and services that can help small businesses succeed.

The key pillars of the Xero platform are:

- Security, privacy and scalability
- Our vital network of partners within the accounting and bookkeeping industry
- Connections with a wide range of financial institutions along with new global fintech companies and our vibrant community of connected apps in our ecosystem

The power of our business platform is more than Xero as a company; it sustains a thriving ecosystem for others who build on the platform and contribute to driving success for our customers.

Each day, people and small businesses rely on Xero's ecosystem for seamless, real-time solutions and data, as well as connections to other people, to understand and run their businesses more effectively and efficiently. Xero's platform delivers a human experience that harnesses the power and efficiencies of automation and machine learning technology.

Scale of the platform this year

- Over 200 connections with banks and financial service providers globally
- $2.8 trillion in transactions flowed through Xero
- $658.6 billion in invoices raised through the Xero platform
- More than 50,000 users of Xero's API developer tools

The Xero Platform

For small business
Small businesses can manage their day-to-day finances with software that's smart and easy-to-use, having real-time access to their data and files

For partners
Accounting and bookkeeping partners can connect to their clients' data and work efficiently, bringing various work streams of their practice on to one platform in the cloud

Connected apps/ ecosystem
700+ linked apps
>50,000 users of Xero's API developer tools

Xero solutions
Gusto (US Payroll)

Xero products
Bank Feeds
Payroll
Expenses
Projects
Hubdoc
WorkflowMax

Connected apps/ ecosystem
Partner specific tools and apps

Xero partner products
Compliance
Workpapers
Tax solutions
HQ apps and explorer
Practice Manager
Reporting

Partnerships at the heart of the Xero platform
Xero's platform continues to grow through our valuable partnerships with accountants and bookkeepers. We believe these special relationships and connections are what makes Xero unique.

The platform allows accountants and bookkeepers to collaborate with their small business clients on one single, real-time general ledger. It also enables access to accounting tools, apps, financial institutions and a range of valuable and relevant data, in one place, available any time, on any device.

Having access to this information has transformed the way small businesses, accountants and bookkeepers work, enabling them to spend less time on manual data-entry tasks and access real-time information required to make critical business decisions.

Automation on the Xero platform is enabling additional efficiencies. For example, through the acquisition of Hubdoc, we can now auto-fetch financial documents from hundreds of utilities, telecom providers, and online vendors, freeing time for partners and small businesses and increasing the accuracy of their records. For accountants and bookkeepers, this means they can run their practices more efficiently and drive business growth.

Xero is a global platform that seamlessly connects businesses, saves time, and enables success.

A marketplace and network for small business and financial solutions

Xero has expanded out from its core accounting products to being a marketplace of ecosystem partners, comprising more than 700 third-party apps and more tightly integrated solutions and services.

Xero's open developer API allows data to flow seamlessly - with partners' and customers' consent - from Xero to third-party apps, enabling businesses of all sizes to build a toolkit that best suits them. To facilitate this integrated ecosystem, we work with more than 50,000 users of Xero's API developer tools who innovate and build according to small businesses' needs.

We have also established industry-leading partnerships with global financial institutions and fintechs to connect businesses with the financial information and services they need to run their businesses. Having a real-time view of cash flow, access to working capital when needed, and tools to get paid faster makes it easier for small businesses to operate. Customers using our payment gateways get paid substantially faster than other customers.

Secure, scalable and efficient technology

Xero's platform is underpinned by robust and scalable infrastructure. Our technology has the capability to store petabytes of data, process millions of customer requests, and convert trillions of pieces of data into business insights to deliver a seamless, intuitive customer experience.

Migration to the Amazon Web Services (AWS) platform in 2017 laid the foundations for Xero to deliver fast-paced innovation, leverage machine-learning technology, improve margins, and drive better business outcomes to help small businesses flourish. Since this migration, Xero has delivered more than 1.5 billion machine-learning recommendations, making it easier to quickly code and reconcile transactions.

Data security and data protection are significant priorities. We are committed to protecting our customers' information, educating users about online-security best practice, and ensuring user-focussed guardrails are in place to safeguard data that flows through our platform.

All data on Xero is encrypted and stored in several locations online so it's safe, secure and available when our customers need it. Xero achieved a data security milestone in December 2018 when we gained ISO 27001 certification, the international standard for implementing, maintaining and continually improving information security management systems. We are continuously working to improve our data security, from two-step authentication on user accounts to data encryption and regular security audits.

We believe that data is the currency of the modern economy. Our global platform leverages the collective power of millions of small businesses, accountants, bookkeepers, business advisors, and the many business activity data points and financial transactions they create. The next generation of innovative products and services we deliver will come from unlocking insights from this valuable data from our platform, and building new solutions to drive small business success.

Lune Croissanterie
Melbourne, AU

Xero's social & environmental impact

Xero is a young, fast-growing company, and we're proud of what we've achieved so far. We are early in our journey to formalise our approach to corporate citizenship and believe we have the foundations to make positive contributions to the environment and sustainability.

The role we play in society at large is also important and we intend to align our present and future efforts on social and environmental impact to our purpose. This is to 'make life better for people in small business, their advisors and communities around the world'.

We have appointed a Social and Environmental Impact Advisor who will steward our programmes to focus and report in the following areas:

- Building on established efforts to deliver further environmental and sustainability initiatives that reflect Xero's purpose, values and strategic direction
- In alignment with our purpose, building out programmes that will engage and contribute to thriving communities around the world
- Championing diversity and inclusion to cultivate our engaged global workforce

The following are some of the initiatives we have undertaken so far.

Environment and sustainability

We are building on our environmental initiatives within Xero's global office locations. We have taken steps to improve our waste, recycling and energy use to reduce our impact on the environment. A specific activity this year includes phasing out bottled water. In Auckland, New Zealand, the building we selected for our new office has been built to a 5* Green Star rating. In the US, our new Americas headquarters in Denver has a LEED Platinum rating and includes solar panels to supplement the building's energy consumption. End-of-trip facilities are also in place in both of these buildings to better support alternative modes of transport, and charging points for electric vehicles are available.

This year, as part of our efforts to source sustainably, we made the switch to ethically sourced organic cotton t-shirts for our staff t-shirts. As a branded garment, they have become a point of pride and belonging for our Xero team.

As a tech company, Xero has relatively low power consumption. Outside of our electricity usage in our global offices, a significant portion of energy consumption is through the data centres of AWS, our cloud services platform partner. It's pleasing that AWS has a long-term commitment to 100 percent renewable energy use for its global infrastructure and in 2018, AWS exceeded 50 percent of its energy from renewables. We're working with AWS to determine how we can optimise infrastructure utilisation.

Auckland, NZ | The Xero office

Wellington, NZ | Xero employees

Community initiatives

We are committed to building thriving communities and deepening our partnerships with for-purpose organisations, including non-profits.

Examples include:

- Xero supports non-profits in communities through our global employee volunteer programme, Community Connect. The programme gives every Xero employee a paid day of leave each year to make a difference to non-profits in the communities in which they live and work. Xero employees have so far contributed more than 2,800 hours as part of the programme
- Xero offers a lifetime discounted subscription for non-profit organisations globally on their Xero plan. We also have a sponsorship programme in each major region, providing funding to selected eligible organisations, events and charities
- Xero champions mental health initiatives globally, including launching a pilot in March 2019 with 5,000 current Xero customers in New Zealand as part of the Xero Assistance Programme. The programme provides small businesses free access to the corporate quality Employee Assistance Programme support for them, their employees and their families
- As part of our efforts to stimulate startup tech business growth, innovation and employment in New Zealand, we recently opened a new tech-focused community co-working space, 'Rewired' in Xero's new Auckland office. The aim is to foster innovation and collaboration in a community environment

Hunt & Gather Bee Co.
Waikato, NZ

Diversity & inclusion

We believe that valuing diverse ideas leads to innovation, as well as inclusion. A diverse workforce reflects our global small business customer and partner communities and allows us to be relevant and well connected to both.

Championing a diverse workforce helps us to attract and retain talent. We acknowledge that we all come to the table with different strengths and challenges, and at Xero we aspire to nurture these. Our efforts help us engage our communities with a greater purpose, and achieve employee satisfaction and increased productivity, which we believe enhances our overall performance.

Looking inside Xero, we've promoted initiatives that have strengthened our own gender diversity. At 31 March 2019:

- The Xero Board was 43 percent female
- Xero's leadership team was 50 percent female
- 42 percent of Xero employees were female

After appointing a Head of Diversity, Inclusion and Community in 2017, Xero has made great strides in this area, underpinned by our Diversity and Inclusion Policy and the objectives we use to measure our progress.

As part of the International Women's Day campaign in 2019, we celebrated what we've achieved so far. We also acknowledged what still needs to be done, to achieve gender balance both at work and more broadly in the communities in which we operate. Xero has joined a number of global organisations supporting and promoting LGBTI inclusion. These include Pride in Diversity in Australia and Stonewall in the UK. Xero has also achieved the Rainbow Tick certification in New Zealand in recognition of our inclusive workplace.

There is more information about diversity and inclusion at Xero in the Corporate Governance Statement on page 79 to 81 of this Annual Report.

For further information on Xero's social and environmental impact initiatives, please visit xero.com/socialimpact.

The Board of Directors

Graham Smith

CHAIR OF THE BOARD

Independent Director since February 2015 and Chair since January 2017

Graham has more than 25 years of finance experience in the software and SaaS industry. He was Chief Financial Officer at Salesforce from 2008 to 2014. He has held executive positions at Advent Software, Vitria Technology, Nuance Communications, and Oracle. Graham is chair of Splunk, and serves on the boards of directors at Slack and BlackLine. He recently served on the Citrix and MINDBODY boards. Graham also gets involved in his local community, as evidenced by his Board membership of the Sonoma Valley Education Foundation.

Nominations Committee (Chair)

Audit and Risk Management Committee

Rod Drury

XERO FOUNDER / NON-EXECUTIVE DIRECTOR

Director since July 2006

For more than a decade, Rod led Xero from humble beginnings with four employees working in a Wellington apartment to a global software business and S&P/ASX 100 company. Rod remains Xero's largest shareholder. Rod started his career at Ernst & Young and went on to establish and lead a number of innovative technology businesses. Rod was an independent director on the NZX Board and the Trade Me Board. At the Deloitte Top 200 Awards in 2017, Rod was named Visionary Leader of the Year. He was named Ernst & Young New Zealand Entrepreneur of the Year in 2013, and is a member of the New Zealand Hi-Tech Hall of Fame.

Lee Hatton

NON-EXECUTIVE DIRECTOR

Independent Director since April 2014

Lee has extensive commercial experience across New Zealand, Australia, the UK, and the US. After moving to Australia in 2012 to lead NAB's Group Regulatory function, in 2015 Lee became the Chief Executive Officer of UBank where she is accountable for the business's strategy and performance. Lee believes creating a growth culture, centred on customers, is the true disruptor of companies, and she has led large distribution teams throughout her career leveraging this philosophy. Recognised for her collaboration abilities and experience blending technology innovation and financial services, Lee is also an executive director of NAB Ventures and a non-executive director of BLD Group Pty Ltd. Lee is involved in the community and enjoys mentoring individuals, especially in relation to the future of work.

Audit and Risk Management Committee (Chair)

Susan Peterson

NON-EXECUTIVE DIRECTOR

Independent Director since February 2017

Susan is an experienced independent director on both ASX and NZX listed companies. She is currently an independent director of Trustpower, Vista Group, Property for Industry, and ASB Bank. Susan is a member of the New Zealand Markets Disciplinary Tribunal, was a past Ministerial Appointee to The National Advisory Council for the Employment of Women, and is a Board member of non-profit Global Women (NZ). Susan is founding co-chair and a shareholder in fast-growing health and wellness start-up company Organic Initiative Limited.

People and Remuneration Committee

Dale Murray, CBE
NON-EXECUTIVE DIRECTOR

Independent Director since April 2018

Dale is a technology entrepreneur and growth-company advisor. Dale co-founded mobile pioneer Omega Logic in 1999, which co-launched prepay top-ups in the UK. She led the growth of top-up transactions to £450m within five years, generating net revenue of £25 million. After selling the company in a trade sale, she turned to investing and advising start-ups and won the British Angel Investor of the Year award in 2011. Dale is currently a Europe Beachheads advisor for NZTE, a non-executive director at The Cranemere Group Ltd, and a board advisor to Seedrs. She was formerly a non-executive director and Trustee for the Peter Jones Foundation and a non-executive director at Sussex Place Ventures and the Department for Business, Innovation & Skills. She served on the Business Taskforce on EU Redtape for the British Prime Minister in 2013.

Audit and Risk Management Committee

Bill Veghte
NON-EXECUTIVE DIRECTOR

Independent Director since February 2014

Bill has spent 25 years in the IT industry building teams, businesses and technology. He spent 20 years at Microsoft where he served in a variety of engineering and leadership capacities, including running the Windows business and managing Microsoft's North American business. He was the Chief Operating Officer of HP and served as Executive Vice President and General Manager of HP's US$27 billion Enterprise Group. He was the CEO and director at SurveyMonkey. Bill is currently the Executive Chairman of Turbonomic, a market leader of IT workload automation.

People and Remuneration Committee (Chair)

Nominations Committee

Craig Winkler
NON-EXECUTIVE DIRECTOR

Director since May 2009

Craig co-founded Australian small business accounting software provider MYOB in 1991. Craig built MYOB to be a popular business tool and brand which, in 2004, merged with Solution 6 to become Australia's largest IT company. Craig joined the Xero Board in 2009. He now spends the majority of his time working in the philanthropic sector.

People and Remuneration Committee

Nominations Committee


xero

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. References to FY19 are to the year ended 31 March 2019. References to the comparative period or FY18 are to the year ended 31 March 2018.

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.

Effective from 1 April 2018, Xero has adopted NZ IFRS 9: Financial Instruments, NZ IFRS 15: Revenue from Contracts with Customers and NZ IFRS: 16 Leases. Prior year comparatives including key SaaS metrics have been restated to reflect these new standards. See note 2 to the financial statements for more information on the impact of these standards on the financial performance and position of the Group.

Sukhjinder Pannu, Accounts + Legal, with Rishi Ruparelia, Xero Partner Success Manager, and Megan Hall, Accounts + Legal, London

Business results

Year ended 31 March	2019 ($000s)	2018 ($000s)	change
Subscription revenue	538,384	397,772	35%
Other operating revenue	14,435	8,887	62%
Total operating revenue	**552,819**	**406,659**	**36%**
Cost of revenue	(90,915)	(75,349)	21%
Gross profit	**461,904**	**331,310**	**39%**
Gross margin percentage	83.6%	81.5%	2.1pp*
Total operating expenses	**(451,881)**	**(352,245)**	**28%**
Percentage of operating revenue	81.7%	86.6%	-4.9pp
Other income and expenses	(96)	364	-126%
Operating profit/(loss) before asset impairments	**9,927**	**(20,571)**	**NM****
Asset impairments	(18,604)	(1,550)	NM
Operating loss	**(8,677)**	**(22,121)**	**-61%**
Percentage of operating revenue	-1.6%	-5.4%	3.8pp
Net finance expense	(14,459)	(1,750)	NM
Income tax expense	(4,007)	(1,043)	284%
Net loss	**(27,143)**	**(24,914)**	**9%**
Percentage of operating revenue	-4.9%	-6.1%	1.2pp

**pp stands for percentage points*
***NM stands for not meaningful*

During the 2019 financial year (FY19), Xero continued to deliver strong operating revenue growth of 36% alongside further demonstration of operational discipline. This was reflected in achieving Xero's first positive free cash flow result of $6.5 million for the year, an improvement of $35.0 million over the comparative year. The second half of the year resulted in Xero's first net profit after tax of $1.4 million, compared to a $5.3 million loss for the second half of the comparative period.

Operating revenue growth was primarily driven by subscriber growth in all markets. Cost of revenue decreased as a proportion of operating revenue due to continued efficiencies in the costs of hosting Xero's cloud services and further productivity gains from investment in the customer service platform.

Total operating expenses increased year-on-year as Xero continued to invest in scaling its global business, new products, and quality subscriber growth. Total operating revenue increased by 36% while operating expenses grew proportionately less at 28%, driven by efficiencies and financial discipline.

The operating loss reduced by 61%, despite the adverse impact of a $16.3 million impairment. This impairment related to the decision to discontinue the US payroll product and move to a full service solution in the US, provided by our partner Gusto, a US cloud-based payroll service provider. Without the impact of this impairment, operating profit would have been $7.6 million.

The statutory net loss increased by $2.2 million over the comparative period, with FY19 being adversely impacted by the impairment mentioned above.

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 in understanding Xero's financial performance. EBITDA is calculated by adding back depreciation, amortisation, net finance expense, and income tax expense to net losses.

EBITDA excluding the impact of non-cash share-based payments and impairments (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	2019 ($000s)	2018 ($000s)	change
Net loss	(27,143)	(24,914)	9%
Add back: net finance expense	14,459	1,750	NM
Add back: depreciation and amortisation	81,848	70,318	16%
Add back: income tax expense	4,007	1,043	284%
EBITDA	**73,171**	**48,197**	**52%**
EBITDA margin	13.2%	11.9%	1.3pp

EBITDA increased by 52% for FY19 against the comparative period. This was impacted by non-cash asset impairments, including a $16.3 million write off of the US payroll product and attributable goodwill relating to the decision to discontinue the US payroll product, and $7.9 million of transaction costs and operating losses from the acquisition of Hubdoc. EBITDA was positively impacted by $1.4 million resulting from an increase in capitalisation rates from 42.3% in the comparative period to 43.1% in FY19.

Year ended 31 March	2019 ($000s)	2018 ($000s)	change
EBITDA	**73,171**	**48,197**	**52%**
Add back: non-cash share-based payments	28,946	17,004	70%
Add back: non-cash impairments	18,604	1,550	NM
EBITDA excluding non-cash share-based payments and impairments	**120,721**	**66,751**	**81%**
Percentage of operating revenue	21.8%	16.4%	5.4pp

EBITDA excluding non-cash share-based payments and non-cash impairments improved by $54.0 million or 81% over the comparative period. This increase was due to operating revenue growth of 36% and expenses growing to a lesser extent over the comparative period.

EBITDA excluding non-cash share-based payments and non-cash impairments for the second half of the year was $71.4 million, representing 24% of operating revenue. This was a 74% improvement over the second half of the comparative period.

Cash flows

Free cash flow is a non-GAAP financial measure that has been included to show readers net cash generated by and invested into the business. We define free cash flow as cash flows from operating activities less cash flows used for investing activities, excluding cash used for acquisitions of, and investments into, businesses and strategic assets.

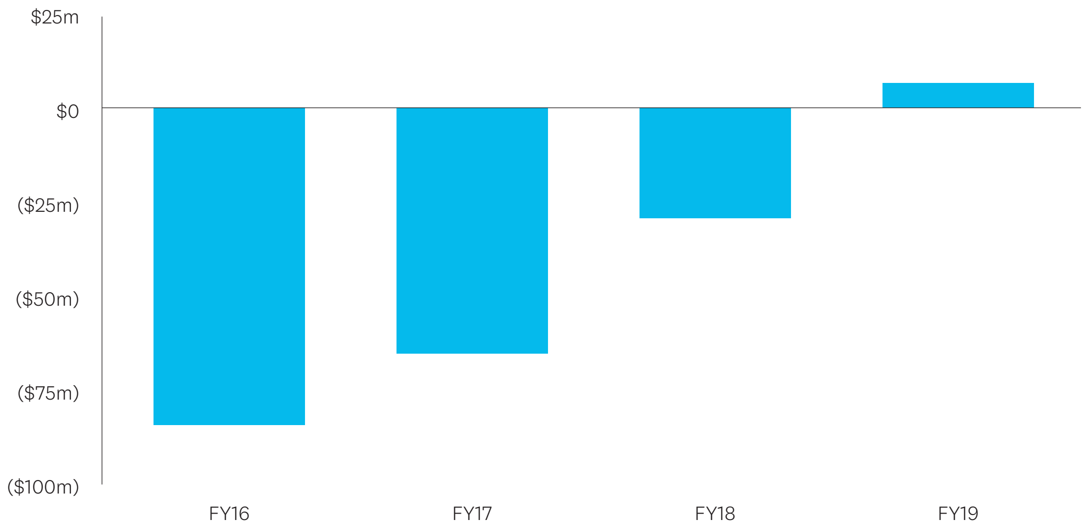
Year ended 31 March	2019 ($000s)	2018 ($000s)	change
Receipts from customers	552,256	410,470	35%
Other operating cash flows	(438,030)	(349,274)	25%
Total cash flows from operating activities	**114,226**	**61,196**	**87%**
Investing activities	(140,471)	(89,709)	57%
Add back: acquisitions	32,696	-	NM
Free cash flows	**6,451**	**(28,513)**	**NM**

Free cash flows for FY19 are positive for the first year in Xero's history, with a $6.5 million inflow when excluding the cash cost of acquiring Hubdoc and Instafile from investing cash flows.

Receipts from customers increased by 35% or $141.8 million to $552.3 million which is closely aligned with revenue growth. Other operating cash outflows increased by 25% or $88.8 million to $438.0 million, in line with headcount growth of 25% and operating expenses growth of 28%. Net cash flows from operating activities increased by $53.0 million to $114.2 million as receipts from customers increased by 35%, while payments to suppliers increased by 24% compared to the previous year.

Cash outflows from investing activities, excluding acquisitions, increased by 20% or $18.1 million. The increase is largely driven by an increase in cash outflows for capitalised development costs of $15.9 million (excluding Instafile), as well as $2.0 million more capitalised sales commissions.

Free cash flows



Operating revenue

Subscription revenue comprises recurring monthly fees from subscribers to Xero's online 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, revenue share agreements with other financial web service providers, and the implementation of online accounting software services. Subscription revenue comprises 97% of operating revenue in FY19.

Year ended 31 March	2019 ($000s)	2018 ($000s)	change	change in constant currency
Subscription revenue	538,384	397,772	35%	34%
Other operating revenue	14,435	8,887	62%	62%
Total operating revenue	**552,819**	**406,659**	**36%**	**34%**

The 35% increase in subscription revenue during the year was primarily driven by year-on-year subscriber growth of 31%, adding 432,000 subscribers in the year. It is also due to an increase in uptake in the Xero payroll, projects and expenses modules now being sold as add ons in most markets, as well as the acquisition of Hubdoc in August 2018. Excluding Hubdoc revenue from FY19, subscription revenue would have grown by 34% compared to FY18.

Other operating revenue increased by 62%. A significant component of other operating revenue is the monetisation of financial web partners where Xero works with providers to offer online financial solutions, such as payments and lending referrals, to subscribers resulting in an associated share of revenue. A further component of the increase in other operating revenue is due to the revenue from Xerocon events. Conference income increased as a result of one additional Xerocon being held during FY19, as well as an increase in the number of attendees and exhibitors attending Xerocon events.

Constant currency operating revenue (a non-GAAP financial measure) is provided to assist readers 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 FY19 at the effective exchange rates for FY18.

As 82% of Xero's operating revenue is denominated in foreign currencies, the comparatively weaker NZD against Great British pound (GBP) and United States dollar (USD) during FY19 compared to FY18 had a positive impact on reported revenue. Constant currency operating revenue for the Group for FY19 was $4.0 million lower than reported operating revenue. Year-on-year constant currency operating revenue growth of 34% was lower than reported revenue growth at 36%.

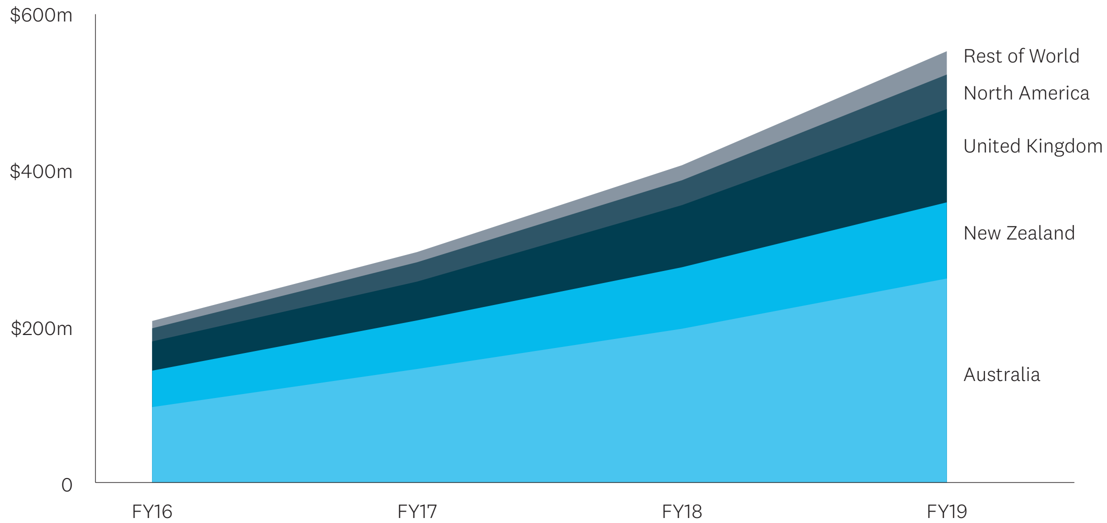
Operating revenue by geography

Year ended 31 March	2019 ($000s)	2018 ($000s)	change	change in constant currency
Australia	261,468	197,094	33%	33%
New Zealand	97,639	78,807	24%	24%
Australia and New Zealand (ANZ) total	**359,107**	**275,901**	**30%**	**31%**
United Kingdom (UK)	119,521	79,611	50%	45%
North America	44,270	31,873	39%	33%
Rest of World	29,921	19,274	55%	48%
International total	**193,712**	**130,758**	**48%**	**43%**
Total operating revenue	**552,819**	**406,659**	**36%**	**34%**

Operating revenue grew in all of Xero's geographies, with growth of 30% in the established ANZ markets largely due to the increased subscriber base. The two countries combined added 193,000 subscribers in FY19. Constant currency operating revenue growth for the ANZ markets was higher at 31% with a stronger average NZD against AUD compared to FY18. This growth is higher than subscriber growth of 22% largely due to a 3.7% increase in average revenue per user.

International markets continue to exhibit strong growth, particularly in the UK market, which achieved an operating revenue increase of 50% (45% in constant currency) from FY18. The Rest of World markets revenue grew by 55% (48% in constant currency) with strong performances in South Africa and Asia.

Total Group operating revenue by geography*



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

Subscriber numbers

Xero has refined its methodology regarding how it defines a subscriber. Now, subscribers to multiple Xero owned but independently billed products (for example Xero and Hubdoc, or Xero and WorkflowMax) are counted as a single subscriber to the Xero platform. The comparative period has not been adjusted as the change in methodology did not have a significant impact on that period's subscriber balance.

The revised definition of 'Subscriber' is: *Each unique subscription to a Xero-offered product that is purchased by a user (eg small business or accounting partner) and which is, or is available to be, deployed. Subscribers that have multiple subscriptions to integrated products on the Xero platform are counted as a single subscriber.*

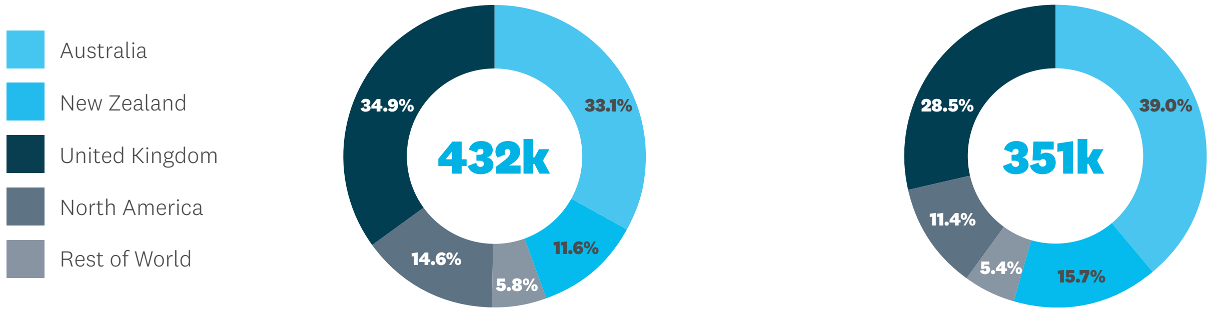
At 31 March	2019	2018	change
Australia	726,000	583,000	25%
New Zealand	351,000	301,000	17%
Australia and New Zealand (ANZ) total	**1,077,000**	**884,000**	**22%**
United Kingdom	463,000	312,000	48%
North America	195,000	132,000	48%
Rest of World	83,000	58,000	43%
International total	**741,000**	**502,000**	**48%**
Total paying subscribers	**1,818,000**	**1,386,000**	**31%**

Subscribers grew by 432,000 during the year, or 31%, bringing total subscribers to 1,818,000 at 31 March 2019. North American subscribers at 31 March 2019 includes 19,000 subscribers acquired through the acquisition of Hubdoc. Excluding acquired Hubdoc subscribers, North American subscribers grew by 44,000 or 33%, and total Group subscribers grew by 413,000 or 30%.

ANZ surpassed one million subscribers in FY19, adding 193,000 subscribers or 22% in the year as Xero continues to strengthen its presence in these established markets.

For the first time, International markets added more subscribers than the ANZ markets, increasing by 239,000 or 48% (220,000 or 44% excluding acquired Hubdoc subscribers) in FY19. The UK was of particular note, adding 151,000 subscribers in FY19, with 108,000 of those added in the second half of the year. Both the FY19 and second half FY19 UK subscriber additions are new records for any one country.

Net subscriber additions



Regional subscribers at 31 March 2019*

Australia
726,000
2018 // 583,000

New Zealand
351,000
2018 // 301,000

United Kingdom
463,000
2018 // 312,000

North America
195,000
2018 // 132,000

** Rest of World subscribers at 31 March 2019 83,000 (31 March 2018: 58,000)*

Annualised monthly recurring revenue

Annualised monthly recurring revenue (AMRR) is a non-GAAP financial measure, which 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, transaction volumes, pricing, and foreign exchange remain unchanged during the year.

Constant currency AMRR (also a non-GAAP financial measure) is calculated by translating AMRR at 31 March 2019 at the foreign exchange rates from 31 March 2018, and is provided to assist in understanding and assessing year-on-year growth rates, excluding the impact of foreign currency fluctuations.

At 31 March	2019 ($000s)	2018 ($000s)	change	change in constant currency
ANZ	396,233	314,496	26%	28%
International	241,946	169,925	42%	40%
Total	**638,179**	**484,421**	**32%**	**32%**

The growth in AMRR was driven by both subscriber and average revenue per user (ARPU) growth. ARPU increases were due to increased revenue from non-accounting services, such as financial web revenue, that grew at a faster rate than subscription revenue as well as price increases in Australia and New Zealand. Xero added $153.8 million of AMRR in FY19.

The weaker NZD exchange rate against USD at 31 March 2019 compared to 31 March 2018 has had a favourable impact on the reported AMRR growth for the International segment, with constant currency AMRR growth of 40% two percentage points lower than reported growth of 42%. In constant currency, total AMRR has grown by 32%, one percentage point higher than subscriber growth, led by higher ARPU in the ANZ segment.

For the first time, more AMRR was added in the second half of the year in the International markets than the ANZ markets in both actual and constant currency terms.

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 data from financial institutions, and providing support to subscribers.

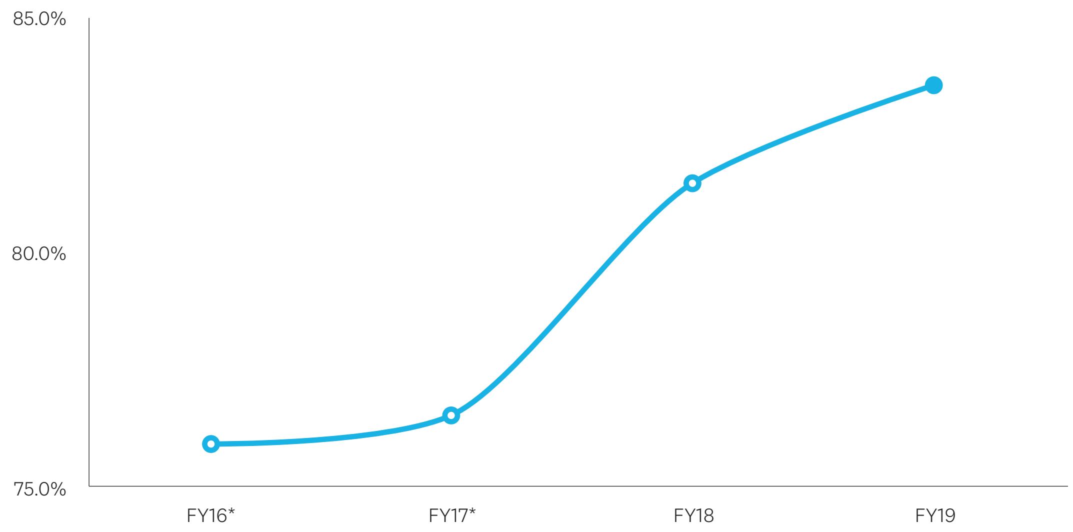
The costs include hosting and content distribution costs, bank feed costs, personnel and related expenses (including salaries, benefits, bonuses, and share-based payments) directly associated with cloud infrastructure and subscriber support, contracted third-party vendor costs, related depreciation and amortisation, and allocated overheads.

Year ended 31 March	2019 ($000s)	2018 ($000s)	change
Operating revenue	552,819	406,659	36%
Cost of revenue	(90,915)	(75,349)	21%
Gross profit	**461,904**	**331,310**	**39%**
Gross margin percentage	83.6%	81.5%	2.1pp

Cost of revenue for FY19 grew by $15.6 million to $90.9 million, representing a 21% increase when compared to the comparative period. The primary reasons for the change were increases in personnel costs required by Xero's customer support teams to support more subscribers, and increased cloud hosting costs against the comparative period. Operating revenue growth of 36% resulted in gross profit increasing by $130.6 million, or 39%, to $461.9 million.

Cost of revenue decreased as a percentage of operating revenue compared to FY18 due to efficiencies in hosting costs and in the customer support platform. Customer support became more efficient with the release of Xero Central during FY19. Xero Central utilises machine learning to suggest and refine answers to customers' questions as they are asking them. Gross margin for the year of 83.6% is an improvement of 2.1 percentage points compared to FY18.

Gross margin percentage



** affected by AWS migration*

Sales and marketing

Sales and marketing expenses consist of personnel and related expenses (including salaries, benefits, bonuses, the amortisation of deferred commission costs and share-based payments) directly associated with the sales and marketing teams, and the cost of educating and onboarding both partners and small business customers. Costs also include relationship management costs incurred to support the existing subscriber base. Other costs included are external advertising costs, marketing costs and promotional events, as well as allocated overheads.

Year ended 31 March	2019 ($000s)	2018 ($000s)	change
Sales and marketing expenses	248,014	189,203	31%
Percentage of operating revenue	44.9%	46.5%	-1.6pp

Sales and marketing costs increased by $58.8 million, or 31%, to $248.0 million for the year, compared to operating revenue growth of 36% and subscriber growth of 31%. 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 and a half years on average). Note that sales commission costs are now capitalised and amortised to sales and marketing costs over a five-year period. Sales and marketing costs in the International markets increased by 34%, compared to operating revenue growth of 48% as Xero looks to benefit from the opportunity MTD offers in the UK market. Sales and marketing costs in the ANZ markets increased by 26% compared to operating revenue growth of 30%.

The average cost of acquiring each subscriber has increased to $397 per gross subscriber added in FY19 compared to $376 in FY18. The increase is largely due to segment mix effects with the strong growth in International subscriber numbers as well as additional investment in the more established ANZ markets. Group customer acquisition metrics remain strong and the associated spend continues to power increased levels of subscriber and AMRR growth.

As a percentage of operating revenue, sales and marketing costs decreased from 46.5% in FY18 to 44.9% for FY19.

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 and meets certain requirements under IFRS 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	2019 ($000s)	2018 ($000s)	change
Total product design and development costs (including amounts capitalised)[1]	**170,946**	**140,513**	**22%**
Percentage of operating revenue	30.9%	34.6%	-3.7pp
Less capitalised development costs	(73,598)	(59,374)	24%
Product design and development expense (excluding amortisation of amounts capitalised)	**97,348**	**81,139**	**20%**
Less government grants	(5,219)	(4,517)	16%
Add amortisation of capitalised development costs	45,666	39,683	15%
Product design and development expenses	**137,795**	**116,305**	**18%**
Percentage of operating revenue	24.9%	28.6%	-3.7pp

[1] excludes impairments

Xero continues to invest in its global product and platform, developing a significant range of new features during FY19, including:

- Xero Central, a one-stop shop for our users to manage their relationship with Xero
- Making Tax Digital functionality, allows users to manage UK VAT compliance digitally through integrated HMRC and Xero workflows
- Profit and Loss at a glance on mobile, gives users a quick view of their profit and loss, and a breakdown of income and spending, from their Android or iOS dashboard
- A global API, allows any bank or other financial institution to sync their bank feeds directly to the Xero platform
- Single Touch Payroll functionality, allows Australian employers to comply with new Australian Taxation Office payroll reporting requirements
- Payday Filing functionality, allows New Zealand employers to comply with new Inland Revenue payroll reporting requirements
- New Navigation, intuitive navigation experience that makes it quicker and easier for Xero businesses and advisors to discover new features and seamlessly navigate to those they most frequently use

Total product design and development costs were $170.9 million in FY19, $30.4 million or 22%, higher than in the previous period. Of this, $73.6 million was capitalised, with the balance of $97.3 million included as an expense in the Income Statement. The amount capitalised represents a capitalisation rate of 43.1% of total product design and development costs for FY19, which is 0.8 percentage points higher than the comparative period.

As a proportion of operating revenue, total product design and development costs for FY19 (including amounts capitalised) decreased by 3.7 percentage points to 30.9%, compared to 34.6% for the comparative period, as revenue grew at a faster rate than product design and development costs.

The amortisation of previously capitalised product design and development expenditure of $45.7 million was included as a non-cash expense in the Income Statement, giving total net expenses (after the netting of government grants) for the period of $137.8 million. Amortisation of previously capitalised development costs increased due to higher intangibles balances than in the comparative period.

Product design and development expenses increased by 18% on the comparative period as Xero continued to increase investment in product and innovation. As a proportion of operating revenue, product design and development expenses decreased to 24.9% in FY19 from 28.6% in the comparative period.

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, and the Xero Board. It also includes legal, accounting and other professional services fees, insurance premiums, other corporate expenses, and allocated overheads.

Year ended 31 March	2019 ($000s)	2018 ($000s)	change
General and administration expenses	66,072	46,737	41%
Percentage of operating revenue	12.0%	11.5%	0.5pp

General and administration costs were $66.1 million for FY19, $19.3 million or 41% higher than in FY18. The current period includes $1.3 million of costs relating to the acquisition of Hubdoc, as well as a $5.0 million increase in non-cash share-based compensation.

General and administration costs as a proportion of operating revenue remained relatively consistent with FY18, increasing 0.5 percentage points from 11.5% in FY18 to 12.0% in FY19.

Employees

At 31 March	2019	2018	change
Total Group	2,531	2,021	25%

Full-time equivalent (FTE) employees increased by 510 or 25% in FY19, taking the total FTEs to 2,531, compared to a 31% increase in subscribers and 36% increase in operating revenue. The increase includes 83 FTEs who joined Xero as part of the acquisition of Hubdoc. The slower growth compared to revenue and subscribers reflects the benefits of economies of scale and operating efficiencies.

Net finance expense

Year ended 31 March	2019 ($000s)	2018 ($000s)	change
Interest income on deposits	8,035	2,440	229%
Total finance income	**8,035**	**2,440**	**229%**
Interest on convertible notes	(12,753)	-	NM
Bank standby facility costs	(1,847)	(775)	NM
Finance lease interest	(4,987)	(3,100)	61%
Other finance expense	(2,907)	(315)	823%
Total finance expense	**(22,494)**	**(4,190)**	**NM**
Net finance expense	**(14,459)**	**(1,750)**	**NM**

Finance income in FY19 was $8.0 million, an increase of $5.6 million or 229% from the previous year due to increased cash and short-term deposit balances from the issue of convertible notes in October 2018. Proceeds from the convertible notes issue are held on deposit until required.

This increase to finance expense was driven by interest on the convertible notes and on term debt used for the acquisition of Hubdoc, combined with fees relating to an undrawn committed standby facility. Finance lease interest increased by $1.9 million due to leases for office space entered into during the year, particularly the Auckland building lease which has a 12 year term.

Segment contribution

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 user support costs.

	ANZ ($000s)	International ($000s)	Total ($000s)
Year ended 31 March 2019			
Operating revenue	359,107	193,712	552,819
Expenses	(140,175)	(198,754)	(338,929)
Other income	69	331	400
Segment contribution	**219,001**	**(4,711)**	**214,290**
Contribution margin percentage	61.0%	-2.4%	38.8%
Year ended 31 March 2018			
Operating revenue	275,901	130,758	406,659
Expenses	(118,683)	(145,869)	(264,552)
Other income	16	1,071	1,087
Segment contribution	**157,234**	**(14,040)**	**143,194**
Contribution margin percentage	57.0%	-10.7%	35.2%

ANZ Operating revenue for FY19 grew by 30% compared to the comparative period, further reinforcing Xero's market leading position in the region. Revenue growth tracked ahead of subscriber growth of 22%, largely due to improvements in ARPU. This, along with cost efficiencies, resulted in a segment contribution for the year of $219.0 million, which improved as a percentage of operating revenue from 57.0% to 61.0%. Across ANZ 193,000 subscribers were added in FY19 to finish with 1,077,000 subscribers.

International Operating revenue for FY19 grew by 48% due to subscriber growth of 48% as well as an additional Xerocon being held in the year. International's contribution loss decreased to $4.7 million in FY19, compared to $14.0 million in FY18. The contribution margin improved from -10.7% to -2.4% due to scaling and efficiencies, particularly in the UK, while maintaining strong revenue growth. The contribution margin was comparatively lower than that of ANZ, reflecting the investment in subscriber growth in the UK, North America, and Asia, as Xero continues to build brand recognition and distribution channels in these markets.

Key SAAS metrics

SaaS companies like Xero operate on many of the same performance metrics as traditional companies, such as revenue, cash flow, and customer numbers. However, understanding the performance of SaaS companies, and being able to benchmark them requires an understanding of SaaS-specific metrics. Below are some of the headline metrics we utilise to manage and drive Xero's performance.

Average revenue per user (ARPU) is calculated as AMRR (see definition on page 27) at 31 March divided by subscribers at that time (and divided by 12 to get a monthly view).

CAC months are months of ARPU to recover the cost of acquiring each new subscriber. With the adoption of NZ IFRS 15 and the resulting spreading of contract acquisition costs, Xero has changed the calculation of CAC months to adjust for the deferral and amortisation of contract acquisition costs. The revised calculation is sales and marketing costs for the year excluding the deferral and amortisation of contract acquisition costs, less conference revenue (such as Xerocon), divided by gross new subscribers added during the same period, divided by ARPU. The revised calculation of the cost of acquiring each new subscriber is consistent with that used in prior years, as the deferral and amortisation of contract acquisition costs was not required prior to the implementation of NZ IFRS 15.

MRR churn is the value of monthly recurring revenue (MRR) from subscribers who leave Xero in a month as a percentage of the total MRR at the start of that month. The percentage provided is the average of the monthly churn for the previous 12 months.

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 (one divided by MRR churn), multiplied by ARPU, multiplied by the gross margin percentage. Group LTV is calculated as the sum of the individual segment LTVs, multiplied by their respective segment subscribers, divided by total Group subscribers.

LTV/CAC is the ratio between the LTV and the cost to acquire that subscriber, eg. the LTV derived from a subscriber in ANZ is currently on average 10.7 times the cost of acquiring that subscriber.

We strive to maximise total lifetime value whilst maintaining the optimal level of investment to maintain a desirable LTV/CAC ratio. We improve total lifetime value in multiple ways, such as increasing subscriber numbers, enhancing products and services for existing subscribers thereby increasing ARPU, improving gross margin through cost efficiencies, and investing in retaining customers.

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

At 31 March 2019	ANZ	International	Total
ARPU ($)	30.66	27.21	29.25
CAC months	9.4	18.3	13.6
MRR churn	0.85%	1.55%	1.10%
LTV per subscriber ($)	3,075	1,413	2,398
LTV/CAC	10.7	2.8	6.0

At 31 March 2018	ANZ	International	Total
ARPU ($)	29.65	28.21	29.13
CAC months	8.3	18.6	12.9
MRR churn	0.86%	1.62%	1.10%
LTV per subscriber ($)	2,841	1,402	2,320
LTV/CAC	11.5	2.7	6.2

ANZ – ARPU increased by 3.4% driven by the higher value product mix and pricing in both Australia and New Zealand, as Xero focuses on being a small business platform and sees increased use of Xero add-ons such as payroll, expenses, and projects as well as adjacent products. In constant currency terms ARPU increased by 4.8%. CAC months at 31 March 2019 was higher when compared to 31 March 2018 as Xero continues to invest in small business platform, ecosystem, and finweb strategies that target existing customers, as well as investing to drive growth to further increase market share in the ANZ segment.

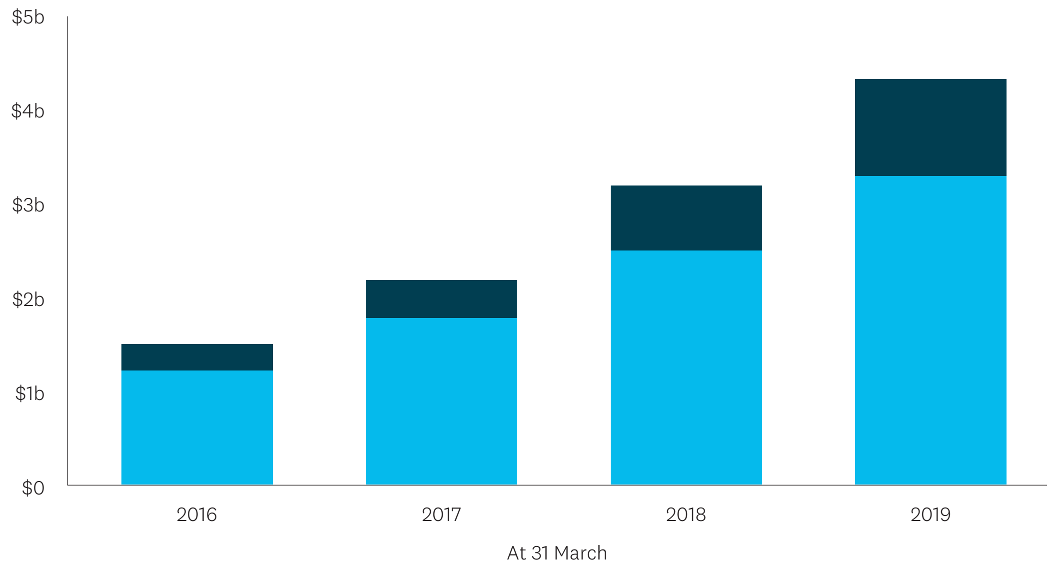
Improved ARPU, gross margin and lower churn led to an 8% improvement in LTV per subscriber (10% in constant currency). Total subscriber LTV increased by 32% to $3.3 billion at 31 March 2019 compared to the comparative period.

International – ARPU across the International segment decreased by 3.5% (4.8% in constant currency) over FY19 due to a focus on the lower ARPU partner channel in the UK and US markets.

Despite a lower ARPU, lower churn and higher gross margin led to a 1% improvement in LTV per subscriber at 31 March 2019 compared to the comparative period (flat in constant currency). Total LTV for the International segment increased by 49% to $1.0 billion at 31 March 2019 due to subscriber growth, particularly in the UK market, and improvements in gross margin.

Total Group – ARPU increased slightly by 0.4% (0.8% increase in constant currency) due to product mix and pricing in ANZ being offset by a shift towards the more efficient but lower ARPU partner channel, particularly in the International segment. LTV increased 3% from the same time last year to $2,398 per subscriber, due to the improvements in ARPU and gross margin. Group constant currency LTV per subscriber at 31 March 2019 was 4% higher than at 31 March 2018. Total LTV at 31 March 2019 was $4.4 billion, an improvement of $1.1 billion compared to 31 March 2018. CAC months increased 5% to 13.6 months when compared to 31 March 2018 due to the International markets contributing a larger component to the Group as well as continued investment in the ANZ markets.

Total lifetime value



ANZ
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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 40 to 75, which comprise the consolidated statement of financial position of the group as at 31 March 2019, and the consolidated income statement, 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 40 to 75 present fairly, in all material respects, the consolidated financial position of the group as at 31 March 2019 and its consolidated 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 a SOC 2 assurance report pertaining to Xero's technology control environment, R&D tax credit advice, and other assurance services related to the issuance of convertible notes and the Group's preparation for compliance with ISO 27001. 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.

Convertible Notes and related derivatives

Why significant

During the year, the Group raised US$300 million through the issue of convertible notes, listed on the Singapore Exchange Securities Trading Limited (SGX-ST).

In connection with the issuance, Xero also entered into call spread transactions. The lower strike call options are accounted for as derivative assets and are recorded by the Group at fair value. Gains and losses at each reporting period are recognised through the consolidated income statement. The upper strike call options are accounted for as equity.

The conversion features of the notes are accounted for as a derivative financial liability at fair value through the consolidated income statement.

Decisions regarding the appropriate accounting treatment of each element requires judgement.

Significant judgement is also required to determine the value of the conversion features and related call spread transactions. Note 14 of the financial statements describes the accounting for the convertible notes and associated call spreads.

How our audit addressed the key audit matter

Our work on the convertible notes and call spreads has focused on the appropriateness of the accounting treatment as well as the judgements made in determining their valuations. Our audit procedures included:

- Involving our financial instrument accounting specialists to consider and challenge the group's adopted accounting treatments;
- Consideration of the external valuation of the derivative instruments and the conversion elements of the notes by engaging our internal financial instrument valuation specialists to assess the appropriateness of the valuation methods adopted, the inputs used in the valuations and the resulting valuation amounts adopted by management;
- Reviewing the disclosures in the financial statements for appropriateness.

Hubdoc business combination and goodwill impairment testing

Why significant

During the year the Group acquired 100% of the ordinary shares in data capture solution provider Hubdoc Inc consideration included NZ $31.2m cash and NZ $54.9 million in ordinary shares of Xero Limited. A further US $10 million of shares may be payable contingent on certain conditions.

The acquisition has been treated as a business combination under NZ IFRS 3: Business Combinations. The assessment of the fair value of the various assets and liabilities acquired requires judgement.

The impact of the business combination is disclosed in Note 18 of the consolidated financial statements.

As a result of the acquisition goodwill of $78.8 million has been recognised. The Group is required to test goodwill for impairment at least annually. This assessment requires judgment including consideration of both internal and external sources of information.

How our audit addressed the key audit matter

Our audit procedures included:

- Considering the appropriateness of the cash generating units to which the acquired net assets have been allocated;
- Challenging the purchase price allocation from a methodology perspective and the key inputs used, including considering the experience and qualification of management's experts used in the assessment of the fair values of assets and liabilities purchase;
- Engaging our own internal valuation experts to assess the fair values determined;
- Comparing the key inputs such as WACC used in the model to rates observed in similar situations and ensuring that the stated WACC was used in the calculations;
- Discussing the basis on which management had assessed the likelihood of the contingent considerations being paid and its associated accounting treatment;
- Performing a review of the business combination note disclosure in the financial statements to assess compliance with NZ IFRS 3;
- Considering management's impairment assessment, including Hubdoc's actual trading performance against its forecasts.

Capitalisation of Software 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 are disclosed in Note 10 to the 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 can be capitalised under NZ IAS 38: Intangible Assets. Our audit procedures included the following:

- Assessing the nature of a sample of projects against the requirements of NZ IAS 38 to determine if they were capital in nature;
- Assessing the procedures applied by the Group to review the rates applied to capitalise payroll costs;
- Assessing the effectiveness of controls over the payroll process;
- Assessing capitalised costs with reference to actual payroll information for a sample of employees; and
- Assessing the adequacy of the disclosures related to capitalised development costs in the consolidated financial statements.

Impairment Considerations Relating to Capitalised Software Development Costs

Why significant

Intangible assets make up 76% of the Group's non-current assets. The most significant of these intangibles is capitalised software development costs.

NZ IAS 36: Impairment of Assets requires that finite life intangible assets be tested for impairment whenever there is an indication that the intangible assets may be impaired and this assessment requires judgment.

Disclosures relating to Intangible Assets, including key assumptions, are disclosed in Note 10 to the consolidated financial statements.

The assessment as to whether there are any indicators of impairment requires judgment including consideration of both internal and external sources of information.

Significantly, during the year the Group entered into a new strategic partnership with external payroll provider, Gusto. This triggered the impairment of Xero's own US payroll product of $11.1 million and goodwill related to the previous acquisition of Monchilla Inc of $5.2 million.

How our audit addressed the key audit matter

We assessed the factors that the Group considered regarding impairment of capitalised development costs and whether any indicators of impairment existed. This included having regard to:

- Significant changes in the extent or manner in which the associated software is used;
- Potential or actual redundancy or disposal of developed software;
- Forecast cash flows associated to the capitalised development costs;
- Amortisation periods 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 considered the appropriateness of management's decision to fully impair previously capitalised costs related to US payroll functionality.

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

Information other than the financial statements and auditor's report
The directors of the company 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 the External Reporting Board's website: https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/. 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

Chartered Accountants
Wellington
16 May 2019

Financial Statements

Income Statement

Year ended 31 March	Notes	2019 ($000s)	2018 Restated ($000s)
Subscription revenue		538,384	397,772
Other operating revenue		14,435	8,887
Total operating revenue	**4**	**552,819**	**406,659**
Cost of revenue	5	(90,915)	(75,349)
Gross profit		**461,904**	**331,310**
Operating expenses			
Sales and marketing		(248,014)	(189,203)
Product design and development		(137,795)	(116,305)
General and administration		(66,072)	(46,737)
Total operating expenses	**5**	**(451,881)**	**(352,245)**
Asset impairments	9, 10	(18,604)	(1,550)
Other expenses		(1,183)	(723)
Other income		1,087	1,087
Operating deficit		**(8,677)**	**(22,121)**
Finance income	6	8,035	2,440
Finance expense	6	(22,494)	(4,190)
Net loss before tax		**(23,136)**	**(23,871)**
Income tax expense	20	(4,007)	(1,043)
Net loss		**(27,143)**	**(24,914)**
Basic and diluted loss per share	7	($0.19)	($0.18)

Statement of Comprehensive Income

Year ended 31 March	Note	2019 ($000s)	2018 Restated ($000s)
Net loss		(27,143)	(24,914)
Other comprehensive income*			
Movement in cash flow hedges (net of tax)	16	999	2,863
Translation of foreign operations		1,006	(9)
Total other comprehensive income for the year		**2,005**	**2,854**
Total comprehensive loss for the year		**(25,138)**	**(22,060)**

** 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 Financial Position

	Notes	At 31 March 2019 ($000s)	At 31 March 2018 Restated ($000s)	At 1 April 2017 Restated ($000s)
Assets				
Current assets				
Cash and cash equivalents		121,527	20,955	27,699
Short-term deposits		336,819	59,000	86,000
Trade and other receivables	8	49,466	33,792	32,564
Derivative assets	14, 16	77,328	2,508	801
Other current assets		1,478	993	393
Total current assets		**586,618**	**117,248**	**147,457**
Non-current assets				
Property, plant and equipment	9	91,491	61,804	40,862
Intangible assets	10	289,731	168,816	145,539
Deferred tax assets	20	1,613	500	37
Derivative assets	16	238	41	17
Other non-current assets		627	2,207	1,958
Total non-current assets		**383,700**	**233,368**	**188,413**
Total assets		**970,318**	**350,616**	**335,870**
Liabilities				
Current liabilities				
Trade and other payables	11	27,043	26,285	31,995
Employee entitlements		37,830	27,980	27,336
Lease liabilities	13	11,541	7,531	6,475
Income taxes payable	20	1,958	537	1,105
Derivative liabilities	16	147	822	2,397
Other current liabilities	12	26,560	5,494	2,228
Total current liabilities		**105,079**	**68,649**	**71,536**
Non-current liabilities				
Term debt	14	357,731	–	–
Derivative liabilities	14, 16	77,367	–	17
Lease liabilities	13	71,308	37,906	21,286
Deferred tax liabilities	20	1,789	613	821
Other non-current liabilities		3,735	2,364	2,880
Total non-current liabilities		**511,930**	**40,883**	**25,004**
Total liabilities		**617,009**	**109,532**	**96,540**
Equity				
Share capital	17	627,848	537,744	522,610
Reserves		69,333	20,069	8,535
Accumulated losses		(343,872)	(316,729)	(291,815)
Total equity		**353,309**	**241,084**	**239,330**
Total liabilities and shareholders' equity		**970,318**	**350,616**	**335,870**

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)	Premium on call spread options ($000s)	Total equity ($000s)
Restated balance at 1 April 2018		549,596	(11,852)	18,904	(316,729)	(102)	1,267	–	241,084
Net loss		–	–	–	(27,143)	–	–		(27,143)
Other comprehensive income		–	–	–	–	1,006	999	–	2,005
Total comprehensive loss		**–**	**–**	**–**	**(27,143)**	**1,006**	**999**	**–**	**(25,138)**
Transactions with owners:									
Share-based payments	23	13,673	1,466	17,343	–	–	–	–	32,482
Exercising of employee and director share options	17, 23	20,115	–	(5,345)	–	–	–	–	14,770
Issue of shares – acquisition of Hubdoc, net of issue costs	18	54,850	–	–	–	–	–	–	54,850
Premium on call spread options, net of issue costs	14	–	–	–	–	–	–	35,261	35,261
Balance at 31 March 2019		**638,234**	**(10,386)**	**30,902**	**(343,872)**	**904**	**2,266**	**35,261**	**353,309**
Balance at 1 April 2017		**532,583**	**(9,973)**	**10,224**	**(306,995)**	**(93)**	**(1,596)**	**–**	**224,150**
Adjustment on adoption of new IFRS		–	–	–	15,180	–	–	–	15,180
Restated balance at 1 April 2017		**532,583**	**(9,973)**	**10,224**	**(291,815)**	**(93)**	**(1,596)**	**–**	**239,330**
Net loss		–	–	–	(24,914)	–	–	–	(24,914)
Other comprehensive income/(loss)		–	–	–	–	(9)	2,863	–	2,854
Total comprehensive loss		**–**	**–**	**–**	**(24,914)**	**(9)**	**2,863**	**–**	**(22,060)**
Transactions with owners:									
Share-based payments	23	13,830	(1,879)	9,517	–	–	–	–	21,468
Exercising of employee share options	17, 23	3,183	–	(837)	–	–	–	–	2,346
Restated balance at 31 March 2018		**549,596**	**(11,852)**	**18,904**	**(316,729)**	**(102)**	**1,267**	**–**	**241,084**

The accompanying notes form an integral part of these financial statements

Statement of Cash Flows

Year ended 31 March	Note	2019 ($000s)	2018 Restated ($000s)
Operating activities			
Receipts from customers		552,256	410,470
Other income		5,370	5,157
Interest received		5,028	2,315
Payments to suppliers and employees		(435,043)	(351,141)
Interest paid		(9,502)	(3,100)
Income tax paid		(3,883)	(2,505)
Net cash flows from operating activities	**21**	**114,226**	**61,196**
Investing activities			
Capitalised development costs		(82,182)	(63,767)
Acquisition of Hubdoc		(30,312)	–
Purchase of property, plant and equipment		(15,727)	(15,329)
Capitalised contract acquisition costs		(13,512)	(11,613)
Rental bonds		1,262	(507)
Sale of property, plant and equipment		–	1,507
Net cash flows from investing activities		**(140,471)**	**(89,709)**
Financing activities			
Proceeds from issuance of convertible notes, net of issue costs		447,766	–
Purchase of call spread options		(45,810)	–
Proceeds from borrowings		30,850	3,515
Repayment of borrowings		(31,583)	(2,782)
Receipt of lease incentive		14,500	–
Payment of lease liabilities		(9,103)	(8,432)
Exercising of share options		14,770	2,346
Payments for short-term deposits		(336,819)	(74,000)
Proceeds from short-term deposits		59,000	101,000
Net cash flows from financing activities		**143,571**	**21,647**
Net increase/(decrease) in cash and cash equivalents		**117,326**	**(6,866)**
Foreign currency translation adjustment		(16,754)	122
Cash and cash equivalents at the beginning of the year		**20,955**	**27,699**
Cash and cash equivalents at the end of the year		**121,527**	**20,955**

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 New Zealand Companies Act 1993 and is listed on the Australian Securities Exchange (ASX). The audited consolidated financial statements of the Company and its subsidiaries (together 'the Group' or 'Xero') have been prepared in accordance with the ASX Listing Rules.

The consolidated financial statements of the Group for the year ended 31 March 2019 were authorised for issue in accordance with resolution of the directors on 16 May 2019.

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 consolidated financial statements comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS), 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 consolidated financial statements have been prepared using the historical cost convention.

The consolidated 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

Except as described below, the accounting policies and disclosures adopted are consistent with those of the previous year.

The Group adopted the standards detailed below from 1 April 2018, resulting in restatements of comparative balances. No restatement of comparatives has been made outside of those required as a result of the new standards. Certain comparative information has also been reclassified to conform with the current period's presentation.

New Zealand Equivalent to International Financial Reporting Standard 15: *Revenue from Contracts with Customers*

NZ IFRS 15 replaces NZ IAS 18: *Revenue* and related interpretations and applies to all revenue arising from contracts with customers. The new standard establishes a five-step model to account for revenue arising from contracts with customers.

Under NZ IFRS 15 revenue is apportioned to individual performance obligations within customer contracts based on their relative stand-alone selling price. Based on certain criteria, revenue is then recognised either over time or at a point in time consistent with when these performance obligations are satisfied.

The majority of the Group's customers are on monthly recurring contracts, as a result NZ IFRS 15 has not had a material impact on recognition of revenue.

Under NZ IFRS 15 the incremental costs of obtaining a contract, and costs directly related to fulfilling a contract are capitalised, where these costs are expected to be recovered. The costs are amortised over a period consistent with the estimated pattern of revenue recognition. The Group identified commission costs as an incremental cost of obtaining revenue contracts. These costs were expensed as incurred prior to the adoption of NZ IFRS 15 and are now capitalised.

The Group adopted NZ IFRS 15 using the retrospective approach, resulting in restatement of comparative figures. All practical expedients available under this approach have been applied.

The effect of adopting NZ IFRS 15 on the Income Statement for the year ended 31 March 2018 is as follows:

Income Statement impact	($000s)
Increase in subscription revenue	80
Decrease in sales and marketing expenses	(4,168)
Increase in income tax expense	603
Decrease in net loss	(3,645)

The above effect on sales and marketing expenses includes an $11.4 million decrease in commission expense and a $7.2 million increase in amortisation expense.

The effect of adopting NZ IFRS 15 on the Statement of Financial Position is as follows:

Statement of Financial Position impact	At 31 March 2018 ($000s)	At 1 April 2017 ($000s)
Assets		
Increase in intangible assets	24,035	19,920
Decrease in deferred tax assets	(2,658)	(2,206)
Total increase in assets	**21,377**	**17,714**
Liabilities		
Increase in other current liabilities	41	122
Increase in deferred tax liabilities	535	370
Total increase in liabilities	**576**	**492**
Total increase in equity	**20,801**	**17,222**

The adoption of NZ IFRS 15 also resulted in a reclassification in the Statement of Cash Flows between operating cash flows and investing cash flows. The reclassification resulted in an $11.6 million increase to operating cash flows and a corresponding decrease to investing cash flows.

New Zealand Equivalent to International Financial Reporting Standard 9: *Financial Instruments*

NZ IFRS 9: *Financial Instruments* replaces NZ IAS 39: *Financial Instruments: Recognition and Measurement*. The new standard includes three areas of change:

1. Classification and measurement of financial instruments
2. A single forward looking 'expected loss' impairment model
3. A new approach to hedge accounting

Classification and measurement

NZ IFRS 9 largely retains the existing requirements in NZ IAS 39 for the classification and measurement of financial liabilities. However, it eliminates the previous NZ IAS 39 categories for financial assets of held to maturity, loans and receivables, and available for sale. Under NZ IFRS 9, on initial recognition, a financial asset is classified as measured at amortised cost, fair value through other comprehensive income – debt investment, fair value through other comprehensive income – equity investment, or fair value through profit or loss. Additional information on the classification and measurement of the Group's financial instruments under IFRS 9 is included in note 15. The adoption of the new categories has had no significant impact on the Group's financial statements other than disclosure changes.

New impairment model

For financial assets, NZ IFRS 9 replaces the 'incurred loss' model in NZ IAS 39 with an 'expected credit loss' (ECL) model. Additional information on the recognition of impairment losses under NZ IFRS 9 is included in note 8. The adoption of the ECL requirements of NZ IFRS 9 resulted in an increase to the impairment allowances of Xero's trade receivables.

Hedge accounting

The Group applied the changes to hedge accounting under NZ IFRS 9 prospectively. At the date of the initial application, all of the Group's existing hedging relationships were eligible to be treated as continuing hedging relationships. Consistent with prior periods, the Group has continued to designate the change in fair value of foreign exchange hedge derivative assets and liabilities in the Group's cash flow hedge relationships. As such, the adoption of the hedge accounting requirements of NZ IFRS 9 had no significant impact on the Group's financial statements.

With the exception of hedge accounting which the Group applied prospectively, the Group applied NZ IFRS 9 retrospectively, resulting in restatement of comparative figures.

The effect of adopting NZ IFRS 9 on the Income Statement for the year ended 31 March 2018 is as follows:

Income Statement impact	($000s)
Increase in sales and marketing expenses	76
Decrease in income tax expense	(34)
Increase in net loss	42

The effect of adopting NZ IFRS 9 on the Statement of Financial Position is as follows:

Statement of Financial Position impact	At 31 March 2018 ($000s)	At 1 April 2017 ($000s)
Assets		
Decrease in trade and other receivables	(201)	(126)
Increase in deferred tax assets	30	-
Total decrease in assets	**(171)**	**(126)**
Liabilities		
Decrease in deferred tax liabilities	(4)	-
Total decrease in liabilities	**(4)**	**-**
Total decrease in equity	**(167)**	**(126)**

New Zealand Equivalent to International Financial Reporting Standard 16: *Leases*

NZ IFRS 16: *Leases* replaces NZ IAS 17: *Leases*. It introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. Under the standard a right of use asset is recognised, representing the lessee's right to use the underlying leased asset. A corresponding lease liability is recognised, representing the obligation to make lease payments.

Under the new standard Xero recognises certain building and motor vehicle leases as right of use assets and lease liabilities. At lease inception the lease liability is measured at the present value of the remaining lease payments, discounted at Xero's incremental borrowing rate. The unwind of the discount applied on recognition of a lease liability is recognised as interest expense in the Income Statement using the effective interest method.

Right of use assets are measured at inception comprising the following:

- The amount of initial measurement of lease liability
- Any lease payments made at or before the commencement date, less any lease incentives received
- Any initial direct costs and restoration costs

Note 9 contains further disclosures on right of use assets.

The Group early adopted NZ IFRS 16 using the retrospective approach, resulting in a restatement of comparative figures.

The effect of adopting NZ IFRS 16 on the Income Statement for the year ended 31 March 2018 is as follows:

Income Statement impact	($000s)
Decrease in cost of revenue	(897)
Decrease in sales and marketing expenses	(614)
Decrease in product design and development expenses	(992)
Decrease in general and administration expenses	(214)
Decrease in other income	(340)
Increase in finance expense	3,100
Decrease in income tax expense	(50)
Increase in net loss	674

The above changes include an $11.2 million decrease in rental expense and an $8.5 million increase in depreciation expense.

The effect of adopting NZ IFRS 16 on the Statement of Financial Position is as follows:

Statement of Financial Position impact	At 31 March 2018 ($000s)	At 1 April 2017 ($000s)
Assets		
Decrease in trade and other receivables	(530)	(127)
Increase in property, plant and equipment	40,632	24,981
Increase in deferred tax assets	232	178
Total increase in assets	**40,334**	**25,032**
Liabilities		
Decrease in trade and other payables	-	(717)
Increase in short-term lease liabilities	7,531	6,475
Increase in long-term lease liabilities	37,906	21,286
Decrease in deferred tax liabilities	(91)	(95)
Decrease in other non-current liabilities	(2,335)	-
Total increase in liabilities	**43,011**	**26,949**
Total decrease in equity	**(2,677)**	**(1,917)**

The adoption of NZ IFRS 16 also resulted in a reclassification in the Statement of Cash Flows between operating cash flows and financing cash flows. The reclassification resulted in a $8.4 million increase to operating cash flows and a corresponding decrease to financing cash flows.

New Zealand Equivalent to International Financial Reporting Standard 3: ***Business Combinations***

During the year, the Group early adopted the amendments to NZ IFRS 3: *Business Combinations* as issued on 22 October 2018. The amendments narrow the scope of the definition of a business and introduce a 'concentration test' which, if met, eliminates the need for further assessment. Under this optional test, where substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets), the assets acquired would not represent a business. Under the amendments the acquisition of Cicerone Limited (trading as Instafile) on 14 December 2018 is accounted for as an asset acquisition under NZ IAS 38: *Intangible Assets* with further detail disclosed in note 10.

The adoption of the standards detailed above did not impact earnings per share (EPS) for the comparitive period, apart from the adoption of NZ IFRS 15 which resulted in a decrease in basic and diluted loss per share of $0.02 for the year ended 31 March 2018.

(c) Standards or interpretations issued but not yet effective and relevant to the Group

There are no standards or amendments that have been issued but are not yet effective that are expected to have a significant impact on the Group.

The Group has not adopted, and currently does not anticipate adopting, any standards prior to their effective dates other than those detailed above.

(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 within the financial statement notes to which they relate.

3. Segment information

The Group operates in one business segment, providing online business 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 how the Xero leadership 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 costs and an allocation of centrally managed costs.

	ANZ ($000s)	International ($000s)	Total ($000s)
Year ended 31 March 2019			
Operating revenue	359,107	193,712	552,819
Expenses	(140,175)	(198,754)	(338,929)
Other income	69	331	400
Segment contribution	**219,001**	**(4,711)**	**214,290**
Year ended 31 March 2018 restated			
Operating revenue	275,901	130,758	406,659
Expenses	(118,683)	(145,869)	(264,552)
Other income	16	1,071	1,087
Segment contribution	**157,234**	**(14,040)**	**143,194**

Reconciliation from segment contribution to net loss before tax

Year ended 31 March	2019 ($000s)	2018 Restated ($000s)
Segment contribution	214,290	143,194
Product design and development	(137,795)	(116,305)
General and administration	(66,072)	(46,737)
Asset impairments	(18,604)	(1,550)
Other expenses	(1,183)	(723)
Other income	687	–
Finance income	8,035	2,440
Finance expense	(22,494)	(4,190)
Net loss before tax	**(23,136)**	**(23,871)**

At 31 March 2019, $316.6 million, or 83%, of the Group's property, plant and equipment and intangible assets were domiciled in New Zealand (restated 2018: $181.8 million, or 79%)

Depreciation and amortisation by segment

Year ended 31 March	2019 ($000s)	2018 Restated ($000s)
ANZ	11,379	8,526
International	14,542	12,173
Corporate (not allocated to a segment)	55,927	49,619
Total	**81,848**	**70,318**

Non-cash share-based payments by segment

Year ended 31 March	2019 ($000s)	2018 ($000s)
ANZ	5,600	3,577
International	8,325	5,888
Corporate (not allocated to a segment)	15,021	7,539
Total	**28,946**	**17,004**

4. Revenue

Revenue by geographic location

Year ended 31 March	2019 ($000s)	2018 Restated ($000s)
Australia	261,468	197,094
United Kingdom	119,521	79,611
New Zealand	97,639	78,807
North America	44,270	31,873
Rest of World	29,921	19,274
Total operating revenue	**552,819**	**406,659**

Subscription revenue

Subscription revenue comprises the recurring monthly fees from subscribers to Xero's online software. Subscribers are invoiced monthly. Unbilled revenue at year end is recognised in the Statement of Financial Position as accrued income and included within trade and other receivables. Unearned revenue at year end is recognised in the Statement of Financial Position as income in advance and included within other current liabilities.

Other operating revenue

Other operating revenue comprises revenue from related services such as education and the implementation of the online software services, along with conference income, and financial web income.

Revenue is recognised as performance obligations under customer contracts are met. Performance obligations for subscriptions to Xero's cloud based software consist of the provisioning of the software and related support services over the term of the contract. Where the performance obligations of add-ons are usage based (such as payroll and expenses), revenue is recognised consistent with the usage profile. Performance obligations under financial web arrangements include the referral of customers to the revenue share counterparty and the continued servicing of that customer by the counterparty.

Performance obligations for implementation revenue consist of the delivery of the implementation services. Implementation service revenue is recognised based on percentage of completion of the relating services. Performance obligations for conference and event revenue consists of the delivery of the conference or event.

5. 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 employed 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.

Cost of revenue and operating expenses

Year ended 31 March	2019 ($000s)	2018 Restated ($000s)
Employee entitlements	301,559	234,758
Employee entitlements capitalised	(82,200)	(65,003)
Share-based payments	36,612	21,589
Share-based payments capitalised	(7,666)	(4,585)
Advertising and marketing	76,421	61,122
Platform costs	33,468	30,068
Consultants and contractors	18,506	14,804
Computer equipment and software	19,380	13,815
Travel-related costs	11,601	9,245
Superannuation costs	11,373	8,188
Communication, insurance and office administration	6,820	5,051
Rental costs	3,487	2,372
Staff recruitment	2,166	2,340
Auditors' remuneration	821	417
Other operating expenses	28,600	23,095
Total cost of revenue and operating expenses excl. depreciation and amortisation *	**460,948**	**357,276**

**Includes grant income of $5.2 million (2018: $4.5 million)*

Depreciation and amortisation

Year ended 31 March	2019 ($000s)	2018 Restated ($000s)
Relating to:		
Amortisation of development costs	53,600	45,614
Amortisation of other intangible assets	10,358	8,195
Depreciation of property, plant and equipment	17,890	16,509
Total depreciation and amortisation	**81,848**	**70,318**
Total cost of revenue and operating expenses	**542,796**	**427,594**
Depreciation and amortisation included in function expenses as follows:		
Product design and development	53,012	47,850
Cost of revenue	5,393	5,603
Sales and marketing	20,529	15,055
General and administration	2,914	1,810
Total depreciation and amortisation	**81,848**	**70,318**

Auditors' remuneration

Year ended 31 March	2019 ($000s)	2018 ($000s)
Audit and review of financial statements	323	252
Other assurance services *	452	135
Taxation services	43	28
Other services **	3	2
Total fees paid to auditors	**821**	**417**

** Services relate to assurance services in connection with reporting on service organisation controls, ISO 27001 certification, comfort letter over convertible notes issuance, and compliance engagement in respect of grant funding. These additional independent assurance services are closely related to the financial statement audit*

*** Services relate to provision of remuneration market data*

6. Finance income and expense

Finance income

Finance income comprises interest income on cash and short-term deposits. 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.

Finance expense

Year ended 31 March	2019 ($000s)	2018 Restated ($000s)
Interest on convertible notes	12,753	–
Bank standby facility costs	1,847	775
Finance lease interest	4,987	3,100
Other finance expense	2,907	315
Total finance expense	**22,494**	**4,190**

7. Earnings per share

The Group presents basic and diluted earnings per share (EPS) 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 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, 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	2019 (000s)*	2018 Restated (000s)*
Weighted average number of issued ordinary shares	139,204	137,566
Net loss after tax	($27,143)	($24,914)
Basic and diluted loss per share (in New Zealand dollars)	**($0.19)**	**($0.18)**

**Except for per share amounts*

8. Trade and other receivables

At 31 March	2019 ($000s)	2018 Restated ($000s)
Accrued income	21,957	19,089
Prepayments	16,405	8,477
Trade receivables	7,064	5,525
Provision for doubtful debts	(504)	(426)
Interest receivable	3,465	455
Rental bonds and other receivables	1,079	672
Total trade and other receivables	**49,466**	**33,792**

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.

Trade receivables relate primarily to the monthly subscriptions to Xero's products. Subscriptions are charged monthly, the majority being paid by direct debit. At 31 March 2019 trade receivables of the Group of $704,000 were past due and are considered partially impaired (2018: $444,000). At 1 April 2017 accrued income was $14.0 million.

Key estimates and assumptions

In accordance with NZ IFRS 9, the Group recognises impairment losses using the Expected Credit Loss (ECL) model. ECLs are based on the difference between the contractual cash flows due in accordance with the contract and the cash flows that the Group expects to receive. The shortfall is discounted at an approximation to the asset’s original effective interest rate. Under the ECL model, impairment losses may be measured as either the 12 month ECL, which is the portion of lifetime ECLs that result from default events that are possible within 12 months after the reporting date, or the lifetime ECL, which is the expected credit loss resulting from all possible default events over the expected life of the financial instrument. The Group has elected to use the lifetime ECL model to calculate the impairment for trade receivables.

A six month historical default rate is applied to the current period trade receivable balance to calculate any impairment. The carrying amount of the 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 to the Income Statement.

9. Property, plant and equipment

	Leasehold improvements ($000s)	Motor vehicles ($000s)	Computer equipment ($000s)	Furniture and equipment ($000s)	Right of use asset ($000s)	Total ($000s)
Cost						
Restated balance at 1 April 2018	14,938	27	5,817	10,761	57,680	89,223
Additions	8,351	–	4,669	3,828	33,520	50,368
Disposals and write-offs	(2,554)	(27)	(1,655)	(1,660)	(3,148)	(9,044)
Impairments	–	–	–	–	(2,136)	(2,136)
Foreign exchange adjustment	(29)	–	59	123	848	1,001
Balance at 31 March 2019	**20,706**	**–**	**8,890**	**13,052**	**86,764**	**129,412**
Accumulated depreciation						
Restated balance at 1 April 2018	4,667	27	2,390	5,074	15,261	27,419
Depreciation expense	2,077	–	3,084	2,020	10,709	17,890
Disposals and write-offs	(1,507)	(27)	(1,646)	(1,660)	(1,285)	(6,125)
Impairments	–	–	–	–	(1,639)	(1,639)
Foreign exchange adjustment	(5)	–	27	76	278	376
Balance at 31 March 2019	**5,232**	**–**	**3,855**	**5,510**	**23,324**	**37,921**
Net book value at 31 March 2019	**15,474**	**–**	**5,035**	**7,542**	**63,440**	**91,491**

	Leasehold improvements ($000s)	Motor vehicles ($000s)	Computer equipment ($000s)	Furniture and equipment ($000s)	Right of use asset ($000s)	Total ($000s)
Cost						
Restated balance at 1 April 2017	13,159	147	6,331	9,558	41,825	71,020
Additions	6,838	–	3,964	2,674	27,857	41,333
Disposals and write-offs	(5,052)	(120)	(4,502)	(1,436)	(11,600)	(22,710)
Foreign exchange adjustment	(7)	–	24	(35)	(402)	(420)
Restated balance at 31 March 2018	**14,938**	**27**	**5,817**	**10,761**	**57,680**	**89,223**
Accumulated depreciation						
Restated balance at 1 April 2017	5,955	135	3,009	4,611	16,448	30,158
Depreciation expense	3,301	12	2,454	1,861	8,881	16,509
Disposals and write-offs	(4,621)	(120)	(3,075)	(1,431)	(9,966)	(19,213)
Foreign exchange adjustment	32	–	2	33	(102)	(35)
Restated balance at 31 March 2018	**4,667**	**27**	**2,390**	**5,074**	**15,261**	**27,419**
Restated net book value at 31 March 2018	**10,271**	**–**	**3,427**	**5,687**	**42,419**	**61,804**

Key estimates and assumptions

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
Right of use asset*	Term of lease

**Substantially all of the right of use asset relates to building leases.*

The residual values and useful lives of assets 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.

10. Intangible assets

	Note	Software development ($000s)	Software licences ($000s)	Contract acquisition asset ($000s)	Other intangible assets ($000s)	Goodwill ($000s)	Total ($000s)
Cost							
Restated balance at 1 April 2018		239,575	1,939	40,704	464	5,165	287,847
Additions *		89,583	–	13,384	–	–	102,967
Acquisitions	18	15,508	–	–	5,270	78,773	99,551
Disposals and write-offs		(30,726)	(1,939)	(4,301)	(1)	–	(36,967)
Impairments **		(30,696)	–	–	–	(5,165)	(35,861)
Foreign exchange adjustment		–	–	648	–	–	648
Balance at 31 March 2019		**283,244**	**–**	**50,435**	**5,733**	**78,773**	**418,185**
Accumulated amortisation							
Restated balance at 1 April 2018		100,429	1,757	16,669	176	–	119,031
Amortisation		53,600	182	9,154	1,022	–	63,958
Disposals and write-offs		(30,726)	(1,939)	(4,301)	(1)	–	(36,967)
Impairments		(17,754)	–	–	–	–	(17,754)
Foreign exchange adjustment		–	–	186	–	–	186
Balance at 31 March 2019		**105,549**	**–**	**21,708**	**1,197**	**–**	**128,454**
Net book value at 31 March 2019		**177,695**	**–**	**28,727**	**4,536**	**78,773**	**289,731**

** Includes $14.5 million of externally purchased assets, of which $2.5m related to the acquisition of Instafile (2018: externally purchased assets of $9.0 million)*

*** Included within impairments for the period ended 31 March 2019 is a $16.3 million impairment of software development and goodwill related to decision to discontinue the US payroll product and move to a full service payroll solution in the US provided by our partner Gusto*

	Software development ($000s)	Software licences ($000s)	Contract acquisition asset ($000s)	Other intangible assets ($000s)	Goodwill ($000s)	Total ($000s)
Cost						
Restated balance at 1 April 2017	185,093	2,004	31,135	941	5,352	224,525
Additions *	67,524	–	11,369	–	–	78,893
Disposals and write-offs	(10,810)	(65)	(1,631)	(477)	–	(12,983)
Impairments	(2,232)	–	–	–	–	(2,232)
Foreign exchange adjustment	–	–	(169)	–	–	(169)
Adjustment due to change in tax rates	–	–	–	–	(187)	(187)
Restated balance at 31 March 2018	**239,575**	**1,939**	**40,704**	**464**	**5,165**	**287,847**
Accumulated amortisation						
Restated balance at 1 April 2017	66,307	858	11,215	606	–	78,986
Amortisation	45,614	964	7,184	47	–	53,809
Disposals and write-offs	(10,810)	(65)	(1,631)	(477)	–	(12,983)
Impairments	(682)	–	–	–	–	(682)
Foreign exchange adjustment	–	–	(99)	–	–	(99)
Restated balance at 31 March 2018	**100,429**	**1,757**	**16,669**	**176**	**-**	**119,031**
Restated net book value at 31 March 2018	**139,146**	**182**	**24,035**	**288**	**5,165**	**168,816**

Key estimates and assumptions

Software development

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
- The expenditure attributable to the software product during its development can be reliably measured

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

At 31 March 2019, if software development capitalisation rates had been 10% higher/lower with all other variables held constant, the impact on operational expenses would have been $7.4 million lower/higher.

Contract acquisition costs

In accordance with NZ IFRS 15, Xero capitalises incremental costs of obtaining customer contracts. Capitalisable costs consist of sales commissions that have a direct relationship to new revenue contracts obtained. Costs capitalised are amortised to sales and marketing and expensed over the average period of benefit associated with the costs. The period of benefit for the contract acquisition asset is determined to be five years. Management have determined this as appropriate with reference to estimated customer lifespans and the useful lives of the software sold to which the commissions relate.

Other intangible assets

Other intangible assets consist of patents, domains, and trademark costs, along with customer contracts. 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.

Useful lives of intangible assets

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:

Software development	3 – 7.5 years
Software licences	1 – 3 years
Contract acquisition asset	5 years
Customer contracts	3 years
Patents, domains and trademark costs	5 – 10 years

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.

The Group recognised impairment losses of $12.9 million during the year ended 31 March 2019 on write-down of software development (2018: $1.5 million).

Goodwill is tested at least annually for impairment, or whenever indicators of impairment exist.

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. The Group recognised impairment losses of $5.2 million during the year ended 31 March 2019 on the write down of goodwill that arose from the acquisition of Monchilla Inc as the Group decided to discontinue its payroll product.

Goodwill and goodwill impairment testing

Goodwill represents the excess of purchase considerations over the fair value of net assets acquired in a business combination. 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 at 31 March 2019 relates to the acquisition of Hubdoc Inc. and has been allocated to the Hubdoc CGU.

The recoverable amount of the Hubdoc CGU was calculated on the basis of value in use using a discounted cash flow model. Future cash flows were projected for ten years, with key assumptions being CGU earnings which is based on expected future performance of the CGU.

A growth rate of 15.0% was applied for years 10 to 20, with a terminal growth rate of 3.0% being applied. A pre-tax discount rate of 20.0% 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 2019, no impairment arose as a result of the review of the Hubdoc goodwill. The recoverable amount of the Hubdoc CGU is greater than the carrying amount.

11. Trade and other payables

At 31 March	2019 ($000s)	2018 ($000s)
Trade payables	5,690	7,383
Accrued expenses	15,434	13,461
Sales tax payable	5,919	5,441
Total trade and other payables	**27,043**	**26,285**

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 and non-interest bearing.

12. Other current liabilities

At 31 March	2019 ($000s)	2018 Restated ($000s)
Contingent consideration	13,455	–
Income in advance	7,682	4,146
Accrued interest	5,114	–
Other short-term liabilities	309	1,348
Total other current liabilities	**26,560**	**5,494**

The Group recognises other current liabilities, excluding contingent consideration, initially at fair value, and subsequently at amortised cost using the effective interest method. Contingent consideration is recognised at the present value of expected future cash flows, adjustments are made to the fair value where expected achievement against targets changes.

Income in advance is recognised when the Group has received consideration prior to services being rendered. All income in advance from the prior period was subsequently recognised as revenue in the year.

13. Lease liabilities

At 31 March	2019 ($000s)	2018 Restated ($000s)
Balance at 1 April	45,437	27,761
Leases entered into during the period	47,767	28,042
Principal repayments	(9,103)	(8,432)
Change in future lease payments	(1,889)	(1,867)
Foreign exchange adjustment	637	(67)
Total lease liabilities	**82,849**	**45,437**
Current	11,541	7,531
Non-current	71,308	37,906

Under NZ IFRS 16: *Leases* the Group is required to recognise lease liabilities for contracts identified as containing a lease, except when the lease is for 12 months or less or the underlying asset is of low value.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in the Income Statement. Low-value assets comprise IT equipment and small items of office furniture. The expense relating to low-value assets for the year ended 31 March 2019 was $2.2 million (2018: $0.6 million).

Lease liabilities are initially measured at the present value of the remaining lease payments, discounted at Xero's incremental borrowing rate. Subsequently the carrying value of the liability is adjusted to reflect interest and lease payments made. Lease liabilities may be re-measured when there is a change in future lease payments arising from a change in an index or market rate, or if there is a change in the Group's estimate of the amount expected to be payable.

Key estimates and assumptions

The Group assesses at lease commencement whether it expects to exercise renewal options where these are included in the contract. Where it is reasonably certain that renewal options will be exercised, the extension period is included in the lease liability calculation.

14. Term debt

Convertible notes

In September 2018, Xero Investments Limited, a wholly owned subsidiary of the Company, made an offering of USD300 million of convertible notes. The convertible notes were settled and listed on the Singapore Exchange Securities Trading Limited (SGX-ST) on 5 October 2018.

The notes have a coupon interest rate of 2.375% per annum, payable six-monthly in arrears. The initial conversion of the notes is USD46.3386 per ordinary share based on a fixed exchange rate of AUD1.00 = USD0.72745.

The notes are unsubordinated, unsecured obligations of Xero, and are scheduled to mature on 4 October 2023. The settlement of the notes will be in cash unless Xero elects to settle in shares, in which case Xero will be obliged to deliver ordinary shares to relevant noteholders. The cash settlement amount will be calculated based on the volume-weighted average price of the ordinary shares over a 90 day trading period.

In connection with the issue of the notes, Xero entered into derivative financial instruments in the form of call spread options.

Transaction costs

Xero incurred $11.2 million of transaction costs related to the issuance of the convertible notes and call spread options. Transaction costs relating to the convertible notes have been allocated between the debt component and the conversion derivatives using the relative proportions of these on initial measurement of the instruments. Costs attributed to the debt component are amortised to finance expense over the term of the convertible notes using the effective interest method. Costs attributable to the conversion derivatives were immediately recognised in the Income Statement. Transaction costs related to the call spread options have been attributed equally between the lower call options and the upper call options, with the lower call option costs being immediately recognised in the Income Statement. Costs attributable to the upper strike call options are deducted from the amount recognised in equity.

Notes and conversion feature derivative

The conversion feature of the notes is required to be separated from the notes and is accounted for as a derivative financial liability. The fair value of the embedded conversion derivative at the time of issuance was $85.0 million and was recorded at a discount for purposes of accounting for the debt component of the notes. The discount is amortised as interest expense using the effective interest method over the term of the notes.

The principal amount, unamortised debt discount, unamortised issue costs, and net carrying amount of the liability component of the convertible notes as at 31 March 2019 is as follows:

At 31 March 2019	($000s)
Principal amount	440,787
Unamortised debt discount	(75,984)
Unamortised issue costs	(7,072)
Term debt	**357,731**

The effective interest rate for the convertible notes is 7.30%. Coupon interest expense, and amortisation of debt discount and issue costs for the year ended 31 March 2019 were as follows:

Year ended 31 March 2019	($000s)
Coupon interest expense	5,126
Amortisation of debt discount and issue costs	7,627
Total finance expense on convertible notes	**12,753**

Call spread options

In connection with the issue of the convertible notes, Xero purchased call spread options which are expected to reduce potential dilution to shareholders upon conversion of the notes and to offset any cash payments Xero may be required to make in excess of the principal amounts on conversion. The call spread options consist of 6.5 million lower strike call options purchased with an average strike price equal to the conversion price of the notes, and 6.5 million upper strike call options sold with an average strike price of USD60.5966. The call spread options expire in October 2023. The aggregate cost of the call spread was $44.9 million, which was paid from proceeds of the convertible notes.

The upper strike call options are accounted for as equity, and are recognised at their initial fair value, less transaction costs. The carrying value of the upper strike options is $35.3 million.

Bank loan

In August 2018 Xero entered into a $30.9 million term loan with the BNZ and ANZ banks to fund the cash portion of the acquisition of Hubdoc. The loan was repaid early in October 2018 with proceeds from the convertible notes.

15. Financial instruments, capital and financial risk management

Financial instruments

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

Classification and fair values

Xero has carried out a fair value assessment of its financial assets and liabilities at 31 March 2019 in accordance with NZ IFRS 9: *Financial Instruments*.

Under NZ IFRS 9 financial instruments are classified into either measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss. The classification of the Group's financial instruments into these categories is included within the table below.

The Group's foreign exchange hedging derivatives are recognised at fair value. Fair value is determined using forward exchange rates that are quoted in an active market (level two on the fair value hierarchy). The fair values of the conversion feature and call option derivative asset are determined using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity-specific estimates. Inputs into the valuation include share price volitility and time to expiration. The fair value of the convertible notes on initial recognition is determined using a market interest rate for an equivalent non-convertible bond, with the residual amount allocated to the derivative conversion feature. The fair value of the debt component of the convertible notes at 31 March 2019 was $362.6 million. The carrying value of the Group's other financial instruments do not materially differ from their fair value.

	Financial assets at amortised cost ($000s)	Financial instruments at fair value through profit or loss ($000s)	Financial liabilities at amortised cost ($000s)	Total carrying value ($000s)
At 31 March 2019				
Assets				
Cash and cash equivalents	121,527	–	–	121,527
Term deposits	336,819	–	–	336,819
Trade and other receivables	33,688	–	–	33,688
Derivative assets (hedging derivatives)*	–	3,567	–	3,567
Derivative assets (call spread options)	–	73,999	–	73,999
Total financial assets	**492,034**	**77,566**	**–**	**569,600**
Liabilities				
Trade and other payables	–	–	21,124	21,124
Derivative liabilities (hedging instruments)*	–	147	–	147
Derivative liabilities (conversion feature on convertible notes)	–	77,367	–	77,367
Term debt	–	–	357,731	357,731
Other current liabilities	–	13,455	5,114	18,569
Other non-current liabilities	–	600	–	600
Total financial liabilities	**–**	**91,569**	**383,969**	**475,538**
Restated balance at 31 March 2018				
Assets				
Cash and cash equivalents	20,955	–	–	20,955
Term deposits	59,000	–	–	59,000
Trade and other receivables	27,522	–	–	27,522
Derivative assets (hedging derivatives)*	–	2,549	–	2,549
Total financial assets	**107,477**	**2,549**	**–**	**110,026**
Liabilities				
Trade and other payables	–	–	20,844	20,844
Derivative liabilities (hedging derivatives)*	–	822	–	822
Total financial liabilities	**–**	**822**	**20,844**	**21,666**

**Hedging derivatives are hedge accounted when possible with unrealised gains and losses recognised in other comprehensive income until the underlying expense impacts the Income Statement*

Capital management

The capital structure of the Group primarily consists of equity raised by the issue of ordinary shares in the Company and issued debt.

Xero manages its capital to ensure that it maintains an appropriate capital structure to support its business and maximise shareholder value. The Group's capital structure is adjusted based on business needs and economic conditions. During the year ended 31 March 2019, Xero issued USD300 million of convertible notes for the purpose of investments into strategic and complementary businesses and assets which are in line with the Group's strategy to drive long-term shareholder value.

As part of the Group's ongoing risk management, a $100 million syndicated (with BNZ and ANZ) standby debt facility was put in place in November 2017. The facility expires in November 2019. This facility was put in place to provide additional liquidity headroom to navigate against unanticipated events. It is undrawn and there are no current plans to draw down on the facility. The facility agreement contains financial undertakings usual for facilities of this nature.

Financial risk management

The Group is exposed to the following risks through the normal course of business and from its use of financial instruments:

a. Market risk
b. Liquidity risk
c. Credit risk

The following presents both qualitative and quantitative information on the Group's exposure to each of the above risks, along with policies and processes for managing risk.

(a) Market risk

The Group is exposed to market risk primarily through changes in foreign currency exchange rates and interest rates.

Foreign currency risk

Nature of risk

Foreign currency risk is the risk that the New Zealand dollar (NZD) net cash flows that flow through to the Group are negatively impacted by changes to foreign currency exchange rates.

Exposure and risk management

Xero is exposed to currency risk from the operations of foreign subsidiaries and foreign currency denominated expenses in the parent Company. The Group has significant operations in three other currencies, being Great British pounds (GBP), Australian dollars (AUD), and United States dollars (USD), with exposures to other currencies to a lesser degree. The material exposures are USD outflows as well as AUD and GBP inflows. In order to reduce the impact of short-term movements in exchange rates, the Group's treasury policy requires a portion of the next 18 months' cash flows to be hedged with forward exchange contracts and vanilla options (outright purchased options and vanilla collars).

The Group's exposure to monetary foreign currency financial instruments and lease liabilities is outlined below in New Zealand dollars:

	AUD ($000s)	USD ($000s)	GBP ($000s)
At 31 March 2019			
Exposures			
Cash and cash equivalents, and short-term deposits	14,664	366,744	5,734
Trade and other receivables	914	635	1,928
Trade and other payables	(2,649)	(3,639)	(4,787)
Other current liabilities	–	(18,569)	–
Other non-current liabilities	–	–	(600)
Lease liabilities	(5,872)	(19,557)	(3,135)
Term debt (including conversion feature)	–	(440,788)	–
Derivative financial instruments (hedging derivatives)	(64,667)	65,804	(58,957)
Total foreign currency exposure	**(57,610)**	**(49,370)**	**(59,817)**
Restated balance at 31 March 2018			
Exposures			
Cash and cash equivalents	4,583	1,642	5,816
Trade and other receivables	1,127	396	1,387
Trade and other payables	(2,949)	(3,948)	(3,767)
Lease liabilities	(5,685)	(11,791)	(4,248)
Derivative financial instruments	(68,781)	59,771	(30,541)
Total foreign currency exposure	**(71,705)**	**46,070**	**(31,353)**

As at 31 March 2019 a movement of 10% in the NZD would impact the Income Statement and Statement of Changes in Equity (after hedging) as detailed in the table below:

	10% decrease		10% increase	
	2019 ($000s)	2018 ($000s)	2019 ($000s)	2018 ($000s)
Impact on:				
Net loss before income tax (increase/(decrease))	(905)	(4,456)	740	3,646
Equity (before income tax) (increase/(decrease))	1,199	(7,671)	889	6,211

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

Interest rate risk

Nature of risk

Interest rate risk is the risk that changes in interest rates negatively impact the Group's financial performance or the value of its financial instruments.

Exposure and risk management

The Group's interest rate risk arises from its cash and cash equivalents and short-term deposit balances, and when term debt at fixed rates is refinanced. Cash and cash equivalents comprise cash on hand, deposits held on call with banks, and other short-term and highly liquid investments with original maturities of 90 days or less. Balances are placed on short-term deposit at fixed rates. The repricing of these at maturity exposes the Group to interest rate risk. The convertible notes give rise to interest rate risk at maturity (October 2023) if the Group were to refinance at interest rates prevailing at the time, with higher interest rates increasing the cost of debt financing.

The Group does not currently enter into interest rate hedges. However, management regularly reviews its banking arrangements to ensure it achieves the best returns on its funds while maintaining access to necessary liquidity levels to service the Group’s day-to-day activities.

Sensitivity to interest rate risk

If interest rates for the year 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 $4.6 million lower/higher (2018: $0.8 million). This analysis assumes that the cash and cash equivalents and short-term deposits balance was consistent with the year end balance throughout the year.

(b) Liquidity risk

Nature of risk

Liquidity risk is the risk that the Group cannot pay contractual liabilities as they fall due.

Exposure and risk management

At 31 March 2019 the Group held cash and cash equivalents of $121.5 million and term deposits of $336.8 million. Of this, $87.4 million of cash and cash equivalents and $271.8 million of term deposits relates to the proceeds from the issue of convertible notes, which is intended to be used for investments into strategic and complementary businesses and assets. The remaining $34.1 million of cash and cash equivalents and $65.0 million of term deposits available to service the Group’s day-to-day activities. The $100 million syndicated standby facility provides additional liquidity to cover unforeseen operating cash flow requirements. The facility expires in November 2019 and is currently expected to be replaced with a similar standby facility arrangement.

The liquidity risk that arises on maturity of the convertible notes in October 2023 is being closely monitored by management, with the intention that there will be repayment or refinancing plans in place in advance of this, to ensure that the Group has sufficient liquidity to meets its contractual obligations as they fall due.

The Group's exposure to liquidity risk based on undiscounted contractual cash flows relating to financial liabilities and lease liabilities is summarised below:

	Less than 12 months ($000s)	Between 1 and 2 years ($000s)	Between 2 and 5 years ($000s)	Over 5 years ($000s)	Total contractual cash flows ($000s)	Carrying amount ($000s)
At 31 March 2019						
Non-derivative financial liabilities						
Trade and other payables	21,124	–	–	–	21,124	21,124
Lease liabilities	17,819	17,009	30,849	53,200	118,877	82,849
Term debt*	10,349	10,469	472,193	–	493,011	362,845
Other current liabilities	13,455	–	–	–	13,455	13,455
Other non-current liabilities	–	600	–	–	600	600
Contractual cash flows	**62,747**	**28,078**	**503,042**	**53,200**	**647,067**	**480,873**
Derivative financial liabilities						
Forward exchange contracts	–	–	–	–	–	147
Inflows	17,467	–	–	–	17,467	–
Outflows	(17,899)	–	–	–	(17,899)	–
Contractual cash flows	**(432)**	**-**	**-**	**-**	**(432)**	**147**

** Term debt cashflows include $5.1m of interest included in other current liabilities as at 31 March 2019*

	Less than 12 months ($000s)	Between 1 and 2 years ($000s)	Between 2 and 5 years ($000s)	Over 5 years ($000s)	Total contractual cash flows ($000s)	Carrying amount ($000s)
Restated balance at 31 March 2018						
Non-derivative financial liabilities						
Trade and other payables	20,844	–	–	–	20,844	20,844
Lease liabilities	11,574	10,888	19,940	17,323	59,725	45,437
Contractual cash flows	**32,418**	**10,888**	**19,940**	**17,323**	**80,569**	**66,281**
Derivative financial liabilities						
Forward exchange contracts	–	–	–	–	–	822
Inflows	50,625	7,083	–	–	57,708	–
Outflows	(51,278)	(7,100)	–	–	(58,378)	–
Contractual cash flows	**(653)**	**(17)**	**-**	**-**	**(670)**	**822**

(c) Credit risk

Nature of risk

Credit risk arises in the normal course of Xero's business on financial assets if a counterparty fails to meet its contractual obligations.

Exposure and risk management

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, short-term deposits and derivative contracts with high quality financial institutions. The exposure to the credit risk of the call option counterparties means that in the event of default we may have to pay an increased amount on settlement of the convertible notes. The Group manages liquidity factoring in any risk of default. The credit risk associated with trade receivables is small due to the inherently low individual transaction value and the distribution over a large number of customers.

Group financial assets subject to credit risk at balance date are as follows:

At 31 March	2019 ($000s)	2018 Restated ($000s)
Cash and cash equivalents	121,527	20,955
Short-term deposits	336,819	59,000
Trade and other receivables	33,061	25,315
Derivative financial assets	77,566	2,549
Non-current assets	627	2,207
Total financial assets subject to credit risk	**569,600**	**110,026**

A summary of the Group's exposure to credit risk on cash and cash equivalents, short term deposits and derivatives categorised by external credit risk grading is as follows:

At 31 March	2019 ($000s)	2018 ($000s)
Cash, and cash equivalents and short term deposits		
A-1+	406,613	78,539
A-1	47,533	1
A-2	4,201	1,415
Total cash, and cash equivalents and short-term deposits	**458,347**	**79,955**
Derivative assets		
A-1+	2,923	1,775
A-1	74,643	774
Total derivative assets	**77,566**	**2,549**
Total	**535,913**	**82,504**

The Group's trade and other receivables and non-current assets are with counter-parties who have no external credit risk rating. Due to the nature of the Group's business the balances do not consist of any concentration of risk that is considered individually material. Of the total trade and other receivables and non-current asset balance, $704,000 is past due and considered to be partially impaired (2018: $444,000).

16. Derivatives and hedge accounting

The Group's derivative financial instruments consist of forward exchange contracts, vanilla foreign exchange options (outright purchased options and vanilla collars), conversion feature of the convertible notes, and call spread options entered into in connection with the convertible notes.

At 31 March	2019 ($000s)	2018 ($000s)
Current derivative assets		
Call spread options	73,999	–
Forward exchange contracts	2,703	2,508
Foreign exchange options	626	–
Non-current derivative assets		
Forward exchange contracts	189	40
Foreign exchange options	49	1
Total derivative assets	**77,566**	**2,549**
Current derivative liabilities		
Forward exchange contracts	(89)	(759)
Foreign exchange options	(58)	(63)
Non-current derivative liabilities		
Conversion feature of convertible notes	(77,367)	–
Total derivative liabilities	**(77,514)**	**(822)**

Foreign currency hedges

The Group uses derivatives in the form of forward exchange contracts and vanilla foreign exchange options (outright purchased options and vanilla collars) to reduce the risk that movements in foreign exchange rate will affect the Group's NZD cash flows. Whenever possible, these hedges have been designated as a hedge of a highly probable forecast transaction (a cash flow hedge under NZ IFRS 9: *Financial Instruments*). The Group determines the existence of an economic relationship between the hedging instrument and the hedged item based on the currency, and timing of respective cash flows. Derivatives in hedge relationships are designated based on a hedge ratio of 1:1. Hedges that do not have a highly probable forecast transaction are recognised as ineffective hedges. The Group's policy is to hedge a portion of the next 18 months' forecasted 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. Only the intrinsic value of options are designated as hedge relationships with movements in the time value of foreign exchange options recognised immediately in the Income Statement. The Group has taken up the option under NZ IFRS 9 to defer forward points into other comprehensive income.

During the year, a net hedging gain of $6.9 million (before taxation) was recognised in other comprehensive income (2018: gain of $0.6 million). During the year, a gain of $5.5 million (before taxation) was reclassified out of other comprehensive income to the Income Statement (2018: loss of $2.7 million). The remaining balance will be reclassified to the Income Statement in the 18 months following 31 March 2019.

Hedge position

The Group's hedging instruments are as follows:

At 31 March	2019 Average forward price	2019 Fair value ($000s)	2019 Notional amount hedged (NZD) ($000s)	2018 Average forward price	2018 Fair value ($000s)	2018 Notional amount hedged (NZD) ($000s)
Derivative assets						
Buy USD – Sell NZD	0.6898	553	53,641	0.7325	362	29,010
Buy NZD – Sell AUD	0.9214	2,262	58,957	0.9113	2,172	68,859
Buy NZD – Sell GBP	0.5083	730	46,400	0.5078	15	3,938
Total		**3,545**			**2,549**	
Derivative liabilities						
Buy USD – Sell NZD	0.6723	(121)	12,162	0.7155	(333)	30,748
Buy NZD – Sell AUD	0.9633	(16)	5,710	0.9430	(2)	2,121
Buy NZD – Sell GBP	-	–	–	0.5235	(487)	18,031
Total		**(137)**			**(822)**	

Conversion feature and call option derivative

The conversion feature derivative liability of the convertible notes represents an embedded derivative financial instrument in the host debt contract. The conversion feature represents the Group's obligation to issue Xero Limited shares (or an equivalent amount of cash) should noteholders exercise their conversion option. The embedded conversion derivatives are carried in the Statement of Financial Position at their estimated fair value and adjusted at the end of each reporting period, with any unrealised gain or loss reflected in the Income Statement. During the period, the Group recognised a $5.7 million revaluation gain in the Income Statement relating to the conversion feature derivative.

In connection with the issue of the convertible notes, the Group entered into call spread options. The lower strike call options mirror the conversion option embedded in the convertible notes, and are accounted for as derivative assets in the Statement of Financial Position at their estimated fair value. The derivative assets are adjusted to fair value each reporting period, with unrealised gains or losses reflected in the Income Statement. During the period, the Group recognised a $5.0 million revaluation loss in the Income Statement relating to the call lower strike call options.

17. Share capital

	Notes	2019 (000s)	2018 (000s)
Balance at 1 April		138,449	137,761
Issue of ordinary shares – acquisition of Hubdoc	18	1,133	–
Issue of ordinary shares – exercising of employee share options	23	748	133
Issue of ordinary shares – employee restricted share plan	23	228	494
Issue of ordinary shares – restricted stock unit schemes	23	180	54
Issue of ordinary shares – director exercising options	23	26	–
Issue of ordinary shares – directors' fees		10	7
Ordinary shares on issue at 31 March		**140,774**	**138,449**
Treasury shares		(411)	(609)
Ordinary shares on issue at 31 March excluding treasury shares		**140,363**	**137,840**

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

During the year the Company acquired 100% of the ordinary shares of Hubdoc Inc. issuing 1,133,303 ordinary shares as partial consideration at a deemed issue price of AUD44.64.

During the year employees exercised 747,821 share options with a weighted average exercise price of $19.20 (2018: 133,420 at a weighted average price of $17.58).

During the year, the Company allocated 364,955 shares under the employee restricted share plan (RSP), at a weighted average price of AUD45.22 (2018: 600,095 at a weighted average price of $26.03). Of the shares allocated, 228,459 were new shares issued, and 136,496 were the reissue of shares held as treasury stock (2018: 493,568 and 106,527 respectively).

During the year, a director exercised 25,730 share options, with an exercise price of $16.14.

During the year, the Company issued 10,072 shares at a weighted average price of AUD40.17 to directors in lieu of cash payment for directors' fees (2018: 7,131 shares at $26.70).

During the period, 249,608 restricted stock units vested, of which 179,554 were converted to shares with average price of $20.89. The remaining 70,504 were surrendered to settle payroll tax liabilities (2018: 59,888 vested, 53,816 converted at average price of $17.31).

18. Business combinations

On 2 August 2018 Xero acquired 100% of the ordinary shares in data capture solution provider Hubdoc Inc. for consideration of $31.2 million cash, and $54.9 million in ordinary shares of Xero Limited. An additional USD10 million in shares may be issued to the previous shareholders of Hubdoc, 18 months from acquisition date, if certain targets are met.

The USD10 million, or $14.6 million, in shares issuable in February 2020 is dependent on achievement of specific targets. Of this amount, $5.4 million is issuable contingent on both the achievement of the targets and on the continued service of Hubdoc's two founders. The proportion of this $5.4 million that is payable to the founders is considered compensation for continued service and is excluded from the purchase price below, resulting in contingent consideration of $12.4 million. The remaining $2.2 million is recorded as compensation straight-line over the 18 month period from acquisition.

The number of shares issued on settlement of the contingent consideration will be based on the five-day volume-weighted average price of Xero Limited shares preceding issue date. Based on management's projections it is expected that the targets will be met and therefore the contingent consideration is recorded at 100%. Management will continue to assess the probability of achievement throughout the 18 month period and will record any revaluation adjustments accordingly.

Goodwill of $78.8 million has been recognised because Hubdoc's expertise and technology will enable the Group to accelerate its ability to streamline the collection and classification of the data small businesses and their advisors need in order to focus on driving better business outcomes.

The following values are recognised in the financial statements in respect of the Hubdoc acquisition:

	2 August 2018 ($000s)
Assets acquired and liabilities assumed	
Software development asset	15,508
Customer contracts intangible asset	3,809
Brand intangible asset	1,461
Goodwill	78,773
Tangible assets acquired	2,125
Tangible liabilities assumed	(3,152)
Net assets acquired	**98,524**
Consideration transferred	
Cash*	31,194
Shares issued	54,904
Contingent consideration	12,426
Total consideration	**98,524**

** Net of cash acquired as part of the business combination, cash outflows relating to the acquisition was $30.3 million*

The acquired software development asset, customer contracts, and brand have been determined to have useful lives of 7.5 years, 5 years, and 3 years respectively.

For the period from acquisition date to 31 March 2019, Hubdoc contributed $5.3 million in operating revenue and $10.4 million in net loss. If the acquisition had occurred on 1 April 2018, management estimates that consolidated revenues and net loss would have been $3.0 million and $2.5 million higher respectively for the year ended 31 March 2019.

19. Group entities

Consolidation subsidiaries are all 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 2019 (%)	Interest 2018 (%)
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
Xero Software (Canada) Ltd	Service provider	Canada	31 March	100	100
Xero (HK) Limited	Service provider	Hong Kong	31 March	100	100
Xero South Africa (Pty) Ltd	Service provider	South Africa	31 March	100	100
Xero Trustee Limited	Trustee	New Zealand	31 March	100	100
Hubdoc Inc.	Reseller	Canada	31 December	100	–
Hubdoc Pty Limited	Reseller	Australia	30 June	100	–
Hubdoc (UK) Limited	Reseller	United Kingdom	31 March	100	–
Xero Investments Limited	Funding & Investment	New Zealand	31 March	100	–
Cicerone Limited	Non–active	United Kingdom	30 April	100	–

The following changes in relation to the Group's entities occurred during the year ended 31 March 2019:

- Xero Acquisition I Ltd was incorporated in Canada as a wholly owned subsidiary of Xero Limited on 24 July 2018
- Xero Acquisition I Ltd acquired Hubdoc Inc. along with its wholly owned subsidiaries Hubdoc Pty Limited and 10914819 Canada Inc. on 2 August 2018
- Hubdoc Inc., 10914819 Canada Inc., and Xero Acquisition I Ltd amalgamated to form Hubdoc Inc. on 16 August 2018
- Hubdoc (UK) Limited was incorporated as a wholly owned subsidiary of Xero Limited on 5 September 2018
- Xero Investments Limited was incorporated as a wholly owned subsidiary of Xero Limited on 17 September 2018
- Xero Investments Limited acquired Cicerone Limited on 14 December 2018

20. Current and deferred income tax

Tax expense comprises current and deferred tax. Income tax is recognised in the Income Statement or Statement of Comprehensive Income except when it relates to items recognised directly in equity (in which case the income tax is recognised in equity). 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.

Income tax expense

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	2019 ($000s)	2018 Restated ($000s)
Accounting loss before income tax	(23,136)	(23,871)
At the New Zealand statutory income tax rate of 28%	(6,478)	(6,684)
Non-deductible expenditure	1,640	1,038
Prior period adjustment	119	(23)
Impact of prior year research and development credit claims	–	(1,089)
Utilisation of tax losses not previously recognised	(10,074)	(7,690)
Net research and development expense deferred	4,023	8,327
Tax rate variance of subsidiaries	2,890	(3,368)
Total year tax losses not recognised in current year	11,887	10,532
Income tax expense	**4,007**	**1,043**
Comprising:		
Income tax payable	5,361	3,030
Prior period adjustment	119	(23)
Impact of prior year research and development credit claims	–	(1,089)
Deferred tax	(1,153)	(353)
Tax losses utilised	(398)	(483)
Effect of changes in foreign currency	78	(39)
Income tax expense	**4,007**	**1,043**

Income tax payable

At 31 March	2019 ($000s)	2018 Restated ($000s)
Opening balance	537	1,105
Prior period adjustment	177	(43)
Impact of prior period research and development credit claims	–	(1,089)
Income tax liability for the year	5,361	3,030
Income tax paid	(3,883)	(2,505)
Effects of changes in foreign currency	(234)	39
Current tax payable	**1,958**	**537**

Deferred income tax

	Derivatives ($000s)	Provisions and employee benefits ($000s)	Tax depreciation ($000s)	Tax losses ($000s)	Total ($000s)
Year ended 31 March 2019					
Deferred tax asset balances:					
Restated balance at 1 April 2018	–	1,629	(1,129)	–	500
Prior period adjustment	–	42	(48)	21	15
Charged to Income Statement	–	3,273	(1,672)	(503)	1,098
Charged to equity	–	717	–	(717)	–
At 31 March 2019	**–**	**5,661**	**(2,849)**	**(1,199)**	**1,613**
Deferred tax liability balances:					
Restated balance at 1 April 2018	(483)	6,603	(17,041)	10,308	(613)
Prior period adjustment	–	(5)	(409)	322	(92)
Charged to Income Statement	–	671	(268)	(390)	13
Charged to equity	(398)	2,053	–	(1,774)	(119)
Tax losses utilised	–	–	–	398	398
Impact of change in tax rates	–	(46)	88	–	42
Recognition of deferred tax on business combination	–	–	(1,418)	–	(1,418)
At 31 March 2019	**(881)**	**9,276**	**(19,048)**	**8,864**	**(1,789)**
Year ended 31 March 2018					
Deferred tax asset balances:					
Restated balance at 1 April 2017	–	1,164	(1,127)	–	37
Prior period adjustment	–	41	80	–	121
Charged to Income Statement	–	424	(82)	–	342
Restated balance at 31 March 2018	**–**	**1,629**	**(1,129)**	**–**	**500**
Deferred tax liability balances:					
Restated balance at 1 April 2017	447	4,148	(13,521)	8,105	(821)
Prior period adjustment	–	118	(50)	(17)	51
Charged to Income Statement	–	2,093	(4,553)	2,283	(177)
Charged to equity	(930)	762	–	(169)	(337)
Tax losses utilised	–	–	–	483	483
Impact of change in tax rates	–	(518)	1,083	(377)	188
Restated balance at 31 March 2018	**(483)**	**6,603**	**(17,041)**	**10,308**	**(613)**

Recognised temporary differences

The Group's recognised deferred tax asset and deferred tax liability are expected to be recovered by $0.4 million and $1.3 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.

Unrecognised temporary differences

The Group has elected to defer the deduction of research and development expenditure in accordance with sections DB 34(7) and EE 1(5) of the Income Tax Act 2007.

The total amount of deferred research and development expenditure available to the Group is $58.6 million (2018: $54.7 million). The deferred research and development expenditure can be deducted from taxable income in future periods, and the ability to carry forward deferred research and development expenditure is not dependent on maintaining shareholder continuity.

The Group has estimated unrecognised tax losses available to carry forward of $296.9 million (2018 restated: $310.2 million) subject to shareholder continuity being maintained.

Key estimates and assumptions

The Group recognises a deferred tax asset in relation to tax losses to the extent of the Group's deferred tax liabilities. Where it is probable that future taxable profit will be available against which carried forward tax losses can be utilised, a deferred tax asset will be recognised for these amounts, subject to shareholder continuity (or other legislative requirements). No material deferred tax asset has been recognised for losses in the Group, given the uncertainty of the timing of future profitability and the requirement for shareholder continuity.

21. Reconciliation of operating cash flows

Year ended 31 March	2019 ($000s)	2018 Restated ($000s)
Net loss	(27,143)	(24,914)
Adjustments:		
Depreciation	17,890	16,509
Amortisation	63,958	53,809
Employee share-based payments	28,087	15,965
Non-employee share-based payments	859	1,039
Impairment of assets	18,604	1,550
Amortisation of debt discount and issue cost	7,627	–
Deferred tax	(1,153)	(353)
Tax losses utilised	(398)	(483)
Bad debts	1,459	1,412
Other non-cash items	766	641
Changes in working capital:		
Increase in trade receivables and prepayments	(14,111)	168
Increase in interest receivable	(3,008)	(125)
Increase/(decrease) in trade payables and other related items	5,068	(6,142)
Increase/(decrease) in current tax payable	1,421	(561)
Increase in employee entitlements	10,764	40
Increase in income in advance	3,536	2,641
Net cash flows from operating activities	**114,226**	**61,196**

22. Changes in financial assets and liabilities arising from financing activities

Year ended 31 March 2019	At 1 April 2018 ($000s)	Proceeds ($000s)	Payments ($000s)	Amortisation expense ($000s)	Fair value changes ($000s)	Foreign exchange movement ($000s)	Other non-cash items ($000s)	At 31 March 2019 ($000s)
Short-term deposits	59,000	(59,000)	349,459	-	-	(12,640)	-	336,819
Other current liabilities	(733)	-	733	-	-	-	-	-
Bank loans	-	(30,850)	30,850	-	-	-	-	-
Term debt*	-	(455,721)	7,955	(7,627)	-	12,197	85,465	(357,731)

** Other non-cash movements reflects the fair value of the embedded conversion derivative at inception of the debt*

23. Share-based payments

The Group operates equity-settled, share-based compensation plans, under which employees provide services in exchange for non-transferable options, 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

Under the employee restricted share plan, ordinary shares in the Company are issued to a trustee, Xero Limited Employee Restricted Share Trust, 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 AUD45.22 (2018: $26.03) and was determined by the volume-weighted average price of the Company shares for the 20 trading days preceding the grant date. Shares with a grant date fair value of $12.7 million vested during the year (2018: $10.8 million). The Group has no legal or constructive obligation to repurchase or settle the shares for cash.

	2019 Number of shares (000s)	2018 Number of shares (000s)
Unvested shares at 1 April	522	582
Granted	365	600
Forfeited	(90)	(141)
Vested	(426)	(519)
Unvested shares at 31 March – allocated to employees	**371**	**522**
Forfeited shares not yet reallocated – held by Trustee	40	87
Total	**411**	**609**
Percentage of total ordinary shares	0.3%	0.4%
Ageing of unvested shares		
Vest within one year	261	344
Vest after one year	110	178
Total unvested shares at 31 March	**371**	**522**

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. Options are conditional on the completion of the necessary years of service (the vesting period) as appropriate to that tranche.

The options' tranches vest over three to four years from the grant date. No options can be exercised later than the first anniversary of the final vesting date. There were 44 holders of options at 31 March 2019 (2018: 43).

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 are as follows:

	2019 Weighted average exercise price ($)	2019 Options (000s)	2018 Weighted average exercise price ($)	2018 Options (000s)
Outstanding at 1 April	20.65	2,225	18.55	2,188
Granted	39.13	2,092	26.51	585
Forfeited/expired	31.48	(548)	18.86	(415)
Exercised	19.10	(774)	17.58	(133)
Outstanding at 31 March	**31.91**	**2,995**	**20.65**	**2,225**
Exercisable at 31 March	19.55	365	22.09	747

The weighted average share price on date of exercise for options exercised in the year ended 31 March 2019 was AUD43.31 (2018: $25.20). The weighted average remaining contractual term of options outstanding at 31 March 2019 is 3.6 years (2018: 3.2 years).

Options outstanding at 31 March 2019 fall within the following ranges:

Granted	Exercise price	2019 Options (000s)	2018 Options (000s)
2013–14	NZD38.24	–	61
2014–15	NZD16.14	–	26
2015–16	NZD16.00–NZD19.51	30	206
2016–17	NZD17.51–NZD19.50	830	1,407
2017–18	NZD19.77–NZD32.48	327	525
2018–19	AUD34.00–AUD48.33	1,808	–
		2,995	**2,225**

The weighted average fair value of options granted during the year, determined using the Black-Scholes valuation model, was $21.41 per option (2018: $9.67).

The significant inputs into the model were the market share price at grant date, the exercise price as shown above, expected annualised volatility of between 35% and 41%, a dividend yield of 0%, an expected option life of between three and five years, and an annual risk-free interest rate of between 1.7% and 2.2%.

The volatility input is measured as the standard deviation of continuously compounded share returns and is based on a statistical analysis of daily share prices over a period consistent with the options expected life.

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 in the Company.

No cash consideration is required to be paid on vesting of the RSUs. The fair value of RSUs granted in the year ended 31 March 2019 was $12.8 million (2018: $5.8 million) 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, convert to shares in equal amounts over the vesting period.

	2019 Weighted average grant date fair value ($)	2019 RSUs (000s)	2018 Weighted average grant date fair value ($)	2018 RSUs (000s)
Outstanding at 1 April	21.64	401	17.41	327
Granted	46.23	277	26.31	222
Forfeited	32.05	(57)	21.93	(88)
Converted to shares	20.93	(180)	17.31	(54)
Surrendered to pay payroll tax	20.76	(71)	20.21	(6)
Outstanding at 31 March	**38.89**	**370**	**21.64**	**401**

The Company withholds shares under certain circumstances to settle tax obligations on vesting. Based on the market share price on 31 March 2019, future cash payments to meet tax obligations on the vesting of RSUs are expected to be $4.9 million (2018: $3.9 million).

24. 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	2019 ($000s)	2018 ($000s)
Short-term employee benefits	7,807	6,317
Directors' fees	1,214	926
Share-based payments – options	5,841	1,571
Share-based payments – restricted stock units	2,008	854
Share-based payments – employee restricted share plan	889	1,417

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 services provided by the Group. None of these related party transactions are significant to either party, and are completed on arm's length terms. During the year Givia Pty Limited, a related party, was reimbursed $15,000 for legal and tax costs in relation to a share borrow transaction undertaken as part of the convertible notes transaction. There were no other related party transactions during the year.

No amounts with any related parties have been written off or foregone during the year (2018: nil).

25. COMMITMENTS AND CONTINGENCIES

Capital commitments

Capital commitments of $1.0 million for building fit-outs were contracted for at 31 March 2019 but not yet incurred (2018: $0.9 million).

Contingent liabilities

There were no contingent liabilities at 31 March 2019 (2018: nil).

26. 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 these financial statements have been prepared using accounting policies suitable to the Group's circumstances, that these have been consistently applied and are supported by reasonable judgements and estimates, and that all relevant financial reporting and accounting standards have been followed.

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 (New Zealand). They are also responsible for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

During the year ended 31 March 2019, the principal activities of the Group were for the provision of an online business platform to small businesses and their advisors. Other than as disclosed in this Annual Report, there were no significant changes in the state of affairs or activities of the Group during the year.

The Board authorised these financial statements for issue on 16 May 2019.

For and on behalf of the Board

Graham Smith	Lee Hatton
Chair	Director
Xero Limited	Xero Limited
16 May 2019	16 May 2019

Corporate Governance Statement

Xero is committed to high standards of corporate governance. We believe this is essential for the long-term performance and sustainability of Xero and supports the interests of our shareholders. The Xero Board of Directors (the Board) is responsible for ensuring that Xero has an appropriate corporate governance framework to protect and enhance Xero's performance and to build sustainable value. Xero's corporate governance framework is designed to support our business operations, deliver on our strategy, monitor performance, and manage risk.

Xero has a sole listing on the Australian Securities Exchange (ASX) but remains a New Zealand incorporated and domiciled company. From a regulatory perspective, this means that while the ASX Listing Rules will apply to Xero, certain provisions of the Australian Corporations Act 2001 (Cth) will not.[1]

Xero's corporate governance reporting framework has been developed with regard to the ASX Listing Rules and the ASX Corporate Governance Principles and Recommendations (3rd Edition). This Corporate Governance Statement (Statement) addresses the recommendations contained in the ASX Principles and Recommendations. This Statement is current as at 18 April 2019, and has been approved by the Board.

This Statement should be read in conjunction with this Annual Report and the Investor section of Xero's website at www.xero.com/about/investors/governance, where there are further details on Xero's corporate governance policies and charters.

References to FY19 are to the reporting period which is the year ended 31 March 2019.

1. Xero complies with the ASX Listing Rules. As Xero is not incorporated in Australia, it is not a disclosing entity for the purpose of Chapter 2M of the Australian Corporations Act 2001 (Cth) (financial reports and audit) and certain provisions of that will not apply (eg section 295 on annual financial report contents, section 298 regarding directors' report or section 300A regarding remuneration reporting). As a New Zealand company, Xero's annual reporting is primarily governed by the Companies Act 1993 (New Zealand)

ASX Principles and Recommendations

Principle 1: Lay solid foundations for management and oversight

The Board

Charter The Board's Charter outlines the Board's roles and responsibilities and describes those matters expressly reserved for the Board's determination and those matters delegated to management.

Xero's CEO has responsibility for the day-to-day management and administration of the Xero business, supported by the rest of Xero's leadership team. The CEO manages Xero in accordance with the strategic plan, annual budget, and the risk management strategies approved by the Board.

The Board comprises directors who bring a mix of skills, knowledge, experience, diversity and independence, together with a deep understanding of, and competence to deal with, current and emerging issues to guide the business.

Xero's Board Charter is available on Xero's website.

Responsibilities The Board retains full responsibility for overseeing and appraising Xero's strategies, policies, performance and governance framework. To assist with discharging its responsibilities, the Board has established the following committees:

1. Audit and Risk Management Committee (ARM Committee)
2. People and Remuneration Committee (P&R Committee)
3. Nominations Committee

From time to time, the Board may form other committees or delegate specific functions to ad hoc committees.

The Board is responsible for monitoring the management and performance of Xero and for ensuring that management's activities are aligned with the expectations and risks identified by the Board and management. The Board has a number of mechanisms to ensure this is achieved, including:

1. Approving Xero's corporate strategic plan, and overseeing performance to ensure its performance is aligned with the strategic plan
2. Focusing Xero's objectives on long-term shareholder value
3. Adopting an annual budget for financial performance and monitoring progress against that budget
4. Confirming accurate and reliable systems are in place to identify, manage, mitigate and report risks

Other functions reserved to the Board include:

1. Selecting, appointing, evaluating and removing (if necessary) the CEO
2. Confirming that Xero's financial position is sound, that Xero is able to meet its debts and other obligations when they are due, and that Xero has sufficient financial resources to achieve its strategic plan
3. Assessing that an appropriate culture and management framework is in place
4. Determining that Xero's governance policies and practices are appropriate and are aligned with shareholder interests and relevant laws and regulations
5. Ensuring that any significant risks that arise are identified, assessed, appropriately managed, and monitored

Appointment Before electing a candidate as a director, Xero undertakes appropriate background checks to determine that candidate's suitability.

Board and Committee membership and meeting attendance The members of Xero's Board and each of Xero's committees for FY19, the number of scheduled[1] meetings and attendance at those meetings is:

Director	Board		Nominations Committee		ARM Committee		P&R Committee	
	Held[2]	Attended	Held[2]	Attended	Held[2]	Attended	Held[2]	Attended
Mr Graham Smith	8	8	4[4]	4	5	5	-	-
Mr Rod Drury	8	7	-	-	-	-	-	-
Ms Lee Hatton	8	7	-	-	5[4]	5	-	-
Ms Dale Murray[3]	7	7	-	-	5	5	-	-
Ms Susan Peterson	8	8	-	-	-	-	6	6
Mr Bill Veghte	8	7	4	4	-	-	6[4]	6
Mr Craig Winkler	8	8	4	4	-	-	6	6

1. In addition to scheduled meetings, the Board also holds unscheduled meetings as appropriate to meet governance demands

2. Held represents the number of meetings held that the relevant director was eligible to attend

3. Appointed as a director effective 13 April 2018

4. Committee Chair

The qualifications of each director are detailed on pages 17 and 18 of this Annual Report.

All directors and members of Xero's leadership team are appointed pursuant to formal letters of appointment or agreements setting out the key terms and conditions of their appointment (including remuneration and other duties). Director appointment letters also include further details regarding committee responsibilities, directors' duties and responsibilities, the time commitment envisaged, Board performance evaluation, confidentiality of information, the Board's policy on obtaining independent advice, disclosure of interests and matters affecting independence, and entering into deeds of indemnity, insurance, and access.

Company Secretary Chaman Sidhu is the Chief Legal Officer & Company Secretary of Xero. Ms Sidhu's qualifications and experience are set out on Xero's website.

The Company Secretary is accountable to the Board, through the Chair, on all matters to do with the proper functioning of the Board. The formal reporting line of the Company Secretary is through the Chief Executive (CEO). All directors have access to the Company Secretary.

Diversity and inclusion

Xero values diversity and inclusion and considers it a priority in the creation of a sustainable business capable of delivering long-term shareholder value. Xero embraces the diverse experience, ideas, skills and perspectives of our people. Having a diverse workforce enables Xero to innovate, attract and retain top talent, and to better reflect and serve our customers, partners, and the communities we interact with every day. Xero takes a broad view of the meaning of diversity and believes that it's through inclusion that we will tap into the potential and power of our people's differences.

Diversity and Inclusion Policy Xero has a Diversity and Inclusion Policy, which is available on Xero's website. This policy includes requirements for the Board to establish measurable objectives for achieving diversity and to annually assess those objectives and the progress towards achieving them. A Head of Diversity, Inclusion and Community is employed to further Xero's activities and progress towards achieving diversity.

The Diversity and Inclusion Policy reflects six key principles that provide the framework for Xero's goal of developing and maintaining a diverse and inclusive workplace and the implementation of Xero's initiatives to support this. The key principles are:

1. We value diversity because it reflects and serves our customers and ensures our people thrive
2. We're all accountable to create an inclusive culture
3. We're committed to attracting diverse talent and hiring fairly
4. We support flexible ways of working
5. We're committed to equal pay for equal work
6. We have an obligation to champion diversity and inclusion in the community

Respect and Responsibility Policy Xero's global Respect and Responsibility Policy supports a clear and consistent approach to equal opportunity, promotes a workplace free from discrimination, harassment, sexual harassment and bullying and sets out the internal process to resolve concerns and complaints. In FY19, face-to-face training for people managers was conducted and a new online training module for employees was launched with an introduction video from the CEO.

Xero's Australian subsidiaries submit an annual Workplace Gender Equality Report under the Australian Workplace Gender Equality Act 2012 (available once published on WGEA's website at www.wgea.gov.au).

Measurable objectives The following is a summary of progress achieved against Xero's measurable objectives for FY19:

Objective	Progress
Xero attracts diverse talent in the tech industry with a particular focus on women in tech	– At 31 March 2019, 42% of employees were female, 50% of Xero's leadership team were female and 43% of Xero's Board were female – Our Head of Diversity, Inclusion and Community promoted global initiatives and supported our regions to set and monitor local diversity priorities – Continued to incorporate diversity and inclusion in Xero's external communications and activities – Maintained our support of organisations and initiatives to attract a more gender-diverse workforce, including Girl Geek Dinners, Code Like A Girl and Work180 – Commenced a phased roll out of a mentoring programme through Mentorloop to support our employees – Delivered a global International Women's Day campaign including local events across our offices and a video from our CEO and other business leaders – Piloted an internship with Specialisterne (an organisation that supports employment of people on the autism spectrum) in Australia and delivered autism awareness training to some employees – Hired an employee through the Asylum Seeker Resource Centre in Australia and participated in the TupuToa internship programme in New Zealand – Developed new guidelines to set out the support available to those experiencing or impacted by domestic and family violence – Held meetings for our internal recruiters network to discuss and promote diversity in Xero's hiring process – Maintained an internal diversity dashboard to track diversity data for internal monitoring
Xero promotes flexible working across the organisation where possible	– Continued to maintain Xero's Flexible Working Guidelines and a resource for managers on this topic – Developed a flexible work learning video to build understanding of flexible working and how managers can support this – Actively communicated real stories of employees working in flexible work arrangements – Delivered internal surveys to understand the utilisation and satisfaction with flexible work arrangements – Held keeping in touch events to promote an inclusive environment for employees on parental leave in some offices – Maintained a child-friendly workspace in our Melbourne office and also offered child-friendly workspaces in New Zealand during school breaks – Achieved a highly commended recognition in work/life balance category for Diversity Works awards in New Zealand
Xero is an inclusive work environment where difference is valued and everyone can bring their whole self to work	– Implemented a new Respect & Responsibility Policy setting expectations on discrimination, harassment, sexual harassment, and bullying, supported by face-to-face training for people managers and an online training module for employees – Delivered training on topics including diversity, inclusion, bias awareness and LGBTI awareness to certain employees throughout the business – Introduced an option for employees to update their pronoun preferences related to gender identity – Joined the Australian Network on Disability in Australia and signed up to the Government's Disability Confident Scheme in the United Kingdom – Developed a new disability confidence learning video and implemented new workplace adjustments guidelines to support employees with disability and explain how employees can request an adjustment – Delivered surveys to capture feedback on the extent to which employees feel that Xero is an inclusive workplace – Held memberships of organisations supporting LGBTI workplace inclusion – Pride in Diversity in Australia, Stonewall in the United Kingdom – and achieved the Rainbow Tick in New Zealand – Delivered training workshops on mental health and wellbeing topics and launched a new Flourishing@Xero guide with tips for mental health and wellbeing – Held internal events for World Mental Health day and partnered with Beyond Blue on a Xero Now episode on mental health at work – Expanded our definition of sick leave and positioned it as 'wellbeing leave' to encourage employees to look after overall health and mental wellbeing – Commenced pilot of Unmind, a mental wellbeing platform (with mobile app) for the workplace in the United Kingdom – Developed an internal Welcome to and Acknowledgement of Country guide and held NAIDOC week activities to support indigenous awareness in Australia – Shared Xero stories of cultural diversity on World Day for Cultural Diversity, delivered Māori language week activities and Māori language courses in New Zealand, and held shared cultural lunches in some of our offices

Gender diversity statistics The proportion of females employed by Xero (and its wholly owned subsidiaries) as at 31 March 2019 was as follows:[1]

At 31 March	2019 women	2019 men	2019 total	2019 %	2018 women	2018 men	2018 total	2018 %
Directors	3	4	7	43%	2	4	6	33%
Xero's leadership team[2]	5	5	10	50%	4	6	10	40%
Employees	1,060	1,464	2,531[3]	42%	814	1,191	2,010	40%

1. These figures include permanent full-time, permanent part-time, fixed-term, casual employees and interns.

2. Xero's leadership team is defined as the CEO and all senior executives who report directly to the CEO.

3. Xero has an optional self-selection gender identification question that allows employees to choose from the following options: female, male, other and not declared. Employees can also leave this question unanswered. In 2019, the total includes three employees who selected other and four employees who selected not declared. 46 employees were excluded from the total because they did not respond to the gender identification question.

Evaluation of the Board

In accordance with the Board Charter, the performance of the Board is reviewed annually, assisted by the Nominations Committee. The Nominations Committee assists in developing and implementing a process to review and evaluate the performance of the Board (including its performance against the requirements of the Board Charter), Committees, and individual directors.

These performance reviews are conducted both internally and, on a periodic basis, externally with the assistance of a facilitator. The Board conducted an externally facilitated performance review during FY19. This review evaluated Board, Committee, and individual director performance.

The Board, with guidance from the Nominations Committee, determines the size and composition of the Board (having regard to the size of Xero and other factors), and the appointment, re-election or retirement of directors. A director does not participate in the decision regarding their own re-election.

After considering the results of the performance reviews, the Board determines whether it will endorse the directors who will stand for re-election at the Annual General Meeting.

Evaluation of leadership team

The Chair of the Board, with support from the P&R Committee, reviews and makes recommendations to the Board on the performance evaluation of the CEO. The CEO, with oversight from the P&R Committee, reviews and makes recommendations on the performance evaluation of the rest of Xero's leadership team.

The performance of Xero's leadership team is reviewed annually. Performance reviews are conducted by assessing each executive's performance against specific and measurable quantitative and qualitative performance criteria. The assessment is then discussed with the P&R Committee or Board (as appropriate). The performance criteria against which the executives are assessed are aligned with the financial and non-financial objectives of Xero.

Performance evaluations for Xero's leadership team took place for FY19 in accordance with the process referred to above.

Principle 2: Structure the Board to add value

Nominations Committee

The Board has established a Nominations Committee that operates under a Charter, which is available on Xero's website. The Charter provides that the Committee will consist of a majority of independent directors, be chaired by an independent non-executive director, and have at least three members. The current composition of the Committee meets these requirements. The Committee meets at least three times per year and all directors have a standing invitation to attend its meetings.

Responsibilities The Committee's role is to assist the Board in relation to:

- Board and Committee size and composition
- Director selection, appointment, election, and re-election
- The selection, appointment and, if necessary, termination of the CEO
- Director induction and continuing professional development
- Evaluating the performance of the Board, its Committees, and individual directors
- Succession planning for the Board (in particular the Chair) and the CEO

Director appointment The Board's policy and procedures for selecting and appointing new directors to the Board is to identify and consider qualified potential candidates, in light of the appropriate mix of skills, knowledge, experience, diversity, and independence that the Board and Committees are seeking to achieve, and the time commitment required from non-executive directors.

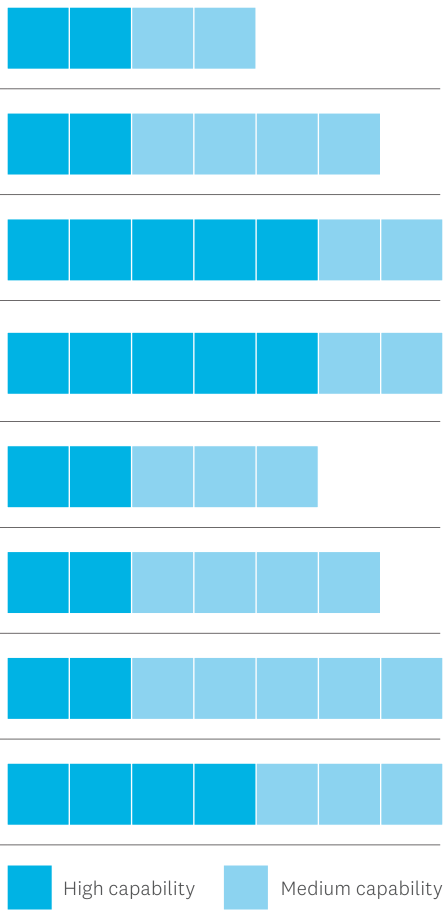
Suitable candidates are appointed by the Board. Any new director appointed by the Board holds office until Xero's next Annual General Meeting and is then eligible for election.

In determining Board membership, the Board seeks to achieve a mix of skills and diversity that includes experience in the areas set out in the table below. The table summarises the directors' relevant skills as at 31 March 2019.

The Board is satisfied that the skills matrix demonstrates that the Board has the appropriate mix of skills and experience necessary to oversee the governance and operations of Xero.

Board skills matrix

Capability	Number of directors with the capability
Cloud Expertise in business software and delivering solutions at scale through cloud platforms within the SaaS industry	
Digital product management and marketing Digital product expertise with extensive experience across technology trends, and implications and the software and technology product value chain	
Strategy and development Corporate strategy and development including M&A and strategic partnerships	
Go-to-market and customer experience Deep customer insight and advocacy. Go-to-market expertise including direct sales, internet sales and new markets, and specific customer channel experience	
Financial expertise Public company-experienced financial expert with deep experience in finance, accounting, planning and investor relations	
International markets Exposure to at least two of Xero's key International markets (Asia, Americas, UK, New Zealand and/or Australian markets)	
Listed company governance; risk Depth of expertise in listed company governance, compliance and risk management	
People and culture Remuneration, workforce planning, talent, culture, and diversity and inclusion	



Independence

Xero considers a director to be independent when they are a non-executive director who is independent of management and free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the independent exercise of their unfettered judgement, having regard to the best interests of Xero as a whole.

In the context of director independence, “materiality” is considered from both Xero and an individual director perspective.

The Board makes an assessment of the independence of each director upon their appointment and annually thereafter. Directors are required on an ongoing basis to disclose to the Board relevant personal interests and conflicts of interest. In accordance with the definition of independence above, and having regard to the relevant factors listed in the ASX Principles and Recommendations, the following directors of Xero are considered to be independent:

- Mr Graham Smith (Chair)
- Ms Lee Hatton
- Ms Susan Peterson
- Mr Bill Veghte
- Ms Dale Murray

The length of service of each director is ascertainable from the information on pages 17 and 18 of this Annual Report.

Board composition and Chair

The Board Charter states that the Board will consist of a majority of independent non-executive directors. The Chair of Xero, Graham Smith, is assessed as an independent non-executive director. The Chair’s role is to lead the Board, facilitate constructive discussion at Board meetings, and ensure that the Board functions effectively.

Induction

All new Board members are given an appropriate induction programme to enable new directors to gain an understanding of Xero, its operations and values, its financial, strategic, and risk management position, and the rights, duties and responsibilities of the Board, its Committees and management. Each new Board member has the opportunity to meet with existing Board members, Xero’s leadership team, and relevant members of the senior management team. All Board members are expected to maintain the skills required to discharge their respective roles.

Principle 3: Act ethically and responsibly

Code of Conduct

In FY19 Xero adopted a new Code of Conduct (the Code), which applies to all directors, officers, employees, and contractors in the Xero group. The Code captures the standards and values of Xero and sets out the way Xero conducts business and how we believe we should behave. The Code is underpinned by Xero policies, some of which are global and some of which are country specific, and which include topics covering diversity and inclusion, fraud, respect and responsibility, workplace behaviour, and work health and safety.

The Code of Conduct is available on Xero’s website and is also made available to employees via Xero’s intranet.

Principle 4: Safeguard integrity in corporate reporting

Audit and Risk Management Committee

Purpose The Board has an ARM Committee that operates under a Charter, which is available on Xero’s website. The Committee was established to review and make recommendations to the Board on areas including financial reporting principles and policies, risk management, compliance, external audit functions, and internal control processes.

Composition The Committee Charter states that the Committee will comprise at least three members. All members must be non-executive directors, and the majority must be independent. The Committee is to be chaired by an independent member, who is not the Chair of the Board. The Charter also states that the members should be financially literate, and at least one member will have accounting or related financial management expertise. The current Committee composition meets these requirements.

The Committee Charter provides that the Committee will meet at least four times per year. The CEO and CFO are routinely invited to attend meetings of the Committee, and other senior managers are invited to relevant parts of the meetings.

Details of the membership of the Committee and attendance at its meetings are set out under Principle 1.

Responsibilities The Committee is responsible for reviewing and making recommendations to the Board on areas including the following:

1. The financial statements and reports intended for publication at half year and full year
2. The adequacy of accounting policies, processes and financial reporting practices, and ensuring appropriate new policies and revisions to existing policies are made to ensure compliance with relevant accounting standards
3. Approval of the appointment, reappointment or replacement, and remuneration of the external auditor
4. The provision of non-audit services by the external auditor, and whether it may compromise the independence of the external auditor

5. The overall adequacy and effectiveness of the internal control systems, controls to safeguard assets, compliance with applicable laws, ethical compliance, and insurance coverage

6. The overall adequacy and effectiveness of the risk management framework and the methodology and processes for assessing, monitoring, and managing financial and non-financial risks

Reporting The Chair of the Committee communicates the findings of the Committee to the Board at the next Board meeting.

To ensure that the external auditor remains independent at all times, non-audit work is authorised by the Committee.

Xero is committed to ensuring that the external auditor carries out its function independently and has adopted an Auditor Independence Policy. The policy requires that the senior audit partner must be rotated at least every five years. The auditor was last changed in 2015. The policy also requires the external auditor to confirm annually that it has complied with all professional regulations relating to auditor competency and independence.

The external auditor will attend and be available to answer shareholder questions at the Annual General Meeting.

Declaration regarding financial statements

As a New Zealand company, section 295A of the Australian Corporations Act 2001 (Cth) is not applicable to Xero. However, the CEO and the CFO provide written statements to the Board in accordance with the ASX Principles and Recommendations, in respect of the half and full-year reporting periods. These statements confirm that, in their opinion, the financial records of Xero have been properly maintained and that the financial statements comply with the accounting standards and give a true and fair view of the financial position and performance of Xero, and that their view is founded on the basis of a sound system of risk management and internal control which is operating effectively in all material respects.

Principle 5: Make timely and balanced disclosure

Disclosure Policy

Xero's Continuous Disclosure Policy is available on Xero's website. The policy describes the key obligations of the Board and Xero's leadership team to ensure that Xero complies with its disclosure obligations under the ASX Listing Rules. The Board is responsible for compliance with Xero's continuous disclosure obligations. The Board has established a Disclosure Committee, comprising the CEO, a director, the CFO, and the Chief Legal Officer and Company Secretary to support this primary responsibility and provide assurance. Xero's Chief Legal Officer and Company Secretary is primarily responsible for overseeing and coordinating all communications with the ASX, and is the Disclosure Officer for the purpose of the policy. The Authorised Spokespersons of Xero include the Chair, the CEO, the CFO, the Director of Corporate Affairs, and any other person authorised by the CEO.

Principle 6: Respect the rights of security holders

Shareholder communication

Investor centre Xero has a dedicated Investor Centre on Xero's website. This provides important information relevant to Xero to its shareholders, and enables two-way communication with investors. Xero's Investor Centre includes:

- Copies of Board and Committee Charters and policies
- Profiles of Xero's directors and leadership team
- ASX and media releases
- Half and full year financial results and investor presentations
- Historical financial reports and share price history
- Details of Xero's share register, Link Market Services Limited
- An online form to enable investors to send enquiries directly to the Xero investor relations function

Investor relations function Xero has an investor relations function which, in collaboration with the company secretariat function, has a programme to support Xero's commitment to ensuring its shareholders receive important information in a timely and effective manner, including the following:

1. The Investor Centre on Xero's website is accessible by shareholders and updated in a timely manner

2. The Annual Report is made available to all shareholders, either electronically or by post, and includes relevant information about the operations of Xero and other required disclosures

3. Each shareholder receives a Notice of Annual General Meeting invitation, and has the opportunity to attend and participate in the meeting. Shareholders may vote electronically or appoint a proxy. For the last three years, Xero has held a hybrid Annual General Meeting, meaning shareholders can attend the meeting in person or virtually via an online platform. If shareholders attend the Annual General Meeting virtually, they are able to watch the meeting live, vote, and ask questions online

Electronic communications Shareholders can elect to communicate with Xero's share registry electronically.

Principle 7: Recognise and manage risk

Audit and Risk Management Committee

Purpose As mentioned in Principle 4, the Board has established an ARM Committee that operates under a Charter, which is available on Xero's website.

The Board is ultimately responsible for ensuring that material risks facing Xero have been identified and that adequate controls, monitoring, and reporting mechanisms are in place and operating effectively. The Board has delegated its oversight of risk management, audit, and compliance to the Committee.

The Committee operates in accordance with its Charter, which sets out its responsibilities for monitoring Xero's risk management, including how Xero identifies, assesses, and controls strategic, operational, and financial risks within the Board approved risk appetite. This is designed to ensure the adequacy and effectiveness of Xero's ongoing risk management programme, including policies and guidelines relating to corporate governance, legal, regulatory and ethical compliance, business continuity management, data privacy, and information systems security.

Risk framework

Xero has a risk management framework which is managed by the internal strategy function (reporting to the CFO) and overseen by the Committee.

Xero's risk framework was developed through a series of workshops conducted by the strategy function and included Xero's leadership team, senior management, and operational specialists. These assessed areas of potential risk to the business, estimated likelihoods, impacts and mitigation strategies. The identified discrete risks are now included in a risk dashboard according to the key risk categories, including operational, strategic, legal, and financial. The risk dashboard is reviewed with each member of Xero's leadership team at least twice each year. Risks lying outside the boundaries of Xero's agreed risk appetite require proactive mitigation and are included as part of an ongoing action plan, which is tracked and monitored on a periodic basis by Xero's leadership team.

The Committee has reviewed and approved the risk appetite parameters, and reviews the risk dashboard at least twice per year to ensure it has oversight of status and key changes. It also periodically oversees the action plan and, together with the Board, key mitigation actions arising from the dashboard.

The Committee has reviewed Xero's overall risk management framework during FY19 and considers that it is sound.

Internal audit

Xero has established an internal Business Assurance function in the reporting period, which provides independent and objective assurance and advice on Xero's organisational governance, risk management and internal control processes. Business Assurance assists the business in understanding and managing risk and provides confidence that key elements of the business that are relied on to manage risk are in place and working effectively.

To maintain independence, the Head of Assurance has a reporting line to the Chair of the ARM Committee and regularly meets with the Chair without management present. Business Assurance develops an assurance plan which is endorsed by the ARM Committee twice each year. The ARM Committee receives and reviews reports regarding assurance activity undertaken and through these reports, monitors the progress of management action plans.

Management of economic, environmental, and social sustainability risks

Xero is an online business and our operational model primarily utilises office-based employees. Accordingly, Xero's environmental footprint is relatively small and arises largely from the energy used in its offices, in third party-data centres and for employee travel, and from the typical consumables of an office-based business. However, we acknowledge that how we conduct our business has an impact on a range of stakeholders and on the environment more broadly. More information about our approach to social and environmental impact is set out on pages 13 to 15 of this Annual Report.

There are a number of business risks that could materially impact Xero. As part of the risk management process described above, Xero has identified and assessed those areas of risk that may impact the business. Effective monitoring and mitigation of these risks supports Xero's ongoing growth and profitability. Key areas of risk are described below. Other risks relevant to economic sustainability are noted on pages 61 to 64 of this Annual Report in the Notes to the Financial Statements.

Technology platform & data security As Xero continues to grow its customer base and broaden product usage across current users, it must ensure that its platform is scalable. This enables Xero to continue to provide the same high levels of quality user experience as traffic grows on the platform. We closely monitor all relevant aspects of the platform to identify areas that may need to be addressed to ensure future performance robustness.

Xero is committed to the security of its customers' data and has partnered with industry-leading security vendors to leverage their platforms and expertise to protect its systems. Xero has a security team that is responsible for security risk management, product and platform security, security operations, security compliance, and training and awareness.

Xero takes a risk-based approach to security, which means tighter security controls are implemented where business risk is higher. In order to manage security risks within Xero's risk appetite, processes are in place for identification, assessment, and treatment of security risks.

On 3 December 2018, Xero achieved global ISO/IEC 27001 Information Security Certification. ISO/IEC 27001 is globally recognised as the premier information security management system standard and Xero achieved certification by demonstrating a robust security management programme, including a comprehensive information security management system.

Xero hosts its data in AWS in US locations. All locations have the same security measures to protect Xero's and its customers' data.

Xero has the following enterprise-wide security practices and procedures in place:

- An information security management framework
- An information security policy
- Information security standards
- An internal security governance group, which meets regularly

Xero has in place a Business Continuity Management policy and plans and a Data Classification Standard. Xero produces a SOC 2 (Service Organization Control 2) report annually which is the result of an independent assessment of controls in place for security, confidentiality, and availability.

Strategic direction and implementation A clear and disciplined approach to strategic choices and delivery is key to success as Xero grows and pursues a wider range of strategic objectives in more markets. With the oversight of the Board, Xero's leadership team reviews the strategic direction on an ongoing basis and shares learnings from across the business as well as incorporating the impact of external developments as required. Underlying initiatives are reviewed and updated, assigned owners, and tracked on a regular basis.

Innovation momentum and delivery It is critical that Xero maintains its ability to stay ahead of the competition and continues to build and deliver innovative products and services to customers as it has in the past, providing Xero with a competitive advantage.

Xero proactively aligns our teams with our strategy to more rapidly and efficiently advance our goals. We have processes to monitor progress, as well as enabling delivery through improving Xero's product management capability. This foundation of strategic alignment, tracking, oversight, and capability development supports Xero's ongoing delivery of product innovation.

Access to talent As Xero grows, it requires more talent working across the globe. The organisational architecture needs to constantly evolve to serve more independent teams in more diverse locations. In addition to current strategies to attract talent into current locations, alternative approaches are being explored to attract talent to new locations.

Principle 8: Remunerate fairly and responsibly

People & Remuneration Committee

Purpose Xero has a P&R Committee that operates under a Charter, which is available on Xero's website. The Committee has the role of assisting the Board in overseeing the human resources activities of Xero. The Committee's principal function is to oversee Xero's strategies and policies relating to organisational structure, culture, employee performance and development, succession planning, workforce planning, growth, and remuneration.

Composition The Committee Charter states that the Committee will consist of a minimum of three non-executive directors, the majority of whom are independent, and that it is chaired by an independent member. The current Committee composition meets these requirements.

Further details of the membership of the Committee and attendance at its meetings are set out in Principle 1.

Responsibilities The Committee Charter sets out the responsibilities of the Committee to review and make recommendations to the Board on:

1. Remuneration of the Board
2. Executive remuneration, including the remuneration of Xero's leadership team (comprising the CEO and all senior executives who report directly to the CEO)
3. Xero's remuneration strategy, structure and policy, and short and long-term incentive plans, including amendments to such plans, and other material employee benefits
4. Diversity and inclusion at Xero, including measurable objectives for achieving diversity
5. Management succession planning for key roles within Xero

Employee remuneration

Xero is dependent on highly skilled employees who specialise in a broad range of disciplines. Our ability to implement a competitive strategy to attract, retain, reward, and motivate our people is fundamental to our long-term success.

Remuneration policy and practices To align employee interests with shareholders, Xero has a remuneration policy and practices geared towards specific objectives, including to:

- Differentiate and reward excellent performance and key talent, both in the short and long term, and recognise our values
- Enable Xero 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 to influence appropriate behaviours and actions to support a growing business
- Ensure that objectives linked to remuneration are aligned to Xero's overall strategy via quantitative, measurable metrics
- Foster teamwork and collaboration across Xero
- Take into account the long-term performance of Xero in order to create sustainable value for our shareholders
- Ensure diversity has no influence on employees' remuneration, whether it be gender, race, religion, or factors other than performance, experience, education, knowledge, and size/scope of the role

Remuneration model Xero aims to remunerate employees competitively in each of the markets in which we operate. We partner with local and global remuneration data providers to obtain the most relevant IT industry market data.

All Xero employees receive fixed annual remuneration, comprising base salary and retirement benefits (superannuation in Australia, KiwiSaver in New Zealand, and the equivalent in other markets where required). Fixed remuneration is set according to individual skills, experience, accountabilities, performance, potential and behaviours. Fixed remuneration is reviewed on an annual basis and where appropriate is adjusted based on these factors. Some employees receive commission-based remuneration in addition to fixed remuneration.

All permanent employees, other than Xero's leadership team and certain senior management roles, participate in Xero's long term incentive (LTI) employee share plan. This is a time-based retention plan that provides employees with the opportunity to be rewarded with equity that is allocated annually and vests in equal portions over a three-year period subject to the individual remaining employed by Xero. The value of the annual allocation is calculated as a percentage of an employee's fixed salary and based on the seniority of the role they perform and their country of residence. The LTI plan has been established to assist in the reward and retention of all employees and to align the interests of employees with shareholders by providing them with equity in Xero.

Senior leaders are also able to earn a short-term incentive based on agreed performance criteria.

Employment agreements All Xero employees have individual employment contracts. Collective bargaining agreements are not typical in the industry within which Xero operates. Xero's employment contracts and remuneration arrangements are designed to attract and retain talent within the highly competitive technology industry.

Executive remuneration

Remuneration philosophy Xero's executive remuneration philosophy links remuneration to long-term value creation for shareholders by:

- Aligning shareholder and executive interests
- Directly linking strategic objectives and remuneration measures via quantitative, measurable metrics
- Balancing short-term financial performance and long-term sustainability
- Incorporating a mix of financial and non-financial measures and targets

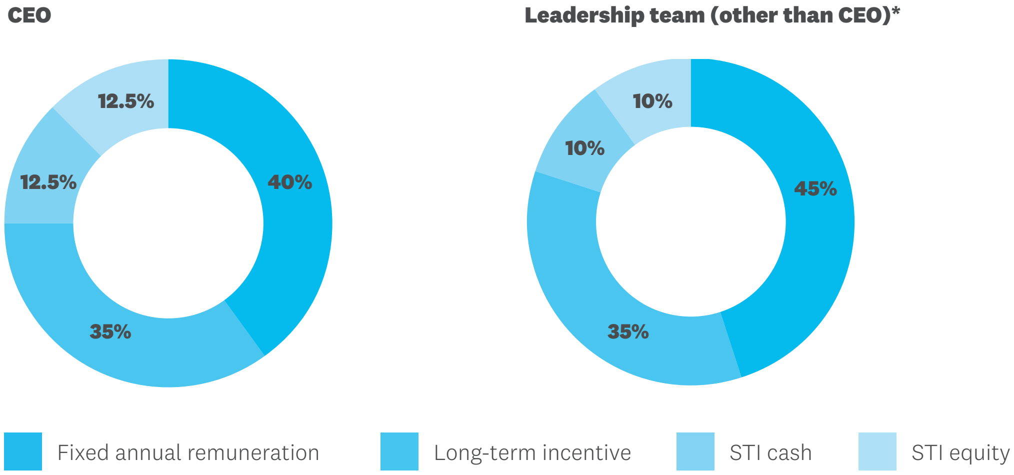
Remuneration principles Xero's executive remuneration framework is designed around the following guiding principles:

Principle	How it is followed
Alignment	Incentive measures are directly aligned to overall strategic priorities and drive long-term, sustainable value for our shareholders
Fairness	Market competitive remuneration that enables Xero to attract and retain executives and motivate them to achieve results with integrity and fairness. A commitment to pay equality
Collaboration	Foster teamwork and collaboration across the company, specifically via shared incentive plan measures and targets
Simplicity	Simple, consistent, transparent remuneration structures and incentive plans that are clearly understood, motivating and driving the right behaviours
Flexibility	A flexible approach that recognises executives, their roles and the market in which they operate are unique

Remuneration structure Xero's executive remuneration structure is deliberately weighted to have a substantial portion of total remuneration at risk. A large part of this at-risk component consists of option grants, providing leverage and a growth orientation for our executives, which is aligned to our overall strategy.

Component	Description	Link to strategy and performance
Fixed annual remuneration	– Base salary – Retirement benefits (superannuation / KiwiSaver or local equivalent)	It is set and reviewed annually based on individual skills, experience, accountabilities, performance, leadership and behaviours
Short-term incentive	– An at-risk component set as a percentage of base salary, based on seniority and country of residence – Calculated based on achievement against a range of organisational performance measures (financial and non-financial) and individual objectives – For Xero's leadership team, STI has evolved to be paid after a 12 month performance period (1 April to 31 March, aligned with Xero's financial year) and to include a deferred component. STI comprises 50% cash and 50% deferred equity (in the form of restricted stock units). Deferred equity vests 12 months after grant subject to continuing employment and confirmation that no award adjustment events have occured (see page 89)	Rewards delivery of key strategic and financial objectives, in line with the annual business plan, and reward outcomes aligned to Xero's aspirations for growth and operational discipline Organisational measures are approved by P&R Committee and aligned with the strategic objectives of Xero
Long-term incentive	– An at-risk component in the form of a block options grant plan – Participating executives are granted a block of options that vest in equal portions in each of the second, third and fourth years after grant – Executives will not receive any new equity grants under the LTI employee share plan (any historical grants under that plan will continue to vest) – New hires / promotions may be invited to participate in the block options plan, with a pro rata allocation to reflect their later entry into the plan	Rewards delivery against longer-term strategy and sustained shareholder value creation. Provides alignment between shareholder and executive outcomes. Vesting is subject to continuing employment, which provides an additional time-based retention incentive, and confirmation that no award adjustment events have occured (see page 89)

Target remuneration mix Remuneration mix refers to the proportion of total remuneration that is made up of each remuneration component. The following diagrams set out the target remuneration mix for the CEO and the rest of Xero's leadership team:



** This reflects the target remuneration mix but actual percentages vary according to roles*

Market position & benchmarking As Xero continues to grow, it is important to ensure that executive remuneration is set at a level to attract and retain high-calibre talent within what is a competitive market. For executive roles based in Australia and New Zealand, total remuneration is benchmarked to a combination of two comparator groups of ASX100 companies based on market capitalisation and revenue levels. For executive roles based outside Australia and New Zealand, total remuneration is benchmarked to the local technology industry.

Oversight of variable remuneration The P&R Committee considers all proposals to award variable remuneration to Xero's leadership team, including recommended cash STI payments and awards of deferred equity, and any upcoming LTI equity vests, to determine whether there is any reason to adjust, delay or withhold those awards. Adjustment, delay or withholding may occur in circumstances where an executive has acted fraudulently or dishonestly, is in material breach of their obligations to Xero or has acted contrary to Xero's values, where Xero becomes aware of a material misstatement or omission in the financial statements of the Xero group, or in any other circumstances (for example, relating to the executive's conduct) where the award would result in an unfair benefit to the executive (collectively, award adjustment events).

No protection arrangements Xero's Securities Trading Policy (available on Xero's website) prohibits employees and directors from entering into transactions that are intended to limit the economic risk of unvested or restricted Xero securities.

Non-executive director remuneration

The Board sets the fees for the non-executive directors at a level that provides Xero with the ability to attract and retain directors of a high calibre.

The fees paid to directors are structured to reflect time commitment, responsibilities, and workloads. Target fees for non-executive directors are benchmarked to the Australia and New Zealand market, except where directors would receive higher fees in their local markets, in which case local benchmarks are used. This reflects the global composition of the Board. The actual fees paid to individual directors take into account the target fees, as well as individual directors' skills, experience and specialist knowledge.

To preserve independence and impartiality, non-executive directors have not been granted any performance-related or at-risk compensation (such as options) since 2016. Xero does not provide any scheme for retirement benefits, other than statutory superannuation, for non-executive directors.

The annual total aggregate non-executive directors' remuneration pool is currently capped at NZ$1.4 million. Any increase is subject to shareholder approval based on a recommendation from the Board.

For the details of the total remuneration of, and value of other benefits received by, the non-executive directors for FY19, please refer to page 92 of this Annual Report.

Disclosures

All financial figures in this section of the Annual Report are in New Zealand dollars except where indicated otherwise. References to FY19 are to the year ended 31 March 2019. References to FY18 are to the year ended 31 March 2018. Group means Xero Limited and its subsidiaries.

Equity holdings of directors, CEO & CFO

At 31 March 2019	Number of shares	Number of options	Number of restricted stock units (RSUs)
Non-executive Directors			
Graham Smith	-	-	-
Rod Drury[1]	17,719,779	-	-
Lee Hatton	7,852	-	-
Dale Murray	950		-
Susan Peterson	1,827	-	-
Bill Veghte[2]	65,598	29,530	-
Craig Winkler[3]	13,025,990	-	-
CEO & CFO			
Steve Vamos[4]	10,000	180,000	32,658
Kirsty Godfrey-Billy[5]	3,833	160,000	3,051

1. Shares are held by Rodanna Ventures Trust. Rodney Kenneth Drury, Anna Margaret Clare Drury, and Scott Moran are the trustees

2. All options held by Bill Veghte have vested (meaning that they are capable of being exercised). 27,117 shares are held by National Financial Services LLC on behalf of Bean Brook Farm 2013 Annuity Trust. Bill Veghte is the trustee of the trust. 38,481 shares are held directly by Bill Veghte

3. 12,004,545 shares are held by Givia Pty Limited, the trustee of an Australian charitable trust. Craig Winkler is a director of Givia Pty Limited; he and his family members are not beneficiaries of the trust. A further 1,000,000 of Givia's shares are the subject of a stock borrow arrangement in connection with the Group's convertible notes issue, as disclosed to ASX on 26 September 2018. 21,445 shares are held by a custodian for the benefit of Bangarie Investments Pty Limited. Craig Winkler is a director of Bangarie Investments Pty Limited

4. 20,383 RSUs will vest (be converted to shares) as set out on page 95 reflecting the FY19 outcome under the CEO LTI/retention structure. The balance will be forfeited

5. Of the 3,833 shares held by Kirsty Godfrey-Billy, 1,359 were issued to her on a restricted basis in previous years under Xero's LTI employee share plan. She currently has a beneficial interest in those shares, which will vest over coming years in accordance with their terms of issue, subject to continuing employment. The 3,051 RSUs will vest (be converted to shares) in May 2019

Entries recorded in the interests register

Xero maintains an interests register in accordance with the Companies Act 1993 (New Zealand). The following are particulars of entries made in the interests register during FY19.

Directors' interests

Directors disclosed the following relevant interests, or cessations of interest, in the following entities.

Director/Entity	Relationship
Rod Drury	
Atomic.io Limited	director & minority shareholder
Dale Murray	
Sussex Place Ventures Limited	director
Peter Jones Foundation	ceased to be a trustee and director
Obelisk Legal Support Solutions Limited	advisor
Seedrs Limited	advisor
New Zealand Trade and Enterprise Beachheads Network in Europe	advisor

Director/Entity	Relationship
Graham Smith	
Citrix Systems, Inc.	ceased to be a director
Slack Technologies, Inc.	director
MINDBODY, Inc.	ceased to be a director
Splunk, Inc.	chair
Bill Veghte	
Embroker, Inc	director
Craig Winkler	
BLD Group Pty Ltd.	ceased to be a director
Philanthropy Australia Ltd	director

Share dealings of directors

Directors disclosed the following acquisitions or disposals of relevant interests in Xero shares during the year. All dollar figures in this table are in Australian dollars except where indicated otherwise.

Registered holder	Date of acquisition/ disposal	Consideration per share	Number of shares acquired/(disposed)
Lee Hatton			
Christopher Hatton[1]	17 May 2018	$39.48	(200)
Lee Hatton	17 May 2018	$39.98	(2,600)
Lee Hatton	18 May 2018	$40.02	(5,000)
Lee Hatton[2]	24 May 2018	$39.66	1,999
Lee Hatton[3]	14 November 2018	$41.04	1,152
Dale Murray			
Dale Jane Murray	22 November 2018	$37.50	950
Susan Peterson			
Susan Ruth Peterson	13 November 2018	$39.22	1,265
Bill Veghte			
William Lewis Veghte[2]	24 May 2018	$39.66	4,333
William Lewis Veghte[3]	14 November 2018	$41.04	2,588
William Lewis Veghte	6 February 2019	NZD $16.14[4]	25,730
William Lewis Veghte	6 February 2019	$45.03	12,865
Craig Winkler			
Givia Pty Limited[5]	17 May 2018	$40.00	(750,000)
Givia Pty Limited[5]	14 June 2018	$45.00	(300,000)
Givia Pty Limited[5]	18 June 2018	$45.00	(400,000)

1. Christopher Hatton is Lee Hatton's husband

2. Shares issued as full payment in lieu of cash remuneration for role as a director of Xero. At the date of issue, shares issued represented, as a percentage of total issued capital, 0.0014% for Lee Hatton and 0.0031% for Bill Veghte

3. Shares issued as full payment in lieu of cash remuneration for role as a director of Xero. At the date of issue, shares issued represented, as a percentage of total issued capital, 0.0008% for Lee Hatton and 0.0018% for Bill Veghte

4. Exercise of vested options at an exercise price of NZD $16.14 each

5. Craig Winkler is a director of Givia Pty Limited, the trustee of an Australian charitable trust. Craig Winkler and his family members are not beneficiaries of the trust. See ASX announcement dated 16 May 2017 for information on disposals by Givia

Insurance

In accordance with the Companies Act 1993 (New Zealand), Xero has continued to insure its directors and officers (through renewal of its D&O insurance policy) against potential liability or costs incurred in any proceeding, except to the extent prohibited by law.

Deeds of Indemnity

Xero has provided Deeds of Indemnity to all directors and officers of Xero and its subsidaries for potential liabilities and costs they may incur for acts or omissions in their capacity as directors or officers of Xero or its subsidaries.

Remuneration disclosures

Xero's remuneration policy and practices are summarised on pages 87 to 89 of this Annual Report. Below is information about non-executive director (NED) and executive remuneration during FY19.

Non-executive director remuneration

The total of the remuneration[1] and the value of other benefits received by each director from Xero during FY19 was as follows:

Director	Country of residence	Role	Committee Chair	2019 base fees ($000s)	2019 committee chair fees ($000s)	2019 one-off payment[2] ($000s)	2019 Total fees ($000s)	2018 Total fees[3] ($000s)
Graham Smith	United States	Chair	Nominations Committee	310	-	150	460	310
Rod Drury[4]	New Zealand	NED	-	90	-	-	90	-
Lee Hatton	Australia	Independent NED	ARM Committee	90	20	-	110	110
Dale Murray[5]	United Kingdom	Independent NED	-	111	-	-	111	-
Susan Peterson	New Zealand	Independent NED	-	90	-	-	90	90
Bill Veghte[6]	United States	Independent NED	P&R Committee	285	14	-	299	357
Craig Winkler	Australia	NED	-	90	-	-	90	90
Total				**1,066**	**34**	**150**	**1,250[1]**	**957**

1. Other than the treatment of options as described in footnote 6, total remuneration is presented based on accounting expense and may include amounts earned, but not yet received. Note that there were two additional paid NEDs in FY19 compared to FY18

2. For activities undertaken for Xero outside the role of Chair in relation to M&A and US$300m convertible notes issue

3. Includes director and Committee Chair fees for the year ended 31 March 2018

4. Became a non-executive director effective 1 April 2018. Rod Drury was an executive director for the year ended 31 March 2018 and received executive remuneration from Xero that year

5. Appointed as a director effective 13 April 2018

6. The fees for Bill Veghte differ from the standard annual fees, because they include the value of options granted to him in prior periods (2015 and 2016) that vested in FY19. For conformity with the current year presentation, fees for the period ended 31 March 2018 for Bill Veghte have been restated so that the value of the options are included at the point of vest. Previously, the value of options was spread over the period from grant to vest

The total remuneration available to non-executive directors is fixed by shareholders. Currently, the annual total aggregate non-executive directors' remuneration is capped at $1.4 million, as approved by shareholders at the Annual General Meeting in July 2017.

Set out below are the standard annual fees payable to non-executive directors during FY19. Due to the global composition of the Board, fees are benchmarked and determined in the currency of each director's country of residence (as explained on page 89), and are converted to New Zealand dollars at the start of each financial year. Hence New Zealand dollar fees vary by each country in the table below.

Country of residence	Chair ($000s)	Director[1] ($000s)	ARM Committee Chair ($000s)	P&R Committee Chair ($000s)
New Zealand	180	90	20	15
Australia	180	90	20	15
United States	310	226	21	14
United Kingdom	260	115	19	19

1. No additional fees are paid for Chair of the Nominations Committee

Executive remuneration

The remuneration structure for Xero's leadership team for FY19 comprises the fixed, LTI and STI components outlined on page 88 of this Annual Report. This revised remuneration structure was implemented during the year following a review of executive remuneration, which included input from external remuneration consultants.

Below is more information about the variable components of the remuneration structure for Xero's leadership team, including details of CEO and CFO remuneration, for the year.

Short-term incentive The following table summarises the short-term incentive arrangements for Xero's leadership team during FY19:

Deferred short-term incentive plan

Participants	Xero's leadership team (CEO and senior executives who report directly to the CEO)
Award type	– 50% payable in cash at the end of the performance period – 50% payable in equity as restricted stock units (RSUs) and deferred for 12 months from the grant date
Performance period	FY19
When are performance conditions tested?	Performance against financial and non-financial measures is determined in parallel with the finalisation of the Group's financial statements and following a review of executive performance by the CEO in consultation with the P&R Committee (and in the case of the CEO, by the Board). If the executive is still employed by Xero 12 months after the end of the performance period, the RSUs will vest and be converted into fully paid ordinary shares of Xero. The P&R Committee reviews and approves upcoming incentive payments and equity vests to ensure all applicable conditions are satisfied and no award adjustment events have occured (see page 89).
Performance metrics and weightings	**Leadership team (other than regional leads)** 60% 10% 10% 20% **Voice of Shareholder** Comprises company financial measures (revenue growth, cash flow and EBITDA) **Voice of Employee** Employee NPS and engagement targets **Voice of Customer** Partner and small business net promoter score (NPS) targets **Individual Objectives** Goals aligned to company strategic objectives **Regional leads** 80% 5% 5% 10% **Voice of Shareholder** Comprises 40% company financial measures (revenue growth, cash flow and EBITDA) and 40% regional financial measures (monthly recurring revenue (MRR) growth and subscriber additions) **Voice of Customer** Partner and small business NPS targets **Voice of Employee** Employee NPS and engagement targets **Individual Objectives** Goals aligned to company strategic objectives
Relationship between performance and payment	Performance targets have been set to drive the desired behaviours consistent with Xero's values and strategic objectives. Depending on achievement against targets, executives have the ability to earn between 0 and 130% of their target short-term incentive. Overachievement against targets is possible in relation to the "Voice of Shareholder" metrics.
Calculation of outcome	Achievement against each metric is calculated, then applied against the weightings shown above and then added to provide the total STI outcome.

Long-term incentive The following table summarises the long-term incentive arrangements for Xero's leadership team during FY19:

Executive block options plan

Participants	Xero's leadership team & selected senior management roles
Award type	Options to acquire fully paid ordinary shares in Xero
Initial grant date	June 2018 (leadership team / senior management roles), August 2018 (CEO), October 2018 (additional grant to CFO following promotion). Other grants are made as executives are invited to join the plan following promotion or appointment.
Vesting period	Options vest in three equal tranches in June 2020, June 2021, and June 2022 (or, in the case of the CEO, two equal tranches vesting in June 2021 and June 2022)
Expiry date	30 June 2023 (for options granted during 2018)
What are the performance vesting conditions?	Vesting is conditional on employment on the vesting date. The P&R Committee reviews and approves all upcoming option vests to ensure all applicable conditions are satisfied and no award adjustment events have occured (see page 89).
How is the option grant determined?	The number of options was determined for each participant based on a combination of their role type and a target amount using a Black-Scholes value at the time of grant.
Interaction with other LTI/equity grants	– Executives participating in the block options plan no longer participate in Xero's LTI employee share plan, but grants made to executives in previous years under that plan will continue to vest in accordance with their terms. Some executives have also previously received other options as part of their remuneration arrangements and these will also continue to vest in accordance with their terms. – The CEO was invited to participate in the executive block options plan from August 2018. To reflect his existing RSU grants under the CEO LTI/retention structure outlined below, the total number of options granted to the CEO was reduced by 25% and vesting in June 2020 was foregone.
CEO & CFO option grants in FY19	– 180,000 options were granted to S Vamos in October 2018 at an exercise price of A$34.00 each (calculated as at 1 April 2018 to align with the start of Xero's financial year and the exercise price applicable for other executives) – 100,000 options were granted to K Godfrey-Billy in 2018 (80,000 granted in June 2018 at an exercise price of A$34.00 each and 20,000 granted in October 2018 at an exercise price of A$48.33 each following promotion to the CFO role)

CEO LTI / retention (LTI/R) structure

Participants	CEO
Award type	RSUs (restricted stock units) – one-off LTI/R target RSU amount equivalent to 70% of FY19 starting base salary
Grant date	April 2018 & June 2018
Vesting period	Vesting in three equal tranches over a 3 year period in May 2019, May 2020, and May 2021, subject to employment on the vesting date
Performance period	FY19
When are performance conditions tested?	Performance against the metrics described below is determined in parallel with the finalisation of the Group's financial statements and following a review of the CEO's performance by the Board. The P&R Committee reviews and approves the annual RSU vests to ensure that no award adjustment events have occured (see page 89).
Performance metrics and weightings	Revenue Growth 40% MRR (Monthly Recurring Revenue) Growth 40% EBITDA 20%
Relationship between performance and payment	The total amount of RSUs to vest (on the vesting schedule above) is determined by performance against the metrics above. The Board has allowed for stretch goals for overachievement, which can increase the amount of RSUs to vest from 70% to 140% of FY19 starting base salary.
Calculation of outcome	Achievement against each metric is calculated, then applied to the weightings shown above and then added to provide the total LTI outcome.

CEO and CFO remuneration The following table provides details of the remuneration received by the CEO and CFO in FY19.

	Fixed annual remuneration		Variable remuneration		Total remuneration
	Salary ($000s)	Superannuation/ KiwiSaver ($000s)	Short-term incentive ($000s)	Long-term incentive ($000s)	($000s)
S Vamos[1]	1,014[2]	54	n/a[3]	n/a[3]	1,067
K Godfrey-Billy	419[4]	11	48[5]	214[6]	692

1. Amounts shown for CEO were paid in AUD but are shown in NZD (the functional currency of the Group) translated at the average exchange rate for the year

2. Base salary increased to A$1,012,500 effective 1 November 2018, following retirement from the Telstra board. Actual remuneration for the year ended 31 March 2019 reflects a blend of the rates that applied before and after that date

3. No STI or LTI amounts were paid to Steve Vamos during FY19 as his employment with Xero commenced on 1 April 2018. The STI and LTI outcomes summarised in the tables below will be reflected in his actual remuneration from FY20 onwards

4. Base salary increased to $450,000 effective 1 October 2018 following promotion to the role of CFO. Actual remuneration for the year ended 31 March 2019 reflects a blend of the rates that applied before and after that date

5. Consists of cash paid during FY19 under the STI arrangements that applied for the prior year. The below STI outcomes for FY19 will be reflected in actual remuneration in FY20

6. Consists of the value of options and restricted shares granted in prior years that vested in FY19

The following table summarises the short-term incentive outcomes for Xero's CEO and CFO for FY19 under the executive deferred short-term incentive plan detailed on page 93:

	Achievement against target	Actual STI awarded ($000s)	50% cash[1] ($000s)	50% equity[2] ($000s)
S Vamos	89.6%	510	255	255
K Godfrey-Billy	89.6%	150	75	75

1. To be paid in May 2019

2. The equity component of the short-term incentive will be granted in May 2019 in the form of RSUs, and deferred for 12 months from grant date. The number of RSUs granted will depend on the volume weighted average price of Xero shares at the grant date

The following table summarises the long-term incentive outcome for Xero's CEO for FY19 under the CEO LTI/retention structure detailed on page 94:

	Achievement against target	Total number of RSUs to vest based on achievement against target	RSUs vesting in May 2019	RSUs vesting in May 2020	RSUs vesting in May 2021
S Vamos	110%[1]	20,383	6,794	6,794	6,795

1. This correlates to 77% of FY19 starting base salary

Employee remuneration The following table shows the number of employees of the Group whose remuneration and benefits for FY19 were within the specified bands above $100,000. The remuneration covered in the table includes monetary payments received and share-based payments vested (ie. restricted shares, RSUs and vested options). The table includes the CEO and CFO.

Remuneration including share-based compensation	2019 Number of employees
100,000 to 109,999	150
110,000 to 119,999	162
120,000 to 129,999	129
130,000 to 139,999	132
140,000 to 149,999	96
150,000 to 159,999	91
160,000 to 169,999	82
170,000 to 179,999	72
180,000 to 189,999	50
190,000 to 199,999	35
200,000 to 209,999	29
210,000 to 219,999	39
220,000 to 229,999	26
230,000 to 239,999	26
240,000 to 249,999	17
250,000 to 259,999	12
260,000 to 269,999	15
270,000 to 279,999	19
280,000 to 289,999	14
290,000 to 299,999	7
300,000 to 309,999	8
310,000 to 319,999	5
320,000 to 329,999	1
330,000 to 339,999	6
340,000 to 349,999	6
350,000 to 359,999	2
360,000 to 369,999	2
370,000 to 379,999	1

Remuneration including share-based compensation	2019 Number of employees
380,000 to 389,999	3
390,000 to 399,999	3
410,000 to 419,999	1
420,000 to 429,999	5
430,000 to 439,999	1
440,000 to 449,999	2
460,000 to 469,999	1
470,000 to 479,999	3
480,000 to 489,999	1
490,000 to 499,999	4
500,000 to 509,999	2
520,000 to 529,999	1
530,000 to 539,999	1
540,000 to 549,999	1
550,000 to 559,999	1
560,000 to 569,999	2
580,000 to 589,999	1
680,000 to 689,999	1
690,000 to 699,999	1
700,000 to 709,999	1
740,000 to 749,999	1
800,000 to 809,999	1
820,000 to 829,999	1
870,000 to 879,999	1
1,030,000 to 1,030,999	1
1,060,000 to 1,069,999	1
1,200,000 to 1,209,999	1
1,330,000 to 1,339,999	1
1,940,000 to 1,949,999	1

Shareholder information

The shareholder information set out below is current at 18 April 2019, unless otherwise specified.

Issued capital The total number of issued ordinary shares in Xero Limited at 31 March 2019 was 140,850,806, of which 411,359 ordinary shares are held on a restricted basis in connection with Xero's share-based compensation plans.

Distribution of shareholding

Range	Number of holders	%	Ordinary shares	%
1 to 1,000	18,693	83.84	5,204,386	3.69
1,001 to 5,000	2,997	13.44	6,268,837	4.45
5,001 to 10,000	341	1.53	2,476,386	1.76
10,001 to 100,000	230	1.03	5,686,716	4.04
100,001 and over	34	0.15	121,214,708	86.06
Total	**22,295**	**100.00**	**140,850,806**	**100.00**

There were 361 holders of less than a marketable parcel of ordinary shares.

RSUs and options There were 44 individuals holding a total of 2,994,591 unlisted options and 492 individuals holding a total of 244,312 RSUs. RSUs are a conditional contractual right to be issued an equivalent number of ordinary shares in Xero.

Substantial holdings and limitations on the acquisition of securities Xero is a New Zealand incorporated and domiciled company listed on the Australian Securities Exchange (ASX). From a regulatory perspective, this means that while the ASX Listing Rules apply to Xero, certain provisions of the Australian Corporations Act 2001 (Cth) do not. Xero is not subject to chapters 6, 6A, 6B, and 6C of the Australian Corporations Act 2001 (Cth) dealing with the acquisition of its shares (including substantial holdings and takeovers). The Companies Act 1993 (New Zealand) applies to Xero, while certain provisions of the Financial Markets Conduct Act 2013 (New Zealand) do not.

There is no requirement on Xero's substantial shareholders to provide substantial holder notices to Xero. Where, however, Xero receives such notices during the year, the most recent notice is detailed.

Substantial holder	Date of most recent notice received by Xero	Ordinary shares in which a relevant interest is held
UBS Group AG	30 August 2018	N/A (cessation of substantial holder)

Key limitations on the acquisition of shares in Xero are imposed by the following New Zealand legislation: Commerce Act 1986, Overseas Investment Act 2005 and Takeovers Act 1993, together with various regulations and codes promulgated under such legislation.

Top 20 holders The names of the 20 largest holders of Xero's ordinary shares are set out below.

Name	Number of ordinary shares held	% of total issued capital
1. HSBC Custody Nominees (Australia) Limited	27,566,146	19.57
2. J P Morgan Nominees Australia Limited	22,918,378	16.27
3. Anna Margaret Clare Drury & Rodney Kenneth Drury & Scott Moran	17,719,779	12.58
4. Citicorp Nominees Pty Limited	14,228,200	10.10
5. Givia Pty Limited[1]	12,004,545	8.52
6. National Nominees Limited	4,730,732	3.36
7. Citicorp Nominees Pty Limited (Colonial First State Inc A/C)	3,115,971	2.21
8. HSBC Custody Nominees (Australia) Limited - GSCO ECA	2,978,248	2.11
9. JBWere (NZ) Nominees Limited (56968 A/C)	1,947,050	1.38
10. Custodial Services Limited (Beneficiaries Holding A/C)	1,791,632	1.27
11. BNP Paribas Nominees Pty Ltd (Agency Lending DRP A/C)	1,427,188	1.01
12. BNP Paribas Noms Pty Ltd (DRP)	1,316,342	0.93
13. Nelson Nien Sheng Wang & Pei-Chun Ko (Wang Family A/C)	1,150,288	0.82
14. Nicola Jane Wilson & David Jonathan Wilson (Wilson Family A/C)	915,857	0.65
15. HSBC Custody Nominees (Australia) Limited - A/C 2	873,162	0.62
16. Australian Foundation Investment Company Limited	740,500	0.53
17. BNP Paribas Nominees Pty Ltd (IB AU Noms Retail Client DRP)	711,122	0.50
18. CS Third Nominees Pty Limited (HSBC Cust Nom AU Ltd 13 A/C)	666,373	0.47
19. HSBC Custody Nominees (Australia) Limited (NT-Comnwlth Super Corp A/C)	638,218	0.45
20. Xero Limited (Employee Restricted Share Plan A/C)	411,359	0.29
Top 20 holders of ordinary fully paid shares (total)	**117,851,090**	**83.67**
Other shareholders (balance on register)	22,999,716	16.33
Grand total	**140,850,806**	**100.00**

1. Refer to page 90 for additional information about Givia's holdings

Voting rights Xero has a single class of ordinary shares on issue. 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. On a poll, every shareholder present in person, or by representative, has one vote for each fully paid ordinary share. In practice, Xero ensures that all resolutions at shareholder meetings are decided by a poll rather than on a show of hands.

On-market buy-back There is no on-market buy-back for Xero's shares.

Company information

Donations The Group made charitable donations totalling $32,379.77 during FY19. The Group made no donations to political parties during FY19.

Company subsidiaries and directors Xero has 14 wholly owned subsidiaries as shown in the table below. The following people held office as directors of Xero's subsidiary companies during FY19:

Jurisdiction	Subsidiary	Current directors	Directors ceased during year
Australia	Hubdoc Pty Ltd	Kirsty Godfrey-Billy Trent Innes Chaman Sidhu	James McDonald (ceased 2 August 2018) James Shulman (ceased 2 August 2018) David Torrible (ceased 2 August 2018)
	Xero Australia Pty Ltd	Kirsty Godfrey-Billy Trent Innes Chaman Sidhu	Rod Drury (ceased 5 October 2018)
Canada	Hubdoc Inc.	Kirsty Godfrey-Billy Keri Gohman James McDonald James Shulman	Kevin Wood (ceased 16 August 2018)
	Xero Software (Canada) Ltd	Kirsty Godfrey-Billy Keri Gohman	Rod Drury (ceased 4 October 2018)
Hong Kong	Xero (HK) Limited	Kevin Fitzgerald Kirsty Godfrey-Billy	Rod Drury (ceased 19 October 2018) Alexander Campbell (ceased 15 February 2019)
New Zealand	Xero Investments Limited	Anna Curzon Kirsty Godfrey-Billy Craig Hudson	Susan Peterson (ceased 15 February 2019) Graham Smith (ceased 15 February 2019)
	Xero (NZ) Limited	Anna Curzon Kirsty Godfrey-Billy Craig Hudson	Rod Drury (ceased 5 October 2018)
	Xero Trustee Limited	Kirsty Godfrey-Billy	Rod Drury (ceased 5 October 2018)
Singapore	Xero (Singapore) Pte. Ltd	Kevin Fitzgerald Kirsty Godfrey-Billy	Rod Drury (ceased 4 October 2018)
South Africa	Xero South Africa (Pty) Ltd	Kirsty Godfrey-Billy Gary Turner	Rod Drury (ceased 5 October 2018)
United Kingdom	Cicerone Ltd	Anna Curzon Kirsty Godfrey-Billy Gary Turner	Keith Carsley (ceased 14 December 2018) Alvin Ho (ceased 14 December 2018)
	Hubdoc (UK) Limited	Anna Curzon Kirsty Godfrey-Billy Gary Turner	
	Xero (UK) Limited	Anna Curzon Kirsty Godfrey-Billy Gary Turner	Rod Drury (ceased 4 October 2018)
United States	Xero, Inc.	Keri Gohman	Rod Drury (ceased 4 October 2018)

During the year, Gary Turner became an advisor to Enterprise Nation. There were no other changes to the interests of the directors of Xero's subsidiaries during FY19.

No employee appointed as a director of Xero's subsidiary companies receives any remuneration or other benefits from Xero in their role as a director. The remuneration and other benefits of such employees, received as employees, are included in the relevant bandings for employee remuneration disclosed on page 96.

Annual General Meeting Xero's AGM will be held on Thursday, 15 August 2019 in Auckland, New Zealand, and virtually through an online platform provided by Xero's share registrar, Link Market Services Limited.

Corporate Directory

Registered Offices

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Telephone: +61 3 9981 0408

Company Numbers
183 0488 (New Zealand)
ARBN 160 661 183 (Australia)

Web Address:
www.xero.com

Directors

Graham Smith (Chair)
Rod Drury
Lee Hatton
Dale Murray, CBE
Susan Peterson
Bill Veghte
Craig Winkler

Leadership Team

Steve Vamos
Chief Executive Officer

Anna Curzon
Chief Product Officer

Kirsty Godfrey-Billy
Chief Financial Officer

Keri Gohman
Chief Platform Business Officer

Craig Hudson
Managing Director, New Zealand & Pacific Islands

Trent Innes
Managing Director, Australia & Asia

Rachael Powell
Chief Customer, People & Marketing Officer

Mark Rees
Chief Technology Officer

Chaman Sidhu
Chief Legal Officer & Company Secretary

Damien Tampling
Chief Strategy & Corporate Development Officer

Gary Turner
Managing Director, United Kingdom & EMEA

Tony Ward
President, Americas

Auditor

Ernst & Young

Stock Exchange
Xero's ordinary shares are listed on the ASX

Share Registrar
Link Market Services Limited
Level 13, Tower 4, 727 Collins Street
Melbourne, Vic 3000
Australia
Telephone: +61 3 9067 2005

Annual General Meeting
Date: 15 August 2019
Time: 11am (NZST)
Location: Auckland, New Zealand

xero

Cover images:
Streamline Management, Australia
Volare, New Zealand
Hunt & Gather Bee Co, New Zealand
The Mindful Company, Singapore
Factor1, Australia
Nubian Skin, United Kingdom
The Little Veggie Patch Co, Australia
Armanino, United States
Beaufort Tax Consultants Pte Ltd, Singapore