Xero Limited

2020 Annual Report

Beautiful business

Cover images:

Momentum Accounting, United States
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Contents

Highlights

OPERATING REVENUE

$718.2m

Up 30% YOY

FREE CASH FLOW

$27.1m

Up $20.7m YOY

NET PROFIT

$3.3m

Increase of $30.5 million YOY

SUBSCRIBERS

2.285m

Up 467,000 YOY

ANNUALISED MONTHLY RECURRING REVENUE

$820.6m

Up 29% YOY

TOTAL AVAILABLE LIQUIDITY

$686.1m

Cash on hand, short-term deposits including proceeds from convertible notes, and undrawn committed debt facilities

TOTAL SUBSCRIBER LIFETIME VALUE

$5.5b

Up $1.2 billion YOY

GROSS MARGIN PERCENTAGE

85.2%

Up 1.6 percentage points

A global ecosystem of 800+ apps,

200+ connections to financial services providers

SCALE OF THE PLATFORM

Total value of transactions through Xero platform in FY20

$3.62 t*

Total value of invoices raised via Xero during FY20

$853.2 b

Offset 100% of our carbon emissions

for FY19 and committed to remaining 'net zero' going forward

at 31 March 2020

42% of Xero's employees were female

Xero was one of 325 global companies included in the 2020 Bloomberg Gender-Equality Index

*Incoming and outgoing transactions, 12-month period

Chair's Review

Dear shareholder

Xero is a unique company - a digital disruptor, born in the Southern Hemisphere - that operates at the intersection of technology and finance, with the opportunity to serve the entire global small business economy.

This past year as a director, I have come to fully understand the vital role Xero plays in supporting small businesses, their advisors and communities around the world. Xero is becoming an integral part of the small business community and economies around the globe.

As COVID-19 impacts businesses and communities, Xero is focused on supporting our customers and maintaining the quality and continuity of our cloud-based products and services. Unquestionably, this is a difficult time for many of our customers.

We have moved swiftly to develop and roll out a range of new support services for small business as well as for accountants and bookkeepers. We recognise many small businesses are facing financial hardship and we have ensured, as has always been the case, that customers in distress are able to downgrade or suspend their subscriptions through this difficult time.

The Xero leadership team has responded strongly to support our people, partners and small business customers during the COVID-19 crisis. Our global teams are committed to upholding the entrepreneurial spirit of Xero's start-up heritage, while building the capabilities and processes to support a global technology company, and focusing on additional ways to support our customers.

FY20 overview

We are pleased to announce for the year ended 31 March 2020 (FY20), Xero was able to maintain financial and operating performance momentum. Xero delivered top-line growth, a first ever full-year net profit after tax, and a positive free cash flow result. This is testimony to the importance of the Xero platform to the operations of our customers and partners.

Xero is becoming an integral part of the small business community and economies around the globe

However, the impact of COVID-19 on March trading did result in some reduction in annualised monthly recurring revenue (AMRR) progress in that month. This outcome, along with the ongoing COVID-19 environment, will be reflected in Xero's FY21 financial performance. Xero does not anticipate significant changes to its long-term strategy and we believe strongly in the value Xero can bring to small businesses and their advisors.

We remain focused on building our community and introducing small businesses to the benefits of doing business in the cloud and, for those already using Xero, extending their activities beyond cloud accounting.

Capital management

Xero had total available liquid resources of $686 million at 31 March 2020. The US$300 million raised from the convertible notes issue in October 2018 remains largely available to fund future investment opportunities. Our standby $150 million debt facility remains undrawn and is available for short-term liquidity requirements should it be required.

Our capital allocation framework remains focused on enabling the business to grow, both through organic opportunities and, where appropriate, through the pursuit of complementary targeted acquisitions that we believe support the execution of our strategic priorities.

Risk management & security

Risk management has always been critical in our ability to execute our strategic and operational priorities, but is even more important in challenging times like this. From a governance perspective, the Board is closely monitoring Xero's risk management activities in light of COVID-19.

Security and data protection are central to our vision of being a trusted and insightful platform. We continue to invest and deliver improvements across data governance, security, scalability, and our quality of service. We are committed to protecting our customers' information, educating the Xero community about best practice in online security, and ensuring guardrails are in place to safeguard data that flows through our platform.

Board update

On behalf of the Board and everyone at Xero we extend our sincere thanks to Graham Smith, our former Chair. Graham stepped down as Chair on 31 January and retired from the Board at the end of the financial year after supporting a smooth Chair succession.

During the financial year, we also farewelled Bill Veghte from the Board after five years, and we thank Bill for his dedicated service.

We welcomed Mark Cross to the Board as an independent non-executive director on 1 April. Among his many strengths, Mark brings to Xero considerable experience and expertise in corporate finance and financial markets.

Xero has an engaged and experienced Board of Directors who are closely connected to the business. It has been a pleasure to join this team, and I'd like to acknowledge my fellow directors for their commitment and thoughtful counsel during the year.

Diversity & Inclusion

We believe that healthy teams are diverse and inclusive. While there is always more to do, we are proud that female representation on Xero's leadership team and across all our employees sits at 42 percent. The Board set a measurable objective for FY20 to maintain a gender balance with at least three female directors and three male directors, which we have achieved and retain as an objective in FY21.

In FY20, we set and achieved numerical targets around representation of women on Xero's leadership team and across our employees. These are expressed as a 40:40:20 approach – at least 40 percent women and 40 percent men, with the remaining 20 percent unspecified, to allow for flexibility and recognising that gender is not binary.

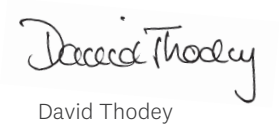
We have also continued our efforts to ensure Xero is an inclusive work environment including initiatives such as LGBTQI+ inclusion, disability inclusion, cultural diversity, flexible working, and employee wellbeing.

More information about our initiatives to support progress in this area is set out in the corporate governance statement (see page 71).

Conclusion

This year Xero has drawn together remuneration information in a consolidated remuneration report (see page 94). We will continue to evolve this report and we welcome your feedback.

On behalf of the Board, I would like to thank our talented and passionate team of Xero people for their valuable contributions in FY20. Finally, I'd like to sincerely thank our customers, partners, and investors for your ongoing trust and confidence in Xero.



David Thodey
Xero Chair

CEO's Review

Dear shareholder

There's no doubt we are facing a time like no other as COVID-19 impacts each of us, so I start by sending you our best wishes. We hope that you and those you care about are safe and well.

It is clear that businesses and communities are now under pressure in what is both a global health and economic crisis. Many of Xero's small business customers, bookkeepers, accountants, and ecosystem partners are having to adapt the way they operate and invest enormous emotional and operational effort to find pathways for business survival.

Businesses are being forced to reset priorities, and Xero is no different. Although our long-term strategy remains unchanged, we've made clear decisions on what we can delay or do without for now, and what must be protected. In that process, three overarching priorities emerge: the need for us to support our customers and partners, the welfare of Xero's people, and the need to ensure continuity of the platform that supports the operations of our millions of subscribers and their advisors.

Supporting our customers and partners during COVID-19

We have moved quickly to support our small business customers and accounting and bookkeeping partners during COVID-19 through a range of new initiatives focused on providing immediate information and support including:

- A business continuity hub on Xero Central, our main customer support centre, which offers a range of resources, including business continuity planning, cash flow management and working from home effectively
- A dedicated 24/7 customer response team to, among other things, help customers understand and access government funding programs available to them

- We have prioritised product development in key COVID-19 response areas including short-term cash flow and business snapshot features, in-product prompts and reminders to help stay informed of government stimulus packages
- Simplifying and automating payroll and tax changes to help small businesses with reporting and filing of data, to prove eligibility and access government stimulus benefits and with financial institutions where applicable
- We also deferred a planned price rise, and from 1 April improved Xero's global small business supplier payment terms to paying in 10 days

During COVID-19 we have moved quickly to support our small business customers and accounting and bookkeeping partners through a range of new initiatives focused on providing immediate information and support

People as a priority

Our people have adapted well to working from home under COVID-19, although this has brought personal and work challenges particularly for those with younger children, living alone, or with homes not easily adapted to work environments.

Our teams are well connected and work collaboratively by using cloud-based tools and technology, which are embedded in the way we operate our global business and allow us to work in an agile way to solve customer and business problems.

Our ability to respond to COVID-19 has been supported by a number of actions we took before the onset of the global crisis. These included bringing together our global Customer Experience, Marketing, Education, Sales, and Communications teams into a single portfolio under our Chief Customer Officer. This focus on customers helps to ensure consistency of decision making and sharing of insights and ideas around the needs of our customers in all markets.

Due to COVID-19, we have cancelled our Asia-Pacific Xerocon event scheduled for September 2020 in Sydney. We communicated our decision early to minimise disruption and impact on our partners, sponsors, speakers, event staff, and employees. We are now considering alternative digital events to connect with our community of cloud accounting leaders to share our latest product and technology updates.

I am incredibly proud of the way our people have embraced the challenges and changes we've faced during these past months. It is a real credit to them and the culture of Xero that we have been able to live our values, and support one another and our customers.

FY20 results update

Xero finished FY20 with 2.3 million subscribers globally and delivered top-line growth and a positive free cash flow result that mean the business has a sound financial position heading into FY21.

Digitisation of tax and compliance remained a key driver of demand for Xero's cloud accounting solutions. The positive subscription growth achieved was supported by Xero's product and marketing response to a number of regulatory initiatives. These included the ATO's Single Touch Payroll (STP) initiative in Australia, and HM Revenue & Customs' (HMRC) Making Tax Digital (MTD) for VAT initiative in the UK.

Performance highlights FY20

(All figures in NZD as at 31 March 2020. Comparisons are made against FY19)

- 30% growth in operating revenue to $718.2 million (29% in constant currency (CC))
- 29% growth in AMRR to $820.6 million
- 26% growth in total subscribers to 2.285 million
- Rest of World and North America contributed almost one in four subscriber additions in H2 FY20
- Total subscriber lifetime value grew by 27% (25% in CC) to $5.5 billion

- Free cash flow was $27.1 million, taking total available liquid resources to $686.1 million
- Net profit of $3.3 million, an improvement of $30.5 million over a net loss of $27.1 million
- EBITDA of $137.7 million, an improvement of 88% compared to $73.2 million

Product & Strategy

While COVID-19 has required us to rapidly implement immediate solutions to help our customers, our long-term strategy and ambitions are unchanged. We remain committed to three strategic priorities: to drive cloud accounting around the world, grow the small business platform, and build for global scale and innovation.

Digitisation of tax and compliance remained a key driver of demand for Xero's cloud accounting solutions. The positive subscription growth achieved was supported by Xero's product and marketing response to a number of regulatory initiatives

Xero's purpose is to make life better for people in small business, their advisors and communities around the world. Our vision is 'to be the most insightful and trusted platform for small business'. This underpins our strategy and our innovation pipeline.

This vision demands that we put data at the centre of everything we do, to develop new products, smarter services, more personalised customer experiences and richer partnerships.

We have invested in strategic capabilities and a strategy that reflects our aspiration and the size of the opportunity we have for the next 10 years and beyond.

Our product vision is based on a passion to provide smarter, simpler and seamless workflows and trusted insights to our customers. We delivered important product milestones in the year with the bundling of Hubdoc and the integration of Instafile. Both businesses were acquired in the past two years and successfully embedded into Xero's product portfolio. Hubdoc is now included in all Xero business edition plans, helping to deliver on our vision for intelligent automation and code-free accounting. Xero Tax in the UK, built on technology acquired via our Instafile acquisition, provides accountants and bookkeepers with an easier way to deal with their tax and compliance needs.

In addition, we announced a number of new product enhancements during the year, including short-term cash flow and business snapshot feature pilots for our customers.

Xero customers have access to an ecosystem of more than 800 connected apps and over 200 connections to financial services providers through our small business platform. These connections are with some of the largest banks and fintechs in the world.

We also developed new and tighter workflow-driven integrations relating to receiving payments and paying bills. For invoice payments, we announced global agreements with Stripe and GoCardless and a recent partnership with Square in Australia. We announced innovative bill payment partnerships with TransferWise in the UK and NAB in Australia. The latter was recognised by Canstar (Australasia's leading product comparison site) with an Innovation Excellence Award for 2020.

Outlook

While Xero has performed strongly in FY20, trading in the early stages of FY21 has been impacted by the COVID-19 environment. The continued uncertainty surrounding COVID-19 means it would be speculative for us to say anything more at this time on its potential impact on our expected performance for FY21.

Xero's ambition is to be a long-term oriented, high-growth business. We continue to operate with disciplined cost management and targeted allocation of capital. This allows us to remain agile so we can continue to innovate, invest, support our customers, and respond to opportunities and changes in our operating environment.

Conclusion

These are extraordinary times, both in life and in business. As remote working becomes the norm and digitisation of the small business economy and government compliance continues to gather pace around the world, we are focused on making it easier to manage small business by using the power of cloud-based technologies.

COVID-19 presents significant challenges to say the least, and has required all of us to quickly adjust. The Xero executive team and I are committed to supporting and connecting closely with our customers, partners, and our people at Xero during this time.

Thanks to our people, our customers and communities, shareholders, and to everyone who supports Xero.

Steve Vamos
Chief Executive Officer

Market highlights

FY20	Australia		New Zealand		United Kingdom		North America		Rest of World	
Subscribers	914k	+26%	392k	+12%	613k	+32%	241k	+24%	125k	+51%
Net additions	188k	+31%	41k	-18%	150k	-1%	46k	+5%[1]	42k	+68%
Revenue	$320m	+23%	$116m	+19%	$184m	+54%	$55m	+25%	$43m	+43%

1 *Excludes acquired Hubdoc subscribers in FY19*

Australia subscribers grew by 26% in the year to reach 914,000. Net subscriber additions of 188,000 set a new high for net additions in all our markets. Revenue was up 23% (25% in CC). We continued to benefit from the opportunity represented by Single Touch Payroll

UK subscribers grew by 32% to 613,000. Revenue grew by 54% (50% in CC). The strong net subscriber additions of 150,000 were assisted in part by the Making Tax Digital initiative and by Xero Tax now offering end-to-end integration with HMRC

New Zealand subscribers grew by 12% in the year to 392,000, with 41,000 subscribers joining in FY20. Revenue outpaced subscriber growth, increasing by 19%

North America subscribers grew by 24% in the year to 241,000. Net additions of 26,000 in H2 FY20 compared to 17,000 in H2 FY19. This is a strong indicator of the early progress from our renewed positioning in a key global market. Revenue grew by 25% (19% in CC)

Rest of World subscribers grew by 51% to 125,000, maintaining the momentum that this part of the business has reported in recent periods. Revenue grew by 43% (36% in CC)

Detailed updates and analysis of Xero's FY20 financial performance can be found in the management commentary on pages 15–30

Social and environmental impact

As a purpose-led business, we understand the importance of our responsibility as a global citizen and to the communities we serve. Xero's social and environmental impact (SEI) program has been a priority during FY20. We have made investments and commitments to support the environment, sustainability and communities around the world.

Raising awareness around the importance of mental health in New Zealand, we extended the pilot of the Xero Assistance Programme (XAP) to provide free and confidential wellbeing support to our customers and partners, as well as their employees and families.

In Australia, Xero has partnered with Beyond Blue, an expert, not-for-profit provider of mental health initiatives, which provides our team and partners in Australia access to resources to support their mental health.

Xero donated funds to support the Red Cross Disaster Relief and Recovery fund to support those impacted by Australian bushfires.

Through our global employee volunteer program, Community Connect, Xero employees contributed more than 4,200 hours in support of their communities this financial year. Every Xero employee is entitled to a paid day of leave each year to help not-for-profit organisations in their community.

Xero launched the Forward Fund scholarship in the US to give aspiring accounting students assistance via three USD$10,000 scholarships.

We announced Net Zero @ Xero, a commitment to offset 100 percent of our carbon emissions to become carbon neutral, while also looking to reduce our environmental impact. Subsequently, we announced we had offset 100 percent of Xero's carbon emissions for the year to 31 March 2019 (assessed retrospectively and finalised during FY20). To achieve this, Xero invested in three internationally recognised environmental and conservation projects.

Global ESG rating agencies and sustainability rankings recognised Xero's efforts to positively contribute to environmental and social impact as well as maintain sustainable and ethical operations. Xero was recognised in FTSE Russell ESG Rating FTSE4Good Index Series in 2019 and received an MSCI ESG Rating of A. We were also rated by RobecoSAM and ISS-oekom.

For information on Xero's SEI initiatives and Net Zero @ Xero projects visit xero.com/socialimpact.

Xero named as a worldwide leader by the IDC MarketScape

In April, Xero was recognised by the IDC MarketScape as a leader in the market. The IDC MarketScape recognised Xero as a Leader for SaaS and Cloud-Enabled Small Business Finance and Accounting Applications Vendors (doc #US45837020, April 2020). This recognition reflects the strength of Xero's strategy, product and service offerings and customer satisfaction.

The report also calls out the strengths of our open API strategy and machine learning for code-free accounting, and the ecosystem of app partners which provides small businesses with point solutions to their needs.

For more information please visit www.xero.com/about/investors/idc-report.

The Board of Directors

David Thodey AO
CHAIR OF THE BOARD

Independent Director since June 2019 and Chair since February 2020

David is a business leader focused on innovation, technology and telecommunications, with more than 30 years of experience creating brand and shareholder value. He is currently chairman of Australia's national scientific research agency, the Commonwealth Scientific and Industrial Research Organisation (CSIRO), and Tyro, Australia's only independent EFTPOS provider, a non-executive board director of Ramsay Health Care, a global hospital group; and of Vodafone Group Plc.

David had a successful executive career as CEO of Telstra, a significant Australian telecommunications company and as CEO of IBM Australia and New Zealand. In 2017, David was made an Officer (AO) in the General Division of the Order of Australia.

People and Remuneration Committee

Nominations Committee (Chair)

Mark Cross
NON-EXECUTIVE DIRECTOR

Independent Director since April 2020

Mark is an experienced professional director with more than 20 years of international experience in corporate finance and investment banking. Mark is currently a non-executive director of dual-listed ASX/NZX businesses Chorus and Z Energy and is Chair of Milford Asset Management. He is also a founding director of Virsae, a communications management SaaS business.

Mark was at Deutsche Bank for 10 years, initially based in Sydney in Mergers and Acquisitions, then in London as a Managing Director and co-head of a European M&A industry group. Mark holds a Bachelor of Business Studies (Accounting & Finance) degree from Massey University New Zealand, is a member of Chartered Accountants Australia and New Zealand, a chartered member of the New Zealand Institute of Directors and a member of the Australian Institute of Company Directors.

Audit and Risk Management Committee

Rod Drury
XERO FOUNDER / NON-EXECUTIVE DIRECTOR

Director since July 2006

For more than a decade, Rod led Xero to be a global software business and S&P/ASX 100 company. 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 over 20 years' experience internationally in the Financial Services industry and has held senior executive roles in Marketing, Strategy, Risk and large scale customer-facing businesses. Lee was the Chief Executive Officer of UBank (a digital bank in Australia) for five years, 2015 to 2020. Lee has been recognised by IBM as one of 40 Women Leaders in Artificial Intelligence across the globe for her work in delivering world-first innovations. Lee holds a Bachelor of Business from Auckland University of Technology (NZ), and is an alumni of Berkeley Haas School of Business. She is also a member of Chief Executive Women (CEW) which represents Australia's most senior and distinguished female leaders

Audit and Risk Management Committee (Chair)

Dale Murray CBE
NON-EXECUTIVE DIRECTOR

Independent Director since April 2018

Dale is a growth strategy consultant and former technology entrepreneur. 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 Partner at Founders Intelligence Ltd, a non-executive director at The Cranemere Group Ltd, and a board advisor to Accelerate:Her. 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. Dale was awarded a CBE by Her Majesty the Queen in 2013, for services to business.

Audit and Risk Management Committee

Nominations Committee

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 (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

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 this commentary. All amounts are presented in New Zealand dollars (NZD) except where indicated. References to the period or FY20 are for the year ended 31 March 2020. References to the comparative period or FY19 are for the year ended 31 March 2019.

Non-GAAP measures have been included, as we believe they provide useful information for readers to assist in understanding Xero's (the Group's) financial performance. Non-GAAP financial measures should not be viewed in isolation or considered as substitutes for measures reported in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

Business results

Year ended 31 March	2020 ($000s)	2019 ($000s)	change
Subscription revenue	696,220	538,384	29%
Other operating revenue	22,011	14,435	52%
Total operating revenue	**718,231**	**552,819**	**30%**
Cost of revenue	(106,582)	(90,915)	17%
Gross profit	**611,649**	**461,904**	**32%**
Gross margin percentage	85.2%	83.6%	1.6pp*
Total operating expenses	**(580,090)**	**(451,881)**	**28%**
Percentage of operating revenue	80.8%	81.7%	-0.9pp
Other income and expenses	2,550	(96)	NM**
Operating profit before asset impairments	**34,109**	**9,927**	**244%**
Asset impairments	(1,427)	(18,604)	-92%
Operating profit/(loss)	**32,682**	**(8,677)**	**NM**
Percentage of operating revenue	4.6%	-1.6%	6.2pp
Net finance expense	(22,845)	(14,459)	58%
Income tax expense	(6,501)	(4,007)	62%
Net profit/(loss)	**3,336**	**(27,143)**	**NM**
Percentage of operating revenue	0.5%	-4.9%	5.4pp

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

During FY20, Xero continued to execute its growth strategy delivering strong operating revenue growth of 30% while remaining focused on operational discipline. This was reflected in Xero's first full year net profit after tax of $3.3 million, an improvement of $30.5 million compared to the $27.1 million loss in FY19. The net profit result was generated by ongoing growth in operating revenue coupled with improved gross margin performance and disciplined management of operating expenses. FY19 results were also impacted by $18.6 million of non-cash asset impairments compared to $1.4 million in FY20.

These results were impacted by the lockdowns that took effect across the world during March, late in Xero's 2020 financial year. This meant the impact of COVID-19 on Xero's operating and financial performance for the period was modest. The sales performance in March was subdued. A planned price increase in March (for the majority of Business Edition customers) was also deferred. As a result, our Business Edition customers now have access to Hubdoc as part of their plan at no extra cost.

Operating revenue growth was supported by subscriber growth in all markets. Xero reached a milestone in the first half of FY20, surpassing two million subscribers globally. 467,000 net subscribers were added during the period, bringing total subscribers to 2,285,000 at 31 March 2020.

Gross margin percentage improved by 1.6 percentage points compared to FY19. This was due to the realisation of continued efficiencies in the costs of hosting Xero's cloud services and further productivity gains from Xero Central (Xero's customer experience and community platform). Total operating expenses increased by 28% compared to the comparative period as Xero continued to invest in scaling its global business, developing new products, and driving quality subscriber growth. Total operating revenue growth of 30% exceeded growth in total operating expenses, resulting in improved operating profit before asset impairments of $34.1 million in FY20, up $24.2 million from $9.9 million in FY19.

Depreciation and amortisation (which is included in costs of revenues and operating expenses) increased by $23m, or 28%, compared to FY19. This was in line with operating expenses increasing by 28%. This was due to an increase in intangible asset balances and increased depreciation due to additional office space.

The increase in net finance expense of $8.4 million was primarily driven by incurring a full year of interest costs associated with the convertible notes issued in October 2018, compared to six months of such costs incurred in FY19.

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 profit/loss.

Year ended 31 March	2020 ($000s)	2019 ($000s)	change
Net profit/(loss)	3,336	(27,143)	NM
Add back: net finance expense	22,845	14,459	58%
Add back: depreciation and amortisation	105,061	81,848	28%
Add back: income tax expense	6,501	4,007	62%
EBITDA	**137,743**	**73,171**	**88%**
EBITDA margin	19.2%	13.2%	6.0pp

EBITDA improved by $64.6 million or 88% in FY20 compared to FY19, resulting in EBITDA as a percentage of revenue increasing from 13.2% in FY19 to 19.2% in FY20. FY19 EBITDA was affected by $18.6 million of asset impairments. The improvement in FY20 EBITDA was primarily driven by revenue growth of 30% compared to FY19, as the business continues to deliver the benefits of scale. Operational efficiencies were delivered across the cost of revenue, sales and marketing, and product design and development functions, as total operating expenses as a proportion of operating revenue decreased to 80.8%, compared to 81.7% in FY19.

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

Year ended 31 March	2020 ($000s)	2019 ($000s)	change
EBITDA	**137,743**	**73,171**	**88%**
Add back: non-cash share-based payments	34,336	28,946	19%
Add back: non-cash impairments	1,427	18,604	-92%
EBITDA excluding non-cash share-based payments and impairments	**173,506**	**120,721**	**44%**
Percentage of operating revenue	24.2%	21.8%	2.4pp

EBITDA excluding non-cash share-based payments and non-cash impairments for FY20 was $173.5 million, an improvement of $52.8 million or 44% compared to FY19. Operating revenue growth of 30% exceeded growth in included cash-based expenses of 26%. This resulted in EBITDA excluding non-cash share-based payments and impairments improving as a percentage of operating revenue by 2.4 percentage points.

Cash flows and liquidity

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 generated from operating activities less cash flows used for investing activities, excluding cash used for acquisitions of, and investments into, businesses and strategic assets.

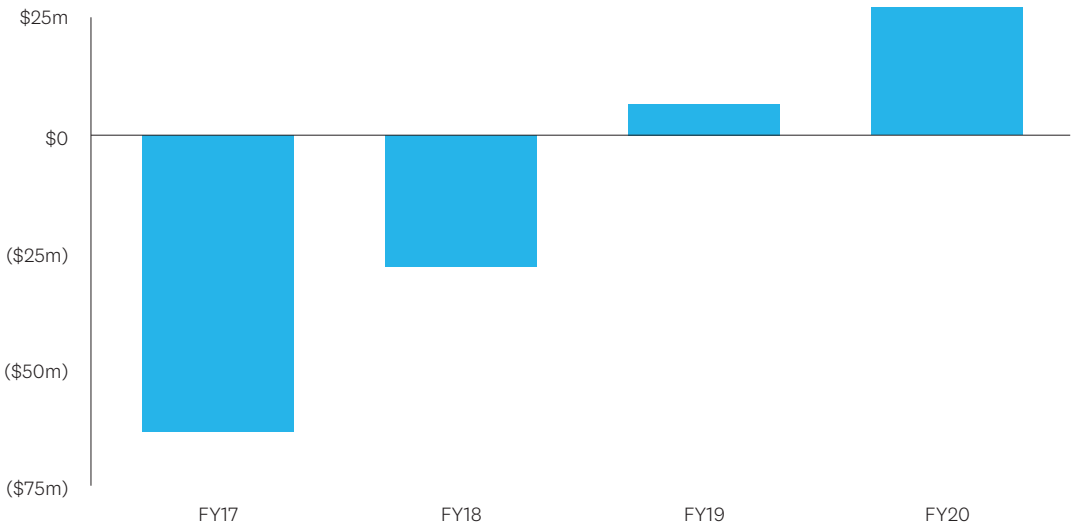
Year ended 31 March	2020 ($000s)	2019 ($000s)	change
Receipts from customers	717,264	552,256	30%
Other operating cash flows	(550,635)	(438,030)	26%
Total cash flows from operating activities	**166,629**	**114,226**	**46%**
Investing activities	(139,524)	(140,471)	-1%
Add back: acquisitions	–	32,696	-100%
Free cash flows	**27,105**	**6,451**	**320%**

Free cash flows for FY20 increased by $20.7 million to $27.1 million, equating to 3.8% of total operating revenue, compared to $6.5 million or 1.2% of total operating revenue in FY19.

Receipts from customers increased by 30% or $165.0 million to $717.3 million which is aligned with operating revenue growth of 30%. Cash flows from operating activities increased by $52.4 million to $166.6 million as receipts from customers grew at a faster rate (30%) than other operating cash flows (26%, primarily due to payments to suppliers and employees).

Cash outflows from investing activities, excluding acquisitions, increased by 29% or $31.7million. The increase was largely driven by higher capitalised spend on product design and development, which increased by $29.0 million or 39% compared to FY19.

Free cash flows



Total available liquidity (defined as *cash and cash equivalents, short-term deposits including proceeds from convertible notes, and undrawn committed debt facilities*) at 31 March 2020 was $686.1 million. This comprised $536.1 million of cash and cash equivalents and short-term deposits as well as access to an undrawn committed debt facility of $150.0 million. Of the cash and cash equivalents and short-term deposits balance, $410.5 million relates to the convertible note proceeds that are held in USD for future strategic investments and acquisitions. None of Xero's term debt nor the standby debt facility matures in the next 24 months.

During FY20, Xero refinanced its standby debt facility for a three year term and upsized it to $150.0 million, an increase from $100.0 million. The lender group was expanded from two to four banks, with existing lenders BNZ and ANZ joined by global banks HSBC and Citibank. This facility is in place to ensure Xero maintains access to prudent levels of operational liquidity, appropriate to the size and maturity of the business.

Operating revenue

Subscription revenue comprises recurring monthly fees from subscribers to Xero's cloud-based platform. Within a subscription, customers also receive support services and product updates.

Operating revenue includes subscription revenue as well as revenue from other related services, including attendance fees for conferences and events such as Xerocon, revenue share agreements with financial services providers including fintech, and the implementation of online accounting and other software services. Subscription revenue comprises 97% of operating revenue in FY20.

Year ended 31 March	2020 ($000s)	2019 ($000s)	change	change in constant currency*
Subscription revenue	696,220	538,384	29%	29%
Other operating revenue	22,011	14,435	52%	50%
Total operating revenue	**718,231**	**552,819**	**30%**	**29%**

**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 FY20 at the effective exchange rates for FY19.*

Operating revenue growth of 30% from FY19 was a key driver of Xero's first full year profit. This was driven by subscriber growth, increased uptake of Xero add-ons, and growth in other operating revenue.

Subscription revenue increased by 29%, primarily driven by organic subscriber growth. Subscriber numbers at 31 March 2020 increased by 26%, or 467,000, compared to 31 March 2019. In addition, uptake of Xero add-ons such as payroll, projects and expenses modules was higher, contributing to the subscription revenue increase.

Other operating revenue increased by 52% as a result of two major contributing components, fintech partnerships and conference revenue. Xerocon conference revenue increased by 29% compared to FY19. Xero partners with fintech providers to offer online financial solutions to subscribers, resulting in an associated share of revenue between the provider and Xero. Other operating revenue excluding conference income increased by 73% compared to FY19.

As 84% of Xero's operating revenue is denominated in currencies other than NZD (the Group's functional currency), changes in foreign exchange rates over the year have influenced reported revenue. The impact of the comparatively stronger NZD against the Australian dollar (AUD) was more than offset by the impacts of the weaker NZD against the US dollar (USD) and Great British pound (GBP) during FY20 compared to FY19. This resulted in constant currency operating revenue for the Group being $3.3 million lower than reported revenue.

Operating revenue by geography

Year ended 31 March	2020 ($000s)	2019 ($000s)	change	change in constant currency
Australia	320,376	261,468	23%	25%
New Zealand	116,154	97,639	19%	19%
Australia and New Zealand (ANZ) total	**436,530**	**359,107**	**22%**	**23%**
United Kingdom	183,565	119,521	54%	50%
North America	55,398	44,270	25%	19%
Rest of World	42,738	29,921	43%	36%
International total	**281,701**	**193,712**	**45%**	**41%**
Total operating revenue	**718,231**	**552,819**	**30%**	**29%**

Operating revenue growth in all geographies is underpinned by continued subscriber growth. In the ANZ market, operating revenue grew by 22%, exceeding the 21% growth in subscribers shown in the next section. With the high level of penetration into the ANZ market, Xero's continued revenue growth in this market is encouraging.

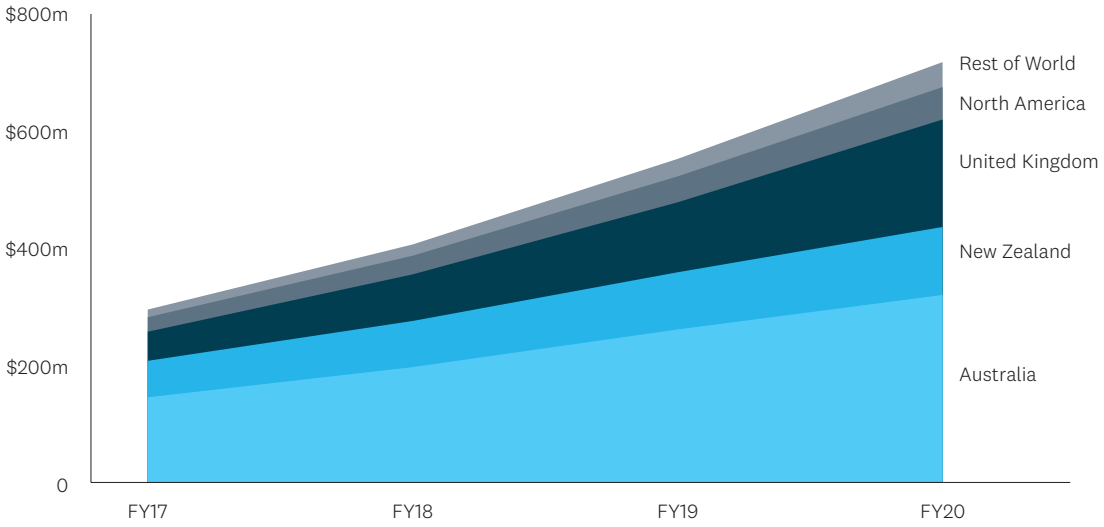
The Australian market's operating revenue grew by 23% compared to subscriber growth of 26%. This was primarily due to the strengthening of the NZD against the AUD during FY20 (with constant currency revenue growth of 25%). Additional factors were the release of lower-priced, payroll-only plans to support the Single Touch Payroll initiative recently introduced by the ATO, and the further extension into existing partner practices with lower ARPU products.

New Zealand operating revenue increased by 19%, comparatively faster than subscriber growth of 12%. This was due to positive movement in product mix and further uptake in platform-related products, such as payroll, and growth of revenue from fintech partnerships.

For the first time, revenue growth in the International segment of $88.0 million, exceeded revenue growth in the more established ANZ market ($77.4 million). Operating revenue in the UK grew by 54% compared to FY19, as Xero was well positioned to benefit from HM Revenue & Customs' (HMRC) Making Tax Digital initiatives. Operating revenue in North America grew by 25% while the Rest of World markets grew by 43%. The Rest of World's performance was driven by subscriber growth of 51%, with South Africa and Singapore the largest contributing markets.

Reported revenue benefited from fluctuations in the foreign exchange rates, specifically the NZD being weaker against both the GBP and USD on average during FY20 compared to FY19. In constant currency, operating revenue for the International segment is $273.0 million, $8.7 million or 3.1% lower than reported revenue.

Total Group operating revenue by geography*



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

Subscriber numbers

The definition of 'subscriber' is: *Each unique subscription to a Xero-offered product that is purchased by a user (e.g. 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	2020	2019	change
Australia	914,000	726,000	26%
New Zealand	392,000	351,000	12%
Australia and New Zealand (ANZ) total	**1,306,000**	**1,077,000**	**21%**
United Kingdom	613,000	463,000	32%
North America	241,000	195,000	24%
Rest of World	125,000	83,000	51%
International total	**979,000**	**741,000**	**32%**
Total paying subscribers	**2,285,000**	**1,818,000**	**26%**

Subscribers grew by 26% compared to 31 March 2019, bringing total subscribers to 2,285,000. Subscriber additions continue to grow, with 467,000 net subscribers added in FY20 compared to 432,000 in FY19. This is the largest subscriber increase in a financial year since Xero's inception in 2006. For the second year in a row, more subscribers were added in the International markets than in ANZ with 238,000 subscribers added in International, compared to 229,000 in ANZ. The impacts of Covid-19 resulted in less than expected subscriber additions in the last month of the year. The UK in particular was impacted to a greater extent in March than Xero's other markets.

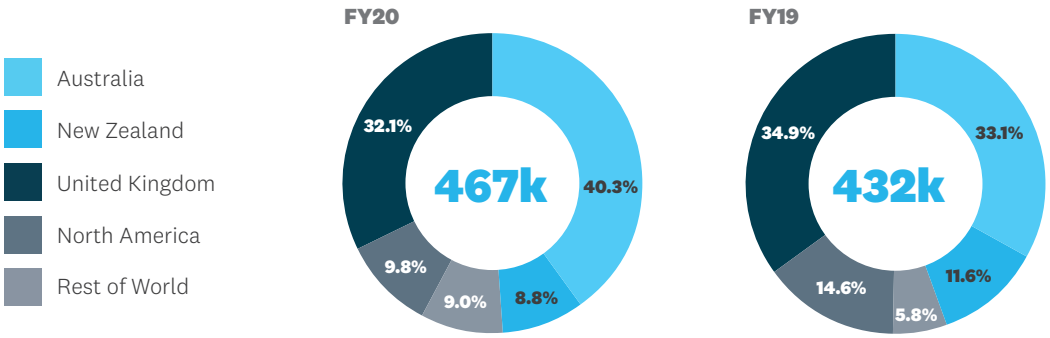
Xero continued to increase its presence in the established ANZ market, growing subscribers by 21%, or 229,000, compared to FY19. Xero's position as market leader in Australia was further solidified as Xero added 188,000 subscribers in FY20 to reach 914,000 subscribers. This result was assisted by the ATO's Single Touch Payroll initiative, which requires businesses to submit payroll reports digitally. Xero released a new payroll-only product in Australia to assist small businesses in their preparation for the new legislative requirements, which is also proving an integral tool for access to COVID-19 government stimulus benefits. While more developed, New Zealand remains a growth market for Xero as it added another 41,000 subscribers, representing a 12% increase.

The UK led the International segment, adding 150,000 subscribers in FY20 to end on 613,000 subscribers, an increase of 32%. The UK performance continued to benefit from HMRC's Making Tax Digital initiatives under which businesses require software to process VAT returns and digitise their financial and other business records.

North American subscriber numbers increased by 24%, or 46,000, from the comparative period, the highest annual net organic additions to date. This performance is an early sign of progress from the partner channel strategy across North America.

Rest of World markets also performed strongly with 51% growth in subscribers in FY20. These numbers reflect Xero's adoption across a number of regions, with South Africa and Singapore continuing to gain traction.

Net subscriber additions



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 2020 at the foreign exchange rates at 31 March 2019, and is provided to assist in understanding and assessing year-on-year growth rates, excluding the impact of foreign currency fluctuations.

At 31 March	2020 ($000s)	2019 ($000s)	change	change in constant currency
ANZ	467,537	396,233	18%	19%
International	353,020	241,946	46%	33%
Total	**820,557**	**638,179**	**29%**	**25%**

Total Group – AMRR surpassed $800 million during the year, ending FY20 at $820.6 million - up $182.4 million, or 29%, from 31 March 2019. Growth of AMRR was principally driven by subscriber growth in all regions. In constant currency terms, total AMRR grew by 25%, due to subscriber growth of 26% offset by a 1% decrease in constant currency ARPU. The impact of Covid-19 on March trading, with fewer subscriber additions, resulted in less than expected AMRR growth for the month. Of particular impact to AMRR was the decision to defer a planned price rise for business edition subscribers for all regions except the UK. While the lower than expected AMRR growth had little impact on FY20 operating revenue, revenue in FY21 will be impacted to a greater extent.

ANZ – Continued subscriber growth of 21% drove AMRR, which increased 18% to $467.5 million. Constant currency AMRR growth was 1 percentage point higher than reported growth, due to the stronger NZD against the AUD at 31 March 2020 compared to 31 March 2019.

International – AMRR growth in the International markets was 46%, driven by growth in subscriber numbers (32%) and the impact of foreign exchange. The weaker NZD against the USD and GBP at 31 March 2020 compared to 31 March 2019 had a favourable impact on reported AMRR for the International segment. Constant currency AMRR growth was 33%, slightly ahead of subscriber growth due in part to a price change in the UK market.

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.

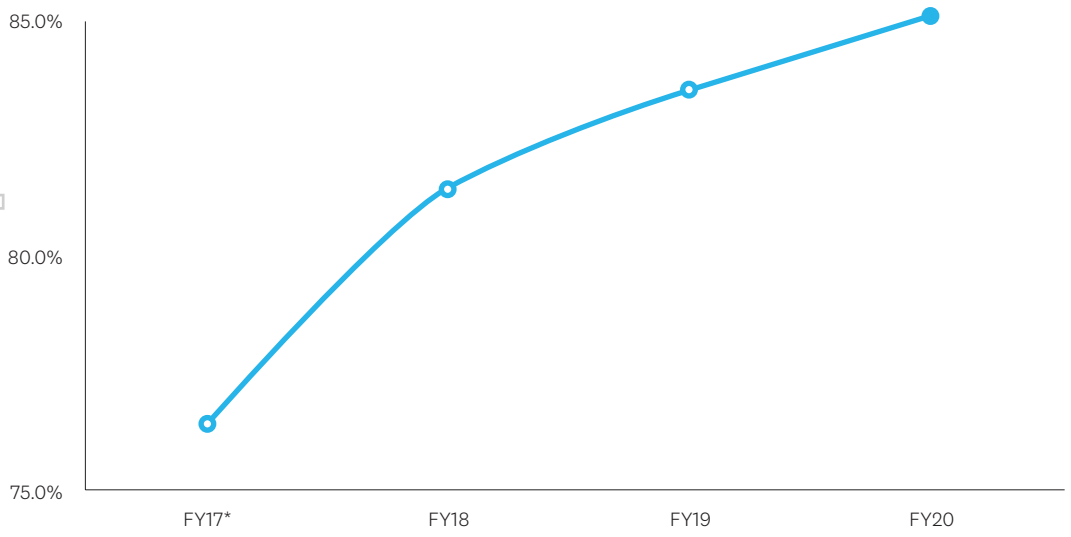
The costs include hosting and content distribution costs, bank feed costs, personnel and related expenses (including salaries, benefits, bonuses, and share-based payments) directly associated with cloud infrastructure and subscriber support, contracted third-party vendor costs, related depreciation and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

Year ended 31 March	2020 ($000s)	2019 ($000s)	change
Operating revenue	718,231	552,819	30%
Cost of revenue	(106,582)	(90,915)	17%
Gross profit	**611,649**	**461,904**	**32%**
Gross margin percentage	85.2%	83.6%	1.6pp

Gross margin increased by 1.6 percentage points to reach 85.2% for FY20. This was driven by operating revenue growth of 30%, as well as efficiencies in cost of revenue. This resulted in gross profit increasing by $149.7 million, or 32%, to $611.6 million. Cost of revenue for FY20 grew by $15.7 million to $106.6 million, representing a 17% increase when compared to FY19. The primary reasons for the change in cost of revenue were increases in personnel costs related to higher headcount in Xero's customer support teams, and increased cloud hosting costs.

Growing use of Xero Central (launched in FY19) and hosting cost efficiencies were the main drivers of improvement in gross margin. There has been an emphasis on customer self-service with the aid of machine learning, via Xero Central, which has helped offset the need for additional customer experience headcount as we continue to scale. Xero has also realised efficiencies in hosting through optimising the Amazon Web Services (AWS) product mix and reducing wastage by scaling resources to reflect actual user load at any given time.

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 capitalised 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	2020 ($000s)	2019 ($000s)	change
Sales and marketing expenses	312,852	248,014	26%
Percentage of operating revenue	43.6%	44.9%	-1.3pp

Sales and marketing costs increased by $64.8 million, or 26%, to $312.9 million for FY20, compared to operating revenue growth of 30%. 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 (typically more than seven years).

Sales and marketing spend has increased as Xero continues to pursue subscriber growth in all regions. Campaigns to drive sales in Australia and the UK, to take advantage of the Single Touch Payroll and Making Tax Digital initiatives, accounted for a significant share of investment in sales and marketing costs in the period. These contributed towards strong net subscriber additions in both countries, 26% in Australia and 32% in the UK.

The average cost of acquiring a subscriber increased to $420 per gross subscriber added in FY20 compared to $397 in FY19. This reflects the increasing globalisation of Xero's subscriber mix with an increased contribution to our subscriber growth from the less developed markets within our International segment.

As a percentage of operating revenue, sales and marketing costs decreased from 44.9% in FY19 to 43.6% in FY20. While an improvement as a percentage of revenue, which shows increased efficiency, the significant continued investment in sales and marketing reflects the intention to reinvest cash back into the business to deliver on Xero's strategic priorities, realising benefits in future years.

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 teams, 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 NZ 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	2020 ($000s)	2019 ($000s)	change
Total product design and development costs (including amounts capitalised)*	**225,756**	**170,946**	**32%**
Percentage of operating revenue	31.4%	30.9%	0.5pp
Less capitalised development costs	(102,621)	(73,598)	39%
Product design and development expense (excluding amortisation of amounts capitalised)	**123,135**	**97,348**	**26%**
Less government grants	(5,164)	(5,219)	-1%
Add amortisation of capitalised development costs	60,287	45,666	32%
Product design and development expenses	**178,258**	**137,795**	**29%**
Percentage of operating revenue	24.8%	24.9%	-0.1pp

**excludes impairments*

Xero continues to invest in its product and platform, developing and deploying a significant range of features in FY20 including:

- Xero Tax in the UK digitally prepares and files accounts and tax returns more efficiently, with an end-to-end integration with HMRC
- Xero HQ VAT in the UK supports managing Making Tax Digital compliance by providing accountants and bookkeepers oversight over VAT filings
- Xero HQ Payroll provides deeper insights for accountants and bookkeepers, which helps them support their clients by providing a single aerial view and insights over their clients' payroll. This also allows visibility in Australia on clients' Single Touch Payroll status
- The Hubdoc product is now included globally in Business Edition plans with a streamlined set up, single sign-on, and access from within Xero
- Xero NAB payments is a feature that provides a seamless and secure process for small businesses to pay and approve multiple bills from Xero's real-time integrated platform. This is provided in partnership with leading Australian bank NAB
- Our strategic partnership and product integration with Stripe enables new payment experiences including a new Stripe feed and auto pay feature
- Short-term cash flow and Business Snapshot are two pilots underway that give small businesses deeper insights into their future cash flow and important trends
- Single Sign-On is a new, seamless and secure way for developers to build on the Xero platform, onboard new users without making them remember more passwords, and integrate Xero with certified third-party apps more easily
- Advisor-powered app recommendations allows advisors to curate the Marketplace to ensure businesses get a tailored experience to help source the right tools and apps for them

Total product design and development costs were $225.8 million in FY20, $54.8 million or 32% higher than in FY19. Of this, $102.6 million was capitalised, with the balance of $123.1 million included in the Income Statement within total product design and development expenses. The amount capitalised represents a capitalisation rate of 45.5% of total product design and development costs for FY20, which is 2.4 percentage points higher than FY19.

As a proportion of operating revenue, total product design and development costs for FY20 (including amounts capitalised) increased by 0.5 percentage points to 31.4%. This highlights the continued investment in Xero's global platform as product design and development costs keep pace with revenue growth.

The amortisation of previously capitalised product design and development expenditure of $60.3 million was included as a non-cash expense in the Income Statement, giving total net expenses (after the netting of government grants) of $178.3 million for FY20. Amortisation of previously capitalised development costs increased due to higher intangibles balances than in FY19.

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, strategy, corporate development, 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	2020 ($000s)	2019 ($000s)	change
General and administration expenses	88,980	66,072	35%
Percentage of operating revenue	12.4%	12.0%	0.4pp

General and administration costs were $89.0 million for FY20, $22.9 million or 35% higher than FY19. This is due to the growth in personnel related expenses as Xero continues to scale. In particular, investment was made in building out strategy and corporate development functions to enable future growth.

General and administration costs as a proportion of operating revenue remained consistent with FY19, increasing 0.4 percentage points to 12.4%.

Employees

At 31 March	2020	2019	change
Total Group	3,055	2,531	21%

Full-time equivalent (FTE) employees increased by 524 or 21% in FY20, taking the total FTEs to 3,055. This is compared to a 26% increase in subscribers and 30% increase in operating revenue. The slower growth in FTEs compared to revenue and subscribers reflects the benefits of economies of scale and operating efficiencies, while investment continues to be made in sales and marketing as well as product design and development.

Net finance expense

Year ended 31 March	2020 ($000s)	2019 ($000s)	change
Interest income on deposits	13,432	8,035	67%
Total finance income	**13,432**	**8,035**	**67%**
Interest on convertible notes	(28,033)	(12,753)	120%
Bank standby facility costs	(1,691)	(1,847)	-8%
Lease liability interest	(6,280)	(4,987)	26%
Other finance expense	(273)	(2,907)	-91%
Total finance expense	**(36,277)**	**(22,494)**	**61%**
Net finance expense	**(22,845)**	**(14,459)**	**58%**

Finance income in FY20 was $13.4 million, an increase of $5.4 million from the comparative period. This was due to a significant increase in cash and short-term deposit balances from the issue of convertible notes in October 2018, being held for all of FY20 compared to six months of FY19. Proceeds from the convertible notes issue remain largely undeployed and are held on deposit until required.

Finance expense increased by 61%, driven by interest on the convertible notes combined with lease liability interest. Of the $28.0 million of interest on convertible notes, $11.0 million relates to coupon payments, a cash cost, and the remainder being the non-cash amortisation of the related debt liability discount. Lease liability interest increased by $1.3 million, largely due to the lease of Xero's Auckland office, which was entered into during the second half of FY19. Net cash finance costs, cash interest income less cash interest expense, were $5.1 million compared to $4.5 million in FY19.

Segment information

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 2020			
Operating revenue	436,530	281,701	718,231
Expenses	(164,962)	(254,472)	(419,434)
Segment contribution	**271,568**	**27,229**	**298,797**
Contribution margin percentage	62.2%	9.7%	41.6%
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%

ANZ - Operating revenue for FY20 grew by 22% compared to the comparative period, further reinforcing Xero's market leading position in the region. Australia led the growth in this segment as the ATO's Single Touch Payroll initiative contributed to strong demand for cloud accounting and payroll-specific solutions. Constant currency operating revenue grew by 23% compared to the comparative period. This exceeded the 21% growth in subscribers, largely due to the timing of new subscriber additions, with more subscribers added in the first half of the year than the second half.

The operating revenue growth, along with continued cost efficiencies, resulted in an FY20 segment contribution of $271.6 million. This was an increase of 24% on FY19 and represents 62.2% of operating revenue, up from 61.0% in the comparative period. Across the ANZ segment, 229,000 net subscribers were added during FY20, a new record for this segment.

International - Operating revenue for FY20 grew by 45%, or 41% in constant currency, largely due to subscriber growth of 32%. Revenue growth exceeded subscriber growth due to a UK price increase during H1 FY20, along with the annualised revenue benefit of strong subscriber growth in H2 FY19, which benefited from the rollout of Making Tax Digital for VAT. The International segment had a positive segment contribution in FY20 of $27.2 million, compared to a contribution loss of $4.7 million in FY19. This is the first positive full year contribution for the International segment.

As a percentage of revenue, the contribution margin improved from -2.4% to 9.7%. This was due to strong revenue growth, combined with scaling and efficiencies, particularly in the UK. The contribution margin remained comparatively lower than that of ANZ, reflecting the emphasis on investment in growing subscriber additions in the UK, North America, Asia, and South Africa, as Xero continues to develop brand recognition and build 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 is assisted by an understanding of SaaS-specific metrics. Below are some of the headline metrics we use to manage and drive Xero's performance.

Average revenue per user (ARPU) is calculated as AMRR (see definition on page 22) at 31 March, divided by subscribers at that time (and divided by 12 to get a monthly view).

CAC months are the months of ARPU to recover the cost of acquiring (customer acquisition costs: CAC) each new subscriber. The calculation represents the sales and marketing costs for the year excluding the capitalisation 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.

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 churn), multiplied by ARPU, multiplied by the gross margin percentage. Group LTV is calculated as the sum of the individual segment LTV, 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. For example, the LTV derived from a subscriber in ANZ is currently on average 10.6 times the cost of acquiring that subscriber.

We strive to maximise total LTV while optimising the level of CAC investment we undertake in order to achieve a desirable LTV/CAC ratio. We can improve total LTV in multiple ways, such as increasing subscriber numbers, enhancing products and services for existing subscribers thereby increasing ARPU and/or reducing churn, and improving gross margin through cost efficiencies.

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

At 31 March 2020	ANZ	International	Total
ARPU ($)	29.83	30.05	29.93
CAC months	9.7	18.1	14.0
Churn	0.84%	1.59%	1.13%
LTV per subscriber ($)	3,058	1,573	2,422
LTV/CAC	10.6	2.9	5.8

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

ANZ – ARPU within the ANZ segment decreased by 3% compared to 31 March 2019. This was largely due to the launch of Single Touch Payroll focused products in Australia during FY20, with a lower associated ARPU, as well as a weaker AUD against the NZD at 31 March 2020 compared to 31 March 2019. This was partially offset by increases in ARPU within New Zealand, driven by a greater emphasis on add on solutions such as Xero Payroll, which benefited from the introduction of payday filing by Inland Revenue on 1 April 2019.

In constant currency terms, ANZ ARPU decreased 2% to $30.19 compared to $30.66 at 31 March 2019. CAC months at 31 March 2020 was moderately higher than at 31 March 2019 as Xero continues to invest in its small business platform, ecosystem and fintech strategies that target existing customers, as well as investing to drive growth to further increase market share in the ANZ segment.

The decrease in ARPU, offset by improved gross margin and lower churn, led to a 1% decrease in LTV per subscriber (a 1% increase in constant currency) within ANZ. Total ANZ subscriber LTV increased by $0.7 billion, or 21% to $4.0 billion at 31 March 2020 compared to $3.3 billion at 31 March 2019.

International – ARPU across the International segment increased by 10% (1% in constant currency) from 31 March 2019. A price increase in the UK for Standard and Premium pricing plans in August 2019 had a favourable impact on UK ARPU.

The comparatively stronger USD against the NZD also had a positive effect on ARPU within North America and Rest of World. This was partially offset by a shift towards the more efficient but lower ARPU partner channel in these markets.

Improvements in ARPU resulted in the decline in CAC months from 18.3 months to 18.1 months. This was despite increased sales and marketing costs in this segment contributing to a 9% increase in the cost of acquiring each new subscriber (a 6% increase in constant currency) compared to the comparative period.

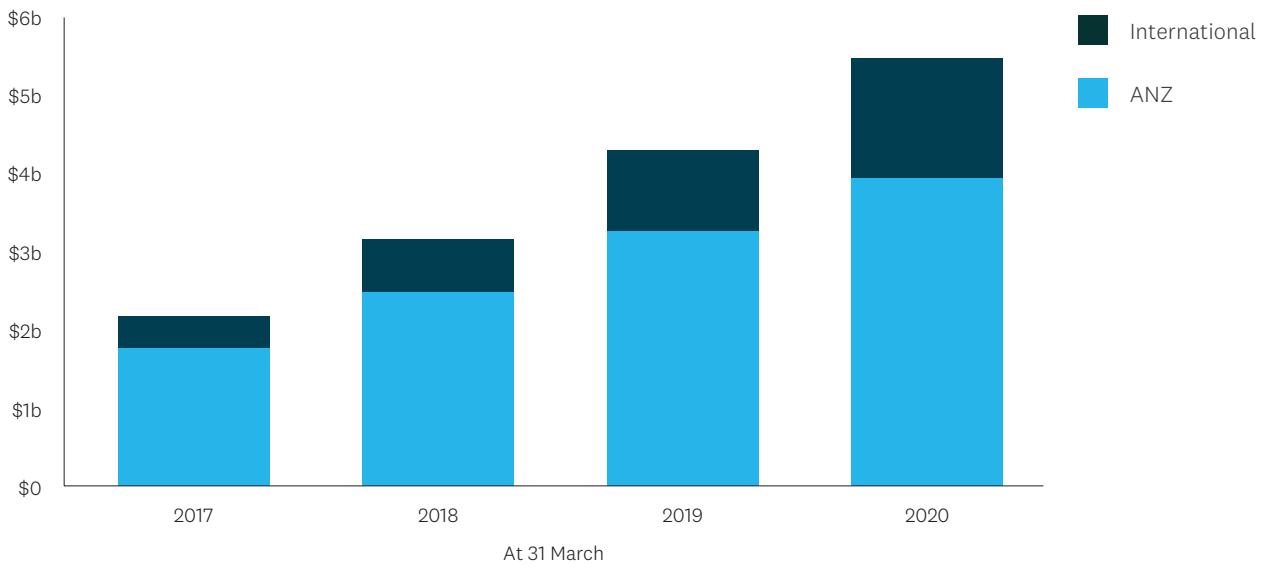
LTV per subscriber improved by 11% at 31 March 2020 compared to the comparative period (an increase of 1% in constant currency), due to higher gross margin and ARPU, despite a slight increase in churn. Total LTV for the International segment increased by 47% to $1.5 billion (34% in constant currency) at 31 March 2020 compared to 31 March 2019 due to subscriber growth, particularly in the UK market.

Total Group – Group ARPU increased by 2% compared to 31 March 2019. This was due to increases in pricing in the UK, and the impact of favourable foreign currency movements in the USD and GBP. ARPU decreased 1% in constant currency compared to 31 March 2019.

LTV per subscriber increased 1% from the same time last year to $2,422, primarily due to improvements in gross margin and ARPU, while churn was slightly higher than FY19. Group constant currency LTV per subscriber at 31 March 2020 was 1% lower than at 31 March 2019.

Total subscriber LTV at 31 March 2020 was $5.5 billion, an improvement of more than $1.1 billion compared to 31 March 2019. CAC months increased 3% to 14.0 months when compared to 31 March 2019, due to a 6% increase in the cost of acquiring each new subscriber. This was despite an ARPU increase in actual currency.

Total lifetime value



Financial Statements

Independent auditor's report to the Shareholders of Xero Limited

EY
Building a better working world

Report on the audit of the financial statements

OPINION

We have audited the financial statements of Xero Limited ("the company") and its subsidiaries (together "the Group") on pages 36 to 69, which comprise the consolidated statement of financial position of the Group as at 31 March 2020, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended of the Group, and the notes to the consolidated financial statements including a summary of significant accounting policies.

In our opinion, the consolidated financial statements on pages 36 to 69 present fairly, in all material respects, the consolidated financial position of the Group as at 31 March 2020 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 R&D tax credit advice and other assurance services related to the Group's compliance with ISO 27001. 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. Ernst & Young uses the Group's platform in delivering services to some clients. We have no other relationship with, or interest in, 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.

Capitalised Software Development Costs including impairment

Why significant

Intangible assets make up 79% of the Group's non-current assets. The most significant of these intangible assets is capitalised software development costs.

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.

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. This assessment requires judgment including consideration of both internal and external sources of information.

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

How our audit addressed the key audit matter

Our work on capitalised development costs focused on the Group's process for estimating the time spent by staff on software development that 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 processing of payroll costs;
- Assessing capitalised costs with reference to actual payroll information for a sample of employees;

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;
- Amortisation periods applied by the Group to developed software relative to its experience of software lifecycle;
- Significant changes in the market in which the assets are used; and

We assessed the adequacy of the disclosures related to capitalised development costs and related impairment considerations in the consolidated financial statements.

Goodwill impairment testing

Why significant

The Group recognises $78.8 million of goodwill related to the 100% acquisition of Hubdoc Inc in FY19.

NZ IAS 36: Impairment of Assets requires that goodwill be tested for impairment annually irrespective of whether there is any indication of impairment and this assessment requires judgement including consideration of both internal and external sources of information.

The Group assesses goodwill impairment by using an internally developed value-in-use model which considers a range of scenarios. The range of scenarios considered by management in this assessment has changed in the period to specifically consider the potential impacts of the economic uncertainty related to the COVID-19 pandemic. Key assumptions used in the value-in-use model are described in Note 10.

During the reporting period management changed the cash generation units to which this goodwill was allocated to reflect a change in the way in which the Hubdoc technology is made available to customers.

Disclosures relating to Goodwill, including key assumptions, are included in Note 10 to the consolidated financial statements.

How our audit addressed the key audit matter

We assessed the Group's judgements in their annual impairment test. Our audit procedures included the following:

- Using our valuation specialists to:
  - assess whether the methodology applied in the value in use model met the requirements of NZ IAS 36; and
  - consider the discount rates and terminal growth rates used in the impairment models;
- Considering the appropriateness of the changes made to the cash generating units to which goodwill is allocated across the Group;
- Assessing the appropriateness of cash flow forecasts considering historical cash flows, our knowledge of the business and relevant external information. Given the current economic uncertainty as a result of the COVID-19 pandemic, we placed a particular focus on the assumed subscriber and associated revenue growth forecasts;
- Performing sensitivity analysis around key drivers of the impairment model, including the sensitivity of the results to changes in future projected cash flows; and
- Assessing whether the assumptions which have the most significant effect on the determination of the recoverable amount of goodwill have been appropriately disclosed 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
14 May 2020

Income Statement

Year ended 31 March	Notes	2020 ($000s)	2019 ($000s)
Subscription revenue		696,220	538,384
Other operating revenue		22,011	14,435
Total operating revenue	**4**	**718,231**	**552,819**
Cost of revenue	5	(106,582)	(90,915)
Gross profit		**611,649**	**461,904**
Operating expenses			
Sales and marketing		(312,852)	(248,014)
Product design and development		(178,258)	(137,795)
General and administration		(88,980)	(66,072)
Total operating expenses	**5**	**(580,090)**	**(451,881)**
Asset impairments	9, 10	(1,427)	(18,604)
Other income and expenses		2,550	(96)
Operating surplus/(deficit)		**32,682**	**(8,677)**
Finance income	6	13,432	8,035
Finance expense	6	(36,277)	(22,494)
Net profit/(loss) before tax		**9,837**	**(23,136)**
Income tax expense	19	(6,501)	(4,007)
Net profit/(loss)		**3,336**	**(27,143)**
Basic and diluted earnings/(loss) per share	7	$0.02	($0.19)

Statement of Comprehensive Income

Year ended 31 March	Note	2020 ($000s)	2019 ($000s)
Net profit/(loss)		3,336	(27,143)
Other comprehensive income*			
Movement in cash flow hedges (net of tax)	16	845	999
Translation of foreign operations		(3,393)	1,006
Total other comprehensive income/(loss) for the period		**(2,548)**	**2,005**
Total comprehensive income/(loss) for the period		**788**	**(25,138)**

** Items of other comprehensive income will be reclassified to the Income Statement when specific conditions are met*
The accompanying notes form an integral part of these financial statements

Statement of Financial Position

	Notes	At 31 March 2020 ($000s)	At 31 March 2019 ($000s)
Assets			
Current assets			
Cash and cash equivalents		108,027	121,527
Short-term deposits		428,052	336,819
Trade and other receivables	8	55,877	49,466
Derivative assets	16	124,698	77,328
Other current assets		1,856	1,478
Total current assets		**718,510**	**586,618**
Non-current assets			
Property, plant and equipment	9	86,638	91,491
Intangible assets	10	342,246	289,731
Deferred tax assets	19	3,751	1,613
Derivative assets	16	–	238
Other non-current assets		2,543	627
Total non-current assets		**435,178**	**383,700**
Total assets		**1,153,688**	**970,318**
Liabilities			
Current liabilities			
Trade and other payables	11	42,954	27,043
Employee entitlements		39,893	37,830
Lease liabilities	13	11,755	11,541
Income tax payable	19	2,679	1,958
Derivative liabilities	16	3,157	147
Other current liabilities	12	15,694	26,560
Total current liabilities		**116,132**	**105,079**
Non-current liabilities			
Term debt	14	424,587	357,731
Derivative liabilities	16	121,972	77,367
Lease liabilities	13	60,871	71,308
Deferred tax liabilities	19	1,114	1,789
Other non-current liabilities		6,646	3,735
Total non-current liabilities		**615,190**	**511,930**
Total liabilities		**731,322**	**617,009**
Equity			
Share capital	17	677,540	627,848
Reserves		85,362	69,333
Accumulated losses		(340,536)	(343,872)
Total equity		**422,366**	**353,309**
Total liabilities and shareholders' equity		**1,153,688**	**970,318**

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)
Balance at 1 April 2019		**638,234**	**(10,386)**	**30,902**	**(343,872)**	**904**	**2,266**	**35,261**	**353,309**
Net profit		–	–	–	3,336	–	–	–	3,336
Other comprehensive income/(loss)		–	–	–	–	(3,393)	845	–	(2,548)
Total comprehensive income		**–**	**–**	**–**	**3,336**	**(3,393)**	**845**	**–**	**788**
Transactions with owners:									
Share-based payments	17, 22	16,282	585	23,497	–	–	–	–	40,364
Exercising of employee and director share options	17, 22	17,353	–	(4,920)	–	–	–	–	12,433
Issue of shares - deferred consideration for acquisition of Hubdoc	17	15,472	–	–	–	–	–	–	15,472
Balance at 31 March 2020		**687,341**	**(9,801)**	**49,479**	**(340,536)**	**(2,489)**	**3,111**	**35,261**	**422,366**
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	17, 22	13,673	1,466	17,343	–	–	–	–	32,482
Exercising of employee and director share options	17, 22	20,115	–	(5,345)	–	–	–	–	14,770
Issue of shares - acquisition of Hubdoc, net of issuance costs	17	54,850	–	–	–	–	–	–	54,850
Premium on call spread options, net of issuance costs		–	–	–	–	–	–	35,261	35,261
Balance at 31 March 2019		**638,234**	**(10,386)**	**30,902**	**(343,872)**	**904**	**2,266**	**35,261**	**353,309**

The accompanying notes form an integral part of these financial statements

Statement of Cash Flows

Year ended 31 March	Note	2020 ($000s)	2019 ($000s)
Operating activities			
Receipts from customers		717,264	552,256
Other income		5,609	5,370
Interest received		14,363	5,028
Payments to suppliers and employees		(542,760)	(435,043)
Interest paid		(19,460)	(9,502)
Income tax paid		(8,387)	(3,883)
Net cash flows from operating activities	**20**	**166,629**	**114,226**
Investing activities			
Capitalised development costs		(111,296)	(82,182)
Acquisition of Hubdoc		–	(30,312)
Capitalised contract acquisition costs		(13,682)	(13,512)
Purchase of property, plant and equipment		(13,872)	(15,727)
Other investing activities		(674)	1,262
Net cash flows from investing activities		**(139,524)**	**(140,471)**
Financing activities			
Payment of lease liabilities		(13,417)	(9,103)
Receipt of lease incentive		504	14,500
Exercising of share options		12,433	14,770
Proceeds from borrowings		–	30,850
Repayment of borrowings		–	(31,583)
Proceeds from issuance of convertible notes, net of issue costs		–	447,766
Purchase of call spread options		–	(45,810)
Payments for short-term deposits		(785,753)	(336,819)
Proceeds from short-term deposits		734,563	59,000
Net cash flows from financing activities		**(51,670)**	**143,571**
Net increase/(decrease) in cash and cash equivalents		**(24,565)**	**117,326**
Foreign currency translation adjustment		11,065	(16,754)
Cash and cash equivalents at the beginning of the period		**121,527**	**20,955**
Cash and cash equivalents at the end of the period		**108,027**	**121,527**

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), and is required to be treated as an FMC Reporting Entity under the Financial Market Conducts Act 2013 and the Financial Reporting Act 2013.

The consolidated financial statements of the Group for the year ended 31 March 2020 were authorised in accordance with a resolution of directors for issue on 14 May 2020.

2. BASIS OF ACCOUNTING

(a) Basis of preparation

The audited consolidated financial statements of the Company and its subsidiaries (together 'the Group' or 'Xero') 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

The accounting policies and disclosures adopted are consistent with those of the previous year.

Certain comparative information has also been reclassified to conform with the current period's presentation.

(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.

(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 2020			
Operating revenue	436,530	281,701	718,231
Expenses	(164,962)	(254,472)	(419,434)
Segment contribution	**271,568**	**27,229**	**298,797**
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**

Reconciliation from segment contribution to net profit/(loss) before tax

Year ended 31 March	2020 ($000s)	2019 ($000s)
Segment contribution	298,797	214,290
Product design and development	(178,258)	(137,795)
General and administration	(88,980)	(66,072)
Asset impairments	(1,427)	(18,604)
Other income and expenses	2,550	(496)
Finance income	13,432	8,035
Finance expense	(36,277)	(22,494)
Net profit/(loss) before tax	**9,837**	**(23,136)**

Depreciation and amortisation by segment

Year ended 31 March	2020 ($000s)	2019 ($000s)
ANZ	14,125	11,379
International	18,799	14,542
Corporate (not allocated to a segment)	72,137	55,927
Total	**105,061**	**81,848**

At 31 March 2020, $361.2 million, or 84%, of the Group's property, plant and equipment and intangible assets was domiciled in New Zealand (2019: $316.6 million, or 83%).

Share-based payments by segment

Year ended 31 March	2020 ($000s)	2019 ($000s)
ANZ	7,601	5,600
International	8,110	8,325
Corporate (not allocated to a segment)	18,625	15,021
Total	**34,336**	**28,946**

4. REVENUE

Operating revenue by geographic location

Year ended 31 March	2020 ($000s)	2019 ($000s)
Australia	320,376	261,468
United Kingdom	183,565	119,521
New Zealand	116,154	97,639
North America	55,398	44,270
Rest of World	42,738	29,921
Total operating revenue	**718,231**	**552,819**

Subscription revenue

Subscription revenue comprises the recurring monthly fees from subscribers to Xero's online software products. 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.

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.

Other operating revenue

Other operating revenue comprises revenue from related non-subscription services like fintech products, along with income from conferences and events.

Performance obligations under fintech arrangements include the referral of customers to the revenue share counterparty and the continued servicing of that customer by the counterparty. Performance obligations for conference and event revenue consist 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 use information technology costs, and depreciation and amortisation not relating to external product software development have been allocated to functions 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	2020 ($000s)	2019 ($000s)
Employee entitlements	371,679	301,559
Employee entitlements capitalised	(106,758)	(82,200)
Share-based payments	45,174	36,612
Share-based payments capitalised	(10,838)	(7,666)
Advertising and marketing	113,227	76,421
Platform costs	40,252	33,468
Computer equipment and software	23,657	19,380
Consultants and contractors	18,936	18,506
Travel-related costs	16,356	11,601
Superannuation costs	15,094	11,373
Communication, insurance and office administration	7,962	6,820
Rental costs	5,768	3,487
Staff recruitment	3,523	2,166
Auditors' remuneration	471	821
Other operating expenses	37,108	28,600
Total cost of revenue and operating expenses excl. depreciation and amortisation*	**581,611**	**460,948**

**Includes grant income of $5.2 million (2019: $5.2 million)*

Depreciation and amortisation

Year ended 31 March	2020 ($000s)	2019 ($000s)
Relating to:		
Amortisation of development costs	69,452	53,600
Amortisation of other intangible assets	12,574	10,358
Depreciation of property, plant and equipment	23,035	17,890
Total depreciation and amortisation	**105,061**	**81,848**
Total cost of revenue and operating expenses	**686,672**	**542,796**
Depreciation and amortisation included in function expenses as follows:		
Product design and development	68,490	53,012
Cost of revenue	7,105	5,393
Sales and marketing	25,819	20,529
General and administration	3,647	2,914
Total depreciation and amortisation	**105,061**	**81,848**

Auditors' remuneration

Year ended 31 March	2020 ($000s)	2019 ($000s)
Audit and review of financial statements	373	323
Other assurance services*	80	452
Taxation services	16	43
Other services**	2	3
Total fees paid to auditors	**471**	**821**

** Other assurance services relate to assurance services in connection with ISO 27001 certification and compliance services in respect of grant funding. Services in the comparative period also included assurance services in connection with reporting on service organisation controls, and comfort letter over convertible notes issuance. These additional independent assurance services were 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 cash equivalents 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	2020 ($000s)	2019 ($000s)
Interest on convertible notes	28,033	12,753
Bank standby facility costs	1,691	1,847
Lease liability interest	6,280	4,987
Other finance expense	273	2,907
Total finance expense	**36,277**	**22,494**

7. EARNINGS PER SHARE

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

Basic EPS is calculated by dividing the net profit/(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 profit/(loss) attributable to ordinary shareholders and the weighted average number of ordinary shares on issue for the effects of all potential dilution to ordinary shares, which comprise convertible notes, restricted shares, options, and restricted stock units (RSUs). Instruments are only treated as dilutive when their conversion to ordinary shares would decrease EPS or increase the loss per share.

Year ended 31 March	2020 (000s)*	2019 (000s)*
Net profit/(loss) after tax	$3,336	($27,143)
Add back: foreign exchange revaluation on contingent consideration included in ordinary shares for basic calculation prior to the date of share issue, net of tax	($44)	–
Net profit/(loss) attributable to equity holders of the Group, used in calculating basic and diluted EPS	**$3,292**	**($27,143)**
Weighted average number of ordinary shares for basic EPS	140,922	139,204
Effect of dilution from:		
Share options	1,376	–
Restricted shares	450	–
Restricted stock units	404	–
Weighted average number of ordinary shares adjusted for the effect of dilution	**143,152**	**139,204**
Basic earnings/(loss) per share	**$0.02**	**($0.19)**
Diluted earnings/(loss) per share	**$0.02**	**($0.19)**

** Except for per share amounts*

For the year ended 31 March 2020, 6,474,084 shares that would be issued on conversion of the convertible notes and 131,941 shares that would be on issue for the full year relating to the Hubdoc acquisition are excluded from the diluted weighted average number of shares because their effect would be anti-dilutive. The shares resulting from the notes and contingent consideration are anti-dilutive as a result of the corresponding adjustments that would be required to be made to net profit attributable to ordinary shareholders.

8. TRADE AND OTHER RECEIVABLES

At 31 March	2020 ($000s)	2019 ($000s)
Accrued income	22,750	21,957
Prepayments	22,617	16,405
Trade receivables	7,614	7,064
Provision for doubtful debts	(633)	(504)
Interest receivable	2,534	3,465
Rental bonds and other receivables	995	1,079
Total trade and other receivables	**55,877**	**49,466**

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 online products. Subscriptions are charged monthly, the majority being paid by direct debit. At 31 March 2020, trade receivables of the Group of $876,000 were past due and are considered partially impaired (2019: $704,000). At 1 April 2018, accrued income was $19.1 million.

Key estimates and assumptions

In accordance with NZ IFRS 9: *Financial Instruments*, the Group recognises impairment losses using the lifetime 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.

A six month historical default rate is applied to the current period trade receivables balance to calculate the impairment. At 31 March 2020, this default rate was increased to reflect the potential impact of the COVID-19 pandemic on credit losses. 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 against the Income Statement.

9. PROPERTY, PLANT AND EQUIPMENT

	Right of use asset ($000s)	Leasehold improvements ($000s)	Furniture and equipment ($000s)	Computer equipment ($000s)	Total ($000s)
Year ended 31 March 2020					
Opening net book value	63,440	15,474	7,542	5,035	91,491
Additions	8,312	4,866	4,478	4,770	22,426
Disposals*	(6,795)	(87)	(366)	(41)	(7,289)
Depreciation expense	(12,614)	(3,662)	(2,355)	(4,404)	(23,035)
Impairment reversals	207	–	–	–	207
Foreign exchange adjustment	2,257	152	279	150	2,838
Closing net book value	**54,807**	**16,743**	**9,578**	**5,510**	**86,638**
At 31 March 2020					
Cost	79,552	23,836	15,374	11,602	130,364
Accumulated depreciation	(24,745)	(7,093)	(5,796)	(6,092)	(43,726)
Closing net book value	**54,807**	**16,743**	**9,578**	**5,510**	**86,638**

** $6.8m of right of use asset disposals relates to disposal of lease liabilities (2019: $1.9 million)*

	Right of use asset ($000s)	Leasehold improvements ($000s)	Furniture and equipment ($000s)	Computer equipment ($000s)	Total ($000s)
Year ended 31 March 2019					
Opening net book value	42,419	10,271	5,687	3,427	61,804
Additions	33,520	8,351	3,828	4,669	50,368
Disposals	(1,863)	(1,047)	–	(9)	(2,919)
Depreciation expense	(10,709)	(2,077)	(2,020)	(3,084)	(17,890)
Impairments	(497)	–	–	–	(497)
Foreign exchange adjustment	570	(24)	47	32	625
Closing net book value	**63,440**	**15,474**	**7,542**	**5,035**	**91,491**
At 31 March 2019					
Cost	86,764	20,706	13,052	8,890	129,412
Accumulated depreciation	(23,324)	(5,232)	(5,510)	(3,855)	(37,921)
Closing net book value	**63,440**	**15,474**	**7,542**	**5,035**	**91,491**

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**
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*
*** Lease terms range between 1 -12 years*

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

	Software development ($000s)	Contract acquisition asset ($000s)	Other intangible assets ($000s)	Goodwill ($000s)	Total ($000s)
Year ended 31 March 2020					
Opening net book value	177,695	28,727	4,536	78,773	289,731
Additions*	120,542	13,829	345	–	134,716
Amortisation expense	(69,452)	(10,937)	(1,637)	–	(82,026)
Impairments	(1,634)	–	–	–	(1,634)
Foreign exchange adjustment	–	1,459	–	–	1,459
Closing net book value	**227,151**	**33,078**	**3,244**	**78,773**	**342,246**
At 31 March 2020					
Cost	370,563	60,360	6,075	78,773	515,771
Accumulated amortisation	(143,412)	(27,282)	(2,831)	–	(173,525)
Closing net book value	**227,151**	**33,078**	**3,244**	**78,773**	**342,246**

** Included in software development additions is $17.3 million of externally purchased assets (2019: $14.5 million)*

	Software development ($000s)	Contract acquisition asset ($000s)	Other intangible assets ($000s)	Goodwill ($000s)	Total ($000s)
Year ended 31 March 2019					
Opening net book value	139,146	24,035	470	5,165	168,816
Additions	89,583	13,384	–	–	102,967
Acquisitions	15,508	–	5,270	78,773	99,551
Amortisation expense	(53,600)	(9,154)	(1,204)	–	(63,958)
Impairments	(12,942)	–	–	(5,165)	(18,107)
Foreign exchange adjustment	–	462	–	–	462
Closing net book value	**177,695**	**28,727**	**4,536**	**78,773**	**289,731**
At 31 March 2019					
Cost	283,244	50,435	5,733	78,773	418,185
Accumulated amortisation	(105,549)	(21,708)	(1,197)	–	(128,454)
Closing net book value	**177,695**	**28,727**	**4,536**	**78,773**	**289,731**

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 when 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 when incurred.

At 31 March 2020, if software development capitalisation rates had been 10% higher/lower with all other variables held constant, the impact on operational expenses would have been $10.3 million lower/higher.

Contract acquisition asset

In accordance with NZ IFRS 15: *Revenue*, 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 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
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 $1.6 million during the year ended 31 March 2020 on write-down of software development (2019: $12.9 million).

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

An impairment loss is recorded against goodwill 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.

Goodwill and goodwill impairment testing

Goodwill represents the excess of purchase consideration 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 2020 relates solely to the acquisition of Hubdoc Inc. and has been allocated to the ANZ and International CGUs. Of the $78.8 million of goodwill, $39.0 million is allocated to ANZ and $39.8 million is allocated to International.

For the year ended 31 March 2019, the Hubdoc Inc. goodwill was allocated to the Hubdoc CGU. The reallocation of goodwill to new CGUs in the current year has arisen from the fact that the Hubdoc product from March 2020 was bundled with Xero's core accounting software, therefore separately identifiable cash flows are no longer able to be attributed to the Hubdoc CGU.

The recoverable amount of the ANZ and International CGUs were calculated on the basis of value in use using a discounted cash flow model. Future cash flows were projected for five years for ANZ and ten years for International, with key assumptions being CGU earnings which is based on expected future performance of the CGUs. A period of ten years was used to project future cash flows for the International CGU due to the early stage of growth the market is in.

Key assumptions applied for the Group include growth rate of 7.0% (2019: 15.0%), pre-tax discount rate of 10.0% (2019: 20.0%), and terminal growth rate of 5.6% (2019: 3.0%). 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. Estimated potential future impacts of COVID-19 have been considered within forecast financial information. 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.

No impairment arose as a result of goodwill impairment testing for the year ended 31 March 2020.

11. TRADE AND OTHER PAYABLES

At 31 March	2020 ($000s)	2019 ($000s)
Trade payables	10,615	5,690
Accrued expenses	23,440	15,434
Sales tax payable	8,899	5,919
Total trade and other payables	**42,954**	**27,043**

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	2020 ($000s)	2019 ($000s)
Income in advance	9,607	7,682
Accrued interest	5,812	5,114
Other short-term liabilities	275	309
Contingent consideration	–	13,455
Total other current liabilities	**15,694**	**26,560**

The Group recognises other current liabilities initially at fair value, and subsequently at amortised cost using the effective interest method.

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

	2020 ($000s)	2019 ($000s)
Balance at 1 April	82,849	45,437
Leases entered into during the period	5,988	33,267
Lease incentives received	504	14,500
Principal repayments	(13,417)	(9,103)
Change in future lease payments	(6,213)	(1,889)
Foreign exchange adjustment	2,915	637
Balance at 31 March	**72,626**	**82,849**
Current	11,755	11,541
Non-current	60,871	71,308

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 2020 was $2.8 million (2019: $2.2 million).

Lease liabilities are initially measured at the present value of the remaining lease payments, discounted at the Group'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 included in contracts. 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 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.

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 principal amount, unamortised debt discount, unamortised issuance costs, and net carrying amount of the liability component of the notes at 31 March are as follows:

At 31 March	2020 ($000s)	2019 ($000s)
Principal amount	500,526	440,787
Unamortised debt discount	(69,473)	(75,984)
Unamortised issuance costs	(6,466)	(7,072)
Term debt	**424,587**	**357,731**

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

Year ended 31 March	2020 ($000s)	2019 ($000s)
Coupon interest expense	11,010	5,126
Amortisation of debt discount and issuance costs	17,023	7,627
Total finance expense on convertible notes	**28,033**	**12,753**

Call spread options

In connection with the issuance 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 on 4 October 2023.

The upper strike call options are accounted for as equity, and are recognised at their fair value, less transaction costs. On initial recognition, the upper strike options were recognised at a fair value of $35.3 million and were not subsequently revalued.

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 2020 in accordance with NZ IFRS 9.

Under NZ IFRS 9, financial instruments are classified as 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 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 relating to the convertible notes 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 (level two on the fair value hierarchy). Inputs into the valuation include share price volatility and time to expiration.

At initial recognition, the fair value of the convertible notes was determined using a market interest rate for an equivalent non-convertible bond. The notes are subsequently recognised at amortised cost. The fair value of the debt component of the convertible notes at 31 March 2020 was $454.5 million (2019: $362.6 million).

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

There were no transfers between classes of financial instruments during the period.

	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 2020				
Assets				
Cash and cash equivalents	108,027	–	–	108,027
Term deposits	428,052	–	–	428,052
Trade and other receivables	11,837	–	–	11,837
Derivative assets (foreign currency derivatives)*	–	7,347	–	7,347
Derivative assets (call spread options)	–	117,351	–	117,351
Total financial assets	**547,916**	**124,698**	**–**	**672,614**
Liabilities				
Trade and other payables	–	–	34,055	34,055
Derivative liabilities (foreign currency derivatives)*	–	3,256	–	3,256
Derivative liabilities (conversion feature on convertible notes)	–	121,873	–	121,873
Term debt	–	–	424,587	424,587
Other current liabilities	–	–	5,812	5,812
Other non-current liabilities	–	2,840	–	2,840
Total financial liabilities	**–**	**127,969**	**464,454**	**592,423**
At 31 March 2019				
Assets				
Cash and cash equivalents	121,527	–	–	121,527
Term deposits	336,819	–	–	336,819
Trade and other receivables	11,731	–	–	11,731
Derivative assets (foreign currency derivatives)*	–	3,567	–	3,567
Derivative assets (call spread options)	–	73,999	–	73,999
Total financial assets	**470,077**	**77,566**	**–**	**547,643**
Liabilities				
Trade and other payables	–	–	21,124	21,124
Derivative liabilities (foreign currency derivatives)*	–	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**

** Foreign currency derivatives are hedge accounted when possible with unrealised gains and losses recognised in other comprehensive income until the underlying cashflows are realised, at which point the gains and losses are reclassified to 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, during the year ended 31 March 2020 the Group renewed its standby syndicated facility for a further three year term. As part of this, the facility was increased from $100 million to $150 million. Counterparties to the facility are ANZ, BNZ, HSBC, and Citibank.

The facility provides Xero with additional liquidity to cover unforeseen operating cash flow requirements. The facility agreement contains financial undertakings usual for facilities of this nature. The facility remains undrawn and there are no current plans to draw down on the facility.

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 four currencies, being Great British pounds (GBP), Australian dollars (AUD), United States dollars (USD), and Canadian dollars (CAD), with exposures to other currencies to a lesser degree.
The material exposures are USD and CAD 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 NZD:

	AUD ($000s)	USD ($000s)	GBP ($000s)	CAD ($000s)
At 31 March 2020				
Exposures				
Cash and cash equivalents, and short-term deposits	8,525	419,699	9,004	2,310
Trade and other receivables	1,387	3,695	2,736	174
Trade and other payables	(8,766)	(7,019)	(6,187)	(524)
Other current liabilities	–	(5,812)	–	–
Other non-current liabilities	–	–	(2,840)	–
Lease liabilities	(5,392)	(13,523)	(1,794)	(1,223)
Term debt (including conversion feature)	–	(500,526)	–	–
Derivative financial instruments (foreign currency derivatives)	85,164	(31,517)	63,990	(13,231)
Total foreign currency exposure	**80,918**	**(135,003)**	**64,909**	**(12,494)**
At 31 March 2019				
Exposures				
Cash and cash equivalents, and short-term deposits	14,664	366,744	5,734	874
Trade and other receivables	914	635	1,928	207
Trade and other payables	(2,649)	(3,639)	(4,787)	(551)
Other current liabilities	–	(18,569)	–	–
Other non-current liabilities	–	–	(600)	–
Lease liabilities	(5,872)	(19,557)	(3,135)	(102)
Term debt (including conversion feature)	–	(440,788)	–	–
Derivative financial instruments (foreign currency derivatives)	64,667	(65,804)	58,957	–
Total foreign currency exposure	**71,724**	**(180,978)**	**58,097**	**428**

At 31 March, 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 2020 ($000s)	10% decrease 2019 ($000s)	10% increase 2020 ($000s)	10% increase 2019 ($000s)
Impact on:				
Net profit/(loss) before income tax (increase/(decrease))	(1,751)	905	1,432	(740)
Equity (before income tax) (increase/(decrease))	12,646	1,199	(10,214)	889

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 at call with banks, funds invested in money market funds, and other short-term and highly liquid investments with original maturities of 90 days or less. Surplus balances are placed on short-term deposit at fixed rates. The repricing of these at maturity exposes the Group to interest rate risk. Money market funds invested into include a broad range of highly-rated short-term fixed income securities and calculate investment returns on a daily basis. Changes to interest rates will impact the returns generated by each fund. The convertible notes give rise to interest rate risk at maturity (October 2023) if the Group were to refinance at prevailing interest rates, with higher interest rates increasing the cost of debt financing should they be in effect at this time.

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 profit and accumulated losses of the Group would have been $5.4 million lower/higher (2019: $4.6 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 2020, the Group held cash and cash equivalents of $108.0 million and term deposits of $428.1 million. Of this, $43.4 million of cash and cash equivalents and $367.1 million of term deposits relates to the proceeds from the issuance of convertible notes, which is intended to be used for investments into strategic and complementary businesses and assets. The remaining $64.6 million of cash and cash equivalents and $61.0 million of term deposits is available to service the Group's day-to-day activities. The $150 million syndicated standby facility provides additional liquidity to cover unforeseen operating cash flow requirements.

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 advance of this, to ensure that the Group has sufficient liquidity to meet 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 2020						
Non-derivative financial liabilities						
Trade and other payables	34,055	–	–	–	34,055	34,055
Lease liabilities	18,446	16,468	33,470	53,003	121,387	72,626
Term debt*	11,887	11,887	524,301	–	548,075	430,399
Other non-current liabilities	–	2,840	–	–	2,840	2,840
Contractual cash flows	**64,388**	**31,195**	**557,771**	**53,003**	**706,357**	**539,920**
Derivative financial liabilities						
Forward exchange contracts	–	–	–	–	–	(3,256)
Inflows	62,563	3,095	–	–	65,658	–
Outflows	(65,158)	(3,128)	–	–	(68,286)	–
Contractual cash flows	**(2,595)**	**(33)**	**–**	**–**	**(2,628)**	**(3,256)**
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 cash flows and carrying value include $5.8 million of interest included in other current liabilities at 31 March 2020 (2019: $5.1 million)*

(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 the Group 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 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	2020 ($000s)	2019 ($000s)
Cash and cash equivalents	108,027	121,527
Short-term deposits	428,052	336,819
Trade and other receivables	10,510	11,104
Derivative financial assets	124,698	77,566
Non-current assets	1,327	627
Total financial assets subject to credit risk	**672,614**	**547,643**

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	2020 ($000s)	2019 ($000s)
Cash and cash equivalents and short-term deposits		
A-1+	470,121	406,612
A-1	60,379	47,533
A-2	5,579	4,201
Total cash and cash equivalents and short-term deposits	**536,079**	**458,346**
Derivative assets		
A-1+	5,917	2,923
A-1	118,781	74,643
Total derivative assets	**124,698**	**77,566**
Total exposure to credit risk	**660,777**	**535,912**

The Group's trade and other receivables and non-current assets are with counterparties 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.

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	2020 ($000s)	2019 ($000s)
Current derivative assets		
Call spread options	117,351	73,999
Foreign exchange contracts	5,732	2,703
Foreign exchange options	1,615	626
Non-current derivative assets		
Forward exchange contracts	–	189
Foreign exchange options	–	49
Total derivative assets	**124,698**	**77,566**
Current derivative liabilities		
Forward exchange contracts	(1,937)	(89)
Foreign exchange options	(1,220)	(58)
Non-current derivative liabilities		
Conversion feature of convertible notes	(121,873)	(77,367)
Forward exchange contracts	(39)	–
Foreign exchange options	(60)	–
Total derivative liabilities	**(125,129)**	**(77,514)**

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 rates 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). 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 $6.8 million (before taxation) was recognised in other comprehensive income (2019: gain of $6.9 million). During the year, a gain of $5.6 million (before taxation) was reclassified out of other comprehensive income to the Income Statement (2019: gain of $5.5 million). The remaining balance will be reclassified to the Income Statement in the 18 months following 31 March 2020.

Due to the uncertainty resulting from COVID-19, the Group revised its forecasted currency exposures, resulting in some hedge ineffectiveness. As a result of this ineffectiveness, a loss of $0.3 million was reclassified from other comprehensive income to the Income Statement. Amounts reclassified are recorded within other income and expenses. There was no other material ineffectiveness of hedging relationships.

Hedge position

The Group's hedge accounted financial instruments are as follows:

At 31 March	2020 Average forward rate	2020 Fair value ($000s)	2020 Notional amount hedged (NZD) ($000s)	2019 Average forward rate	2019 Fair value ($000s)	2019 Notional amount hedged (NZD) ($000s)
Derivative assets						
Buy USD - Sell NZD	0.6692	3,388	28,180	0.6898	553	53,641
Buy CAD - Sell NZD	0.8692	528	13,231	–	–	–
Buy NZD - Sell AUD	0.9332	3,034	85,164	0.9214	2,262	58,957
Buy NZD - Sell GBP	–	–	–	0.5083	730	46,400
Total		**6,950**			**3,545**	
Derivative liabilities						
Buy USD - Sell NZD	–	–	–	0.6723	(121)	12,162
Buy NZD - Sell AUD	–	–	–	0.9633	(16)	5,710
Buy NZD - Sell GBP	0.5051	(2,643)	53,665	–	–	–
Total		**(2,643)**			**(137)**	

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 $33.6 million revaluation loss in the Income Statement relating to the conversion feature derivative (2019: $5.7 million gain).

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 year, the Group recognised a $32.9 million revaluation gain in the Income Statement relating to the lower strike call options (2019: $5.0 million loss).

17. SHARE CAPITAL

	Note	2020 (000s)	2019 (000s)
Balance at 1 April		140,774	138,449
Issue of ordinary shares - acquisition of Hubdoc		176	1,133
Issue of ordinary shares - exercising of employee share options	22	504	748
Issue of ordinary shares - restricted stock unit schemes	22	266	180
Issue of ordinary shares - employee restricted share plan	22	67	228
Issue of ordinary shares - exercising of director and advisor share options	22	60	26
Issue of ordinary shares - directors' fees		4	10
Ordinary shares on issue at 31 March		**141,851**	**140,774**
Treasury shares		(339)	(411)
Ordinary shares on issue at 31 March excluding treasury shares		**141,512**	**140,363**

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

During the year, the company issued 176,230 shares at a price of AUD84.85 for the settlement of the contingent consideration relating to the acquisition of Hubdoc.

During the year, employees exercised 504,021 share options with a weighted average exercise price of $22.70 (2019: 747,821, $19.20).

During the year, 327,917 RSUs vested, of which 266,190 were converted to shares with a weighted average price of $48.01. The remaining 61,727 were surrendered to settle payroll withholding obligations (2019: 249,608 vested, 179,554 converted at a weighted average price of $20.89, 70,504 surrendered to settle payroll withholding obligations).

During the year, the Company allocated 141,582 shares under the employee restricted share plan (RSP), at a weighted average price of AUD63.95 (2019: 364,955, AUD45.22). Of the shares allocated, 66,823 were new shares issued, and 74,759 were the reissue of shares held as treasury shares (2019: 228,459 and 136,496 respectively).

During the year, a director and an advisor exercised 59,530 share options, with a weighted average exercise price of $16.76 (2019: a director exercised 25,730 options with an exercise price of $16.14).

During the year, the Company issued 4,605 shares at a weighted average price of $59.65 to directors in lieu of cash payment for directors' fees (2019: 10,072, $40.17).

18. 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 2020 (%)	Interest 2019 (%)
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 March	100	100
Hubdoc Pty Limited	Reseller	Australia	31 March	100	100
Hubdoc (UK) Limited	Reseller	United Kingdom	31 January	100	100
Xero Investments Limited	Funding & investment	New Zealand	31 March	100	100
Cicerone Limited	Non-active	United Kingdom	31 August	100	100

19. 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 regulations 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 profit/(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	2020 ($000s)	2019 ($000s)
Accounting profit/(loss) before income tax	9,837	(23,136)
At the New Zealand statutory income tax rate of 28%	2,754	(6,478)
Non-deductible expenditure	370	1,640
Prior period adjustment	(116)	119
Utilisation of tax losses not previously recognised	(14,036)	(10,074)
Net research and development expense deferred	7,803	4,023
Tax rate variance of subsidiaries	847	2,890
Losses not recognised in current year	8,879	11,887
Income tax expense	**6,501**	**4,007**
Comprising:		
Income tax payable	9,196	5,361
Prior period adjustment	(116)	119
Deferred tax	(1,565)	(1,153)
Tax losses utilised	(972)	(398)
Effect of changes in foreign currency	(42)	78
Income tax expense	**6,501**	**4,007**

Income tax payable

	2020 ($000s)	2019 ($000s)
Balance at 1 April	1,958	537
Prior period adjustment	(83)	177
Income tax liability for the year	9,196	5,361
Income tax paid	(8,387)	(3,883)
Effects of changes in foreign currency	(5)	(234)
Income tax payable	**2,679**	**1,958**

Deferred income tax

	Derivatives ($000s)	Provisions and employee benefits ($000s)	Tax depreciation ($000s)	Tax losses ($000s)	Total ($000s)
Year ended 31 March 2020					
Deferred tax asset balances					
At 1 April 2019	–	5,661	(2,849)	(1,199)	1,613
Prior period adjustment	–	(547)	584	647	684
Charged to Income Statement	–	4,153	(547)	(2,718)	888
Charged to equity	–	(23)	–	591	568
Impact of change in tax rates	–	44	(46)	–	(2)
At 31 March 2020	**–**	**9,288**	**(2,858)**	**(2,679)**	**3,751**
Deferred tax liability balances					
At 1 April 2019	(881)	9,276	(19,048)	8,864	(1,789)
Prior period adjustment	–	(267)	39	(412)	(640)
Charged to Income Statement	–	2,185	(3,968)	2,462	679
Charged to equity	(328)	3,452	–	(3,460)	(336)
Tax losses utilised	–	–	–	972	972
At 31 March 2020	**(1,209)**	**14,646**	**(22,977)**	**8,426**	**(1,114)**
Year ended 31 March 2019					
Deferred tax asset balances					
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					
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)**

Recognised temporary differences

The Group's recognised deferred tax asset and deferred tax liability are expected to be recovered by $2.36 million and $0.48 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 $85.4 million (2019: $58.6 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 $279.9 million (2019: $296.9 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.

20. RECONCILIATION OF OPERATING CASH FLOWS

Year ended 31 March	2020 ($000s)	2019 ($000s)
Net profit/(loss)	3,336	(27,143)
Adjustments:		
Depreciation	23,035	17,890
Amortisation	82,026	63,958
Share-based payments	34,336	28,946
Amortisation of debt discount and issuance costs	17,023	7,627
Impairment of assets	1,427	18,604
Deferred tax	(1,565)	(1,153)
Tax losses utilised	(972)	(398)
Bad debts	1,974	1,459
Other non-cash items	(2,435)	766
Changes in working capital:		
Increase in trade receivables and prepayments	(5,833)	(14,111)
(Increase)/decrease in interest receivable	931	(3,008)
Increase in trade payables and other related items	6,396	5,068
Increase in income tax payable	721	1,421
Increase in employee entitlements	4,304	10,764
Increase in income in advance	1,925	3,536
Net cash flows from operating activities	**166,629**	**114,226**

21. CHANGES IN FINANCIAL ASSETS AND LIABILITIES ARISING FROM FINANCING ACTIVITIES

Year ended 31 March 2020	At 1 April 2019 ($000s)	Proceeds ($000s)	Payments ($000s)	Amortisation expense ($000s)	Foreign exchange movement ($000s)	Other non-cash items ($000s)	At 31 March 2020 ($000s)
Short-term deposits	336,819	(734,563)	785,753	–	40,043	–	428,052
Term debt	(357,731)	–	–	(17,023)	(49,833)	–	(424,587)

Year ended 31 March 2019	At 1 April 2018 ($000s)	Proceeds ($000s)	Payments ($000s)	Amortisation expense ($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*

22. 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 restricted shares. The value of the employee services rendered for the grant of non-transferable options, RSUs, and restricted 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 restricted 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 AUD63.95 (2019: AUD45.22) 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 $11.1 million vested during the year (2019: $12.7 million). The Group has no legal or constructive obligation to repurchase or settle the shares for cash.

	2020 Number of shares (000s)	2019 Number of shares (000s)
Outstanding restricted shares at 1 April	371	522
Granted	142	365
Forfeited	(61)	(90)
Settled	(139)	(426)
Outstanding restricted shares at 31 March - allocated to employees	**313**	**371**
Forfeited shares not yet reallocated - held by Trustee	26	40
Total	**339**	**411**
Percentage of total ordinary shares	0.2%	0.3%
Ageing of unvested shares		
Vest within one year	138	261
Vest after one year	44	110
Total unvested shares at 31 March*	**182**	**371**

** Varies to outstanding restricted shares above as shares which vested on 31 March 2020 were not settled until 1 April 2020*

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

The options' tranches vest within four years from the grant date. No options can be exercised later than the second anniversary of the final vesting date. There were 52 holders of options at 31 March 2020 (2019: 44).

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:

	2020 Weighted average exercise price ($)	2020 Options (000s)	2019 Weighted average exercise price ($)	2019 Options (000s)
Outstanding at 1 April	31.91	2,995	20.65	2,225
Granted	64.85	763	39.13	2,092
Forfeited/expired	37.12	(333)	31.48	(548)
Exercised	22.07	(564)	19.10	(774)
Outstanding at 31 March	**42.04**	**2,861**	**31.91**	**2,995**
Exercisable at 31 March	21.32	288	19.55	365

The weighted average share price on date of exercise for options exercised in the year ended 31 March 2020 was AUD67.94 (2019: AUD43.31). The weighted average remaining contractual term of options outstanding at 31 March 2020 is 3.1 years (2019: 3.6 years).

Options outstanding at 31 March fall within the following ranges:

Granted	Exercise price	2020 Options (000s)	2019 Options (000s)
2015-16	NZD16.00	–	30
2016-17	NZD17.51 - NZD19.50	445	830
2017-18	NZD25.75 - NZD32.48	190	327
2018-19	AUD34.00 - AUD48.33	1,463	1,808
2019-20	AUD51.82 - AUD83.04	763	–
		2,861	**2,995**

The weighted average fair value of options granted during the year, determined using the Black-Scholes valuation model, was $18.89 per option (2019: $21.41).

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 31% and 36%, a dividend yield of 0%, an expected option life of between three and five years, and an annual risk-free interest rate of between 0.7% and 1.4%.

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 2020 was $28.1 million (2019: $12.8 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, converted to shares in equal amounts over the vesting period.

	2020 Weighted average grant date fair value ($)	2020 RSUs (000s)	2019 Weighted average grant date fair value ($)	2019 RSUs (000s)
Outstanding at 1 April	38.89	370	21.64	401
Granted	66.00	425	46.23	277
Forfeited	53.71	(89)	32.05	(57)
Converted to shares	48.01	(266)	20.93	(180)
Surrendered to settle payroll withholding obligations	34.33	(61)	20.76	(71)
Outstanding at 31 March	**60.16**	**379**	**38.89**	**370**

The Company withholds shares under certain circumstances to settle tax withholding obligations on vesting. Based on the market share price on 31 March 2020, future cash payments to meet tax withholding obligations on the vesting of RSUs are expected to be $1.5 million (2019: $4.9 million).

23. 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	2020 ($000s)	2019 ($000s)
Short-term employee benefits	8,329	7,807
Directors' fees	1,332	1,214
Share-based payments - options	7,807	5,841
Share-based payments - restricted stock units	1,360	2,008
Share-based payments - employee restricted share plan	147	889

Related party transactions

During the year Atomic.io Limited, a related party, provided product development services to the Group of $0.2m.

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. 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 (2019: nil).

24. COMMITMENTS AND CONTINGENCIES

Capital commitments

Capital commitments of $1.2 million for building fit-outs were contracted for at 31 March 2020 but not yet incurred (2019: $1.0 million).

Contingent liabilities

There were no contingent liabilities at 31 March 2020 (2019: nil).

25. EVENTS AFTER THE BALANCE SHEET DATE

In March 2020, the World Health Organisation declared the outbreak of a novel coronavirus (COVID-19) as a pandemic. Subsequent to 31 March 2020, the virus continues to spread globally, giving rise to economic uncertainties which may impact Xero's customers.

While the ultimate disruption which may be caused by the outbreak is uncertain, it may result in an adverse impact on the Group's financial position, performance, and cash flows, should it result in global economic downturn impacting our subscribers. The related financial impact and duration cannot be reasonably estimated at this time.

There were no other 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 2020, 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 14 May 2020.

For and on behalf of the Board

David Thodey
Chair
Xero Limited
14 May 2020

Lee Hatton
Director
Xero Limited
14 May 2020

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 is listed on the Australian Securities Exchange (ASX) and is a New Zealand incorporated and domiciled company. 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.[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 (ASX Principles and Recommendations). This Corporate Governance Statement (Statement) addresses the recommendations contained in the 3rd edition of the ASX Principles and Recommendations, which applies to Xero for the financial year ended 31 March 2020. For completeness, we note that the 4th edition of the ASX Principles and Recommendations will apply to Xero for the financial year ending 31 March 2021. This Statement is current as at 3 April 2020, and has been approved by the Board.

The Statement should be read in conjunction with this Annual Report and Xero's Investor Centre at www.xero.com/au/about/investors/governance, where full copies of Xero's corporate governance policies and charters can be found.

References to FY20 are to the year ended 31 March 2020.

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 audits) and certain provisions of that chapter do not apply (e.g. section 295 regarding annual financial report, 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 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. The Charter is available on Xero's website.

The Board is appointed by the shareholders (other than directors who are appointed by the Board to fill a casual vacancy, who must be subsequently approved by shareholders at the next general meeting of the company), and meets sufficiently regularly to perform its role effectively. It 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 and to guide the business.

Responsibilities The Board is responsible for overseeing and appraising Xero's strategic direction, purpose, values, policies, performance, risk appetite and governance framework. To assist with carrying out its responsibilities, the Board has established the following standing Committees:

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

The Board may also delegate specific functions to ad hoc Committees from time to time.

Xero's Chief Executive Officer (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, risk appetite, and risk management strategies approved by the Board.

The Board monitors Xero's management and performance and ensures 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:

- Approving Xero's strategic plan, overseeing performance to ensure alignment with the strategic plan, and focusing Xero's activities on long-term shareholder value
- Assessing and making determinations on Xero's culture and management framework, governance policies, procedures and compliance, and relevant Board and Committee frameworks
- Approving Xero's financial statements, required reports and annual budget, as well as confirming Xero's financial position and overseeing and reviewing the integrity of Xero's accounting and corporate reporting systems
- Selecting the CEO, overseeing succession plans for Xero's leadership team, and approving policies, practices and measurable objectives for achieving diversity
- Approving the remuneration framework, ensuring Xero's remuneration policies and practices fit with its strategic goals, and overseeing equity incentive programs
- Approving an annual operating plan and systems of financial and non-financial risk management, as well as confirming Xero has in place accurate and reliable reporting systems, internal controls, compliance activities, and systems to monitor the effectiveness of Xero's risk management framework

Appointment Before appointing 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 FY20, and the number of scheduled[1] meetings and attendance at those meetings was:

Director	Board		Nominations Committee		ARM Committee		P&R Committee	
	Held[2]	Attended	Held[2]	Attended	Held[2]	Attended	Held[2]	Attended
David Thodey[3]	5	4	3*	3	-	-	3	3
Rod Drury	7	7	-	-	-	-	-	-
Lee Hatton	7	6	-	-	6*	6	-	-
Dale Murray[4]	7	7	-	-	6	6	-	-
Susan Peterson[5]	7	7	-	-	-	-	5*	5
Bill Veghte[6]	4	1	2	1	-	-	3	1
Graham Smith[7]	7	7	4	4	6	6	-	-
Craig Winkler	7	7	4	4	-	-	5	5

1 *In addition to meetings scheduled in advance for the year, the Board and Committees hold other meetings as appropriate to meet governance demands. In FY20, the Board held three additional meetings, the Nominations Committee held seven additional meetings, the ARM Committee held one additional meeting and the P&R Committee held one additional meeting*

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

3 *Appointed as a director 27 June 2019; appointed as Chair of the Board 1 February 2020; appointed as Chair of the Nominations Committee 26 February 2020*

4 *Appointed to the Nominations Committee 26 February 2020*

5 *Appointed as Chair of the P&R Committee 1 July 2019; appointed to the Nominations Committee 26 February 2020*

6 *Resigned as Chair of the P&R Committee effective 1 July 2019; resigned as a director effective 15 August 2019*

7 *Resigned as Chair of the Board effective 31 January 2020; resigned as Chair and member of the Nominations Committee effective 26 February 2020; resigned as a director effective 31 March 2020*

* *Committee Chair*

The qualifications of each director are detailed on pages 13 and 14 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. Director appointment letters also include details regarding: Board, Committee and directors' duties and responsibilities, time commitment, Board and individual performance evaluation, disclosure of interests and matters affecting independence, confidentiality, the Board's policy on obtaining independent advice, insurance, and deeds of indemnity.

Company Secretary Chaman Sidhu is the Chief Legal Officer & Company Secretary of Xero. Her 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 effective functioning of the Board. The formal reporting line of the Company Secretary is through the CEO. All directors have direct 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 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's Diversity and Inclusion Policy outlines requirements for the Board to establish measurable objectives for achieving diversity and to annually assess those objectives and the progress towards achieving them. This policy is available on Xero's website.

The 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 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

Xero's joint Heads of Diversity and Inclusion lead our global diversity and inclusion strategy and initiatives and support our regions to achieve local diversity priorities.

Respect and Responsibility Policy Xero's 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. The policy is supported by an online training module for all employees and additional face-to-face training for people managers.

Wellbeing At Xero, we value wellbeing and believe it is part of our commitment to create an inclusive work environment to support our employees, customers and partners. Internally, we have delivered a range of wellbeing activities including mental health training, resilience workshops, mindfulness programs and initiatives to promote physical health and financial wellbeing. In FY20, we also completed a strategic review of our wellbeing initiatives as the first step in developing a global strategy to consolidate and enhance our efforts in this area.

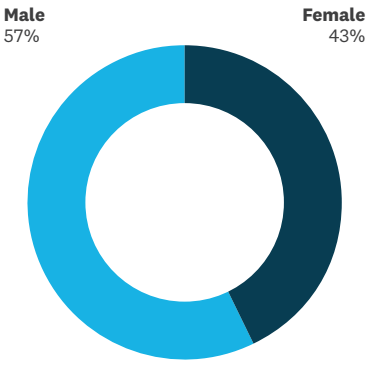
Measurable objectives The following is a summary of progress achieved against Xero's measurable objectives for FY20, as approved by the Board:

Objective	Progress
Xero maintains a gender balance on its Board by having at least 3 female directors and at least 3 male directors	- At 31 March 2020, Xero's Board comprised 3 women and 4 men
Xero attracts diverse talent in the tech industry with particular focus on women in tech, and maintains: - female representation on Xero's leadership team at or above 40% - female representation across all employees at or above 40% *(This reflects a 40:40:20 target for these levels, i.e. 40% women and 40% men, with the remaining 20% unspecified to allow for flexibility and recognise that gender is not binary)*	- **Progress on gender diversity:** At 31 March 2020, 42% of Xero's employees were female and 42% of Xero's leadership team were female - Included in the 2020 Bloomberg Gender Equality Index globally recognising our commitment to supporting diversity in the workplace - **Community engagement:** Maintained our support for organisations and initiatives to attract and develop a more gender diverse workforce, including Code Like A Girl, GirlbossNZ, Tech Girls Movement, Ladies that UX and Leading Ladies - Engaged in community outreach to increase diversity in the pipeline of talent into tech, including promoting careers in tech to girls and women through activities such as coding camps and a one-week Girlcode workshop in Auckland - **Employee networking & development:** Supported the launch of a new Women of Xero (WOX) network group in Australia, hosting regular learning and discussion events in support of gender equality and diversity at Xero - **Measurement & monitoring:** Maintained an internal diversity dashboard to track key diversity data (including gender diversity data) for internal monitoring and accountability - **Gender pay equity:** Conducted our annual organisation-wide pay equity review at Xero and communicated results to employees, and won the 'On the Journey' award in the 2019 YWCA Equal Pay Awards (NZ) for our work on pay transparency and gender pay equity - **Communications:** Continued to incorporate diversity and inclusion in Xero's external communications and activities, including through a new page on Xero's website highlighting Xero's activities in these areas, and delivered a global International Women's Day campaign with local events across our offices - **Attraction of talent:** Continued to seek diverse talent through recruitment platforms and partners to promote diversity in hiring including Vercida in the UK, Hired in Canada, and Work180 in Australia - Conducted a disability recruitment review in Australia through Australian Network on Disability to identify potential barriers to recruitment for people with disability, with the goal of utilising findings to implement a best practice, barrier-free approach to recruitment globally

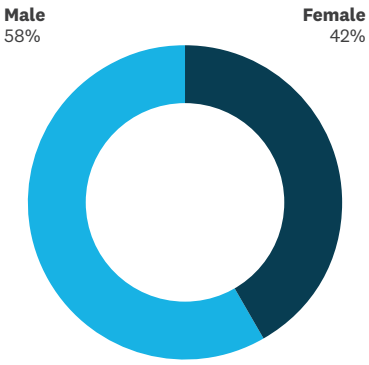
Xero is an inclusive work environment where different contributions and perspectives are valued and everyone can bring their whole self to work	*Some of the ways in which we continued to build our inclusive work environment during the year:* - **Education to underpin an inclusive environment:** Delivered face-to-face training for people managers and online training for employees on Xero's Respect and Responsibility Policy, and additional training to support diversity and inclusion at Xero, including LGBTQI+ awareness and mental health awareness, and launched a new online learning program on worldviews and religion to build understanding of differences between our people - **"Grassroots" inclusion initiatives:** Supported internal groups of diversity and inclusion champions to develop locally meaningful initiatives, such as the creation of the WOX network group in Australia and participation in the Midsumma Festival Pride parade in Melbourne - **LGBTQI+ inclusion:** Introduced options in Xero's internal human resources system for employees to identify as non-binary or gender diverse - **Disability inclusion:** Participated in the Australian Network on Disability's PACE mentoring program in Australia, and achieved Level 2 Disability Confident Employer status in the United Kingdom - **Mental health & wellbeing:** Delivered a range of wellbeing activities including mental health training, resilience workshops, mindfulness programs and initiatives to promote physical health and financial wellbeing - Craig Hudson, Xero's Managing Director New Zealand & Pacific Islands, was awarded the DiversityWorks 2019 'Walk the Talk' award for his leadership to encourage open discussion of mental health and wellbeing by our people and our small business customers - Completed a strategic review of Xero's wellbeing initiatives with a view to developing a FY21 global strategy to consolidate and enhance our efforts in this area - **Cultural diversity:** Promoted cultural diversity through sharing Xero stories of cultural diversity on World Day for Cultural Diversity, delivering Māori language week activities and Māori language courses in New Zealand, participating in the TupuToa internship program in New Zealand, and holding shared cultural lunches in some of our offices - **Indigenous engagement in Australia:** Held NAIDOC week activities to support Indigenous awareness among our people, and hosted events in Sydney and Melbourne for Kinaway and IndigiSpace, organisations that support Indigenous business owners and the development of small businesses by Indigenous people - **Flexible work:** Continued initiatives to promote flexible working, including flexible working resources for our people, and conducted a XeroNow episode on work-life balance - Delivered internal polls and a survey to track flexible working and satisfaction with flexible working at Xero - **Support for parents:** Launched a pilot parental leave coaching program in Australia, and completed a strategic review of current parental leave entitlements across our regions to support the development of a new global parental leave policy in FY21 - **Measuring inclusion:** Delivered surveys to capture feedback on the extent to which employees feel that Xero is an inclusive workplace - **Capability development:** Joined the Diversity Council of Australia

Gender diversity statistics The proportion of women employed by Xero Limited and its subsidiaries (Xero Group) as at 31 March 2020 is shown below:[1]

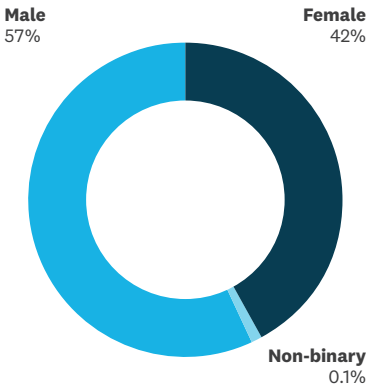
DIRECTORS



LEADERSHIP TEAM



EMPLOYEES



At 31 March	2020 women	2020 men	2020 total	2020 %	2019 women	2019 men	2019 total	2019 %
Directors	3	4	7	43%	3	4	7	43%
Leadership team[2]	5	7	12	42%	5	5	10	50%
Employees	1,292	1,743	3,047[3]	42%	1,060	1,464	2,531	42%

1 *These figures include permanent full-time, permanent part-time, fixed-term, casual employees and interns, and do not include contractors*

2 *Xero's leadership team is defined as the CEO and all senior executives who report directly to the CEO. The leadership team increased from 10 to 12 during the year. The number of women on the leadership team remained unchanged*

3 *Xero has an optional gender identification question that allows employees to choose from the following options: female, male, gender diverse, non-binary, none of the options offered and prefer not to say. At 31 March 2020, 3 employees (0.1%) had selected non-binary and 9 employees (0.3%) had selected none of the options offered or prefer not to say, and are included in the total. 50 employees (1.6%) were excluded from the total because they have not responded to the gender identification question*

WGEA report notification Xero's Australian subsidiary, Xero Australia Pty Limited, submits 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).

Evaluation of the Board

On an annual basis, the Board, with assistance from the Nominations Committee, reviews and evaluates its performance (including against the requirements of the Board Charter) and the performance of 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 internal performance review during FY20. 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, and the appointment, re-election or retirement of directors. A director does not participate in the decision regarding their own re-election.

After considering a number of factors, including the results of the performance reviews, the Board determines whether to endorse the directors who will stand for re-election at the Annual General Meeting (AGM).

Evaluation of the leadership team

The Chair of the Board, with support from the P&R Committee, reviews and makes recommendations 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. The performance criteria against which the executives are assessed are aligned with the financial and non-financial objectives of Xero.

Performance reviews for Xero's leadership team took place for FY20 in accordance with this process. The remuneration outcomes resulting from the performance reviews for the CEO and Chief Financial Officer (CFO) are detailed in pages 98 to 106 of this Annual Report in the Remuneration Report.

PRINCIPLE 2: STRUCTURE THE BOARD TO ADD VALUE

Nominations Committee

Charter The Nominations Committee Charter sets out the Nominations Committee's role to, in summary, assist the Board in relation to Board and Committee size, composition, performance evaluation, succession planning, and director and CEO appointment. The Nominations Committee Charter is available on Xero's website.

The Nominations Committee 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 Committee composition meets these requirements. The Committee meets at least four times per year and all directors have a standing invitation to attend its meetings.

Details about the Nominations Committee membership and meeting attendance are set out in Principle 1 on page 73.

Responsibilities The Nominations Committee's duties and responsibilities include:

- Regularly reviewing and making recommendations to the Board as to the size and composition of the Board and its Committees
- Overseeing the search for, and selection of, new directors for nomination for appointment by the Board
- Making recommendations to the Board regarding the appointment of the CEO, as well as the nomination of directors for election or re-election by shareholders
- Overseeing and regularly reviewing an appropriate director induction program, as well as ensuring all directors have access to a professional development program
- Overseeing the regular assessment of, and making recommendations to the Board as to, the independence of each director and associated disclosures
- Developing succession plans for the Board to maintain an appropriate mix of skills, knowledge, experience, independence and diversity

Director appointment In selecting and appointing new directors, the Board identifies and considers 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. Before appointing a director, Xero undertakes appropriate background checks to determine the candidate's suitability.

Suitable candidates are appointed by the Board and hold office until Xero's next AGM, where they are 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 on the following page. The table summarises the directors' relevant skills as at 3 April 2020.

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 expertise 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 Financial expertise with deep public company experience in finance, accounting, planning and investor relations	
International markets Exposure to at least two of Xero's key international markets (Asia, Americas, EMEA, 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	

High capability *Medium capability*

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 to disclose to the Board relevant personal interests and conflicts of interest on an ongoing basis. 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:

- David Thodey (Chair)
- Mark Cross (commenced 1 April 2020)
- Lee Hatton
- Dale Murray
- Susan Peterson
- Graham Smith (resigned as a director effective 31 March 2020)

The length of service of each director is ascertainable from the information on pages 13 and 14 of this Annual Report.

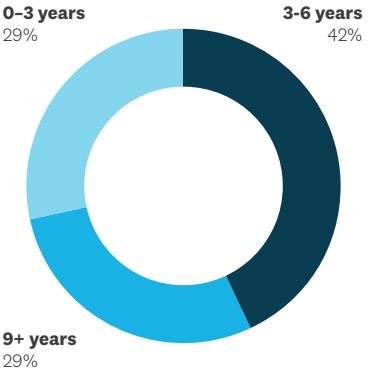
Board composition and Chair

The Board Charter states that the Board will consist of a majority of independent non-executive directors. The Chair of Xero, David Thodey, is assessed as an independent non-executive director. The Chair's role is to, in summary, lead the Board, facilitate constructive discussion at Board meetings, and ensure that the Board functions effectively and communicates the Board's position to shareholders.

Board diversity and tenure

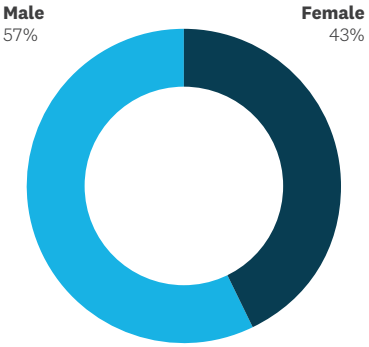
As at 31 March 2020

Tenure

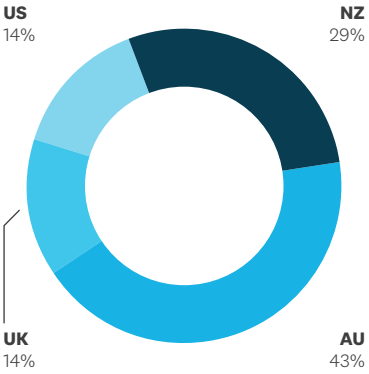


No directors are within the 6-9 year tenure bracket

Gender



Location



Induction

All new Board members are given appropriate induction to enable them 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

Xero has a Code of Conduct (the Code), which applies to all directors, officers, employees, contractors and consultants of the Xero Group. The Code details Xero's standards and values and sets out expectations for behaviour and conducting business at Xero. The Code is underpinned by Xero policies, some of which are global and some of which are country specific, and include topics covering safety and wellbeing, respect and consideration, and workplace behaviour. The Code also sets out Xero's zero-tolerance approach to bribery, facilitation payments, and corruption in any form.

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

Whistleblower Policy

Xero has a Whistleblower Policy, which applies to everyone who currently works or formerly worked at any entity in the Xero Group (including all directors, officers, employees, contractors, consultants, volunteers, interns, casual workers and agency workers) and to any current or former supplier of goods or services (whether paid or unpaid) to any entity in the Xero Group (and their employees). The policy also applies to the relatives, dependants or spouses of any of those people. The policy aims to encourage a culture of openness and accountability within the Xero Group. It includes topics such as the types of concerns that can be raised, how to raise concerns, how whistleblowers will be protected and supported, and how Xero will investigate and deal with any concerns that are raised.

The policy is available on Xero's website and is also made available to employees via Xero's intranet along with supporting information specific to relevant regions.

Modern Slavery and Human Trafficking Statement

Xero has published a statement (under Section 54(1) of the United Kingdom's Modern Slavery Act 2015) setting out the actions that it has taken to understand potential modern slavery risks related to its business and supply chains and to implement steps to prevent slavery and human trafficking (the UK Statement).

The current UK Statement is available on Xero's website.

PRINCIPLE 4: SAFEGUARD INTEGRITY IN CORPORATE REPORTING

Audit and Risk Management Committee

Purpose The ARM Committee Charter (the ARM Charter) sets out the ARM Committee's role to, in summary, assist the Board in relation to financial reporting principles and policies, integrity of Xero's financial statements, audit functions, internal control processes, risk management, and legal and regulatory compliance. The ARM Charter is available on Xero's website.

The ARM Charter provides that the Committee will consist of non-executive directors, be chaired by an independent director and have at least three members, a majority of whom are independent. The ARM Charter also provides that all members will be financially literate, and at least one member will have accounting or related financial management expertise. The Committee composition meets these requirements. The Committee meets at least four times per year and all directors have a standing invitation to attend its meetings.

Details about ARM Committee membership and meeting attendance are set out in Principle 1 on page 73.

Responsibilities The ARM Committee is responsible for providing recommendations and advice to the Board on areas including:

- Reviewing financial statements and financial forecasts intended for external publication and the results of the half-year review and full year audit
- Reviewing Xero's corporate and financial reporting and disclosure processes, as well as Xero's accounting policies and financial reporting practices
- Overseeing the effectiveness of the accounting and internal control systems
- Appointment, reappointment, removal, and remuneration or replacement of the external auditor as well as approving and reporting annually on the fees for and terms of the external auditor's engagement, and on the scope and adequacy of the audit plan of the external auditors
- Reviewing and reporting on the overall adequacy and effectiveness of relevant internal controls, processes and compliance

- Approving and reviewing the structure of the Assurance function, the scope and adequacy of the program of work and reviewing significant assurance findings and action taken by management to address these
- Annually assessing and reviewing the overall adequacy and effectiveness of Xero's risk management framework, the methodology and processes for identifying, assessing, monitoring and managing financial and non-financial risks, and the risk appetite

Reporting The Chair of the ARM 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 ARM 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 current senior audit partner has been serving since FY16 and will be replaced by a new senior audit partner from FY21. 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 AGM.

Declaration regarding financial statements

As a New Zealand domiciled company, section 295A of the Australian Corporations Act 2001 (Cth) is not applicable to Xero. However, the CEO and 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 whether, 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

Continuous Disclosure Policy

Xero's Continuous Disclosure 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, an independent director, the CFO, and the Chief Legal Officer & Company Secretary to support this primary responsibility and provide assurance. Xero's Chief Legal Officer & 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 Executive General Manager of Investor Relations, the Executive General Manager of Communications, the Director of Corporate Communications, and any other person authorised by the CEO.

The policy is available on Xero's website.

PRINCIPLE 6: RESPECT THE RIGHTS OF SECURITY HOLDERS

Shareholder communication

Investor centre Xero's website has a dedicated Investor Centre. This provides important information about Xero and its governance that is relevant to Xero's shareholders. Xero's Investor Centre includes:

- Xero's Board and Committee Charters, policies and Constitution
- Profiles of Xero's directors and leadership team
- ASX releases
- Media releases
- Half and full year financial results and investor presentations
- Links to live webcasts or conference calls for the financial results investor briefings
- Historical financial reports and share price
- Details of Xero's share registry provider, Link Market Services Limited
- An online form to enable investors to send enquiries directly to the Xero investor relations team

Annual Report and other shareholder communications
Alongside the publication of half and full year results, Xero's Annual Report is made available to shareholders electronically (and by post when elected) and includes relevant information about the operations of Xero and other required disclosures. Each shareholder also receives a Notice of Annual General Meeting, inviting them to attend and participate in Xero's AGM.

Investor relations program

Xero has an investor relations function which operates a comprehensive and active investor relations program. The program supports Xero's commitment to ensure its shareholders receive important information in a timely and effective manner and facilitates close dialogue with investors. Activities undertaken as part of the investor relations program include:

- Post-result and ad hoc meetings with institutional investors and analysts
- Attendance at a range of domestic, regional and global investor conferences
- Pre-AGM engagement with our largest beneficial interest holders and the primary governance advisory bodies
- Engagement with the retail investor community through close involvement with shareholder associations

Annual General Meeting

Xero actively encourages shareholders to attend our AGM and to ask questions of the Chair, Board, CEO, CFO and other attending members of Xero's leadership team:

- Shareholders are notified of the AGM in advance of the meeting in accordance with regulatory requirements
- Shareholder voting is conducted via a poll, and shareholders may vote electronically or by proxy
- For the last four years, Xero has held a hybrid AGM, meaning shareholders can attend the meeting in person or virtually via an online platform. If shareholders attend virtually, they are able to watch the meeting live, vote, and ask questions online. Xero's FY20 AGM will be fully virtual via an online platform provided by Xero's share registrar, Link Market Services Limited

PRINCIPLE 7: RECOGNISE AND MANAGE RISK

Audit and Risk Management Committee

Purpose As mentioned in Principle 4 on page 81, the Board has established an ARM Committee that operates under the ARM 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 ARM Committee assists the Board with its oversight of risk management, audit, and compliance.

The ARM Committee operates in accordance with the ARM 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 program, 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 an enterprise risk management framework that is managed by the CFO and overseen by the ARM Committee.

There are several components to Xero's risk management framework including:

- Policies and procedures covering key financial and non-financial risks
- Guidelines and limits for approval of all expenditure, including capital expenditure and investments
- Various risk management governance forums to oversee key areas of risk, including the Security Governance Group
- Due diligence processes for M&A activities

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

The ARM Committee reviews and approves 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, monitors key mitigation actions recorded on the dashboard. The ARM Committee reviewed Xero's overall risk management framework during FY20 and considered that it is sound. During FY20 an Executive General Manager of Risk and Assurance was appointed to oversee and better optimise the operation of the risk management framework and drive further improvements.

Internal audit

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

To maintain independence, the Executive General Manager of Risk and Assurance has a reporting line to the Chair of the ARM Committee and regularly meets with the Chair without other management present. The Assurance function develops an assurance plan which is endorsed by the ARM Committee twice per 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 operates in an online environment, with its operational model primarily utilising office-based employees. Accordingly, Xero's environmental footprint is relatively small and is made up largely from the energy used in its offices, third-party data centres, employee travel, and from the typical consumables of an online, office-based business. However, we acknowledge that how we conduct our business has an impact on a range of stakeholders, the communities in which we operate, and on the environment more broadly. More information about our approach to social and environmental impact is available on Xero's website at www.xero.com/au/about/social-and-environmental-impact.

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 protects returns. Key areas of risk are described below. Other risks relevant to economic sustainability are noted on pages54 to 58 of this Annual Report in the Notes to the Financial Statements.

Technology platform & information 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 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' information 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 security training and awareness.

Xero takes a risk-based approach to security, which means tighter security controls are implemented where risk to the business and our customers 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.

Xero maintains a robust security management program, including a comprehensive information security management system which is audited annually by an accredited and independent external auditor. As part of our commitment to information security, Xero has successfully maintained an ISO/IEC 27001 Information Security Certification for the past two years. Xero has also produced a Service Organization Control 2 (SOC 2) type II report annually for the past four years, which is the result of an independent assessment of controls in place for security, confidentiality, and availability.

Xero hosts its data in Amazon Web Services (AWS) in US locations. All locations have the same security measures to protect Xero's and our customers' information.

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

- Executive General Manager of Security, accountable for information security
- Security strategy, which is communicated to the Board by Xero's leadership team
- An internal security governance group, which meets regularly and has Xero leadership team representation
- An information security risk management framework
- Formalised security policy and security standards
- Business continuity management policy and plans
- Security awareness training is conducted at least annually
- Data Classification Standards are regularly communicated to our employees, which incorporate the understanding of the sensitivity of data that is dealt with as part of business activities

Data protection Xero has a global data protection framework and privacy program in place. Xero's data protection framework enables management of all personal data collected in compliance with regulations in regions where Xero operates. Our approach to data protection is built around four key principles – transparency, enablement, stewardship and security.

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 Board oversight, 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, providing Xero with a competitive advantage.

Xero proactively aligns its teams with its strategy to more rapidly and efficiently advance Xero's 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 model needs to constantly evolve to serve more 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

Charter The P&R Committee Charter (the P&R Charter) sets out the P&R Committee's role to, in summary, assist the Board in relation to overseeing the human resources activities of Xero, including overseeing strategies and policies relating to organisational structure and culture, remuneration, employee performance and development, and succession planning of Xero's leadership team (other than the CEO). The P&R Charter is available on Xero's website.

The P&R 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 Committee composition meets these requirements. The Committee meets at least four times per year and all directors have a standing invitation to attend its meetings.

Details about P&R Committee membership and meeting attendance are set out in Principle 1 on page 73.

Responsibilities The P&R Committee's duties and responsibilities include:

- Overseeing appointment, termination, performance and succession planning of Xero's leadership team (other than the CEO)
- Reviewing and recommending to the Board Xero's remuneration strategy, structure and policy, and short and long-term incentive plans, including amendments to such plans and other material employee benefits
- Annually making recommendations to the Board about measurable objectives for achieving diversity and assessing the effectiveness of the Diversity and Inclusion Policy, measurable objectives for diversity and the progress toward achieving them

More information about our approach to remuneration is set out on pages 94 to 111 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 FY20 are to the financial year ended 31 March 2020. References to FY19 are to the financial year ended 31 March 2019. Xero Group means Xero Limited (Xero) and its subsidiaries.

EQUITY HOLDINGS OF DIRECTORS, CEO & CFO

At 31 March 2020	Number of ordinary shares (Shares)	Number of unlisted options (Options)	Number of restricted stock units (RSUs)
Non-executive directors			
David Thodey[1]	4,461	–	–
Rod Drury[2]	15,719,779	–	–
Lee Hatton	9,378	–	–
Dale Murray	950	–	–
Susan Peterson	2,630	–	–
Graham Smith	–	–	–
Craig Winkler[3]	9,275,990	–	–
CEO & CFO			
Steve Vamos	10,500	180,000	18,118
Kirsty Godfrey-Billy[4]	1,884	120,000	1,261

1 *Shares are held by Aspiring Co Pty Limited on behalf of the Thodey Family Trust. David Thodey is a director of Aspiring Co Pty Limited and the beneficiaries of the Thodey Family Trust are the immediate family members of David Thodey*

2 *Shares are held by Rodanna Ventures Trust. The trustees of the Rodanna Ventures Trust are Rodney Kenneth Drury, Anna Margaret Clare Drury, and Scott Moran. The beneficiaries of the Rodanna Ventures Trust are the immediate family members of Rodney Kenneth Drury and Anna Margaret Clare Drury*

3 *8,254,545 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 Xero's convertible notes issue, as disclosed to the Australian Securities Exchange (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 *The 1,261 RSUs will vest (be converted to Shares) in May 2020*

ENTRIES RECORDED IN THE INTERESTS REGISTER

Xero maintains an interests register in accordance with the Companies Act 1993 (New Zealand).

Directors' interests

Directors disclosed the following relevant interests, or cessations of interest, during FY20.

Director/Entity	Relationship
David Thodey	
Commonwealth Scientific and Industrial Research Organisation (CSIRO)	chair and director
National COVID-19 Coordination Commission (NCCC)[1]	deputy chair
Ramsay Health Care Limited	director
Tyro Payments Limited	chair and director
Vodafone Group Plc	director
Mark Cross*	
Chorus Limited	director
MFL Mutual Fund Limited / Superannuation Investments Limited	chair and director
Milford Asset Management Limited	chair and director
Z Energy Limited	director
Lee Hatton	
BLD Group Pty Limited	ceased to be a director
National Australia Bank Limited	ceased to be chief executive officer of UBank and executive general manager of direct banking
Suncorp Group Limited	chief executive officer of banking and wealth division
Dale Murray	
Founders Intelligence Ltd	partner
Obelisk Legal Support Solutions Limited	ceased to be an advisor
Sussex Place Ventures Limited	ceased to be a director
The Cranemere Group Limited	director

1 Finite commitment, at the request of the Australian Government, to advise on Australia's economic and social response to COVID-19

** Commenced 1 April 2020*

Share dealings of directors

Directors disclosed the following acquisitions or disposals of relevant interests in Xero Shares during FY20.

Registered holder	Date of acquisition/ disposal	Consideration per Share (AUD)	Number of Shares acquired/ (disposed)
David Thodey			
Aspiring Co Pty Limited[1]	5 July 2019	$62.96	4,000
Aspiring Co Pty Limited[1]	11 October 2019	$66.24	138
Aspiring Co Pty Limited[1]	14 October 2019	$67.67	170
Aspiring Co Pty Limited[1]	15 October 2019	$68.63	153
Rod Drury			
Rodanna Ventures Trust[2]	21 May 2019	$58.00	(2,000,000)
Lee Hatton			
Lee Hatton[3]	22 May 2019	$56.20	780
Lee Hatton[4]	13 November 2019	$70.52	746
Susan Peterson			
Susan Peterson	6 August 2019	$59.00	803
Craig Winkler			
Givia Pty Limited[5]	23 May 2019	$59.72	(650,000)
Givia Pty Limited[5]	27 May 2019	$60.00	(100,000)
Givia Pty Limited[5]	11 November 2019	$75.00	(3,000,000)
Bill Veghte[6]			
William Lewis Veghte[7]	22 May 2019	$56.20	2,164
William Lewis Veghte[8]	19 July 2019	$61.88	915

1 *Shares are held by Aspiring Co Pty Limited on behalf of the Thodey Family Trust. David Thodey is a director of Aspiring Co Pty Limited and the beneficiaries of the Thodey Family Trust are the immediate family members of David Thodey*

2 *Shares are held by Rodanna Ventures Trust. The trustees of the Rodanna Ventures Trust are Rodney Kenneth Drury, Anna Margaret Clare Drury, and Scott Moran. The beneficiaries of the Rodanna Ventures Trust are the immediate family members of Rodney Kenneth Drury and Anna Margaret Clare Drury*

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, 0.001%*

4 *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, 0.001%*

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 Pty Limited*

6 *Resigned as a director of Xero effective 15 August 2019*

7 *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, 0.002%*

8 *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, 0.001%*

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 subsidiaries for potential liabilities and costs they may incur for acts or omissions in their capacity as directors or officers of Xero or its subsidiaries, to the extent permitted by law.

REMUNERATION REPORTING

Xero's remuneration policy and practices are summarised on pages 94 to 111 of this Annual Report.

SHAREHOLDER INFORMATION

The shareholder information set out below is current as at 3 April 2020, unless otherwise specified.

Issued capital The total number of issued Shares in Xero at 31 March 2020 was 141,851,409, of which 339,176 Shares were held on a restricted basis in connection with Xero's share-based compensation plans.

Distribution of shareholding

Range	Number of holders	%	Shares	%
1 to 1,000	23,028	88.64	5,229,991	3.69
1,001 to 5,000	2,457	9.46	5,163,082	3.64
5,001 to 10,000	269	1.04	1,930,400	1.36
10,001 to 100,000	196	0.75	5,063,580	3.57
100,001 and over	28	0.11	124,511,568	87.75
Total	**25,978**	**100**	**141,898,621**	**100**

There were 514 holders of less than a marketable parcel of Shares as at 3 April 2020, based on a market price of AUD $65.66 per Share.

RSUs and Options There were 52 individuals holding a total of 2,860,873 Options and 1,746 individuals holding a total of 317,196 RSUs. RSUs are a conditional contractual right to be issued an equivalent number of Shares in Xero.

Substantial holdings and limitations on the acquisition of securities Xero is a New Zealand incorporated and domiciled company listed on the 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 and certain provisions of the Financial Markets Conduct Act 2013 (New Zealand) also apply to Xero (including in relation to financial reporting, but not including the provisions relating to substantial shareholdings).

There is no requirement on Xero's substantial shareholders to provide substantial product holder notices to Xero. Xero has not received any such notices during FY20.

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 Shares as at 3 April 2020 are listed below.

	Shares	
Name	**Number held**	**% of issued capital**
1. HSBC Custody Nominees (Australia) Limited	32,569,591	22.95
2. J P Morgan Nominees Australia Limited	27,704,696	19.52
3. Rodney Kenneth Drury & Anna Margaret Clare Drury & Scott Moran	15,719,779	11.08
4. Citicorp Nominees Pty Limited	12,939,515	9.12
5. Givia Pty Limited	8,254,545	5.82
6. HSBC Custody Nominees (Australia) Limited - GSCO ECA	7,367,903	5.19
7. National Nominees Limited	4,410,523	3.11
8. BNP Paribas Noms Pty Ltd <DRP>	2,207,778	1.56
9. Custodial Services Limited <Beneficiaries Holding A/C>	1,869,148	1.32
10. JBWere (NZ) Nominees Limited <56968 A/C>	1,745,207	1.23
11. BNP Paribas Nominees Pty Ltd <Agency Lending DRP A/C>	1,617,717	1.14
12. Citicorp Nominees Pty Limited <Colonial First State Inv A/C>	1,522,962	1.07
13. Nelson Nien Sheng Wang & Pei-Chun Ko <Wang Family A/C>	1,138,688	0.80
14. Solium Nominees (Australia) Pty Ltd <VSA A/C>	913,800	0.64
15. Australian Foundation Investment Company Limited	870,500	0.61
16. HSBC Custody Nominees (Australia) Limited - A/C 2	664,962	0.47
17. HSBC Custody Nominees (Australia) Limited <NT-Comnwlth Super Corp A/C>	535,556	0.38
18. BNP Paribas Nominees Pty Ltd <IB AU Noms Retail Client DRP>	465,706	0.33
19. BNP Paribas Noms (NZ) Ltd <DRP>	286,780	0.20
20. W5 Limited	270,000	0.19
Top 20 holders of fully paid Shares (total)	**123,075,356**	**86.73**
Other shareholders (balance on register)	18,823,265	13.27
Grand total	**141,898,621**	**100.00**

Voting rights Xero has a single class of Shares on issue. Where voting at a meeting of shareholders is by voice or a show of hands, every shareholder present in person, or representative, has one vote. On a poll, every shareholder present in person, or by representative, has one vote for each fully paid Share. In practice, Xero ensures that all resolutions at shareholder meetings are decided by a poll rather than a show of hands.

On-market buy-back There is no current on-market buy-back for Xero Shares.

COMPANY INFORMATION

Donations The Xero Group made charitable donations totalling $109,158 during FY20. The Xero Group made no donations to political parties during FY20.

Company directors The following persons held office as directors of Xero Limited during FY20.

Directors	Directors who ceased to hold office during FY20
David Thodey (Chair)	Bill Veghte (resigned effective 15 August 2019)
Rod Drury	
Lee Hatton	
Dale Murray	
Susan Peterson	
Graham Smith	
Craig Winkler	

Company subsidiaries and directors Xero has 14 wholly owned subsidiaries as shown in the table below. The following persons held office as directors of Xero's subsidiary companies during FY20.

Jurisdiction	Subsidiary	Directors	Directors who ceased to hold office during FY20
Australia	Hubdoc Pty Limited	Kirsty Godfrey-Billy Trent Innes Chaman Sidhu	
	Xero Australia Pty Limited	Kirsty Godfrey-Billy Trent Innes Chaman Sidhu	
Canada	Hubdoc Inc.	Will Buckley Andy Burner Kirsty Godfrey-Billy	Keri Gohman (resigned effective 27 August 2019) James McDonald (resigned effective 25 March 2020) James Shulman (resigned effective 25 March 2020)
	Xero Software (Canada) Ltd	Will Buckley Andy Burner Kirsty Godfrey-Billy	Keri Gohman (resigned effective 27 August 2019)
Hong Kong	Xero (HK) Limited	Kevin Fitzgerald Kirsty Godfrey-Billy Damien Tampling	
New Zealand	Xero Investments Limited	Anna Curzon Kirsty Godfrey-Billy Craig Hudson	
	Xero (NZ) Limited	Anna Curzon Kirsty Godfrey-Billy Craig Hudson	
	Xero Trustee Limited	Kirsty Godfrey-Billy	
Singapore	Xero (Singapore) Pte. Ltd	Kevin Fitzgerald Kirsty Godfrey-Billy Damien Tampling	
South Africa	Xero South Africa (Pty) Ltd	Kirsty Godfrey-Billy Colin Timmis Gary Turner	

United Kingdom	Cicerone Limited	Anna Curzon Kirsty Godfrey-Billy Gary Turner	
	Hubdoc (UK) Limited	Damon Anderson Kirsty Godfrey-Billy Gary Turner	Anna Curzon (resigned effective 16 October 2019) Edward Berks (resigned effective 1 December 2019)
	Xero (UK) Limited	Damon Anderson Kirsty Godfrey-Billy Gary Turner	Anna Curzon (resigned effective 16 October 2019) Edward Berks (resigned effective 1 December 2019)
United States	Xero, Inc.	Kirsty Godfrey-Billy	Keri Gohman (resigned effective 27 August 2019)

There were no changes to the interests of directors of Xero's subsidiaries during FY20.

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 110 of this Annual Report.

Annual General Meeting Xero's AGM will be held on Thursday, 13 August 2020 and will be fully virtual via an online platform provided by Xero's share registrar, Link Market Services Limited. Further details in relation to the AGM will be released in a notice of meeting at the relevant time.

Remuneration Report

In this report

Introduction

We are pleased to present this report, which is intended to provide greater clarity about the ways we seek to reward and recognise the contribution our Xero teams are making to the success of small businesses and their advisors around the world. Our approach to reward and recognition is designed to support Xero's purpose and the successful delivery of our strategy.

This report outlines the principles, approach and structure of Xero's remuneration of directors, CEO Steve Vamos, and CFO Kirsty Godfrey-Billy, and how they align with Xero's purpose, values, strategy, and financial results. We also provide details on how Xero's performance in the financial year ended 31 March 2020 (FY20) has driven remuneration outcomes for our CEO and CFO.

Xero's FY20 performance included strong top-line growth, a first ever full-year net profit after tax, and a positive free cash-flow result. However, the global operating environment changed dramatically in March as COVID-19 escalated around the world, and some of the steps taken by Xero to support customers resulted in reduced performance against FY20 financial targets.

This is reflected in moderate performance against short-term incentive (STI) targets for the CEO and CFO.

In recognition of the global COVID-19 crisis, we are conscious of the challenges and uncertainties that we, along with many organisations, face with respect to business performance and remuneration. We will continue to monitor and review the appropriateness of our remuneration approach and outcomes in this unprecedented environment.

In the interest of providing greater transparency and insight into our remuneration practices, this report goes beyond what we are required to disclose as a New Zealand incorporated company. We welcome feedback on this report.

Remuneration strategy

Our purpose and values

Xero's purpose is to make life better for people in small business, their advisors and communities around the world. Our purpose is underpinned by five values that are fundamental to everything we do.

Human
Xeros are authentic, inclusive and really care

Kind and assume best intent

Inclusive, approachable and show empathy

Are willing to be vulnerable, share fears, failures and learnings

Challenge
Xeros dream big, lead and embrace change

Are curious and think big

Welcome challenging conversations and do it with respect

Lead and embrace change, seeking new and better ways

Team
Xeros are great team players

Champion Xero's purpose and priorities

Work together to do what's best for Xero and our customers

Appreciate and celebrate each other and success

Ownership
Xeros deliver on our commitments

Do what we say we will do

Own our mistakes and take positive action

Move fast to get the right things done

Beautiful
Xeros create experiences that people love

Create experiences that inspire and delight

Do high-quality work

Go the extra mile

Our remuneration principles are designed to ensure our remuneration strategy links closely to Xero's purpose by driving alignment with Xero's strategy and values.

Xero's remuneration framework is designed to attract and retain best-in-class talent through a remuneration structure that:

- ensures alignment with business strategy
- supports sustainable long-term value creation for shareholders
- supports appropriate risk management

Remuneration principles

As a global technology company, Xero is dependent on highly skilled, specialist employees to implement our strategy. Our ability to attract, retain, reward, and motivate our people is fundamental to our long-term success.

Our executive remuneration framework has been carefully and purposefully developed to enable this by offering:

- Market competitive fixed remuneration
- Short-term incentives based on challenging individual and company-wide targets, with a deferred equity component
- A long-term, options-based equity plan that is aligned with Xero's long-term strategy

This framework is designed to conserve cash so we can prioritise investment in Xero's growth. The high proportion of equity within the remuneration structure, and the application of options as an equity instrument, continues to attract highly skilled people. It also aligns executive performance with shareholder interests and rewards the effective execution of Xero's strategic plan over a multi-year period. Each remuneration principle is reflected in our remuneration structure as follows:

Alignment: A significant proportion of executive remuneration is contingent on share price, ensuring Xero executives receive rewards that mirror shareholder outcomes

Fairness: Market competitive up-front cash-based remuneration is balanced by equity remuneration with significant potential upside. Value creation for shareholders is matched by value creation for employees

Collaboration: Performance conditions are largely company-wide focused, with a less significant individual component. Emphasis on delivering against Xero's strategic objectives via a significant equity component ensures Xero's people must collaborate to drive personal rewards

Simplicity: There are no complicated long-term performance measures that require extensive explanation or to which the executives do not have a direct line of sight – the structure simply incentivises long-term value creation. Short-term measures are aligned with the voices of the shareholder, customer and employee

Flexibility: Xero's short-term performance measures combined with long-term options strike the right balance between ensuring that Xero executives have sufficient flexibility to respond to changing needs and circumstances, while always having regard to Xero's strategy, long-term vision, and long-term value creation

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 that is aligned to our overall strategy.

Component	Description	Link to strategy and performance
Fixed annual remuneration (FAR)	• Base salary • Retirement benefits (superannuation / KiwiSaver or local equivalent)	Reviewed annually based on individual skills, experience, accountabilities, performance, leadership and behaviours
Short-term incentive (STI)	• An at-risk component set as a percentage of base salary • Calculated based on achievement against a range of company-wide performance measures (financial and non-financial) and individual objectives • Paid after a one-year performance period (1 April to 31 March, aligned with Xero's financial year). STI comprises 50% cash and 50% deferred equity in the form of restricted stock units (RSUs). Deferred equity vests one year after grant, subject to continuing employment and confirmation that no award adjustment events have occurred	Rewards delivery of key strategic and financial objectives, in line with the annual business plan, and rewards outcomes aligned to Xero's goals for growth and operational discipline Organisational measures are approved by the People and Remuneration Committee and aligned with the strategic objectives of Xero
Long-term incentive (LTE)	• 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 • 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 • Vesting is subject to continuing employment, which provides an additional time-based retention incentive, and confirmation that no award adjustment events have occurred	Rewards delivery against longer-term strategy and sustained shareholder value creation. Provides alignment between shareholder and executive outcomes

Malus and clawback

All executive variable remuneration is subject to malus and clawback in certain award adjustment events, including the following:

- where an executive has acted fraudulently or dishonestly or is in material breach of their obligations to Xero;
- 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

Remuneration benchmarking

Executive remuneration is benchmarked to a specific S&P/ASX100 peer group that is determined to be similar to Xero in terms of operations. Each year, the peer group is reviewed and updated. Xero's People and Remuneration Committee (P&R Committee), in partnership with an external consultant, conducts a comparative analysis of the executive team's compensation against reported roles within that identified peer group.

Xero's performance

Xero's financial results over the last five years are shown below:

Measure	FY16	FY17	FY18*	FY19	FY20
Subscribers	717,000	1,035,000	1,386,000	1,818,000	2,285,000
Annualised Monthly Recurring Revenue	$257,925,000	$359,669,000	$484,421,000	$638,179,000	$820,557,000
Operating Revenue*	$207,060,000	$295,389,000	$406,659,000	$552,819,000	$718,231,000
Free Cash Flow*	($88,590,000)	($70,831,000)	($28,513,000)	$6,451,000	$27,105,000

**Operating Revenue and Free Cash Flow for FY18 has been restated for changes in NZ IFRS 9, NZ IFRS 15, and NZ IFRS 16. FY16 and FY17 have not been restated*

Xero's share price, total shareholder return, and the ASX100 index return over the last five years are shown below:

Measure	FY16	FY17	FY18	FY19	FY20
Xero Share Price (AU$)*	13.95	18.10	33.44	48.65	67.91
Xero Total Shareholder Return	-40.18%	29.75%	84.75%	45.48%	39.59%
ASX100 Total Shareholder Return	-8.95%	22.78%	3.08%	14.16%	-12.60%

* *Closing price for the last trading day in the financial year*

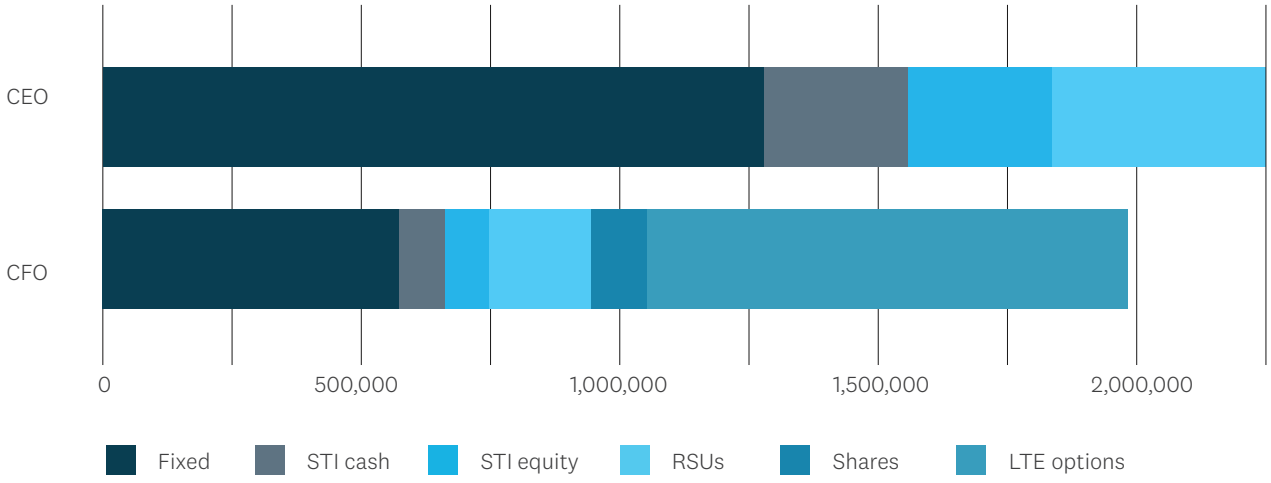
Remuneration outcomes overview

Headline remuneration outcomes for Xero's CEO and CFO are disclosed in the graph below on a realisable basis for FY20, including:

- Fixed annual remuneration
- Realisable cash and deferred RSU STI awarded based on FY20 performance, with deferred RSUs yet to be granted and vest pending service. 81.8 percent of target STI (56.4 percent of maximum) was awarded to each of the CEO and CFO. 50 percent is paid in cash and 50 percent deferred into RSUs to vest one year post grant
- Value of the CEO's one-off performance-based RSUs that vested during the year ended 31 March 2020. 110% of target RSUs were awarded (55 percent of maximum), with one-third vesting this year
- Value of the CFO's one-off service-based RSUs and shares that vested during the year ended 31 March 2020. All of the RSUs and shares vested
- Value of the CFO's options that vested during the year ended 31 March 2020. 20,000 options from a legacy grant in 2016 vested for the CFO this year

Further details on the CEO's and CFO's STI outcomes are presented on page 105.

Further details on the CEO's and CFO's other remuneration elements and outcomes for the year are included in on page 102.



Directors and senior executives

This report focuses on the remuneration of Xero's directors, CEO and CFO in FY20 as identified in the table below.

	Country of residence	Position	Period position was held during the year
Executive			
Steve Vamos	New Zealand	CEO	Full year
Kirsty Godfrey-Billy	New Zealand	CFO	Full year
Non-executive directors			
David Thodey	Australia	Independent non-executive Chair	Appointed as director 27 June 2019. Appointed Board Chair effective 1 February 2020
Rod Drury	New Zealand	Founder, non-executive director	Full year
Lee Hatton	Australia	Independent non-executive director	Full year
Dale Murray, CBE	United Kingdom	Independent non-executive director	Full year
Susan Peterson	New Zealand	Independent non-executive director	Full year
Craig Winkler	Australia	Non-executive director	Full year
Former			
Bill Veghte	United States	Independent non-executive director	Ceased as director effective 15 August 2019
Graham Smith	United States	Independent non-executive Chair	Ceased as director effective 31 March 2020

Remuneration governance

Xero's remuneration governance framework is managed by the P&R Committee on behalf of the Board. The P&R Committee is tasked with ensuring that Xero's remuneration practices are aligned with Xero's strategic objectives and consistent with Xero's remuneration principles and risk appetite. The P&R Committee has regard to the interplay between remuneration structures and risk when designing structures and setting and determining remuneration outcomes.

Role of the People and Remuneration Committee

The P&R Committee operates under a charter, which is available on Xero's website at www.xero.com/about/investors/governance. The P&R Committee oversees Xero's strategies and policies relating to:

- Organisational structure and culture
- Remuneration
- Employee performance and development
- Succession planning for direct reports to the CEO (succession planning for the CEO is managed by the Nomination Committee)

The P&R Committee provides strategic, structural and policy oversight of remuneration, employee performance and culture for the general Xero workforce, making recommendations to the Board regarding HR policies, remuneration budgets, employee incentive plans, and material employee benefits.

The P&R Committee's oversight of the remuneration of the CEO and direct reports involves closer scrutiny of remuneration quantum and performance outcomes, including developing independent recommendations for CEO remuneration increases and performance outcomes to be presented to the Board.

The P&R Committee seeks input from management where appropriate and also engages the services of independent advisors from time to time to inform decisions.

People and Remuneration Committee independence

Consistent with the ASX Corporate Governance Principles and Guidelines, the P&R Committee consists of three members, the majority of whom are independent, including the Chair. The current membership comprises:

- Susan Peterson (Chair)
- David Thodey
- Craig Winkler

Other members of the Board, the CEO and members of Xero's leadership team may be invited to attend meetings of the P&R Committee where appropriate.

The P&R Committee considers all proposals to award variable remuneration to executives, including recommended cash STI payments and awards of deferred equity, awards of LTE, and any upcoming vests to determine whether there is an award adjustment event (see malus and clawback section on page 96).

External and independent advice

During the year, the P&R Committee engaged the services of independent external consultants to provide guidance on Xero's remuneration framework to ensure it remains fit for purpose given Xero's current and expected growth trajectory.

The engagement of independent external consultants ensured the P&R Committee did not receive advice solely from management or advisors who also received significant fees from additional work commissioned by management.

No protection arrangements

Xero's Securities Trading Policy prohibits employees and directors from entering into transactions that are intended to hedge or otherwise limit the economic risk of unvested or restricted Xero securities.

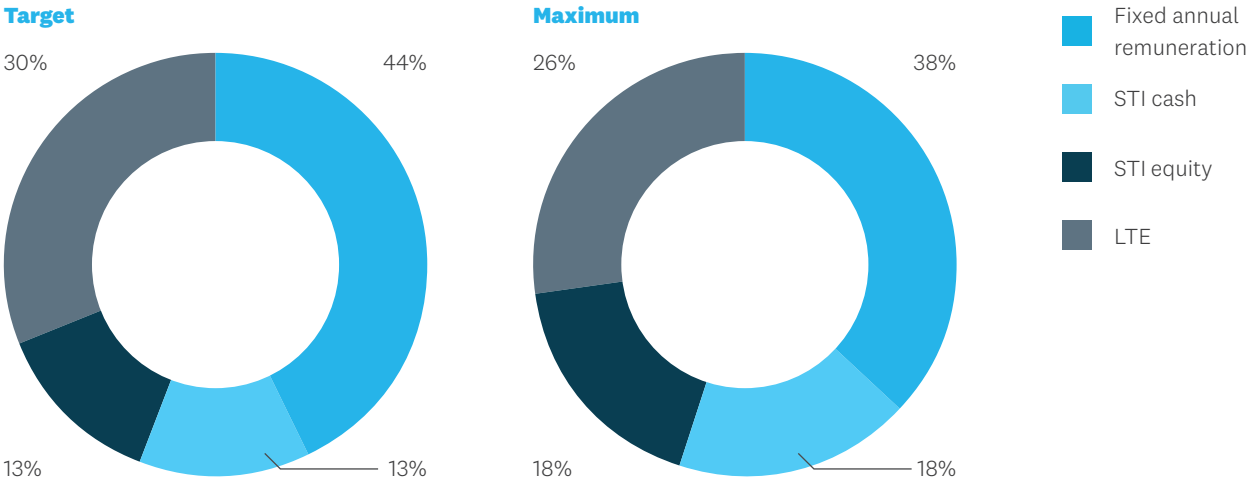
A copy of Xero's Securities Trading Policy is available on Xero's website at www.xero.com/about/investors/governance

Key remuneration components for the CEO and CFO

Further detail is outlined below on how the remuneration structure described on page 96 applies to the CEO and CFO.

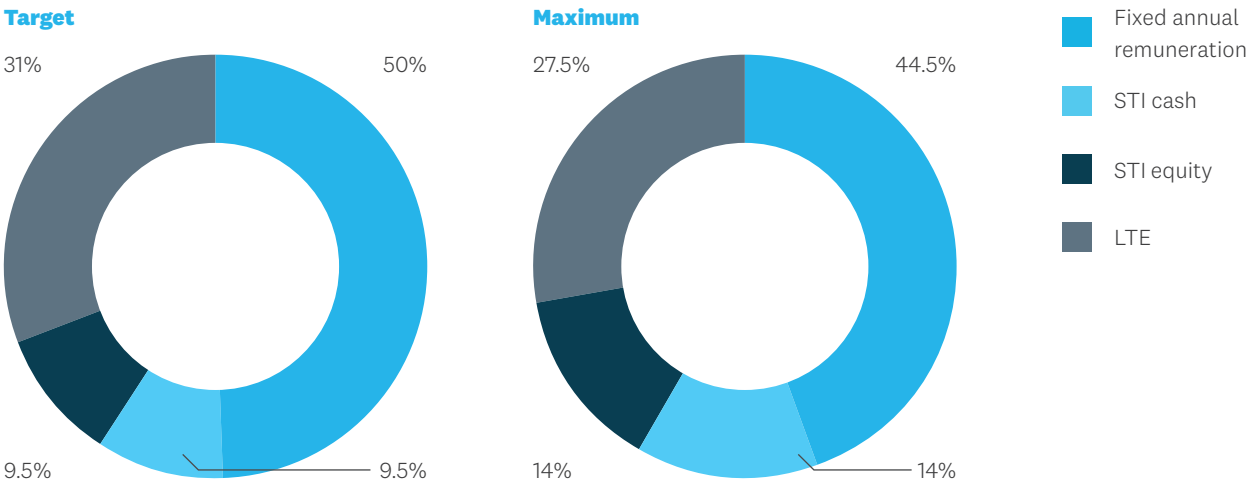
CEO remuneration mix

The CEO's remuneration mix is as follows.



CFO remuneration mix

The CFO's remuneration mix is as follows.



Fixed annual remuneration (FAR)

Fixed annual remuneration is set in the context of Xero's wider, growth-orientated remuneration strategy and considers an individual executive's skills, experience, accountabilities, performance, leadership and behaviours.

For the CEO, the FY20 remuneration review process resulted in his base salary increasing to $1,145,000 from 1 April 2019. There was also a change in payment currency from Australian currency to New Zealand dollars.

For the CFO, the FY20 remuneration review process resulted in her base salary increasing to $550,000 from 1 April 2019.

Element	Details
Components	Base salary Retirement benefits (superannuation, KiwiSaver or local equivalent)
Process	Set and reviewed annually based on individual skills, experience, accountabilities, performance, appropriate benchmarks, leadership and behaviours

At risk – short-term incentive (STI)

STI is an at-risk component of remuneration that is structured to reward progress towards and alignment with Xero's strategic and financial objectives together with creation of value for customers, employees and shareholders in the financial period. STI incentive payments are set as a percentage of base salary, based on level of responsibility and country of residence.

STI is calculated based on achievement against a range of organisational performance measures (financial and non-financial) and individual objectives. STI payments comprise 50% cash and 50% deferred equity in the form of restricted stock units (RSUs).

Element	Details
Purpose	Focus participants on delivery of business objectives over a one-year period
Target opportunity (% base salary)	CEO 60%, CFO 40%
Maximum opportunity (% base salary)	CEO 87%, CFO 58%
Performance period	Performance is measured from 1 April to 31 March
Performance measures	Performance metrics measure success in relation to our key stakeholders, reflecting the voice of employee, customer and shareholder
Financial objectives (60%)	Financial objectives reflect the "voice of shareholder" - cash flow and net new monthly recurring revenues (MRR) targets
Non-financial objectives (40%)	Non-financial metrics are based on: • Voice of Customer – Partner and small business net promoter score (NPS) targets • Voice of employee – Employee NPS and engagement targets • Individual objectives – Goals aligned to company strategic objectives
Pay vehicle	50% of STI awarded is paid in cash with the remaining 50% issued in RSUs
Vesting conditions	RSUs vest one year from grant date, subject to continued service for both executives

The STI performance metrics have been chosen as they focus the CEO and CFO on growing the global subscriber base and creating valued customer experiences while at the same time maintaining operational discipline.

The targets set at the beginning of each financial year are reviewed and approved by the P&R Committee and are aligned to our longer-term strategic objectives.

Performance against financial and non-financial objectives is determined at the end of the financial period after review of executive performance by the CEO, in consultation with the P&R Committee (and in the case of the CEO, by the Board).

At all times the Board retains discretion over any variable payments made and such payments are supported by the P&R Committee which applies a qualitative overview of outcomes to ensure an appropriate balance is always maintained. This ensures there is not undue emphasis on short-term results at the expense of our longer-term vision.

The CEO, Chief People Officer and P&R Committee review and approve all upcoming incentive payments and equity vests to ensure there is not any reason for withholding.

At risk – long-term incentive (LTE)

LTE is an at-risk component of executive remuneration that is structured to reward the effective execution of Xero's strategic plan over a multi-year period.

Element	Details
Purpose	Rewards delivery against longer-term strategy and sustained shareholder value creation. Provides alignment between shareholder and executive outcomes and time-based retention through multi-year vesting
Maximum opportunity (% base salary)	CEO 72%, CFO 64%
Pay vehicle	Options with an exercise price based on the 20-day VWAP leading up to grant date. Options lapse five years from grant date
Grant date	Options were granted to the CEO in August 2018 and CFO in June and October 2018
Vesting conditions	For the CEO, options vest in two equal tranches in each of the third and fourth years after grant. For the CFO, options vest in three equal tranches in each of the second, third and fourth years after grant. Vesting is contingent upon continued service for both executives

The CEO was invited to participate in the LTE plan from August 2018. As an offset to his existing RSU grants outlined on page 104 below, the total number of options granted to the CEO under the LTE was reduced by 25 percent and vesting in June 2020 was foregone.

Legacy CEO and CFO equity arrangements

Details of other equity grants made to the CEO and CFO before the current LTE was adopted are outlined below.

Legacy CEO equity arrangements

Element	Details
Purpose	Focus participant on delivery of business objectives over a one-year period and provide time-based retention through multi-year vesting
Target opportunity (% base salary)	70%
Maximum opportunity (% base salary)	140%
Performance period	Performance was measured from 1 April 2018 to 31 March 2019
Performance measures	The performance metrics were as follows: Revenue growth 40 percent MRR 40 percent EBITDA 20 percent
Pay vehicle	RSUs
Grant details	A total of 32,658 RSUs were issued in April and June 2018 to account for maximum performance. Following confirmation of achievement against targets, 12,276 RSUs were forfeited, leaving 20,382 RSUs to vest.
Vesting conditions	Shares vest in three equal tranches in May 2019, 2020 and 2021. Vesting is contingent upon continued service
Outcome	The first tranche of 6,794 RSUs vested in May 2019. The second and third tranches of 6,794 and 6,794 RSUs will vest in May 2020 and May 2021

Legacy CFO equity arrangements

Legacy CFO Options

Element	Details
Purpose	Executive team retention plan intended to reward delivery against longer-term strategy and sustained shareholder value creation. Provides alignment between shareholder and executive outcomes and time-based retention through multi-year vesting
Pay vehicle	Options with an exercise price based on the 20-day VWAP leading up to grant date. Options lapse five years from grant date
Grant details	80,000 options were granted in June 2016
Vesting conditions	Options vest in four equal tranches at each 12-month anniversary of the grant date. Vesting is contingent upon continued service
Outcome	Tranches of 20,000 options vested in June 2017, 2018 and 2019. The final tranche of 20,000 options will vest in June 2020

Legacy CFO RSUs

Element	Details
Purpose	Retention of executives during CEO transition
Pay vehicle	RSUs
Grant details	3,051 RSUs were granted in April 2018
Vesting conditions	Vesting is contingent upon continued service
Outcome	All RSUs vested in May 2019

Legacy CFO shares

Element	Details
Purpose	Company-wide long-term incentive plan incorporating time-based retention through multi-year vesting
Pay vehicle	Restricted shares
Grant details	1,359 shares were granted in July 2017
Vesting conditions	Vesting is contingent upon continued service
Outcome	All shares vested in March 2020

STI outcomes in detail

The annual outcomes achieved for CEO and CFO are based on Xero's FY20 performance as follows:

Objectives	Weighting	Outcome				
		Threshold	Target	Maximum	Outcome (% of target)	Outcome (% of max)
Company Objectives						
Voice of the shareholder[1]	60%				78.0%	44.6%
Voice of the customer	10%				50.0%	50.0%
Voice of the employee	10%				100.0%	100.0%
Total Company Objectives					61.8%	49.4%
Individual Objectives						
CEO individual targets	20%				100.0%	100.0%
CFO individual targets	20%				100.0%	100.0%
Total CEO Outcome					81.8%	56.4%
Total CFO Outcome					81.8%	56.4%

1 *For the voice of the shareholder component, there is the ability to out-perform up to 200% on the net new MRR measure*

CEO and CFO remuneration

The following table provides details of the actual remuneration received by the CEO and CFO, in the years ended 31 March 2020 and 31 March 2019.

	Fixed remuneration			Variable remuneration[1]				
				Accounting value of grants vested during the year, in the form of:			Additional value of all grants vested in the year, attributable to share price appreciation ($000s)	Total remuneration received inclusive of share price appreciation ($000s)
	Salary ($000s)	Superannuation/ KiwiSaver ($000s)	Other[2] ($000s)	Cash STI ($000s)	Option/ Share grants ($000s)	RSU grants ($000s)		
S Vamos 2020	1,145	54	79[3]	270	-	246	167	1,960
S Vamos[4] 2019	1,013[5]	54	-	-[6]	-	-	-	1,067
K Godfrey-Billy 2020	550	14	2	75	184	110	940	1,875
K Godfrey-Billy 2019	417[7]	11	2	48	212	-	506	1,196

1 Includes the value of options, RSUs and shares granted in prior years that vested in the year

2 Other fixed pay relating to annual leave

3 Relates to payout of annual leave under New Zealand requirements, which includes STI received in calculation of payments

4 Amounts shown for S Vamos in FY19 were paid in AUD and are shown in NZD (translated at the average exchange rate for the year)

5 Base salary increased to AU$1,012,500 effective 1 October 2018

6 No STI or LTI amounts were paid to S Vamos during FY19 as his employment with Xero commenced on 1 April 2018

7 Base salary increased to $450,000 effective 1 October 2018 following promotion to the role of CFO

The following tables present current at-risk equity and holdings for the CEO and CFO.

At-risk equity as at 31 March 2020

	Opening balance[1]	Granted during the year	Vested	Exercised	Lapsed/ Forfeited	Closing balance
Options						
CEO	180,000	-	-	-	-	180,000
CFO	160,000	-	20,000	40,000	-	120,000
RSUs						
CEO	20,383	4,530	6,794	N/A	-	18,118
CFO	3,051	1,261	3,051	N/A	-	1,261
Restricted Shares						
CFO	1,359	-	1,359	N/A	-	-

1 The opening balances in this table disclose all vested and unvested options, unvested RSUs and unvested Restricted Shares at 1 April 2019

Equity holdings as at 31 March 2020

	Shares	Options	RSUs
CEO	10,500	180,000	18,118
CFO	1,884	120,000	1,261

CEO and CFO employment conditions

Item	Details
Basis of contract	Ongoing (no fixed term)
Notice period	CEO – 6 months by either party CFO – 3 months by either party Shorter notice may apply by agreement

Non-executive director remuneration

The total remuneration available to non-executive directors is fixed by shareholders.

Currently, the annual total aggregate non-executive directors' remuneration is capped at $2.2 million, as approved by shareholders at Xero's Annual Meeting in August 2019.

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. Directors have the option to receive their fees in cash or Xero shares.

The fees paid to non-executive directors are structured to reflect time commitment, responsibilities, and workloads. Target fees for non-executive directors are benchmarked to the Australian and New Zealand markets, except where benchmarked non-executive director fees are higher in another market, in which case local benchmarks are used for that market. This reflects the global composition of Xero's Board.

To preserve independence and impartiality, non-executive directors have not received 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.

Below are the annual fees payable to non-executive directors during FY20. Directors' fees are paid in New Zealand dollars in order to avoid exchange rate fluctuations impacting the annual fee cap. Fees are reviewed every two years and were last reviewed early in 2019.

Country of residence	Chair ($000s)	Director ($000s)	Audit & Risk Management Committee Chair ($000s)	People & Remuneration Committee Chair[1] ($000s)
New Zealand	358	145	30	30
Australia	358	145	30	30
United States	358	252	30	30
United Kingdom	373	145	30	30

1 *No additional fees are currently paid for Chair of the Nominations Committee or for membership of any committee*

The total remuneration[1] of, and the value of other benefits received by, each non-executive director during FY20 was:

Director	Country of residence	Role	Committee Chair	2020 base fees ($000s)	2020 Committee Chair fees ($000s)	2020 Vested Equity ($000s)	2020 One-off Payment ($000s)	2020 Total fees ($000s)
David Thodey[2]	Australia	Chair	Nominations Committee	143	-	-	-	143
Rod Drury	New Zealand	NED	-	138	-	-	-	138
Lee Hatton	Australia	Independent NED	ARM Committee	138	29	-	-	167
Dale Murray CBE	United Kingdom	Independent NED	-	138	-	-	-	138
Susan Peterson	New Zealand	Independent NED	P&R Committee	138	22	-	-	160
Craig Winkler	Australia	NED	-	138	-	-	-	138
Former Director								
Bill Veghte[3]	United States	Independent NED	-	45	4	-	-	49
Graham Smith[4]	United States	Former Chair	Nominations Committee	399	-	-	-	399
Total				**1,277**	**55**	**-**	**-**	**1,332[1]**

1 Total remuneration is presented based on accounting expense and may include amounts earned but not yet received

2 Appointed director 27 June 2019, appointed Board Chair effective 1 February 2020

3 Ceased as a director effective 15 August 2019

4 Ceased as a director effective 31 March 2020

Lee Hatton was issued 1,526 Shares in lieu of receiving her director fees in cash during FY20 and Bill Veghte was issued 3,079 Shares in lieu of receiving his director fees in cash during FY20 (for further details, please see the explanatory notes of the 2018 and 2019 notices of meeting). In total, this represented 0.003% of Xero's issued capital as at 31 March 2020.

The total remuneration[1] of, and the value of other benefits received by, each non-executive director during the year ended 31 March 2019 (FY19) was:

Director	Country of residence	Role	Committee Chair	2019 base fees ($000s)	2019 Committee Chair fees ($000s)	2019 Vested Equity ($000s)	2019 one-off payment[2] ($000s)	2019 Total fees ($000s)
Graham Smith	United States	Chair	Nominations Committee	310	-	-	150	460
Rod Drury[3]	New Zealand	NED	-	90	-	-	-	90
Lee Hatton	Australia	Independent NED	ARM Committee	90	20	-	-	110
Dale Murray CBE[4]	United Kingdom	Independent NED	-	111	-	-	-	111
Susan Peterson	New Zealand	Independent NED	-	90	-	-	-	90
Bill Veghte[5]	United States	Independent NED	P&R Committee	226	14	59	-	299
Craig Winkler	Australia	NED	-	90	-	-	-	90
Total				**1,007**	**34**	**59**	**150**	**1,250[1]**

1 *Total remuneration is presented based on accounting expense and may include amounts earned but not yet received*

2 *For additional Board duties related to M&A and US$300m capital raising in FY19*

3 *Appointed as a non-executive director effective 1 April 2018. Rod Drury was an executive director during the year ended 31 March 2018 and received executive remuneration from Xero. During that year, he did not participate in Xero's share-based compensation plans or receive additional remuneration in his capacity as a director*

4 *Appointed as a director effective 13 April 2018*

5 *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 the current year*

Employee remuneration

The following table shows the number of current and former employees of the Xero Group whose remuneration and benefits for FY20 were within the specified bands above $100,000.

Remuneration including share-based remuneration	Number of employees	Remuneration including share-based remuneration	Number of employees
100,000 to 109,999	176	460,000 to 469,999	3
110,000 to 119,999	171	470,000 to 479,999	1
120,000 to 129,999	164	480,000 to 489,999	1
130,000 to 139,999	145	500,000 to 509,999	1
140,000 to 149,999	140	530,000 to 539,999	2
150,000 to 159,999	121	550,000 to 559,999	2
160,000 to 169,999	88	580,000 to 589,999	3
170,000 to 179,999	105	590,000 to 599,999	1
180,000 to 189,999	72	610,000 to 619,999	1
190,000 to 199,999	75	640,000 to 649,999	1
200,000 to 209,999	50	750,000 to 759,999	1
210,000 to 219,999	41	760,000 to 769,999	1
220,000 to 229,999	34	820,000 to 829,999	1
230,000 to 239,999	22	850,000 to 859,999	1
240,000 to 249,999	28	860,000 to 869,999	1
250,000 to 259,999	14	870,000 to 879,999	1
260,000 to 269,999	18	890,000 to 899,999	2
270,000 to 279,999	8	910,000 to 919,999	1
280,000 to 289,999	15	960,000 to 969,999	1
290,000 to 299,999	7	980,000 to 989,999	1
300,000 to 309,999	9	1,000,000 to 1,009,999	1
310,000 to 319,999	15	1,020,000 to 1,029,999	1
320,000 to 329,999	8	1,050,000 to 1,059,999	1
330,000 to 339,999	6	1,250,000 to 1,259,999	2
340,000 to 349,999	7	1,420,000 to 1,429,999	1
350,000 to 359,999	5	1,470,000 to 1,479,999	1
360,000 to 369,999	1	1,650,000 to 1,659,999	1
370,000 to 379,999	4	1,720,000 to 1,729,999	1
380,000 to 389,999	2	1,760,000 to 1,769,999	1
390,000 to 399,999	7	1,870,000 to 1,879,999	1
400,000 to 409,999	3	1,880,000 to 1,889,999	1
410,000 to 419,999	1	1,960,000 to 1,969,999	2
420,000 to 429,999	2	2,060,000 to 2,069,999	1
430,000 to 439,999	2	2,810,000 to 2,819,999	1
450,000 to 459,999	2		

The remuneration covered in the table includes monetary payments received and share-based payments vested (i.e. restricted shares, restricted stock units, and vested options). The table above includes the total remuneration received by the CEO and CFO.

The value of options vested during the year has been calculated as the difference between the exercise price of those options and the share price on the day the options vest (become exercisable). This methodology is different from that used for this disclosure in Xero's FY19 annual report where the value attributed to vested options was calculated based on the fair value at grant date as determined using the Black-Scholes valuation model. Our revised methodology has been chosen as it provides a closer representation of the actual remuneration received by employees during the year and is consistent with the approach made within the CEO and CFO remuneration disclosures detailed above.

Corporate Directory

Registered offices

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Hawthorn, Vic 3122
Australia
Telephone: +61 3 9981 0408

Directors

David Thodey, AO (Chair)
Mark Cross
Rod Drury
Lee Hatton
Dale Murray, CBE
Susan Peterson
Craig Winkler

Leadership team

Steve Vamos
Chief Executive Officer

Anna Curzon
Chief Product Officer

Kirsty Godfrey-Billy
Chief Financial Officer

Craig Hudson
Managing Director,
New Zealand &
Pacific Islands

Trent Innes
Managing Director,
Australia & Asia

Rachael Powell
Chief Customer Officer

Mark Rees
Chief Technology Officer

Nicole Reid
Chief People 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

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

Web address
www.xero.com

Auditor
Ernst & Young

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

Share registrar
Link Market Services Limited
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Telephone: +61 1300 554 474