Xero Limited
Interim Report

xero

For the six months ended
30 September 2017

Cover image – *A Little Farm on the Hill,* Malaysia | Xero customer

Inside cover image – *Woodblock Cheese,* Brisbane | Xero customer

Contents

Highlights

$187.8 MILLION

Total operating revenue*; 37% growth on same period last year

80%

Gross margin*

$5.4 MILLION

Positive EBITDA* for the first time in Xero's history

$6.1 MILLION

Positive operating cash flows*

** for the six months ended 30 September 2017*

1,199,000

Subscribers at 30 September 2017

$416.9 MILLION

Annualised committed monthly revenue at 30 September 2017

$2.8 BILLION

Total lifetime value of the subscriber base at 30 September 2017; a $1 billion improvement compared to the same time last year

6.3 TIMES

Ratio of lifetime value to the cost of aquiring that subscriber at 30 September 2017

Chair and Chief Executive Report

Dear Shareholder

Xero delivered another strong half-year, continuing to execute on its strategy to invest for long-term global growth, while maintaining prudent financial discipline. We are excited by the progress the company is making and are delighted to provide the following update:

Operating highlights

- Operating revenue up 37% (38% in constant currency) on the same period last year, to $187.8 million
- Continued growth in annualised committed monthly revenue (ACMR) adding $113.7 million in the 12 months to 30 September 2017 to $416.9 million
- Positive EBITDA of $5.4 million
- Added more than $1 billion in total subscriber lifetime value (LTV) in the past 12 months

Corporate highlights

- Consolidating Xero's listing onto the Australian Securities Exchange (ASX) to support the company's next phase of growth
- Xero has put in place a $100 million undrawn stand-by debt facility

Continued execution of global growth strategy

Having surpassed one million subscribers in March 2017, Xero added more than 160,000 net new subscribers in the half-year, bringing total subscribers to 1,199,000. Xero hit half a million subscribers in Australia, and exceeded a quarter of a million subscribers in each of the New Zealand and United Kingdom markets. Xero's North American business crossed 100,000 subscribers finishing with 110,000 subscribers at 30 September 2017.

Xero delivered a wave of significant new products - including Xero Expenses, Xero Projects, Xero HQ App Suite, Xero HQ Ask and Xero Discuss - demonstrating that Xero is evolving from a back office product to providing front office solutions, and from online accounting software to a global small business platform. Xero is leveraging its investment in Amazon Web Services with Artificial Intelligence and Machine Learning features that are in production across the Xero product set. The company continues to expand its ecosystem of more than 600 certified app partners and 40,000 developers.

Xero's new education solution, the Xero Lifelong Learning Platform, which aims to help people upskill and stay relevant in an environment of constant change, has received interest from around the world. Xero also received recognition for customer service and product innovation including Canstar Blue's

Most Satisfied Customers Award for Small Business Accounting Software in Australia for the third year running, and Product of the Year at the British Accountancy Awards 2017.

Following cash flow break-even, it is intended that surplus cash flow will be reinvested, subject to investment criteria, to drive long term value.

Next chapter: Consolidating listing on ASX

Xero celebrated its 10th anniversary since going public, reached positive EBITDA for the half-year, and has emerged as one of the largest and fastest growing listed technology companies in Australasia.

To support the company's next phase of growth, we are in the process of consolidating Xero's listing on the ASX. As part of this process, it is intended that Xero will delist from the New Zealand Stock Exchange (NZX), with effect from the close of business on Friday, 2 February 2018.

Xero is an ambitious New Zealand business, and will remain headquartered and domiciled in New Zealand. As Xero continues to grow, gaining enhanced access to deeper capital markets, increased trading liquidity and a broader base of potential investors is critical to fulfilling the company's aspirations. A sole listing on the ASX will advance these goals.

While more than half of Xero's employees live and work in New Zealand, 80% of the company's revenue now comes from outside New Zealand and Xero's strategy is to drive further growth in markets including the United Kingdom, North America and South East Asia.

Information on Xero's intended move to a sole listing on the ASX and delisting from the NZX is being sent to shareholders (shareholders do not need to take any action to facilitate this process). We thank the NZX for providing a valuable platform to support Xero's first decade as a public company.

Bank facility

Additionally, appropriate to Xero's size, scale and stage of development, Xero has established a $100 million stand-by debt facility, with the BNZ and ANZ banks. The facility will improve the company's overall liquidity position. There are no current plans to draw down on the facility.

Conclusion

We continue to execute Xero's strategy and deliver strong outcomes for our shareholders and stakeholders. We sincerely thank all of Xero's customers, partners, team and investors for your continued support.

Graham Smith
Chair

Rod Drury
Chief Executive

Management Commentary

You should read the following commentary with the interim 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 forward-looking statements that involve risks and uncertainties. Actual results and the timing of certain events may differ materially from future results expressed or implied by the forward-looking statements contained in the following commentary. All amounts are presented in New Zealand dollars (NZD), except where indicated.

Non-GAAP measures have been included, as we believe they provide useful information for readers to assist in understanding Xero's financial performance. Non-GAAP financial measures do not have standardised meanings and should not be viewed in isolation or considered as substitutes for amounts reported in accordance with New Zealand Equivalents to International Financial Reporting Standards. These measures have not been independently audited or reviewed.*

BUSINESS RESULTS

Six months ended 30 September	**2017 ($000s)**	**2016 ($000s)**	**change**
Subscription revenue	183,024	133,107	38%
Other operating revenue	4,773	4,140	15%
Total operating revenue	**187,797**	**137,247**	**37%**
Cost of revenue	(37,437)	(33,842)	11%
Gross profit	**150,360**	**103,405**	**45%**
Percentage of operating revenue	80%	75%	5pp**
Total operating expenses	**(171,470)**	**(149,182)**	**15%**
Percentage of operating revenue	91%	109%	-18pp
Foreign exchange and other income	(85)	815	-110%
Operating deficit	**(21,195)**	**(44,962)**	**-53%**
Percentage of operating revenue	-11%	-33%	22pp
Net interest income	1,057	2,114	-50%
Income tax expense	(945)	(1,072)	-12%
Net loss	**(21,083)**	**(43,920)**	**-52%**
Percentage of operating revenue	-11%	-32%	21pp

**GAAP stands for Generally Accepted Accounting Principles*
***pp stands for percentage point*

The growth in operating revenue was driven by subscriber growth in all markets. Cost of revenue decreased as a proportion of operating revenue, largely driven by the migration to Amazon Web Services (AWS) and productivity gains from investment in the customer service platform. Total operating expenses increased as Xero continued to invest in scaling its global business, new products and quality subscriber growth. Total operating revenue increased by 37% while operating expenses grew proportionately less, driven by headcount and marketing efficiencies, resulting in the operating deficit being 53% lower than in the comparative period.

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

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

Six months ended 30 September	**2017 ($000s)**	**2016 ($000s)**	**change**
Net loss	**(21,083)**	**(43,920)**	**-52%**
Add back: net interest income	(1,057)	(2,114)	-50%
Add back: depreciation and amortisation	26,582	19,065	39%
Add back: income tax expense	945	1,072	-12%
EBITDA	**5,387**	**(25,897)**	**NM***
EBITDA margin	3%	-19%	22pp

**NM stands for not meaningful*

EBITDA for the six month period was positive for the first time in Xero's history, improving by $31.3 million on the six months ended 30 September 2016. The primary reason for this improvement was revenue growth, as well as operating efficiencies across expense areas. EBITDA for the period was impacted by write-offs of capitalised software development totalling $1.5 million, as a result of periodic reviews.

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

Six months ended 30 September	**2017 ($000s)**	**2016 ($000s)**	**change**
EBITDA	**5,387**	**(25,897)**	**NM**
Add back: non-cash share-based payments	8,642	7,390	17%
EBITDA excluding non-cash share-based payments	**14,029**	**(18,507)**	**NM**
Percentage of operating revenue	7%	-13%	20pp

EBITDA excluding non-cash share-based payments (SBP) improved by $32.5 million on the comparative period.

OPERATING REVENUE

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

Operating revenue also includes revenue from other related services, including attendance fees for conferences and events such as Xerocon, the implementation of online accounting software services, and revenue share agreements with other financial web service providers. Subscription revenue comprises around 97% of operating revenue.

Six months ended 30 September	**2017 ($000s)**	**2016 ($000s)**	**change**
Subscription revenue	183,024	133,107	38%
Other operating revenue	4,773	4,140	15%
Total operating revenue	**187,797**	**137,247**	**37%**

The 38% increase in subscription revenue during the six month period was primarily driven by year-on-year subscriber growth of 39%, from 862,000 to 1,199,000 subscribers at 30 September 2017. Other operating revenue increased by 15%, primarily due to financial web services revenue. Conference income remained consistent, despite holding one fewer Xerocon during the six months ended 30 September 2017 compared to the same period last year.

Constant currency operating revenue (a non-GAAP financial measure) is provided to assist readers in understanding and assessing Xero's financial performance during the six month period, excluding the impact of foreign currency fluctuations. Constant currency operating revenue is calculated by translating operating revenue for the six months ended 30 September 2017 at the effective exchange rates for the six months ended 30 September 2016.

As 80% of Xero's operating revenue is denominated in foreign currencies, the comparatively stronger NZD against the Great British pound (GBP) during the six month period had a negative impact on reported revenue, offset partially by a weaker average NZD against the Australian dollar (AUD). Constant currency subscription revenue year-on-year growth was 39%. Constant currency operating revenue for the Group in the current period was $1.9 million higher than reported operating revenue, with year-on-year growth of 38%.

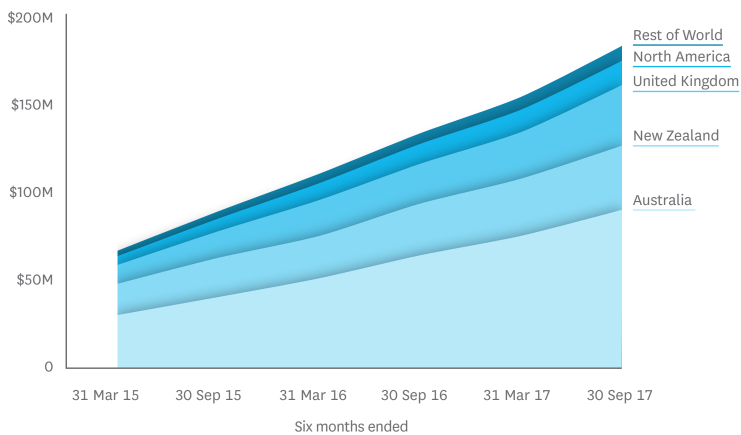
OPERATING REVENUE – BY GEOGRAPHY

Six months ended 30 September	2017 ($000s)	2016 ($000s)	change
Australia	92,874	67,148	38%
New Zealand	37,516	29,360	28%
Australia and New Zealand (ANZ) total	**130,390**	**96,508**	**35%**
United Kingdom	34,198	22,902	49%
North America	14,531	11,953	22%
Rest of World	8,678	5,884	47%
International total	**57,407**	**40,739**	**41%**
Total operating revenue	**187,797**	**137,247**	**37%**

Operating revenue grew in all of Xero's geographies, with growth of 35% in the more established ANZ markets largely due to the increased subscriber base. Constant currency revenue growth for the ANZ markets was slightly lower at 34%, with a weaker average NZD against the AUD compared to the six months ended 30 September 2016.

Revenue growth rates in the International markets were adversely affected by movements in foreign exchange. Constant currency revenue growth in the International markets was 48% with actual revenue growth of 41%, which was primarily driven by strong constant currency revenue growth of 61% in the United Kingdom.

*Total Group operating revenue by geography**



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

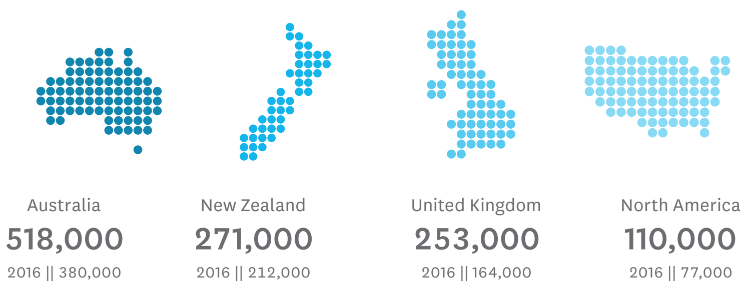
SUBSCRIBER NUMBERS

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

At 30 September	2017	2016	change
Australia	518,000	380,000	36%
New Zealand	271,000	212,000	28%
ANZ total	**789,000**	**592,000**	**33%**
United Kingdom	253,000	164,000	54%
North America	110,000	77,000	43%
Rest of World	47,000	29,000	62%
International total	**410,000**	**270,000**	**52%**
Total subscribers	**1,199,000**	**862,000**	**39%**

Subscribers at 30 September 2017 grew by 337,000, or 39% from 30 September 2016, bringing total subscribers to 1,199,000. ANZ grew by 197,000 subscribers or 33% in the 12 months ended 30 September 2017, demonstrating strong growth even in our established markets. International subscribers grew at a higher rate, increasing by 140,000 or 52% in the 12 months ended 30 September 2017 compared to the 102,000 subscribers added in the 12 months ended 30 September 2016.

*Regional subscribers at 30 September 2017**



**Rest of World subscribers 47,000 at 30 September 2017 (29,000 at 30 September 2016)*

ANNUALISED COMMITTED MONTHLY REVENUE

Annualised committed monthly revenue (ACMR, a non-GAAP financial measure) represents monthly recurring revenue at 30 September, multiplied by 12. It provides a 12 month forward view of revenue, assuming any promotions have ended and other factors such as subscriber numbers, pricing and foreign exchange remain unchanged during the 12 months.

Constant currency ACMR (also a non-GAAP financial measure) is calculated by translating ACMR at 30 September 2017 at the foreign exchange rates at 30 September 2016, and is provided to assist readers in understanding and assessing year-on-year growth rates, excluding the impact of foreign currency fluctuations.

At 30 September	**2017 ($000s)**	**2016 ($000s)**	**change**
ANZ	280,989	212,617	32%
International	135,904	90,554	50%
Total	**416,893**	**303,171**	**38%**

The growth in ACMR was driven by subscriber growth, which was consistent with subscription revenue. $113.7 million of ACMR was added in the year ended 30 September 2017, 34% more than the $85.0 million in the year ended 30 September 2016. This growth was achieved without any significant price changes during the six months ended 30 September 2017, compared to price increases in both Australia and the United Kingdom in the six months ended 30 September 2016.

The weaker NZD at 30 September 2017 when compared to 30 September 2016 had a positive impact on ACMR growth. Group constant currency ACMR at 30 September 2017 was $104.3 million higher than in the prior period, with year-on-year growth of 34%.

GROSS PROFIT

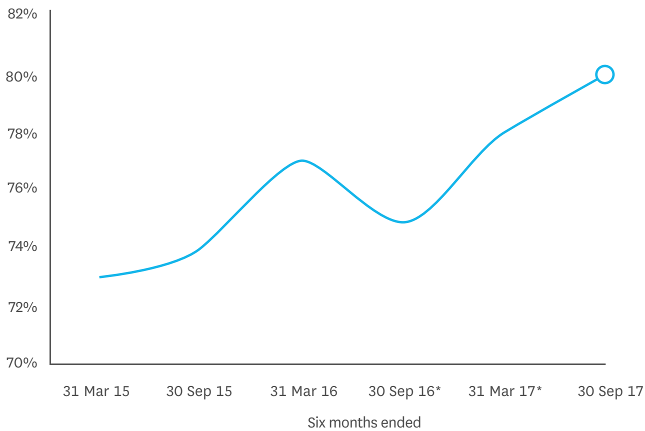
Gross profit represents operating revenue less cost of revenue. Cost of revenue consists of expenses directly associated with securely hosting Xero's services, sourcing relevant data from financial institutions and providing support to subscribers. The cost includes hosting and content distribution costs, 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.

Six months ended 30 September	**2017 ($000s)**	**2016 ($000s)**	**change**
Operating revenue	187,797	137,247	37%
Cost of revenue	(37,437)	(33,842)	11%
Gross profit	**150,360**	**103,405**	**45%**
Gross margin percentage	80%	75%	5pp

Cost of revenue for the six months ended 30 September 2017 increased by $3.6 million, or 11%, to $37.4 million. The primary reason for the change was an increase in personnel costs related to increased headcount in Xero's customer support teams required to support more subscribers. Hosting costs decreased, with efficiencies from the migration to the AWS hosting platform, and the comparative period included significant costs to operate dual platforms during the migration. Operating revenue growth of 37% resulted in gross profit increasing by $47.0 million, or 45%, to $150.4 million.

Cost of revenue decreased as a percentage of operating revenue compared to the same period last year due to efficiencies and savings in hosting costs noted above, efficiencies in the customer support teams, and reductions in bank feed costs per subscriber. Gross margin for the period of 80% is an improvement of five percentage points on the six months ended 30 September 2016.

Gross margin percentage



**affected by AWS migration*

SALES AND MARKETING

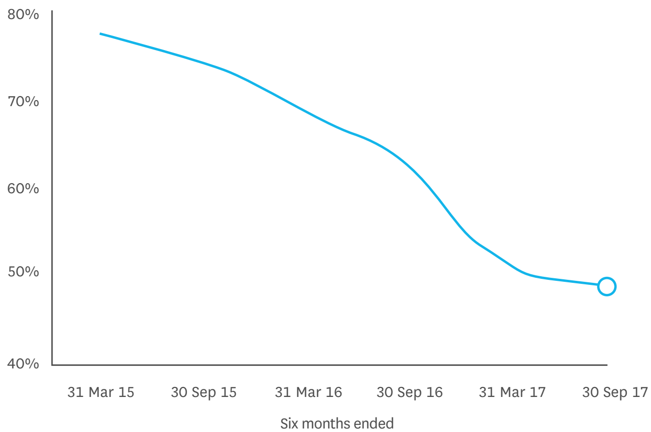
Sales and marketing expenses consist of personnel and related expenses (including salaries, benefits, bonuses, commissions and share-based payments) directly associated with the sales and marketing teams, and the cost of educating and onboarding both partners and small business customers. Other costs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

Six months ended 30 September	**2017 ($000s)**	**2016 ($000s)**	**change**
Sales and marketing expenses	92,278	86,203	7%
Percentage of operating revenue	49%	63%	-14pp

Sales and marketing costs increased by $6.1 million or 7% to $92.3 million in the six months ended 30 September 2017, compared to operating revenue growth of 37% and subscriber growth of 39%. The majority of sales and marketing costs are incurred in acquiring new subscribers and are expensed in the period, in contrast to the associated revenue from those subscribers, which is recognised over the life of the subscriber (currently around seven and a half years on average). The majority of the increase in absolute sales and marketing costs was incurred in the International markets, while costs in the ANZ markets increased at a lower rate. The average cost of acquiring each subscriber decreased 15% in the six months ended 30 September 2017 to $364 per gross subscriber added, compared to $428 per gross subscriber added in the six months ended 30 September 2016.

As a percentage of operating revenue, sales and marketing costs decreased to 49% in the six months ended 30 September 2017 compared to 63% in the six months ended 30 September 2016, as sales and marketing costs grew at a slower rate than operating revenue. This was due to efficiencies and channel development to achieve more targeted and effective sales and marketing expenditure, including efficiencies from growing Xero's global network of accountants and bookkeepers.

Sales and marketing as a percentage of operating revenue



PRODUCT DESIGN AND DEVELOPMENT

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

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

Six months ended 30 September	2017 ($000s)	2016 ($000s)	change
Total product design and development costs (including amounts capitalised)	**70,832**	**58,071**	**22%**
Percentage of operating revenue	38%	42%	-4pp
Less capitalised development costs	(29,619)	(25,528)	16%
Product design and development expense excluding amortisation of amounts capitalised	**41,213**	**32,543**	**27%**
Less government grants	(2,174)	(1,542)	41%
Add amortisation of capitalised development costs	18,700	12,886	45%
Product design and development expense	**57,739**	**43,887**	**32%**
Percentage of operating revenue	31%	32%	-1pp

Xero continues to invest in its global product and platform, launching a significant number of new products in the six month period, including:

- Xero HQ App Suite – an app ecosystem which integrates directly into Xero HQ. Xero HQ is an integrated, multi-vendor platform for accountants and bookkeepers to run their entire back office
- Xero HQ Ask – driving meaningful engagement between advisors and clients
- Xero Expenses – mobile-first expense management with Open APIs for banks to connect to the millions of employees in small business
- Xero Projects – time and job costing for small businesses in professional services
- Xero Discuss – allows users and their advisors to communicate within the Xero platform
- Xero Lifelong Learning Platform – an online learning tool aimed at students and helping people upskill, which will be delivered by educational institutions

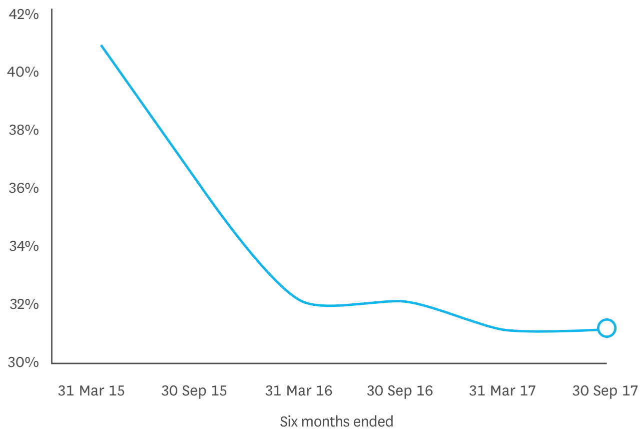
Total product design and development costs were $70.8 million in the six months ended 30 September 2017, $12.8 million higher than in the six months ended 30 September 2016. Of this, $29.6 million was capitalised, with the balance of $41.2 million included as an expense in the Income Statement. The amount capitalised represents a capitalisation rate of 42% of total product design and development costs for the period, which is two percentage points lower than in the six months ended 30 September 2016. The amount expensed in the six months to 30 September 2017 includes write-offs of previously capitalised software development, as a result of periodic reviews.

The amortisation of capitalised product design and development expenditure of $18.7 million was included as an expense in the Income Statement, giving a total net expense (after government grants) for the period of $57.7 million. Non-cash amortisation of previously capitalised development costs increased due to higher intangibles balances than in the prior period.

As a proportion of operating revenue, total product design and development costs, including amounts capitalised, decreased four percentage points to 38% in the six months ended 30 September 2017 from 42% in the same period last year, as costs increased at a slower rate than revenue.

As a proportion of operating revenue, product design and development expenses decreased to 31% in the six months ended 30 September 2017, from 32% in the same period last year.

Product design and development as a percentage of operating revenue



GENERAL AND ADMINISTRATION

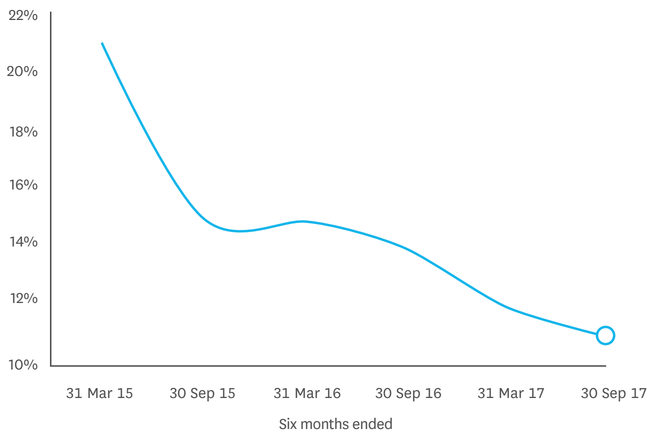
General and administration expenses consist of personnel and related expenses (including salaries, benefits, bonuses and share-based payments) for executive, finance, billing, legal, human resources and administrative employees. They also include legal, accounting and other professional services fees,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

Six months ended 30 September	**2017 ($000s)**	**2016 ($000s)**	**change**
General and administration expenses	21,453	19,092	12%
Percentage of operating revenue	11%	14%	-3pp

General and administration costs were $21.5 million for the six months ended 30 September 2017, $2.4 million or 12% higher than in the six months ended 30 September 2016. The increase was primarily due to increased personnel-related costs as a result of headcount growth to support improving infrastructure as Xero scales globally, and increased merchant fees.

General and administration costs decreased as a proportion of operating revenue, from 14% in the six months ended 30 September 2016 to 11% in the six months ended 30 September 2017 as economies of scale continue to be realised.

General and administration as a percentage of operating revenue



EMPLOYEES

At 30 September	2017	2016	change
Total Group	1,853	1,513	22%

The number of full-time equivalent (FTE) employees increased by 340 or 22% in the year ended 30 September 2017, taking the total FTEs to 1,853, compared to a 39% increase in subscribers and a 37% increase in operating revenue. The slower growth compared to revenue and subscribers reflects the benefits of economies of scale and operating efficiencies.

OTHER INCOME AND INTEREST

Six months ended 30 September	2017 ($000s)	2016 ($000s)	change
Foreign exchange and other income			
Other income	525	599	-12%
Foreign exchange gains/(losses)	(610)	216	NM
Total foreign exchange and other income	**(85)**	**815**	**-110%**
Interest			
Interest income	1,227	2,166	-43%
Interest expense	(170)	(52)	227%
Net interest income	**1,057**	**2,114**	**-50%**

Interest income in the six months ended 30 September 2017 was $1.2 million, a decrease of $0.9 million or 43% from the six months ended 30 September 2016, due to lower cash and short-term deposit balances as well as lower effective interest rates in the six months ended 30 September 2017.

CASH FLOWS

Net movement in cash excluding movements in short-term deposits is a non-GAAP financial measure that has been included to show readers the net usage of cash and short-term deposits in the period. Xero manages cash and short-term deposits as a portfolio to ensure that adequate liquidity is always maintained while preserving capital.

Six months ended 30 September	2017 ($000s)	2016 ($000s)	change
Receipts from customers	188,940	131,764	43%
Other operating cash flows	(182,864)	(145,131)	26%
Total cash flows from operating activities	**6,076**	**(13,367)**	NM
Investing activities	(40,709)	(32,445)	25%
Total operating and investing cash flows	**(34,633)**	**(45,812)**	**-24%**
Financing activities, excluding short-term deposits	5,199	498	NM
Currency revaluation	66	(798)	NM
Net movement in cash, excluding movements in short-term deposits	**(29,368)**	**(46,112)**	**-36%**

Receipts from customers increased by 43% or $57.2 million to $188.9 million, consistent with operating revenue growth. Other operating cash outflows increased by 26% or $37.7 million to $182.9 million, which includes $3.5 million of outflows relating to future expenditure on software licences. The future licence payments were funded through financing arrangements included in financing inflows. Net cash flows from operating activities improved by $19.4 million on the same period last year, as revenue growth outpaced growth in expenditure.

Investing activities increased by 25% or $8.3 million, largely due to capital expenditure relating to Xero's new headquarters in Wellington, New Zealand, and higher capitalised software development costs. Total operating and investing cash outflows decreased by 24% from the six months ended 30 September 2016, due to increases in receipts from customers and increased efficiencies across operating and capital expenditure.

Net movement in cash, excluding movements in short-term deposits of $29.4 million, improved by $16.7 million or 36% when compared to the same period last year.

SEGMENT INFORMATION

	ANZ ($000s)	International ($000s)	Total ($000s)
Six months ended 30 September 2017			
Operating revenue	130,390	57,407	187,797
Expenses	(60,738)	(68,977)	(129,715)
Other income	-	525	525
Segment contribution	**69,652**	**(11,045)**	**58,607**
Contribution margin percentage	53%	-19%	31%
Six months ended 30 September 2016			
Operating revenue	96,508	40,739	137,247
Expenses	(58,633)	(61,412)	(120,045)
Other income	-	599	599
Segment contribution	**37,875**	**(20,074)**	**17,801**
Contribution margin percentage	39%	-49%	13%

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

ANZ – Operating revenue for the six months ended 30 September 2017 grew by 35% compared to the six months ended 30 September 2016, consistent with subscriber growth of 33%. This, along with cost efficiencies, resulted in the segment contribution for the year improving as a percentage of operating revenue, from 39% to 53%. The improvement was driven by performance in both Australia and New Zealand. Australia added 138,000 subscribers in the year to 30 September 2017 to finish with 518,000 subscribers, and revenue for the six months ended 30 September 2017 grew 38% to $92.9 million compared to the six months ended 30 September 2016.

International – Operating revenue grew by 41% due to subscriber growth. International markets were adversely affected by a stronger NZD during the period. In constant currency terms, International revenue growth was 48%, compared to subscriber growth of 52%. The contribution margin improved significantly due to efficiencies and channel development, in particular in the United Kingdom and North America, while maintaining strong revenue growth. The contribution margin was comparatively lower than that of ANZ, reflective of the investment in growth in the United Kingdom, North America and Asia as Xero builds brand recognition and distribution channels in its emerging markets. International's contribution loss halved to $11.0 million in the six months ended 30 September 2017 from $20.1 million in the six months ended 30 September 2016.

KEY SAAS METRICS

Average revenue per user (ARPU) is calculated as ACMR at 30 September divided by subscribers at that time (and divided by 12 to get a monthly view).

CAC months or months of ARPU to recover cost of acquiring subscribers (CAC) represent the number of months of revenue required to recover the cost of acquiring each new subscriber. The calculation is sales and marketing costs for the 12 month period less conference revenue (such as Xerocon) divided by new gross subscribers added during the same period, divided by ARPU.

CMR churn is the value of committed monthly revenue (CMR) from subscribers who leave Xero in a month as a percentage of the total CMR at the start of that month. The percentage provided is the average of the monthly churn for the 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 CMR churn) multiplied by ARPU multiplied by the gross margin percentage. Group LTV is calculated as the sum of the individual segment LTVs multiplied by their respective segment subscribers, divided by total Group subscribers.

LTV/CAC is the ratio between the LTV (described above) and the cost to acquire that subscriber, e.g. the gross margin derived from a subscriber in ANZ is currently on average 12.2 times the cost of acquiring that subscriber.

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

At 30 September 2017	**ANZ**	**International**	**Total**
ARPU ($)	29.7	27.6	29.0
CAC months	7.9	19.2	12.6
CMR churn	0.8%	1.7%	1.1%
LTV per subscriber ($)	2,844	1,271	2,306
LTV/CAC	12.2	2.4	6.3

At 30 September 2016	**ANZ**	**International**	**Total**
ARPU ($)	29.9	27.9	29.3
CAC months	9.0	24.0	14.6
CMR churn	0.9%	1.8%	1.2%
LTV per subscriber ($)	2,388	1,161	2,004
LTV/CAC	8.9	1.7	4.7

ANZ – ARPU decreased by less than 1%, softened by the comparatively weaker NZD against the AUD at 30 September 2017 compared to 30 September 2016. In constant currency terms ARPU decreased by 3% in the year to 30 September 2017, driven by product mix in both Australia and New Zealand.

Improved CMR churn and segment gross margin led to a higher LTV. Total LTV increased by 59% to $2.2 billion at 30 September 2017.

CAC months at 30 September 2017 improved by 12% when compared to the same period last year due to a lower cost of acquisition per subscriber. As a result of improvements across most metrics, LTV/CAC at 30 September 2017 had increased 37% to 12.2 times.

International – ARPU decreased by 1%, softened by the comparatively weaker NZD against the United States dollar and GBP at 30 September 2017 compared to 30 September 2016. In constant currency terms ARPU at 30 September 2017 decreased by 3% compared to 30 September 2016, largely driven by a channel shift towards partner sales across the International markets.

Improved CMR churn and segment gross margin led to a 9% higher LTV at 30 September 2017 than at the same time last year. In constant currency terms LTV per subscriber was 7% higher than at 30 September 2016. Total LTV increased by 66% to $521 million at 30 September 2017.

CAC months at 30 September 2017 improved by 20% compared to the same time last year. As a result of improvements across most metrics, LTV/CAC at 30 September 2017 was 2.4 times, a 38% increase on 30 September 2016.

Total Group – ARPU decreased by 1% due to product mix in ANZ and the United Kingdom and a shift towards the more efficient, but lower ARPU, partner channel, particularly in the International markets. Using the same exchange rates as the prior period, constant currency ARPU decreased 3% compared to 30 September 2016. Compared to 31 March 2017, constant currency ARPU has remained flat, following initiatives to drive quality revenue growth. There were no major pricing changes in the six months ended 30 September 2017.

LTV increased 15% to $2,306 per subscriber due to the improvements in churn and gross margin. Group constant currency LTV per subscriber at 30 September 2017 was 12% higher than at 30 September 2016. Total LTV at 30 September 2017 was $2.8 billion, which is a $1.0 billion improvement compared to the same time last year.

CAC months improved 14% to 12.6 months when compared to 30 September 2016 due to a 15% reduction in the average subscriber acquisition cost. As a result of the decreased average cost to acquire each subscriber and an improvement across most metrics, LTV/CAC increased 34% to 6.3 times.

Review Report to the Shareholders of Xero Limited

("the company") and its subsidiaries (together "the group")

We have reviewed the interim financial statements on pages 24 to 40, which comprise the statement of financial position of the group as at 30 September 2017 and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows of the group for the six month period ended on that date, and a summary of significant accounting policies and other explanatory information.

This report is made solely to the company's shareholders, as a body. Our review has been undertaken so that we might state to the company's shareholders those matters we are required to state to them in a review 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 review work, for this report, or for our findings.

Directors' Responsibilities

The directors are responsible for the preparation and fair presentation of interim financial statements which comply with New Zealand Equivalent to International Accounting Standard 34: *Interim Financial Reporting* and for such internal control as the directors determine is necessary to enable the preparation and fair presentation of the interim financial statements that are free from material misstatement, whether due to fraud or error.

Reviewer's Responsibilities

Our responsibility is to express a conclusion on the interim financial statements based on our review. We conducted our review in accordance with NZ SRE 2410 Review of Financial Statements Performed by the Independent Auditor of the Entity. NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements, taken as a whole, are not prepared in all material respects, in accordance with New Zealand Equivalent to International Accounting Standard 34: Interim Financial Reporting. As the auditor of the group, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.

Basis of Statement

A review of interim financial statements in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand). Accordingly we do not express an audit opinion on those financial statements.

We provide remuneration benchmark information and other assurance services to the Group. We have no other relationship with, or interest in, the Group.

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.

Conclusion

Based on our review nothing has come to our attention that causes us to believe that the accompanying interim financial statements, set out on pages 24 to 40, do not present fairly, in all material respects, the financial position of the group as at 30 September 2017 and its financial performance and cash flows for the six month period ended on that date in accordance with New Zealand Equivalent to International Accounting Standard 34: Interim Financial Reporting.

Our review was completed on 9 November 2017 our findings are expressed as at that date.

Ernst & Young

Wellington
9 November 2017

Financial Statements

Income statement

Six months ended 30 September	Notes	2017 Unaudited ($000s)	2016 Unaudited ($000s)
Subscription revenue		183,024	133,107
Other operating revenue		4,773	4,140
Total operating revenue	**4**	**187,797**	**137,247**
Cost of revenue	5	(37,437)	(33,842)
Gross profit		**150,360**	**103,405**
Operating expenses			
Sales and marketing		(92,278)	(86,203)
Product design and development		(57,739)	(43,887)
General and administration		(21,453)	(19,092)
Total operating expenses	**5**	**(171,470)**	**(149,182)**
Foreign exchange gains/(losses)		(610)	216
Other income		525	599
Operating deficit		**(21,195)**	**(44,962)**
Net interest income		1,057	2,114
Net loss before tax		**(20,138)**	**(42,848)**
Income tax expense		(945)	(1,072)
Net loss		**(21,083)**	**(43,920)**
Earnings per share			
Basic and diluted loss per share		($0.15)	($0.32)

The accompanying notes form an integral part of these financial statements

Statement of comprehensive income

Six months ended 30 September	Note	2017 Unaudited ($000s)	2016 Unaudited ($000s)
Net loss		(21,083)	(43,920)
Other comprehensive income/(loss)*			
Movement in cash flow hedges	11	564	663
Translation of international subsidiaries		500	(1,780)
Total other comprehensive income/(loss) for the period		**1,064**	**(1,117)**
Total comprehensive loss for the period		**(20,019)**	**(45,037)**

** Items in other comprehensive income may be reclassified to the Income Statement and are shown net of tax*
The accompanying notes form an integral part of these financial statements

Statement of changes in equity

Unaudited	Share capital ($000s)	Accumulated losses ($000s)	Share-based payment reserve ($000s)	Currency translation reserve ($000s)	Hedge reserve ($000s)	Total equity ($000s)
Balance at 1 April 2017	522,610	(306,995)	10,224	(93)	(1,596)	224,150
Net loss	–	(21,083)	–	–	–	(21,083)
Other comprehensive income	–	–	–	500	564	1,064
Total comprehensive loss	**–**	**(21,083)**	**–**	**500**	**564**	**(20,019)**
Transactions with owners:						
Share-based payments – restricted share plan	108	–	5,521	–	–	5,629
Share-based payments – restricted stock units	641	–	1,694	–	–	2,335
Share-based payments – employee share options	–	–	2,218	–	–	2,218
Share-based payments – Directors and advisors	190	–	314	–	–	504
Exercising of employee share options	2,296	–	(612)	–	–	1,684
Balance at 30 September 2017	**525,845**	**(328,078)**	**19,359**	**407**	**(1,032)**	**216,501**

The accompanying notes form an integral part of these financial statements

Statement of changes in equity

Unaudited	Share capital ($000s)	Accumulated losses ($000s)	Share-based payment reserve ($000s)	Currency translation reserve ($000s)	Hedge reserve ($000s)	Total equity ($000s)
Balance at 1 April 2016	503,346	(237,938)	15,985	1,321	(3,625)	279,089
Net loss	–	(43,920)	–	–	–	(43,920)
Other comprehensive (loss)/income	–	–	–	(1,780)	663	(1,117)
Total comprehensive loss	**–**	**(43,920)**	**–**	**(1,780)**	**663**	**(45,037)**
Transactions with owners:						
Share-based payments – restricted share plan	23	–	4,235	–	–	4,258
Share-based payments – restricted stock units	2,125	–	(1,030)	–	–	1,095
Share-based payments – employee share options	–	–	1,741	–	–	1,741
Share-based payments – Directors and advisors	35	–	326	–	–	361
Exercising of employee share options	630	–	(132)	–	–	498
Share-based payments – employee share schemes arising on acquisition	–	–	574	–	–	574
Balance at 30 September 2016	**506,159**	**(281,858)**	**21,699**	**(459)**	**(2,962)**	**242,579**

The accompanying notes form an integral part of these financial statements

Statement of financial position

	Notes	At 30 Sep 2017 Unaudited ($000s)	At 31 Mar 2017 Audited ($000s)
Assets			
Cash and cash equivalents		23,331	27,699
Short-term deposits		61,000	86,000
Trade and other receivables		38,382	32,817
Short-term derivative assets	11	676	801
Other current assets		542	393
Total current assets		**123,931**	**147,710**
Property, plant and equipment	6	21,125	15,881
Intangible assets	6	136,219	125,619
Deferred tax assets		2,384	2,065
Long-term derivative assets	11	121	17
Other receivables		1,533	1,958
Total non-current assets		**161,382**	**145,540**
Total assets		**285,313**	**293,250**
Liabilities			
Trade and other payables		32,684	34,263
Employee entitlements		23,543	27,336
Current income taxes payable		472	1,105
Short-term provisions		513	555
Short-term derivative liabilities	11	1,845	2,397
Financing loan	9	3,510	–
Total current liabilities		**62,567**	**65,656**
Deferred tax liabilities		440	546
Long-term provisions		1,273	851
Long-term derivative liabilities		–	17
Other long-term liabilities		4,532	2,030
Total non-current liabilities		**6,245**	**3,444**
Total liabilities		**68,812**	**69,100**
Equity			
Share capital	7	525,845	522,610
Reserves		18,734	8,535
Accumulated losses		(328,078)	(306,995)
Total equity		**216,501**	**224,150**
Total liabilities and equity		**285,313**	**293,250**

The accompanying notes form an integral part of these financial statements

Statement of cash flows

Six months ended 30 September	Notes	2017 Unaudited ($000s)	2016 Unaudited ($000s)
Operating activities			
Receipts from customers		188,940	131,764
Other income		2,587	2,228
Interest received		1,404	2,309
Payments to suppliers and employees		(184,850)	(149,115)
Income tax paid		(2,005)	(553)
Net cash flows from operating activities	**8**	**6,076**	**(13,367)**
Investing activities			
Capitalised development costs		(32,623)	(28,611)
Purchase of property, plant and equipment		(9,665)	(2,269)
Sale of property, plant and equipment		1,507	–
Rental bonds		72	19
Other intangible assets		–	(1,584)
Net cash flows from investing activities		**(40,709)**	**(32,445)**
Financing activities			
Exercising of share options		1,684	498
Proceeds from borrowings	9	3,515	–
Payments for short-term deposits		(41,000)	(56,000)
Proceeds from short-term deposits		66,000	98,000
Net cash flows from financing activities		**30,199**	**42,498**
Net decrease in cash and cash equivalents		**(4,434)**	**(3,314)**
Foreign currency translation adjustment		66	(798)
Cash and cash equivalents at the beginning of the period		**27,699**	**39,024**
Cash and cash equivalents at the end of the period		**23,331**	**34,912**

The accompanying notes form an integral part of these financial statements

Notes to the Financial Statements (unaudited)

1. BASIS OF PREPARATION

These unaudited interim financial statements of Xero Limited ('the Company') and its subsidiaries (together 'the Group' or 'Xero') have been prepared in accordance with New Zealand Generally Accepted Accounting Principles and comply with the requirements of the New Zealand Equivalent to International Accounting Standard 34: *Interim Financial Reporting*, and International Accounting Standard 34: *Interim Financial Reporting*. The Company is a profit-oriented entity.

The Company is registered under the Companies Act 1993 and listed on the New Zealand Stock Exchange and the Australian Securities Exchange. The Company is an FMC Reporting Entity under the Financial Markets Conduct Act 2013 and the Financial Reporting Act 2013.

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

The unaudited interim financial statements for the Group for the six months ended 30 September 2017 were authorised for issue in accordance with a resolution of Directors on 9 November 2017.

2. ACCOUNTING POLICIES

(a) Changes in accounting policies and disclosures

The unaudited interim financial statements have been prepared using the same accounting policies and methods of computation as, and should be read in conjunction with, the financial statements and related notes included in the Group's annual report for the year ended 31 March 2017.

The changes below were enacted in Xero's annual report for the year ended 31 March 2017 and affect the current period disclosures.

During the year, the Group early adopted the amendments to the New Zealand Equivalent to International Financial Reporting Standard 2: *Share-Based Payment* as issued on 20 June 2016. The amendments provide clarification on the classification and measurement of specific share-based payment transactions for the purpose of eliminating diversity in practice. As a result of the changes, equity awards net settled to meet withholding tax obligations are equity classified in their entirety rather than being split between equity and liability relative to the proportion to be net settled. The balance that would have otherwise been liability classified is disclosed in Note 12. Prior periods have not been restated on application.

(b) Critical accounting estimates

The same significant judgements, estimates and assumptions included in the notes to the financial statements in the Group's annual report for the year ended 31 March 2017 have been applied to these interim financial statements.

3. SEGMENT INFORMATION

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

Xero has two operating segments, Australia and New Zealand (ANZ) and International. These segments have been determined based on the way the Global Executive Team (the chief operating decision-maker) reviews financial performance. Segment operating expenses represent sales and marketing costs and service delivery costs, including both in-country costs and an allocation of centrally managed costs.

Unaudited	ANZ ($000s)	International ($000s)	Total ($000s)
Six months ended 30 September 2017			
Operating revenue	130,390	57,407	187,797
Expenses	(60,738)	(68,977)	(129,715)
Other income	–	525	525
Segment contribution	**69,652**	**(11,045)**	**58,607**
Six months ended 30 September 2016			
Operating revenue	96,508	40,739	137,247
Expenses	(58,633)	(61,412)	(120,045)
Other income	–	599	599
Segment contribution	**37,875**	**(20,074)**	**17,801**

Reconciliation from segment contribution to net loss before tax

Unaudited	2017 ($000s)	2016 ($000s)
Six months ended 30 September		
Segment contribution	58,607	17,801
Product design and development	(57,739)	(43,887)
General and administration	(21,453)	(19,092)
Foreign exchange gain/(loss)	(610)	216
Net interest income	1,057	2,114
Net loss before tax	**(20,138)**	**(42,848)**

At 30 September 2017, $148.7 million, or 94% of the Group's property, plant and equipment and intangible assets, was domiciled in New Zealand (31 March 2017: $133.5 million, or 95%).

Depreciation and amortisation by segment

Unaudited	2017 ($000s)	2016 ($000s)
Six months ended 30 September		
ANZ	1,843	1,345
International	2,753	1,919
Corporate (not allocated to a segment)	21,986	15,801
Total	**26,582**	**19,065**

Share-based payments by segment

Unaudited	2017 ($000s)	2016 ($000s)
Six months ended 30 September		
ANZ	1,762	1,472
International	2,846	2,010
Corporate (not allocated to a segment)	4,034	3,908
Total	**8,642**	**7,390**

4. REVENUE

Revenue by geographic location

Unaudited	2017 ($000s)	2016 ($000s)
Six months ended 30 September		
Australia	92,874	67,148
New Zealand	37,516	29,360
United Kingdom	34,198	22,902
North America	14,531	11,953
Rest of World	8,678	5,884
Total	**187,797**	**137,247**

5. EXPENSES

Unaudited	2017 ($000s)	2016 ($000s)
Six months ended 30 September		
Cost of revenue and operating expenses		
Employee entitlements	114,196	95,701
Employee entitlements – share-based payments	10,578	9,109
Employee entitlements capitalised	(29,323)	(25,251)
Advertising and marketing	28,236	34,503
IT platform costs	14,191	15,942
Consulting and contractors	6,783	6,155
Computer equipment and software	6,584	3,145
Rental costs	5,885	5,169
Travel-related costs	4,479	3,608
Superannuation costs	3,831	3,137
Communication, insurance and office administration	2,392	2,210
Staff recruitment	1,418	881
Directors' fees	495	403
Other operating expenses	12,580	9,247
Total cost of revenue and operating expenses excluding depreciation and amortisation	**182,325**	**163,959**
Depreciation and amortisation		
Relating to:		
Amortisation of software development costs	21,536	14,980
Amortisation of other intangible assets	519	783
Depreciation of property, plant and equipment	4,527	3,302
Total depreciation and amortisation	**26,582**	**19,065**
Total cost of revenue and operating expenses	**208,907**	**183,024**
Depreciation and amortisation included in function expenses as follows:		
Cost of revenue	1,810	1,486
Sales and marketing	2,787	1,787
Product design and development	21,439	15,310
General and administration	546	482
Total depreciation and amortisation	**26,582**	**19,065**

6. INTANGIBLES AND PROPERTY, PLANT AND EQUIPMENT

Intangible assets

Movements in intangible assets for the period were as follows:

Unaudited	Software development ($000s)	Software licences ($000s)	Other intangible assets ($000s)	Goodwill ($000s)	Total ($000s)
Cost					
Balance at 1 April 2017	185,093	2,004	941	5,352	193,390
Additions*	34,205	–	–	–	34,205
Disposals and write offs	(3,078)	(15)	(11)	–	(3,104)
Balance at 30 September 2017	**216,220**	**1,989**	**930**	**5,352**	**224,491**
Amortisation					
Balance at 1 April 2017	66,307	858	606	–	67,771
Amortisation	21,536	495	24	–	22,055
Disposals and write offs	(1,528)	(15)	(11)	–	(1,554)
Balance at 30 September 2017	**86,315**	**1,338**	**619**	**–**	**88,272**
Net book value at 30 September 2017	**129,905**	**651**	**311**	**5,352**	**136,219**
Cost					
Balance at 1 April 2016	138,489	2,807	975	5,352	147,623
Additions*	30,903	318	–	–	31,221
Disposals and write offs	(11,304)	(6)	–	–	(11,310)
Balance at 30 September 2016	**158,088**	**3,119**	**975**	**5,352**	**167,534**
Amortisation					
Balance at 1 April 2016	48,840	415	589	–	49,844
Amortisation	14,980	757	26	–	15,763
Disposals and write offs	(11,300)	(6)	–	–	(11,306)
Balance at 30 September 2016	**52,520**	**1,166**	**615**	**–**	**54,301**
Net book value at 30 September 2016	**105,568**	**1,953**	**360**	**5,352**	**113,233**

** Includes $4.8 million of external purchases (2016: $6.0 million).*

Property, plant and equipment

Additions to property, plant and equipment were $9.6 million for the period, with $6.4 million relating to office space fitout (2016: $2.1 million, with $0.9 million relating to office space fitout).

7. SHARE CAPITAL

At 30 September 2017, in monetary terms, the share capital balance consisted of $548,352,000 of shares on issue, offset by $22,507,000 of treasury stock (2016: $527,704,000 and $21,545,000 respectively).

The table below details the movements in share capital for the six months ended 30 September in terms of number of shares on issue.

Movements in ordinary shares on issue

Unaudited	2017 (000s)	2016 (000s)
Balance as at 1 April	137,761	136,814
Issue of ordinary shares – employee restricted share plan	494	466
Issue of ordinary shares – exercising of employee share options	96	92
Issue of ordinary shares – restricted stock unit schemes	45	133
Issue of ordinary shares – Directors' fees	7	2
Ordinary shares on issue at 30 September	**138,403**	**137,507**
Treasury stock	(1,118)	(1,132)
Ordinary shares outstanding at 30 September	**137,285**	**136,375**

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

During the period the Company allocated 576,374 shares under the employee restricted share plan (RSP), at an average price of $25.75 (2016: 590,237 at an average price of $18.72). Of the shares allocated, 493,568 were new shares issued, and 82,806 were the reissue of shares held as treasury stock (2016: 466,180 and 124,057 respectively).

During the period employees exercised 96,420 share options with a weighted average exercise price of $17.47 (2016: 91,706 at a weighted average price of $5.43).

During the period 49,166 restricted stock units (RSUs) vested, of which 44,599 were converted to shares, the remaining 4,567 being surrendered to settle payroll tax liabilities (2016: 132,669 vested and converted, 74,053 vested and surrendered to settle payroll tax).

During the period the Company issued 7,131 shares at an average price of $26.64 in lieu of cash payment for Directors' fees (2016: 1,803 shares at $19.41).

8. RECONCILIATION OF NET LOSS TO OPERATING CASH FLOWS

Unaudited	2017 ($000s)	2016 ($000s)
Six months ended 30 September		
Net loss	(21,083)	(43,920)
Adjustments:		
Depreciation	4,527	3,302
Amortisation	22,055	15,763
Deferred tax	(341)	(165)
Foreign exchange (gain)/loss	610	(216)
Loss on disposal of intangible assets	1,550	–
Employee share-based payments	8,350	6,956
Non-employee share-based payments	292	434
Bad debts	522	390
Other non-cash items	(19)	60
Changes in working capital items:		
Increase in trade receivables and prepayments	(3,131)	(3,938)
Decrease in interest receivable	177	143
Increase/(decrease) in trade payables and other related items	(6,786)	7,137
Increase/(decrease) in current tax payable	(647)	687
Net cash flows from operating activities	**6,076**	**(13,367)**

9. FINANCING LOAN

During the period ended 30 September 2017 Xero entered into an arrangement with a financing company to fund upfront payment of software licensing. The balance of the loan represents borrowings for services not yet provided, and is payable in three quarterly payments, with a final payment date of 1 May 2018.

10. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES

Xero's hedging derivatives are recognised at fair value. Fair values are calculated using forward exchange rates that are quoted in an active market (level 2 on the fair value hierarchy). Foreign currency forward contracts are valued using a present value model that takes account of observable market inputs including spot exchange rates and forward rate curves.

Xero's other financial instruments are carried at amortised cost. The carrying amounts of these assets and liabilities do not materially differ from their fair values.

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

11. HEDGE ACCOUNTING

The Group uses derivatives in the form of foreign currency forward contracts, purchased options and collars to reduce the impacts that movements in the exchange rate will have on the Group's New Zealand dollar cash flows. These hedges have been designated as hedges of highly probable forecast transactions (cash flow hedges under NZ IAS 39: *Financial Instruments Recognition and Measurement*). The Group's policy is to hedge a portion of the next 18 months' forecast cash flows.

During the period a hedging loss of $1,792,000 (before taxation) was recognised in other comprehensive income (six months ended 30 September 2016: hedging loss of $1,193,000). During the period a loss of $1,228,000 (before taxation) was reclassified out of other comprehensive income to the Income Statement (six months ended 30 September 2016: loss of $1,856,000). The remaining balance will be reclassified to the Income Statement in the 18 months following 30 September 2017.

Hedge position at 30 September 2017

Unaudited	Fair value ($000s)	Notional amount hedged (NZ$000s)
Derivative assets		
Buy USD – sell NZD	260	20,119
Buy NZD – sell AUD	474	38,046
Buy NZD – sell GBP	63	7,436
Total	**797**	
Derivative liabilities		
Buy USD – sell NZD	(572)	27,057
Buy NZD – sell AUD	(951)	57,340
Buy NZD – sell GBP	(322)	14,407
Total	**(1,845)**	

12. SHARE-BASED PAYMENTS

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

Employee restricted share plan

Movements in the number of unvested restricted shares were as follows:

Unaudited	**Number of shares 2017 (000s)**	**Number of shares 2016 (000s)**
Unvested shares as at 1 April	582	608
Granted	576	590
Forfeited	(76)	(85)
Vested	(9)	(6)
Unvested shares as at 30 September – allocated to employees	**1,073**	**1,107**
Forfeited shares not yet reallocated – held by Trustee	45	25
Total	**1,118**	**1,132**
Percentage of total ordinary shares	0.8%	0.8%
Ageing of unvested shares		
Vest within one year	524	510
Vest after one year	549	597
Total unvested shares at 30 September	**1,073**	**1,107**

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

Movements in the number of share options outstanding were as follows:

Unaudited	2017 Weighted average exercise price ($)	2017 Options (000s)	2016 Weighted average exercise price ($)	2016 Options (000s)
Outstanding at 1 April	18.55	2,188	20.18	821
Granted	24.06	415	17.59	1,691
Forfeited	17.58	(261)	14.68	(67)
Exercised	17.47	(96)	5.43	(92)
Outstanding at 30 September	**19.74**	**2,246**	**19.05**	**2,353**
Exercisable at 30 September	21.12	512	27.98	208

Restricted stock units

Movements in the number of RSUs outstanding were as follows:

Unaudited	2017 Weighted average grant date fair value ($)	2017 RSUs (000s)	2016 Weighted average grant date fair value ($)	2016 RSUs (000s)
Outstanding at 1 April	17.41	327	17.30	705
Granted	25.75	204	18.72	256
Forfeited	19.12	(41)	17.91	(98)
Converted to shares	17.27	(45)	17.70	(133)
Surrendered to pay payroll tax	20.58	(5)	18.11	(74)
Outstanding at 30 September	**21.03**	**440**	**17.59**	**656**

The Company withholds shares under certain circumstances to settle tax obligations on vesting. Based on the current market share price, future cash payments to meet tax obligations are expected to be $2,335,000.

13. EVENTS AFTER THE BALANCE SHEET DATE

On 8 November 2017 Xero entered into a $100 million two-year stand-by syndicated facility with the BNZ and ANZ banks. The facility improves the company's overall liquidity position. There are no current plans to draw down on the facility.

On 8 November 2017 the Board resolved its intention to move the company to a sole listing on the Australian Securities Exchange and delist from the NZX Main Board.

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

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LINCOLN
ELECTRIC

Corporate Directory

REGISTERED OFFICES:

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COMPANY NUMBERS:
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160 661 183 AUSTRALIAN REGISTERED BODY NUMBER (ARBN)

WEB ADDRESS:
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DIRECTORS:
GRAHAM SMITH
(CHAIR)

ROD DRURY

LEE HATTON

SUSAN PETERSON

BILL VEGHTE

CRAIG WINKLER

LEADERSHIP TEAM:
ROD DRURY
(CHIEF EXECUTIVE, CO-FOUNDER)

SANKAR NARAYAN
(CHIEF OPERATING AND FINANCIAL OFFICER)

ANNA CURZON
(CHIEF PARTNER OFFICER)

TONY STEWART
(CHIEF PRODUCT, PLATFORM AND DATA OFFICER)

RACHAEL POWELL
(CHIEF CUSTOMER AND PEOPLE OFFICER)

KIRSTY GODFREY-BILLY
(CHIEF ACCOUNTING OFFICER)

COMPANY SECRETARY:
CHAMAN SIDHU

AUDITOR:
EY

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

SHARE REGISTRAR:

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