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1 July 2014

Dear Shareholder

I'm pleased to invite you to the 2014 Annual Meeting of Xero Limited (Xero), to be held on Wednesday 23 July 2014, at 4.00pm (New Zealand time), at Shed 6, Queens Wharf, Jervois Quay, Wellington, New Zealand (the Meeting).

Rod Drury, Chief Executive and Co-founder of Xero, and I, Chairman of the Board, will present to the Meeting on Xero's performance for the financial year to 31 March 2014 and the outlook for the 2015 financial year.

It's been another strong year for Xero, and we look forward to reporting both on our achievements and future plans, and answering any questions that you may have about Xero or its performance. We also look forward to showcasing some of our new products and features so that you can see some of the recent innovation that has been happening at Xero.

Following my address, we'll cover the formal business of the Meeting, which will consist of the items set out below. Further detail on these items is set out in the enclosed Notice of Meeting and Explanatory Notes.

#### **Auditor Remuneration**

Shareholders will be asked to authorise the Board to fix the remuneration of the auditor.

#### **Election and Re-election of Directors**

Shareholders will also be asked to vote on the election of Bill Veghte and myself as directors of Xero, following our appointment by the Board in February 2014, the election of Lee Hatton as a director of Xero following her appointment by the Board in April 2014, and on the re-election of Graham Shaw and Sam Morgan as directors of Xero who retire by rotation at the Meeting.

The Board unanimously supports the re-election of Graham and Sam, and the election of Bill, Lee and I as directors of Xero. Details of our respective backgrounds are set out in the Explanatory Notes to the Notice of Meeting enclosed with this letter. We will each address the Meeting prior to the shareholders being asked to vote on our election.

#### **Non-Executive Director Remuneration**

Shareholders will also be asked to vote on an increase in the maximum aggregate annual remuneration that can be paid to the non-executive Directors from NZ\$500,000 to NZ\$850,000, and to authorise the remuneration of non-executive Directors to be by the issue of Equity Securities (as defined in the NZX Listing Rules to include shares in Xero).

These proposed changes are seen as being critical to ensure that Xero can continue to attract and retain directors that best represent shareholders' interests and achieve Xero's objective to establish itself as the global leader in online accounting software. Additional detailed information on this proposal is set out in the Explanatory Notes to the Notice of Meeting enclosed with this letter.

#### **Grant of Options and Issue of Shares to Directors**

Both Bill Veghte and I feel extremely privileged to have joined the Board of Xero this year, and we look forward to working hard for you to drive Xero's continued success.

In accepting our roles as directors of Xero, both Bill and I, with the agreement of the Board, agreed to receive our director remuneration by way of options to subscribe for shares in Xero, rather than payment in cash. The options that were granted to Bill and me upon joining the Board in February 2014 were granted subject to shareholder approval, which is being sought at the Meeting. The terms relating to these options, and the detail of the proposed approval for these options and future options to be granted to Bill and myself is set out in the Explanatory Notes to the Notice of Meeting enclosed with this letter.



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In April 2014, the Board was pleased to appoint Lee Hatton as an additional non-executive Director. Approval will also be sought from the shareholders at the Meeting to issue ordinary shares in Xero to Lee at market value as her director remuneration, in lieu of cash.

As mentioned above, following the formal business of the Meeting we'll have some of the Xero team provide a live demonstration of some of the innovative products and features that we've been working on recently.

If you cannot attend the Meeting, I encourage you to complete and lodge the enclosed Proxy Form in accordance with the instructions on the back of the Proxy Form so that it reaches our share registrar, Link Market Services Limited, by 4.00pm (New Zealand time) on Monday 21 July 2014. Alternatively you can complete the enclosed Proxy Form online by following the instructions on the Proxy Form.

For those shareholders who are attending the Meeting, please bring the enclosed Proxy/Admission Form with you to assist with your registration.

You are invited to join the Board and management for drinks at the conclusion of the Meeting. I look forward to seeing you then, and thank you for your ongoing support.

Sincerely,

Chris Liddell  
Chairman



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1 July 2014

Dear Shareholder

I'm looking forward to seeing many of you at our Annual Meeting, to take you through our progress to date and talk through the next phases of our strategy.

At this Annual Meeting, we'll be seeking approval for an increase in the aggregate fee cap for non-executive Directors and for the ability to pay some of these fees through the issue of equity in Xero.

Xero has been a strong performer in its first three markets. With our track record of success we're increasing our focus on the large US market.

It has been a deliberate strategy to transition from a New Zealand based company to be a more US centric company as we expand globally. We believe in building the business from the top and are delighted to have attracted outstanding new Directors to our team. We want to continue to build our Board with quality global talent with experience of building substantial international businesses.

In order to do that, Chris and I need the headroom to be able to remunerate our Directors in line with US market expectations and be able to grant new Directors sufficient equity in Xero to attract them to our business and ensure that we're giving Xero the best chance of long-term success.

Thank you for your ongoing support.

Sincerely,

Rod Drury  
Chief Executive



## NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

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Notice is hereby given that the Annual Meeting of Shareholders of Xero Limited (Xero) will be held at Shed 6, Queens Wharf, Jervois Quay, Wellington, New Zealand on Wednesday 23 July 2014 at 4.00pm (New Zealand time) (the Meeting).

### Items of Business

- A. The Chairman's introduction;
- B. Formal business and resolutions;
- C. Chief Executive's presentation; and
- D. Shareholder questions.

### Shareholders will be asked to consider, and if thought fit, pass the following ordinary resolutions:

- 1. That the Board is authorised to fix the remuneration of the auditor.
- 2. That Chris Liddell, appointed by the Board as an additional Director on 12 February 2014, be elected as a Director of Xero Limited.
- 3. That Bill Veghte, appointed by the Board as an additional Director on 12 February 2014, be elected as a Director of Xero Limited.
- 4. That Lee Hatton, appointed by the Board as an additional Director on 10 April 2014, be elected as a Director of Xero Limited.
- 5. That Graham Shaw, retiring from office as a Director of Xero Limited by rotation, be re-elected as a Director of Xero Limited.
- 6. That Sam Morgan, retiring from office as a Director of Xero Limited by rotation, be re-elected as a Director of Xero Limited.
- 7. (a) That the maximum aggregate annual remuneration able to be paid to the Non-Executive Directors be increased by NZ\$350,000 from NZ\$500,000 to NZ\$850,000, with immediate effect.  
(b) That any remuneration payable to Non-Executive Directors may be payable either in part or in whole by way of an issue of Equity Securities (as defined in the NZX Listing Rules) as detailed in the Explanatory Notes to the Notice of Meeting.
- 8. That the grant of 13,481 and 10,785 options to subscribe for ordinary shares in Xero Limited on 12 February 2014 to Chris Liddell and Bill Veghte, respectively, as remuneration for their roles as Directors of Xero Limited (equating to an annual value of NZ\$220,000 and NZ\$176,000 respectively), on the terms set out in the Explanatory Notes to the Notice of Meeting, be approved and ratified, and that the issue of ordinary shares in Xero Limited to Chris Liddell and Bill Veghte upon any exercise of those options, be approved.
- 9. That the grant of options to subscribe for ordinary shares in Xero Limited to Chris Liddell and Bill Veghte, as remuneration for their roles as Directors of Xero Limited (equating to an annual value of NZ\$220,000 and NZ\$176,000 respectively), in or around February 2015, on the terms set out in the Explanatory Notes to the Notice of Meeting, be approved, and that the issue of ordinary shares in Xero Limited to Chris Liddell and Bill Veghte upon any exercise of those options, be approved.
- 10. That the issue of ordinary shares in Xero Limited to Lee Hatton in lieu of cash, as remuneration for her role as Director of Xero Limited to a value of NZ\$70,000 per annum on the terms set out in the Explanatory Notes to the Notice of Meeting, be approved.

By order of the Board.

A handwritten signature in black ink, appearing to read "CLiddell", with a long horizontal line extending to the right.

Chris Liddell  
Chairman

## EXPLANATORY NOTES

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In these Explanatory Notes:

“**2014 Options**” means the 13,481 and 10,785 options to subscribe for ordinary shares in Xero granted on 12 February 2014 to Chris Liddell and Bill Veghte, respectively, as their annual remuneration for acting as Directors (with a value when granted of NZ\$220,000 and NZ\$176,000 respectively) and which are the subject of resolution 8;

“**2015 Options**” means the options to subscribe for ordinary shares in Xero, which, subject to Xero shareholder approval, are to be granted in or around February 2015 to Chris Liddell and Bill Veghte, as their annual remuneration for acting as Directors (with a value when granted of NZ\$220,000 and NZ\$176,000 respectively) and which are the subject of resolution 9;

“**Board**” means the Board of Directors of Xero;

“**Director**” means a director of Xero;

“**Equity Securities**” has the same meaning as in the NZX Listing Rules, which includes Shares but for NZX purposes does not include Options;

“**Non-Executive Director**” means a Director who is not also an employee or executive of Xero;

“**Option**” means an option to subscribe for a Share;

“**Ordinary Resolution**” means a resolution passed by a simple majority of the votes of shareholders of Xero entitled to vote and voting on the resolution;

“**Share**” means an ordinary share in Xero; and

“**Xero**” means Xero Limited.

### Resolution 1 – Fixing the Remuneration of the Auditor

Ordinary Resolution: *“That the Board is authorised to fix the remuneration of the auditor.”*

The proposed resolution, if passed by shareholders, would authorise the Board to fix the remuneration of Xero’s auditor, PricewaterhouseCoopers.

### Resolution 2 – Election of Chris Liddell as a Director

Ordinary Resolution: *“That Chris Liddell, appointed by the Board as an additional Director on 12 February 2014, be elected as a Director of Xero Limited.”*

Chris Liddell was appointed by the Board as an additional Director and Chairman of the Board on 12 February 2014. Under NZX Listing Rule 3.3.6 and ASX Listing Rule 14.4, Chris is required to retire from office as a Director at the Meeting and he offers himself for election by the shareholders. The Board unanimously supports Chris’s election.

### CHRIS LIDDELL

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*Independent, Non-Executive Chairman*

*Term of Office: Appointed by the Board as an additional Director on 12 February 2014*

*Board Committees: Audit and Risk Management Committee; People and Remuneration Committee;*

*Nominations Committee (Chair)*

Chris most recently worked with General Motors where he held the Vice Chairman and CFO roles. He led the company’s global finance operations and its US\$23 billion IPO in November 2010. Prior to General Motors, Chris held the Senior Vice President and CFO roles at Microsoft, served as CFO of International Paper, and held the CFO role at Carter Holt Harvey before becoming CEO in 1999.

Chris is based in New York, and is also Chairman of NEXT Foundation, a philanthropic organisation committed to the environment and education in New Zealand.

### Resolution 3 – Election of Bill Veghte as a Director

Ordinary Resolution: “That Bill Veghte, appointed by the Board as an additional Director on 12 February 2014, be elected as a Director of Xero Limited.”

Bill Veghte was appointed by the Board as an additional Director on 12 February 2014. Under NZX Listing Rule 3.3.6 and ASX Listing Rule 14.4, Bill is required to retire from office as a Director at the Meeting and he offers himself for election by the shareholders. The Board unanimously supports Bill’s election.

#### BILL VEGHTE

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*Independent, Non-Executive Director*

*Term of Office: Appointed by the Board as an additional Director on 12 February 2014*

*Board Committees: People and Remuneration Committee*

Bill is Executive Vice President and General Manager of HP’s \$27 billion Enterprise Group. This group is the world’s largest IT infrastructure business spanning servers, storage, networking, technical services and HP’s cloud efforts. Prior to leading this business, he was HP’s COO.

Bill spent 20 years at Microsoft in a variety of business and engineering leadership roles from leading the Windows Server efforts to leading the Windows business to leading Microsoft’s sales, services and marketing in North America.

Bill is based in Palo Alto, California.

### Resolution 4 – Election of Lee Hatton as a Director

Ordinary Resolution: “That Lee Hatton, appointed by the Board as an additional Director on 10 April 2014, be elected as a Director of Xero Limited.”

Lee Hatton was appointed by the Board as an additional Director on 10 April 2014. Under NZX Listing Rule 3.3.6 and ASX Listing Rule 14.4, Lee is required to retire from office as a Director at the Meeting and she offers herself for election by the shareholders. The Board unanimously supports Lee’s election.

#### LEE HATTON

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*Independent, Non-Executive Director*

*Term of Office: Appointed by the Board as an additional Director on 10 April 2014*

*Board Committees: Audit and Risk Management Committee, People and Remuneration Committee*

Lee Hatton is employed as the General Manager, Regulatory Strategy and Affairs for National Australia Bank and is an Executive Director of BNZ Investment Services Limited.

With 17 years experience in a broad range of international banking and finance roles, Lee is a well-rounded banking executive. She has held senior positions across marketing, risk, payments and strategy and has led large client teams across retail, agriculture, and business banking in the US.

Lee is based in Sydney, Australia.

## Resolution 5 – Re-election of Graham Shaw as a Director

Ordinary Resolution: “That Graham Shaw, retiring from office as a Director of Xero Limited by rotation, be re-elected as a Director of Xero Limited.”

Under NZX Listing Rule 3.3.11 and ASX Listing Rule 14.4, Graham Shaw is required to retire by rotation at the Meeting as a Director. Graham will offer himself for re-election as a Director at the Meeting, and the Board unanimously supports Graham’s re-election.

### GRAHAM SHAW

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*Independent, Non-Executive Director*

*Term of Office: Appointed Director 9 November 2006, re-elected as a Director 23 July 2009, and 26 July 2012*

*Board Committees: Audit and Risk Management Committee (Chair)*

Graham is a chartered accountant with over 30 years’ experience in business. He is a member of a number of corporate and not-for-profit boards and a representative of Downer New Zealand (formerly Works Infrastructure).

Graham spent 10 years with KPMG primarily as an advisor to businesses. He then joined Works Infrastructure where he held a number of finance roles before being appointed Chief Executive, and leading the company to substantial growth and a successful expansion into Australia. Graham has also been CEO of Kensington Swan, one of New Zealand’s national law firms.

## Resolution 6 – Re-election of Sam Morgan as a Director

Ordinary Resolution: “That Sam Morgan, retiring from office as a Director of Xero Limited by rotation, be re-elected as a Director of Xero Limited.”

Under NZX Listing Rule 3.3.11 and ASX Listing Rule 14.4, Sam Morgan is required to retire by rotation at the Meeting as a Director. Sam will offer himself for re-election as a Director at the Meeting, and the Board unanimously supports Sam’s re-election.

### SAM MORGAN

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*Independent, Non-Executive Director*

*Term of Office: Appointed Director on 26 March 2007, re-elected as a Director on 22 July 2010, and 26 July 2012*

*Board Committees: People and Remuneration Committee (Chair); Nominations Committee*

Sam started his career at Deloitte Consulting and is best known for founding the online auction website Trade Me which was sold to Fairfax Media in 2006. Sam remains a director of Trade Me Group Limited.

Sam is an active investor and philanthropist.

## Resolution 7(a) – Non-Executive Director Remuneration

Ordinary Resolution: “That the maximum aggregate annual remuneration able to be paid to the Non-Executive Directors be increased by NZ\$350,000 from NZ\$500,000 to NZ\$850,000, with immediate effect.”\*

\*Please refer to the voting exclusions on page 9 in relation to this resolution.

### NZX Listing Rules and ASX Listing Rules

As a dual listed company, Xero must comply with the Listing Rules of both NZX and ASX in relation to the remuneration of the Non-Executive Directors.

Under NZX Listing Rule 3.5.1 and ASX Listing Rule 10.17, the maximum aggregate annual remuneration that can be paid to Non-Executive Directors must be approved by shareholders by way of an Ordinary Resolution.

### Increase in the Non-Executive Director Remuneration Cap

The current maximum aggregate annual remuneration of NZ\$500,000 that can be paid to the Non-Executive Directors was approved in 2012. Since that time, Xero’s business has grown strongly and the number of Directors has increased to eight. Most recently, the skill set and global coverage of the Board has broadened significantly through the appointment of two US-based Directors and one Australian Director.

The proposed increase in the Non-Executive Director remuneration cap will enhance the Board’s ability to attract and retain directors of the highest calibre to help drive Xero’s continued success. The increase in the remuneration cap will also bring Xero’s

Non-Executive Director remuneration into line with current market rates, particularly those in offshore markets such as the US.

If shareholders approve the proposed increase in the Non-Executive Director remuneration cap, the Board expects there to be NZ\$214,000 per annum of unallocated Non-Executive Director remuneration, which would allow the Board some flexibility to change its composition during the coming year, if the Board considered this to be in Xero's interests.

### **Resolution 7(b) – Issue of Equity Securities as Non-Executive Director Remuneration**

Ordinary Resolution: *“That any remuneration payable to Non-Executive Directors may be payable either in part or in whole by way of an issue of Equity Securities (as defined in the NZX Listing Rules) as detailed in the Explanatory Notes to the Notice of Meeting.”\**

\*Please refer to the voting exclusions on page 9 in relation to this resolution.

#### **NZX Listing Rules and ASX Listing Rules**

Shareholder approval under resolution 7(b) is being sought for the purposes of NZX Listing Rule 3.5.1.

NZX Listing Rule 3.5.1 provides that any resolution to increase the remuneration payable to non-executive directors may expressly provide that the remuneration may be payable either in part or in whole by way of an issue of Equity Securities (as defined in the NZX Listing Rules to include Shares but not Options), without the necessity for a resolution of shareholders, provided that the issue complies with NZX Listing Rule 7.3.8.

NZX Listing Rule 7.3.8, as it applies to an issue of Shares by Xero to a Non-Executive Director requires, among other things, that:

- the Shares are issued after the end of the period (or half period) to which the remuneration of the Non-Executive Director relates; and
- the issue price of the Shares is the volume weighted average market price of Shares over the 20 business days prior to the issue.

The value of the Shares at the time of issue, taken together with all other Non-Executive Director remuneration, cannot exceed the then applicable Non-Executive Director remuneration cap.

The general shareholder approval under proposed resolution 7(b) for the issue of Equity Securities (being Shares but not Options) for Director remuneration is not being sought under the ASX Listing Rules. The ASX Listing Rules set out their own additional shareholder approval requirements for issues of Shares and Options to Directors, with which Xero will comply at the time of issue.

#### **Incentivising through the issue of Equity Securities as Non-Executive Director Remuneration**

The Board considers it to be in Xero's interests to give the Board the discretion to remunerate Non-Executive Directors in part or in whole by way of the issue of Equity Securities rather than solely by cash.

The Board believes that providing remuneration to Directors in the form of Equity Securities more effectively aligns the interests of the Directors with those of shareholders, by giving the Directors an opportunity to share in the success of Xero. Director remuneration in this form can motivate and reward long-term decision making with the aim of creating and maximising shareholder value over the longer term.

Further, in Xero's offshore markets (particularly in the US), remunerating directors by way of Equity Securities is common. As part of Xero's global growth strategy, it is important that the Board is able to attract and retain high quality directors that are experienced in, and knowledgeable about, Xero's offshore markets. Being able to compensate these directors in line with the relevant market expectations is seen as fundamental to this objective.

Please note that resolution 7(a) and resolution 7(b) will be voted on separately and are not interdependent. Accordingly, if only one of the resolutions is approved it will nevertheless be effective.



## Resolution 8 – Ratification of the 2014 Options granted to Chris Liddell and Bill Veghte

Ordinary Resolution: *“That the grant of 13,481 and 10,785 options to subscribe for ordinary shares in Xero Limited on 12 February 2014 to Chris Liddell and Bill Veghte, respectively, as remuneration for their roles as Directors of Xero Limited (equating to an annual value of NZ\$220,000 and NZ\$176,000 respectively), on the terms set out in the Explanatory Notes to the Notice of Meeting, be approved and ratified, and that the issue of ordinary shares in Xero Limited to Chris Liddell and Bill Veghte upon any exercise of those options, be approved.”\**

\*Please refer to the voting exclusions on page 9 in relation to this resolution.

### Background

On 12 February 2014, the Board was pleased to appoint Chris Liddell and Bill Veghte as Non-Executive Directors. Both Chris and Bill bring extensive experience and knowledge to the Board.

In consideration for acting as Non-Executive Directors (and in Chris Liddell’s case, as Chairman of the Board), the Board agreed that the remuneration payable to Chris Liddell and Bill Veghte would be NZ\$220,000 and NZ\$176,000 per annum, respectively. The Board also agreed, subject to shareholder approval and compliance with both NZX and ASX Listing Rules, that such remuneration would be payable by the grant of the 2014 Options, with the number of Options determined using the Black-Scholes valuation methodology.

### NZX Listing Rules and ASX Listing Rules

As a dual listed company, Xero must comply with the Listing Rules of both NZX and ASX in relation to the issue of securities to Directors.

Xero has applied for, and has received, a waiver from NZX of the NZX Listing Rules to enable the Board to make grants of Options as remuneration for Non-Executive Directors. A copy of the waiver will be released through Xero’s Market Announcement Platform on ASX and NZX. The waiver is subject to the condition that shareholder approval is obtained to the terms of the Options under NZX Listing Rule 7.3.1(a), as if the Options were “Equity Securities” (as defined by the NZX Listing Rules to include Shares but not Options). This approval is being sought pursuant to proposed resolution 8.

Under the ASX Listing Rules, ASX Listing Rule 10.11 generally also requires that an issue of Options to Directors be approved by Xero shareholders in accordance with ASX Listing Rule 10.12 before the issue can be made. Accordingly, this approval of the 2014 Options is also being sought pursuant to proposed resolution 8.

### Incentivising through the issue of the 2014 Options

The Board considered it to be in Xero’s interests to grant the 2014 Options as described above to Chris Liddell and Bill Veghte, subject to shareholder approval at this Meeting.

The Board believes that the grant of Options as director remuneration is an effective method of incentivising Non-Executive Directors to maximise the long-term value of Xero for shareholders. The reasons for this are similar to those discussed above in the Explanatory Notes to resolution 7(b) in relation to the issue of Equity Securities (as defined in the NZX Listing Rules to include Shares but not Options) as director remuneration.

Further, the Board considers that Options are particularly effective as they are valuable only to the extent that the price of the underlying Shares is greater than the exercise price of the Options (the exercise price of the Options is set by reference to the market value of the underlying Shares at the time of grant of the Options as set out below).

The grant of options is also commonly used to remunerate directors in Xero’s important offshore markets, such as the US, where both Chris and Bill are based.

### Terms of the 2014 Options

The terms of the 2014 Options that were granted to Chris and Bill were the same as the terms of the Options granted to Xero’s US based employees (other than the requirement for shareholder approval at this Meeting), with the key terms being as follows:

**Options:** Exercisable into Shares on a 1:1 basis.

**Exercise Price:** Market value of the underlying Shares on 12 February 2014, being NZ\$38.24 (based on the volume weighted average price of the underlying Shares for the 5 business days prior to the grant).

**Vesting Schedule:** The 2014 Options vest, and become able to be exercised, in three equal instalments, on 12 February 2015, 12 February 2016, and 12 February 2017, subject to the continued service of the relevant Director on each instalment date. If either Chris Liddell or Bill Veghte ceases to hold office, any 2014 Options granted to Chris Liddell or Bill Veghte, as applicable, that have not vested at such time, will be cancelled.

**Final Exercise Date:** The date that is the fourth anniversary of the date of grant (i.e. 12 February 2018).

**Value of 2014 Options:** This was calculated using the Black-Scholes valuation methodology, which gives an Option a “value” based on inputs that include the market share price at grant date, the exercise price of the Option, the expected annualised volatility of the underlying Shares, the period from grant until final exercise date, and an annual risk-free interest rate. The value of the 2014 Options was NZ\$16.32 each.

The number of 2014 Options granted to Chris Liddell and Bill Veghte was 13,481 and 10,785 respectively, calculated by dividing the annual remuneration of the relevant Director (i.e. NZ\$220,000 for Chris Liddell and NZ\$176,000 for Bill Veghte) by the value of a 2014 Option (being NZ\$16.32).

If this resolution is not approved, the 2014 Options granted to Chris Liddell and Bill Veghte will be cancelled and both Chris Liddell and Bill Veghte will be paid their respective director remuneration in cash effective from the date of their respective appointments as Directors.

### Resolution 9 – Approval of the 2015 Options to be granted to Chris Liddell and Bill Veghte

Ordinary Resolution: *“That the grant of options to subscribe for ordinary shares in Xero Limited to Chris Liddell and Bill Veghte, as remuneration for their roles as Directors of Xero Limited (equating to an annual value of NZ\$220,000 and NZ\$176,000 respectively), in or around February 2015, on the terms set out in the Explanatory Notes to the Notice of Meeting, be approved, and that the issue of ordinary shares in Xero Limited to Chris Liddell and Bill Veghte upon any exercise of those options, be approved.”\**

\*Please refer to the voting exclusions on page 9 in relation to this resolution.

#### Background

On 12 February 2014, the Board was pleased to appoint Chris Liddell and Bill Veghte as Non-Executive Directors.

In consideration for acting as Non-Executive Directors (and in Chris Liddell’s case, as Chairman of the Board), the Board proposes to agree that the annual remuneration payable to Chris Liddell and Bill Veghte for the 12 month period to 12 February 2016 be NZ\$220,000 and NZ\$176,000 per annum, respectively, with such remuneration to be satisfied by the issue of the 2015 Options in or around February 2015. The precise number of 2015 Options to be issued is to be determined by using the Black-Scholes valuation methodology (as described below).

#### NZX Listing Rules and ASX Listing Rules

As discussed above in relation to resolution 8, as a dual listed company, Xero must comply with the Listing Rules of both NZX and ASX in relation to the issue of securities to Directors.

Under the NZX Listing Rules, to enable the Board to grant the 2015 Options in the manner proposed, Xero has applied for, and has received, the waiver from NZX discussed above in relation to resolution 8. The waiver is subject to shareholder approval to the grant of the 2015 Options.

Under the ASX Listing Rules, ASX Listing Rule 10.11 also requires that the issue of the 2015 Options to Directors be approved by Xero shareholders in accordance with ASX Listing Rule 10.12 before they can be issued. This approval is being sought pursuant to proposed resolution 9. Xero has obtained a waiver from the ASX of the requirement that the 2015 Options be granted within one month of the date of the approval of their grant to permit them to be granted no later than 12 months after that date.

#### Incentivising through the issue of the 2015 Options

The Board considers it to be in Xero’s interests to grant the 2015 Options as described above to Chris Liddell and Bill Veghte subject to shareholder approval at the Meeting, for similar reasons to those discussed above in the Explanatory Notes relating to resolution 7(b) and resolution 8.

#### Proposed Terms of the 2015 Options

The terms of the 2015 Options will be the same as the terms of the Options granted to Xero’s US based employees (other than the requirement for shareholder approval at this Meeting), with the key terms being as follows:

**Options:** Exercisable into Shares on a 1:1 basis.

**Exercise Price:** Market value of the underlying Shares on the date of issue to be in or around February 2015 based on the volume weighted average price of the underlying Shares for the 5 business days prior to the grant.

**Vesting Schedule:** The 2015 Options vest, and become able to be exercised, in three equal instalments, on the first, second and third anniversary of the date of the grant of the 2015 Options, subject to the continued service of the relevant Director on each instalment date. If either Chris Liddell or Bill Veghte ceases to hold office, any unvested 2015 Options granted to Chris Liddell or Bill Veghte, as applicable, will be cancelled.

**Final Exercise Date:** The date that is the fourth anniversary of the date of grant (i.e. in or around February 2019).

**Value of 2015 Options:** Calculated in accordance with the Black-Scholes valuation methodology, which gives an Option a “value” based on inputs that include the market share price at grant date, the exercise price of the Option, the expected annualised volatility of the underlying Shares, the period from grant until final exercise date, and an annual risk-free interest rate.

**Number of Options to be Granted:** The number of 2015 Options to be granted to Chris Liddell and Bill Veghte will be calculated by dividing the annual remuneration of the relevant Director (i.e. NZ\$220,000 for Chris Liddell and NZ\$176,000 for Bill Veghte) by the value of a 2015 Option as at the date of grant, up to a maximum number of 50,000 2015 Options each (i.e. 100,000 Options in total). Once the maximum number of 2015 Options is reached, any remaining director remuneration will be paid in cash and not through the grant of further Options.

If this resolution is approved by shareholders, the Board intends to grant the 2015 Options in or around February 2015 to Chris Liddell and Bill Veghte as the whole of their annual director remuneration (and to issue Shares to Chris Liddell and Bill Veghte upon any exercise of such vested 2015 Options), on the terms set out above, provided that such granting of Options occurs no later than the date that is 12 months following the date of the passing of this resolution, and is, in all cases, subject to the Non-Executive Director remuneration cap.

If this resolution is not approved, both Chris Liddell and Bill Veghte will be paid their respective director remuneration in cash or Shares as described below.

### Resolution 10 – Approval of the issue of Ordinary Shares to Lee Hatton

Ordinary Resolution: *“That the issue of ordinary shares in Xero Limited to Lee Hatton in lieu of cash, as remuneration for her role as Director of Xero Limited to a value of NZ\$70,000 per annum on the terms set out in the Explanatory Notes to the Notice of Meeting, be approved.”\**

\*Please refer to the voting exclusions on page 9 in relation to this resolution.

#### Background

On 10 April 2014, the Board was pleased to appoint Lee Hatton as an additional Non-Executive Director. Lee has extensive international banking and finance experience, and is a valuable addition to the Board.

The Board, and Lee, would like Lee’s director remuneration of NZ\$70,000 to be paid by the issue of Shares, in lieu of cash.

#### NZX Listing Rules and ASX Listing Rules

Under the NZX Listing Rules, subject to the passing of resolution 7(b), the Board is able to issue Shares to Lee Hatton or other Directors as director remuneration in the manner proposed in accordance with NZX Listing Rule 7.3.8. That NZX Listing Rule requires, with respect of Shares, that any such Shares must be issued after the end of the period (or half period) to which that remuneration relates, and that the issue of such Shares must be equal to the volume weighted average market price of the Shares over the 20 business days prior to issue.

Under the ASX Listing Rules, Xero must also comply with ASX Listing Rule 10.11 which requires the issue of Shares to a Director to be approved by shareholders.

It is proposed that the maximum number of Shares that may be issued to Lee will be calculated by dividing NZ\$70,000 by the volume weighted average market price of the Shares over the 20 business days prior to the date of issue (which will therefore be the issue price of the Shares).

Such Shares will be issued to Lee at the end of each 6-month period to which the remuneration relates.

#### Approval Sought

Shareholder approval is sought for the issue of Shares to Lee Hatton as described above, for the purpose of ASX Listing Rule 10.11.

Xero has been granted a waiver of ASX Listing Rule 10.13 insofar as it requires that this Notice of Meeting and Explanatory Notes state that:

- the Shares to be issued to Lee Hatton must be issued no more than one month after the date of the Meeting (rather than the 12 month period envisaged); and
- the maximum number of securities that will be issued to Lee Hatton be specified rather than merely the formula for calculating that number.

If this resolution is not approved, Lee Hatton will be paid her director remuneration in cash for the relevant period.

## IMPORTANT INFORMATION

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### PROXIES

Any shareholder who is entitled to attend and vote at the Meeting may appoint a proxy to attend and vote instead of him or her by filling out the enclosed Proxy Form. The person appointed as proxy is not required to be a Xero shareholder. If you appoint a proxy you may either direct your proxy how to vote for you or you may give your proxy discretion to vote as he/she sees fit. If you wish to give your proxy discretion then you must mark the appropriate boxes on the form to grant your proxy that discretion. The Chairman of the Meeting and any Director appointed as proxy intend to vote all discretionary proxies in favour of the relevant resolution (except that the Chairman of the Meeting and any Director cannot vote such discretionary proxies on resolutions 7-10, inclusive). If you do not tick any box for a particular resolution, then your instruction for your proxy will be to abstain from voting.

The completed Proxy Form must be received by our Share Registrar, Link Market Services Limited, no later than 4.00pm (New Zealand time) on Monday 21 July 2014. Any Proxy Form received after that time will not be valid for the scheduled meeting.

Please refer to the instructions on the enclosed Proxy Form as to the ways in which the Proxy Form can be sent to Link Market Services Limited, including instructions on how to appoint your proxy and vote online.

### ORDINARY RESOLUTION

The formal business of the Meeting is to pass the Ordinary Resolutions set out in the preceding pages. An Ordinary Resolution is a resolution passed by a simple majority of the votes of shareholders of Xero entitled to vote and voting on the resolution.

### VOTING

Voting entitlements for the Meeting will be determined as at 5.00pm (New Zealand time) on Monday 21 July 2014. Registered shareholders at that time will be the only persons entitled to vote at the Meeting and only the shares registered in those shareholders' names at that time may be voted at the Meeting.

### VOTING EXCLUSIONS

In relation to resolutions 7-10 (inclusive):

- Xero will disregard any votes cast on a resolution by any Director and any associate (as defined in the ASX Listing Rules) or associated person (as defined in the NZX Listing Rules) of a Director.
- However, Xero need not disregard a vote if it is cast by a person as proxy for a person who is entitled to vote, in accordance with the express directions (i.e. instructions to vote for or against the resolution) on the Proxy Form. Under NZX Listing Rule 9.3.3, a Director that is proxy for a person who is entitled to vote, is not entitled to vote if the direction on the Proxy Form allows the proxy discretion as to how to vote (i.e. discretion to exercise that vote as the proxy sees fit).

### MORE INFORMATION

If you have any questions or require further information in relation to this Notice of Meeting, please contact Xero's Company Secretary, Matt Vaughan, at [companysecretary@xero.com](mailto:companysecretary@xero.com).