

30 April 2015

Ms Kate Kidson
Principal Advisor – Listing Compliance (Melbourne)
ASX Compliance Pty Limited
20 Bridge Street
Sydney, NSW 2000

By email: kate.kidson@asx.com.au

Dear Ms Kidson

Xero Limited (“Xero”): ASX Aware Query

We refer to your letter dated 27 April 2015, and to our email correspondence on that day in which you extended the deadline for our response to your letter to 9:30 am AEST on Thursday 30 April 2015.

We respond to the five questions set out in your letter below, using the numbering in your letter. Terms used, but not defined, in this letter have the same meaning given to them in your letter.

1. Does the Entity consider the information contained in the Results Announcement pertaining to the increase in the Loss to be information that a reasonable person would expect to have a material effect on the price or value of its securities?

No.

2. If the answer to question 1 is “no”, please advise the basis for that view, particularly in light of the Trading Activity.

Please refer to Appendix 1 for a detailed response.

3. If the answer to question 1 is “yes”, when did the Entity first become aware that the FY Loss would materially differ from the previous corresponding period?

Not applicable.

4. If the answer to question 1 is “yes” and the Entity first became aware of the information before the release of the Results Announcement please explain why this information was not released to the market at an earlier time, (commenting specifically on the Entity’s compliance with sections 4.10, 7.3, 7.4 of GN8 referred to above); when you believe the Entity was obliged to release the information under Listing Rules 3.1 and 3.1A; and what steps the Entity took to ensure that the information was released promptly and without delay?

Not applicable.

5. Please confirm that the Entity is in compliance with the Listing Rules and, in particular, Listing Rule 3.1.

Xero confirms that it is in compliance with the Listing Rules and, in particular, Listing Rule 3.1.

Please feel free to contact me if you have any queries regarding this matter.

Yours faithfully,



Matt Vaughan
Company Secretary
Xero Limited

Appendix 1

Detailed response to Question 2

Xero does not consider the Results Announcement pertaining to the increase in the Loss to be information that a reasonable person would expect to have a material effect on the price or value of its securities for the following reasons:

- Xero's results have not been accurately reported in news outlets, such that the variance has, in at least one major publication, been overstated;
- Overall, Xero's results for the 12 months to 31 March 2015 were very positive with strong results for critical indicators such as customer growth and subscription revenue, and an end of financial year cash balance that is in line with analyst consensus estimates. EBIT and NPAT figures are far less relevant indicators of the value of Xero's shares given Xero's stage of growth and, in any event, are counterbalanced by Xero's performance in other more critical areas;
- The resignation of Xero's CFO on the day of the Results Announcement amplified any negative market sentiment relating to the Results Announcement, and by itself had a negative impact on Xero's share price; and
- Movements in the market price of Xero's shares are unpredictable and particularly volatile, so that there may be significant changes to the market price of Xero's shares in response to information that a reasonable person would not expect to have such an effect.

Xero's view that the Results Announcement pertaining to the increase in the Loss was not information that a reasonable person would expect to have a material effect on the price or value of its securities was reasonably formed when all of the factors set out above are taken into account. Further explanation of these factors is set out below.

A. Results not accurately reported

Xero's results have not been accurately reported in news outlets, such that the variance has, in at least one major publication, been overstated.

The table below shows the correct EBIT figures along with the analyst consensus estimates (together with the corresponding NPAT figures). Details of the basis of our calculation of the analyst consensus estimates are set out in Appendix 2. We note that the figures below include reference to two adjustments that are discussed further in Paragraph C below and which are in line with the relevant ASX guidance contained in GN8, specifically at paragraph 7.3.

(NZD millions)	EBIT	NPAT
Reported result	-75.1	-69.5
Adjustments		
One-Off Long Term Incentive costs	5.4	5.4
Reduction in capitalisation of Product costs	2.8	2.8
Adjusted result	-66.9	-61.3
Analyst consensus	-60.1	-53.0
Variance of Analyst Consensus to Adjusted Result	10.2%	13.5%

B. EBIT/NPAT are not the key indicators of the value of Xero's shares

A reasonable person would not regard EBIT and NPAT figures as the key indicators in determining the value of Xero's shares, particularly given Xero's stage of growth and the nature of its business as a Software as a Service (SaaS) company.

This view is well supported by the following:

- Xero is currently an early stage, high-growth, loss-making, SaaS company that derives almost all of its revenue from a recurring revenue business model. Analysts do not commonly rely upon EBIT and NPAT as the key indicators of value for such companies. Loss is less fundamental to the assessment of performance, as significant investment is required up-front to attain customers and drive future revenues in order to adequately capitalise on the growth opportunity and recurring revenue business model.

Instead, key indicators in determining the value of securities in companies such as Xero are:

- trends in customer and revenue growth;
- cash burn rate;
- level of cash reserves and the ability to fund growth; and
- other commonly used SaaS metrics such as Average Revenue Per User ("ARPU"), Costs of Acquiring Customers ("CAC"), Annualised Committed Monthly Revenue ("ACMR"), and customer "Churn".

Xero is of the view that these key indicators can be confirmed by those analysts covering Xero and other listed SaaS companies experiencing comparable levels of growth.

- Xero's only published guidance in FY15 was that Xero expected to achieve approximately 80% subscription revenue growth for FY15, on a constant dollar basis.¹ This demonstrates Xero's view of its key financial metric. On 24 April 2015, Xero disclosed to the market that it had achieved 83% subscription revenue growth on a constant dollar basis for FY15.

We confirm that Xero has not published earnings guidance for the current or prior reporting period.

As noted above, key indicators in determining the value of securities in companies such as Xero are:

- Cash burn - For FY15, Xero's cash burn was within close range of the analyst consensus estimate. The consensus on Xero's cash balance at year-end was NZ\$275.8m (see Appendix 2 for details of this calculation), which is a variance of NZ\$6.9m or 2.5% from the actual end of financial year position of NZ\$268.9m.
- Cash reserves - The market is regularly informed of Xero's cash position by way of Xero's filings of Quarterly Cashflow Reports (Appendix 4C). The most recent Quarterly Cashflow Report will be released to the market today for the period ended 31 March 2015, with the prior Quarterly Cashflow Report (for the period ended 31 December 2014) released to the market on 31 January 2015.
- Industry accepted key SaaS metrics - Xero reports on key SaaS metrics alongside its financial statements. A number of these SaaS metrics for FY15 were disclosed to the market by Xero on 24 April 2015, including Average Revenue Per User ("ARPU"), Costs of Acquiring Customers ("CAC"), Annualised Committed Monthly Revenue ("ACMR"), and customer "Churn", both in respect of the Xero Group and for each core market in which Xero operates.

Xero's view is that the reporting of these SaaS metrics, while not strictly legally required, provides investors with greater insight into Xero's business model and the key indicators of value to allow investors to make an informed decision on the value of Xero's shares. This additional reporting also ensures that Xero's reporting is more closely aligned to other major SaaS companies.

¹ This market guidance was communicated at Xero's Annual Meeting on 23 July 2014 and was stated in Xero's CEO's Annual Meeting presentation that was released to the market on 23 July 2014 prior to the start of Xero's 2014 Annual Meeting.

C. Relevant "One-Off" or Non-cash factors

Even focussing on the EBIT and NPAT results for Xero for the 12 months ended 31 March 2015, the results should be adjusted for unusual items in line with guidance provided by ASX in GN8, and in particular, at paragraph 7.3. See as follows:

- **One-off non-cash costs in connection with long term incentives for key executives:** A number of incremental grants of equity (under Xero's Long Term Incentive Schemes) were allocated to key executives during the period from December 2014 to March 2015. The allocations were fully disclosed to the market in various Appendix 3B notices, and Director and Officer Disclosure Notices (where applicable). These allocations represent a one-off, non-cash cost of approximately NZ\$5.4 million and, while there is no cash impact recognised in FY15, an expense of NZ\$5.4m was added to Xero's FY15 profit and loss statement.
- **Change in capitalisation rate of product development costs:** The proportion of product development costs capitalised can vary each quarter depending on activities conducted during the period. This creates variability in the profit and loss expense without impacting on total costs (i.e., it reflects timing of expenditure). Xero capitalised 50% of product development costs (excluding overheads) for the half year to 30 September 2014 compared with 45% for the full year to 31 March 2015. This change in the capitalisation rate resulted in a lower portion of product development costs capitalised to the balance sheet and higher overall expenditure recognised in the profit and loss statement (equivalent to NZ\$2.8m).

D. CFO resignation announcement

We note that, on the date of the Results Announcement (24 April 2015), Xero also announced the resignation of its then current CFO, US-based Doug Jeffries, after just two months in that position ("**CFO Announcement**").

While it is not possible to determine with any certainty the impact of the CFO Announcement on the price of Xero's quoted equity securities, we view this announcement as material and expect that it amplified any negative sentiment relating to the Results Announcement and by itself had a negative impact on Xero's share price in the days following the Results Announcement.

Supporting this view, we note that following the announcement of Peter Karpas' resignation as head of North America (a less senior position than that of Group CFO) on 12 September 2014, Xero's share price on the ASX dropped by 11.8% by close of trade on the trading day following the announcement.²

E. Limited liquidity and unpredictable historical volatility

Finally, we note that there is relatively limited liquidity for Xero's shares, and that the price of Xero's shares has a history of significant fluctuations on relatively small volumes of trading. The market has a history of reacting strongly and unpredictably to events and announcements by Xero, but this volatility is very difficult or impossible to accurately predict. These factors should also be taken into account in the assessment of the influence of any market announcement by Xero on the value of Xero's shares.

² From AU\$20.41 at close of trade on the ASX on 11 September 2014 to AU\$18.00 at close of trade on the ASX on 15 September 2014.

Appendix 2

Consensus Calculation

Latest Available Report Prior to FY15 Results Announcement				
Analyst	Date of report	EBIT	NPAT	Cash balance at 31 March 2015
Deutsche*	09/12/2014	(63.0)	(58.0)	268.0
Macquarie	30/03/2015	(55.1)	(49.0)	276.0
Credit Suisse	25/02/2015	(59.9)	(52.4)	273.0
Goldman Sachs	03/03/2015	(65.2)	(58.6)	281.1
Forsyth Barr	26/02/2015	(57.4)	(47.0)	281.1
Average		(60.1)	(53.0)	275.8

* Report issued prior to Xero's capital raise in March 2015. Proceeds from the issue of shares in connection with this capital raise (NZ\$147m) were added to the closing cash estimate in this Report to ensure comparability.



27 April 2015

Matt Vaughan
General Counsel & Company Secretary
Xero Limited
3 Market Lane,
Wellington, 6142,
New Zealand, PO Box 24 537

By email only

Dear Mr Vaughan,

Xero Limited (the "Entity"): ASX aware query

ASX Limited ("ASX") refers to the following:

1. The Entity's announcements released on the ASX Market Announcements Platform on 24 April 2015 entitled *"Appendix 4E", "Xero Announces Fiscal 2015 Results" and FY15 Annual Results Presentation* (together, the "Results Announcement"), disclosing the following.
 - 1.1. The Entity's net loss attributable to shareholders ("Loss") for the 12 months ended 31 March 2015 was up 96% to NZ\$ (69,534,000) ("FY Result").
2. The Entity's share price following the Results Announcement which decreased from a closing price on 23 April 2015 of \$22.65 to an intra-day low of \$20.00; and closing price of \$20.32 on 24 April 2015 ("Trading Activity").
3. The FY Result is reported to be approximately 25 percent below analyst's consensus according to various news outlets and broker research reports ("Consensus").
4. Listing Rule 3.1, which requires a listed entity to give ASX immediately any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities.
5. The definition of "aware" in Chapter 19 of the Listing Rules. This definition states that:

"an entity becomes aware of information if, and as soon as, an officer of the entity (or, in the case of a trust, an officer of the responsible entity) has, or ought reasonably to have, come into possession of the information in the course of the performance of their duties as an officer of that entity."

Additionally, you should refer to section 4.4 in Guidance Note 8 *Continuous Disclosure: Listing Rules 3.1 – 3.1B "When does an entity become aware of information"*.

6. Listing Rule 3.1A, which sets out exceptions from the requirement to make immediate disclosure, provided that each of the following are satisfied.

"3.1A Listing rule 3.1 does not apply to particular information while each of the following requirements is satisfied in relation to the information:

3.1A.1 One or more of the following applies:

- It would be a breach of a law to disclose the information;*
- The information concerns an incomplete proposal or negotiation;*
- The information comprises matters of supposition or is insufficiently definite to warrant disclosure;*
- The information is generated for the internal management purposes of the entity; or*
- The information is a trade secret; and*

3.1A.2 The information is confidential and ASX has not formed the view that the information has ceased to be confidential; and

3.1A.3 A reasonable person would not expect the information to be disclosed."

7. ASX's policy position on the concept of "confidentiality" which is detailed in section 5.8 of Guidance Note 8 *Continuous Disclosure: Listing Rules 3.1 – 3.1B* ("GN8")- Listing Rule 3.1A.2 – the requirement for information to be confidential". In particular, the Guidance Note states that:

"Whether information has the quality of being confidential is a question of fact, not one of the intention or desire of the listed entity. Accordingly, even though an entity may consider information to be confidential and its disclosure to be a breach of confidence, if it is in fact disclosed by those who know it, then it ceases to be confidential information for the purposes of this rule."

8. Section 4.10 of GN 8 which, in particular, states (footnotes not included):

"All other things being equal, a listed entity is not expected to release the information in a periodic disclosure document ahead of the scheduled release date for that document. Sometimes, however, in the course of preparing a periodic disclosure document, market sensitive information may become apparent that ought to be disclosed immediately under Listing Rule 3.1. Two areas where this issue commonly arises are "earnings surprises" and material post-balance date events.

If, in the course of preparing a periodic disclosure document, it becomes apparent to a listed entity that its reported earnings will differ materially from market expectations to an extent which is market sensitive, the entity must disclose that information to ASX immediately under Listing Rule 3.1. It cannot wait until the periodic disclosure document is released. The same is true for information about a market sensitive post-balance date event."

9. Section 7.3 of GN8 entitled 'Earnings Surprises'.

10. Section 7.4 of GN8 entitled 'Correcting analyst forecasts'.

Having regard to the above, we ask that you answer the following questions in a format suitable for release to the market in accordance with Listing Rule 18.7A:

1. Does the Entity consider the information contained in the Results Announcement pertaining to the increase in the Loss to be information that a reasonable person would expect to have a material effect on the price or value of its securities?
2. If the answer to question 1 is “no”, please advise the basis for that view, particularly in light of the Trading Activity.
3. If the answer to question 1. is “yes”, when did the Entity first become aware that the FY Loss would materially differ from the previous corresponding period?
4. If the answer to question 1 is “yes” and the Entity first became aware of the information before the release of the Results Announcement please explain why this information was not released to the market at an earlier time, (commenting specifically on the Entity’s compliance with sections 4.10, 7.3 and 7.4 of GN8 referred to above); when you believe the Entity was obliged to release the information under Listing Rules 3.1 and 3.1A; and what steps the Entity took to ensure that the information was released promptly and without delay?
5. Please confirm that the Entity is in compliance with the Listing Rules and, in particular, Listing Rule 3.1.

When and where to send your response

This request is made under, and in accordance with, Listing Rule 18.7. Your response is required as soon as reasonably possible and, in any event, by not later than **9.30 am AEST on Wednesday 29 April 2015**. If we do not have your response by then, ASX will have no choice but to consider suspending trading in the Entity’s securities under Listing Rule 17.3.

You should note that if the information requested by this letter is information required to be given to ASX under Listing Rule 3.1 and it does not fall within the exceptions mentioned in Listing Rule 3.1A, the Entity’s obligation is to disclose the information “immediately”. This may require the information to be disclosed before the deadline set out in the previous paragraph.

ASX reserves the right to release a copy of this letter and your response on the ASX Market Announcements Platform under Listing Rule 18.7A. Accordingly, your response should be in a form suitable for release to the market.

Your response should be sent to me by e-mail at kate.kidson@asx.com.au. It should not be sent directly to the ASX Market Announcements Office. This is to allow me to review your response to confirm that it is in a form appropriate for release to the market, before it is published on the ASX Market Announcements Platform.

Listing Rule 3.1

Listing Rule 3.1 requires a listed entity to give ASX immediately any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity’s securities. Exceptions to this requirement are set out in Listing Rule 3.1A.

The obligation of the Entity to disclose information under Listing Rules 3.1 and 3.1A is not confined to, nor is it necessarily satisfied by, answering the questions set out in this letter.

In responding to this letter, you should have regard to the Entity’s obligations under Listing Rules 3.1 and 3.1A and also to Guidance Note 8 *Continuous Disclosure: Listing Rules 3.1 – 3.1B*.

Trading halt

If you are unable to respond to this letter by the time specified above, you should discuss with us whether it is appropriate to request a trading halt in the Entity’s securities under Listing Rule 17.1.

If you wish a trading halt, you must tell us:

- the reasons for the trading halt;
- how long you want the trading halt to last;
- the event you expect to happen that will end the trading halt;
- that you are not aware of any reason why the trading halt should not be granted; and
- any other information necessary to inform the market about the trading halt, or that we ask for.

We may require the request for a trading halt to be in writing. The trading halt cannot extend past the commencement of normal trading on the second day after the day on which it is granted.

You can find further information about trading halts in Guidance Note 16 *Trading Halts & Voluntary Suspensions*.

If you have any queries or concerns about any of the above, please contact me immediately.

Yours sincerely

[Sent electronically, without signature]

Kate Kidson

Principal Adviser

Listings Compliance (Melbourne)