

# Investor briefing

Half year results to  
30 September 2018

xero

8 November 2018 | Hunt & Gather Bee Co. | Waikato

# Important notice

This presentation is given on behalf of Xero Limited (Xero) (ASX:XRO) (Company number NZ 183 0488, AU ARBN 160 661 183).

Information in this presentation:

- is for general information purposes only, and is not an offer or invitation for subscription or purchase of, or a recommendation to invest in, Xero securities
- should be read in conjunction with, and is subject to, Xero's latest and prior interim and annual reports, including Xero's annual report for the period ended 31 March 2018, and Xero's market releases on the ASX
- includes forward-looking statements about Xero and the environment in which Xero operates, which are subject to uncertainties and contingencies outside of Xero's control – Xero's actual results or performance may differ materially from these statements
- includes statements relating to past performance, which should not be regarded as a reliable indicator of future performance
- may contain information from third parties believed to be reliable, but no representations or warranties are made as to the accuracy or completeness of such information
- includes Non-GAAP measures as we believe they provide useful information for readers to assist in understanding Xero's financial performance. Non-GAAP financial measures do not have a standardised meaning and should not be viewed in isolation or considered as substitutes for measures reported in accordance with NZ IFRS. These measures have not been independently audited or reviewed
- includes comparative period results that have been restated to reflect the effect of three new accounting standards. See page 31 for more information

All information in this presentation is current at 30 September 2018, unless otherwise stated.

All currency amounts are in NZ dollars, unless otherwise stated.

Due to rounding, numbers in this presentation may not add up precisely to the totals provided and percentages may not precisely reflect the absolute figures.

See page 33 for a glossary of the key terms used in this presentation.

# Agenda

## Business update

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**Steve Vamos**  
CHIEF EXECUTIVE OFFICER



## Financial results

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**Kirsty Godfrey-Billy**  
CHIEF FINANCIAL OFFICER



## Outlook

## Q&A

# Business update

**Steve Vamos**  
CHIEF EXECUTIVE OFFICER

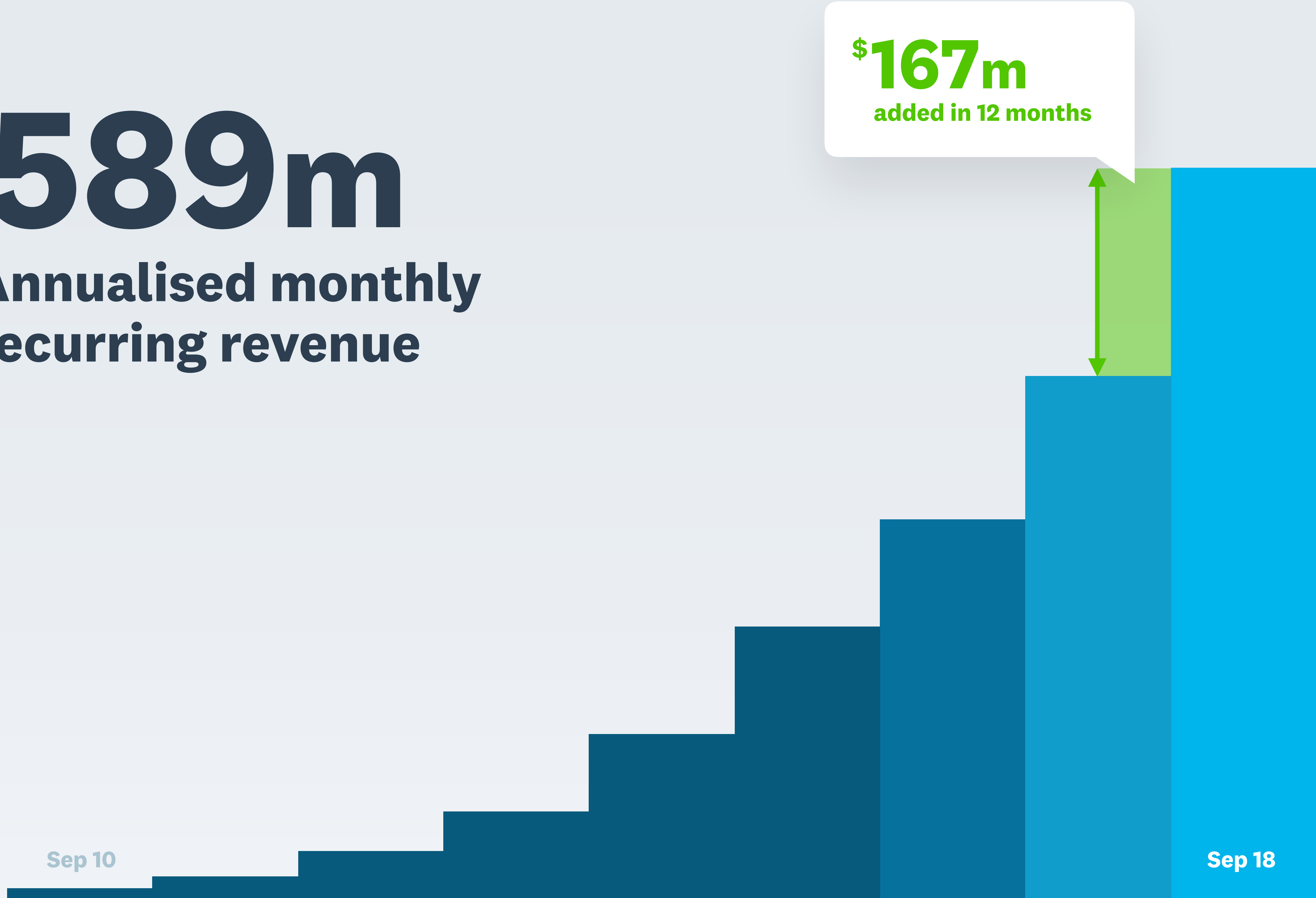


**1,579,000**  
subscribers

**380,000**  
added in 12 months

# \$589m

## Annualised monthly recurring revenue



# Strong growth, disciplined execution

SUBSCRIBERS

**1.6m**

+ 380,000 YOY

ARPU

**\$31.09**

+ 6% YOY

AMRR

**\$589.1m**

+ 40% YOY (36% in constant currency<sup>1</sup>)

OPERATING REVENUE

**\$256.5m**

+ 37% YOY (33% in constant currency<sup>1</sup>)

EBITDA  
EXCLUDING IMPAIRMENTS

**\$34.5m**

+ \$17m YOY

OPERATING CASH FLOW

**\$36.0m**

+20.9m YOY

<sup>1</sup> Constant currency based on FX rates 6 months ended 30 September 2017

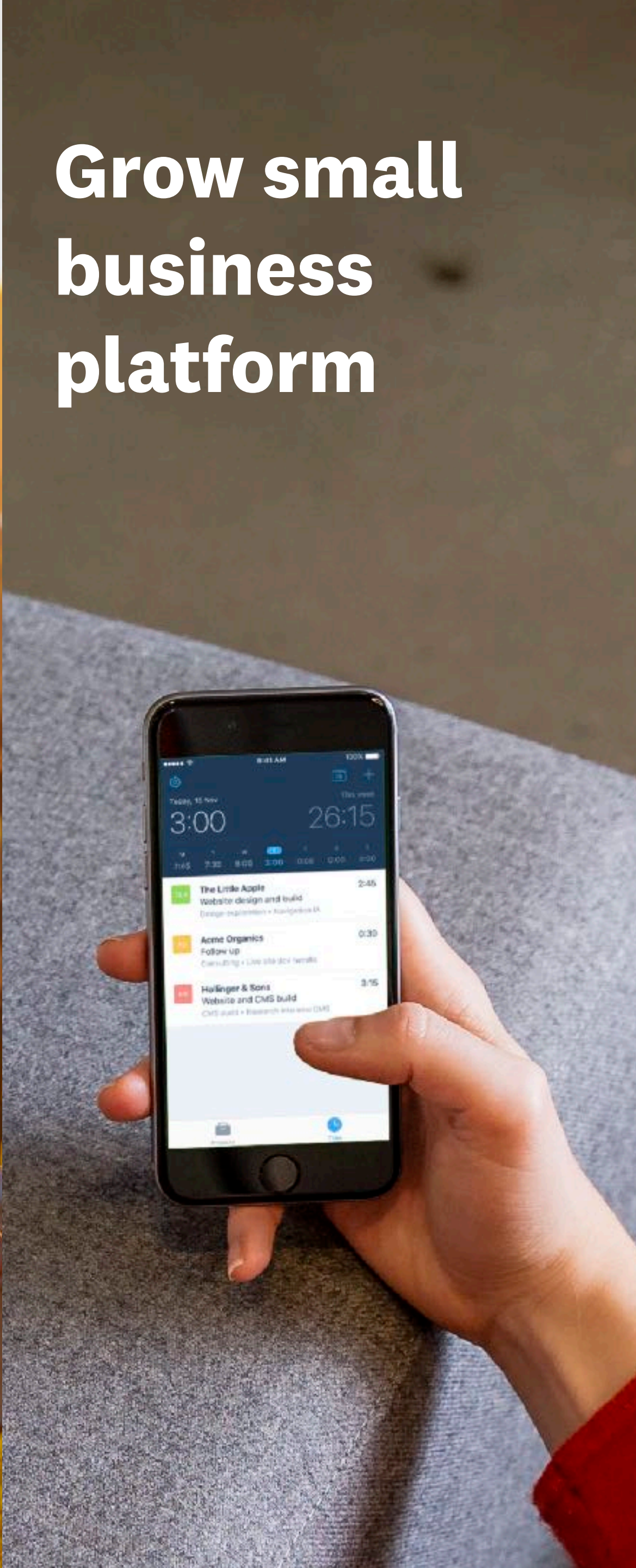
# Strategic priorities

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**Drive cloud accounting**

**Grow small business platform**

**Building for global scale and innovation**





# Xero leadership team



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**Steve Vamos**  
CHIEF EXECUTIVE OFFICER



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**Anna Curzon**  
CHIEF PRODUCT AND  
PARTNER OFFICER



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**Kirsty  
Godfrey-Billy**  
CHIEF FINANCIAL OFFICER



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**Keri Gohman**  
CHIEF PLATFORM BUSINESS  
OFFICER AND  
PRESIDENT OF AMERICAS



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**Craig Hudson**  
MANAGING DIRECTOR, NEW  
ZEALAND AND PACIFIC ISLANDS



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**Trent Innes**  
MANAGING DIRECTOR,  
AUSTRALIA AND ASIA



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**Rachael Powell**  
CHIEF CUSTOMER, PEOPLE AND  
MARKETING OFFICER



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**Mark Rees**  
CHIEF TECHNOLOGY OFFICER



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**Chaman Sidhu**  
GENERAL COUNSEL  
AND COMPANY SECRETARY



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**Gary Turner**  
MANAGING DIRECTOR,  
UNITED KINGDOM AND EMEA

# Australia and New Zealand

## Australia

- 27% subscriber growth YOY to 657,000 subscribers. Revenue growth of 33% YOY (31% constant currency<sup>1</sup>)
- Market leader in small business accounting
- In excess of 1 million employees paid through Xero payroll<sup>2</sup>
- Successful rollout of Single Touch Payroll - driving an increase in TAM penetration

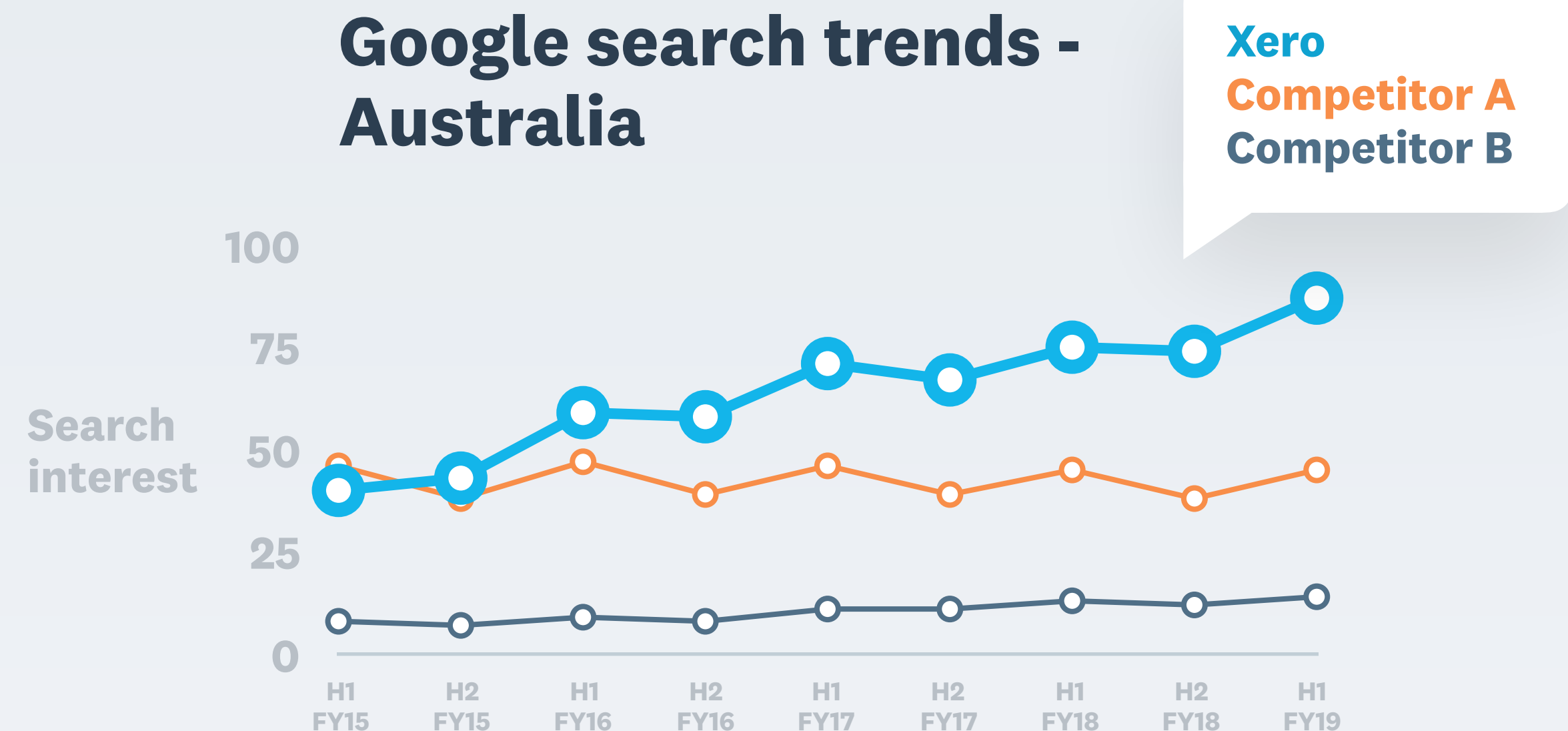
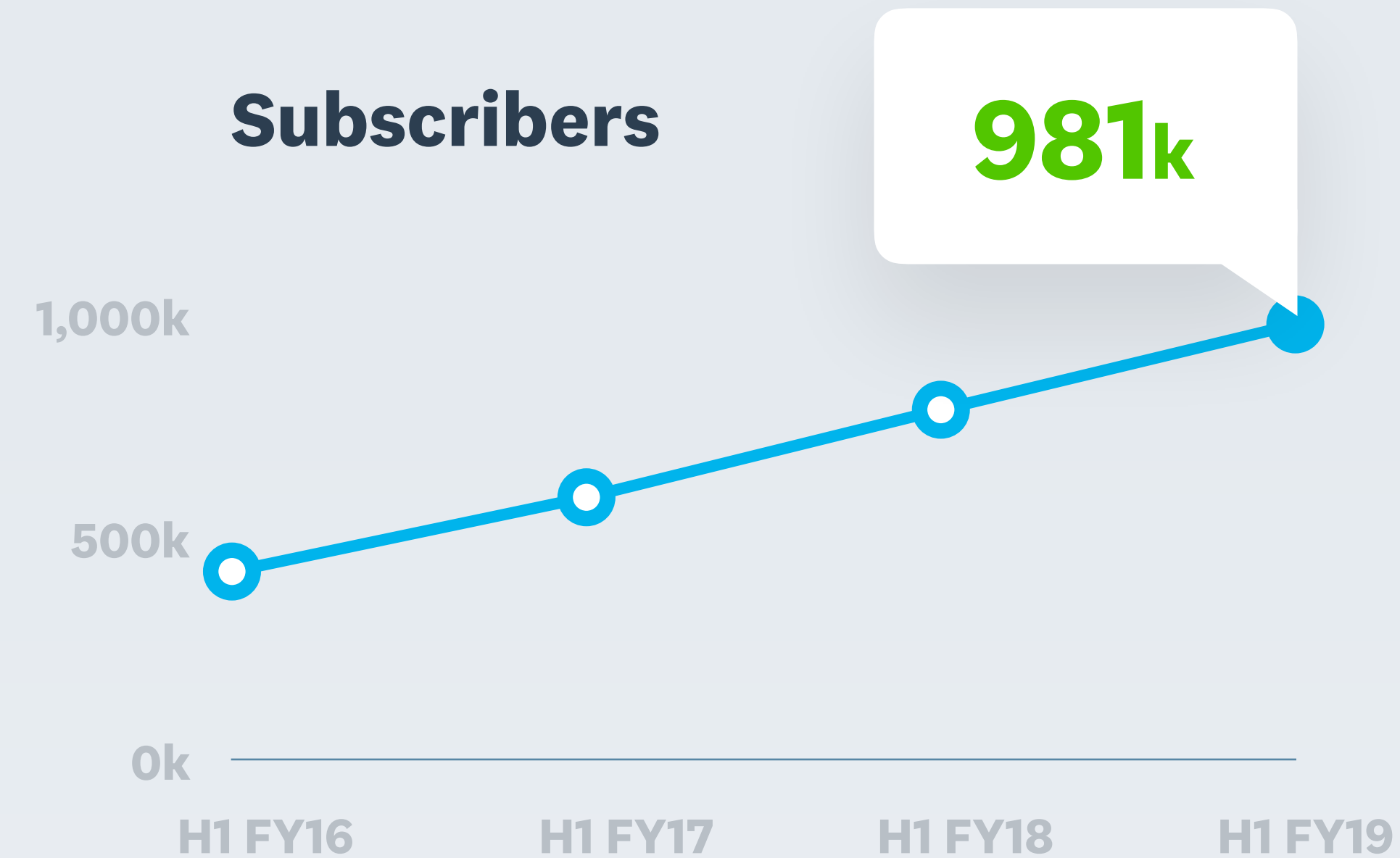
## New Zealand

- 20% subscriber growth YOY to 324,000 subscribers. Revenue growth of 22% YOY
- MRR growth in H1 FY19 outpaced revenue and subscriber growth with increased focus on platform products and deeper customer relationships
- Launched Xero Small Business Insights, a detailed look into the economic health of small businesses

Hosted successful Xerocon South in Brisbane with record attendance of more than 3,500

<sup>1</sup> Constant currency based on FX rates 6 months ended 30 September 2017

<sup>2</sup> For month ending 30 September 2018



Graph source: Google trends of Xero and competitor products

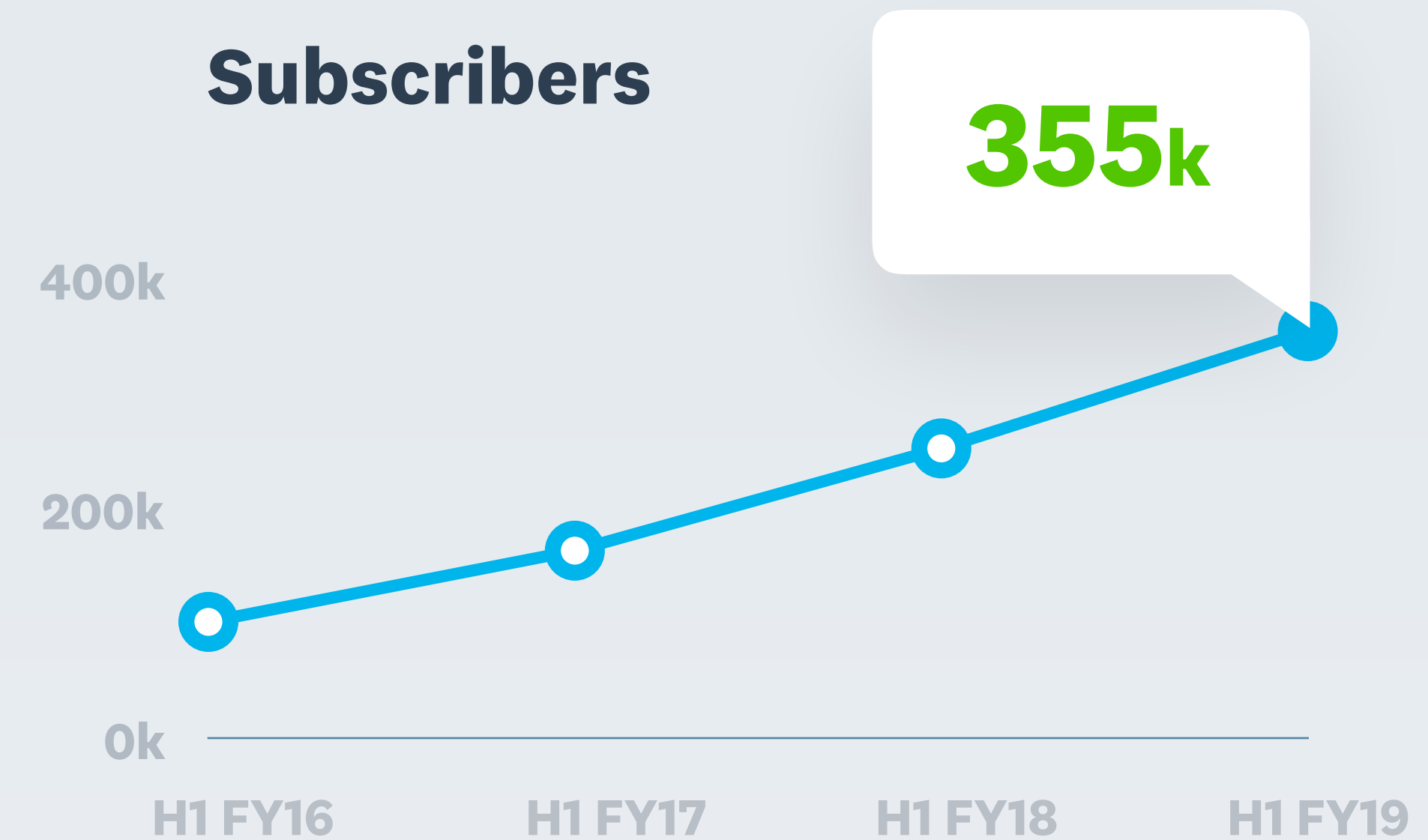
# United Kingdom

40% subscriber growth YOY to 355,000 subscribers. Revenue growth of 56% YOY (46% constant currency<sup>1</sup>)

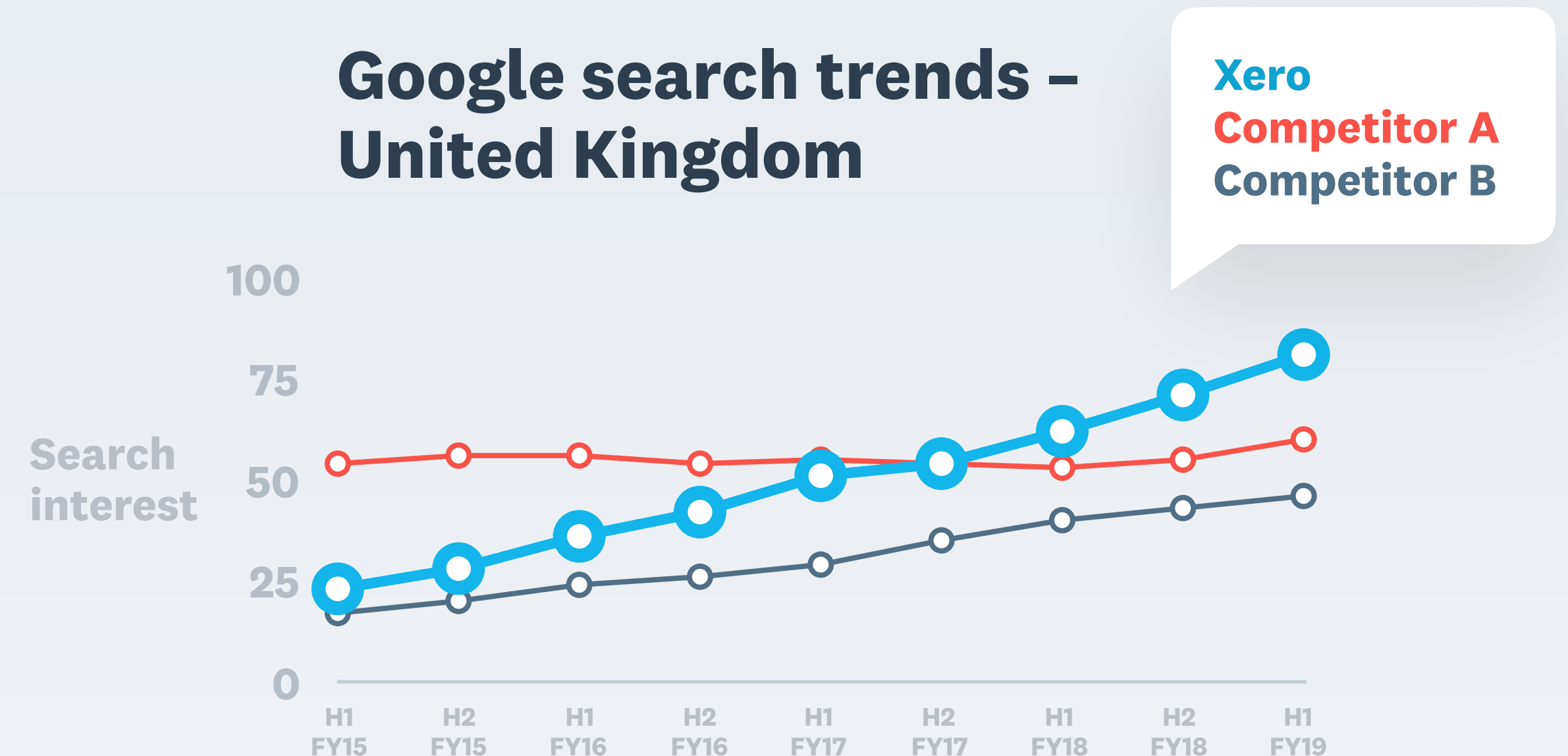
Strong revenue results with MRR growing at 54% YOY (45% constant currency<sup>1</sup>). Momentum achieved through continued focus on premium products and more complex SMBs

Winner of Small Business Accounting, Practitioners' Choice Award at 2018 Accounting Excellence Software Awards

## Subscribers



## Google search trends - United Kingdom



<sup>1</sup> Constant currency based on FX rates 6 months ended 30 September 2017

Graph source: Google trends of Xero and competitor products

# North America

62% subscriber growth YOY to 178,000 subscribers. Revenue growth of 40% YOY (34% constant currency<sup>1</sup>). 45% subscriber growth YOY excluding Hubdoc acquisition

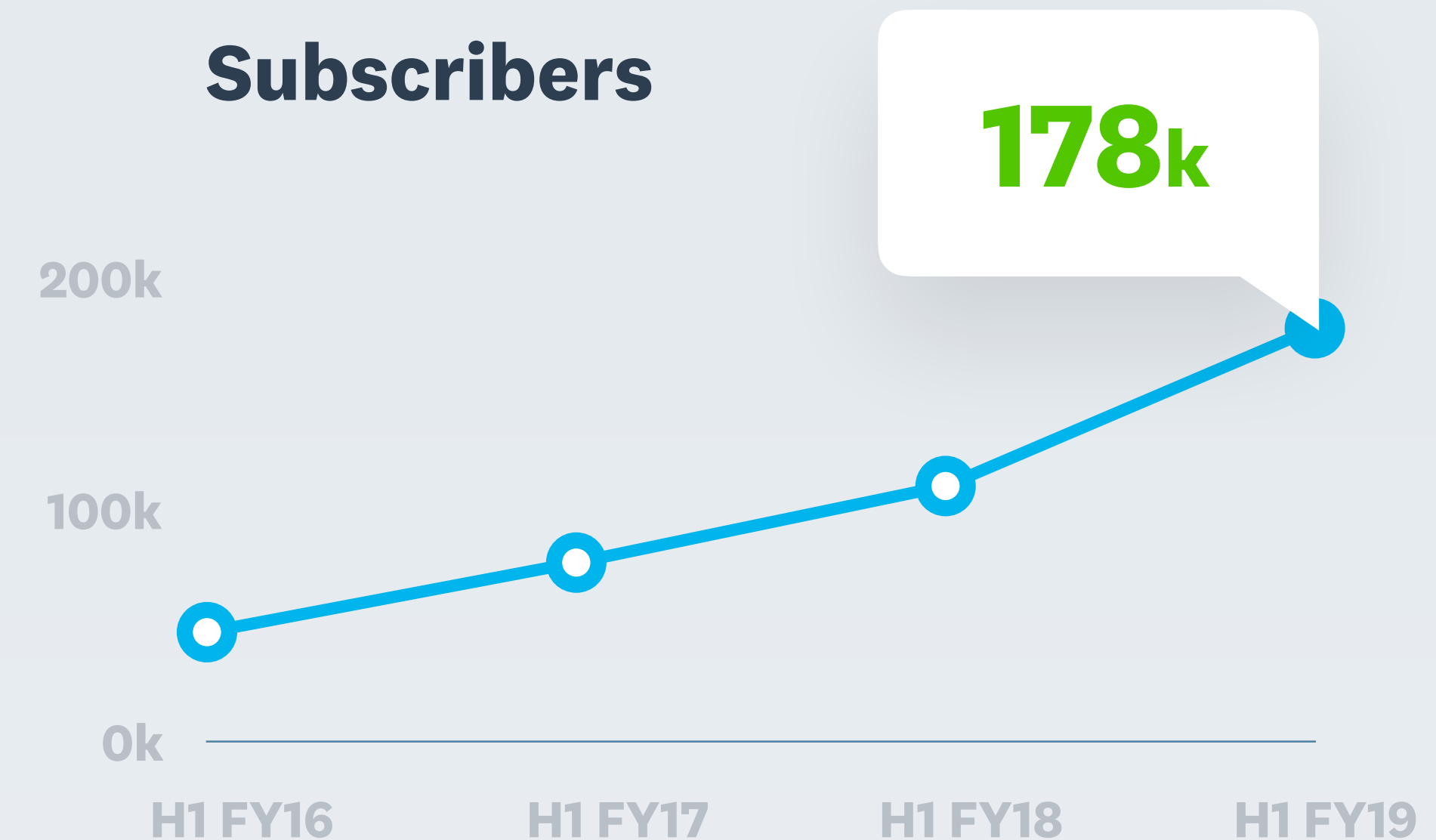
Partner approach continues to deliver early signs of progress in a still significantly under-penetrated cloud accounting market

Finweb strategy continues to strengthen, direct bank feeds partnerships with Citi and BBVA Compass established

Full-service, 50-state payroll solution secured via partnership with Gusto, which is a more comprehensive payroll offering for a wider range of small businesses

More than 2,300 attendees across Xerocon Atlanta and roadshows in US and Canada

<sup>1</sup> Constant currency based on FX rates 6 months ended 30 September 2017



### Accounting partner channel capacity<sup>2</sup>



<sup>2</sup> Capacity is the number of small business clients of Xero's partner accountants and bookkeepers

# Rest of World

38% subscriber growth YOY to 65,000 subscribers. Revenue growth of 55% YOY (48% constant currency<sup>1</sup>)

## South East Asia

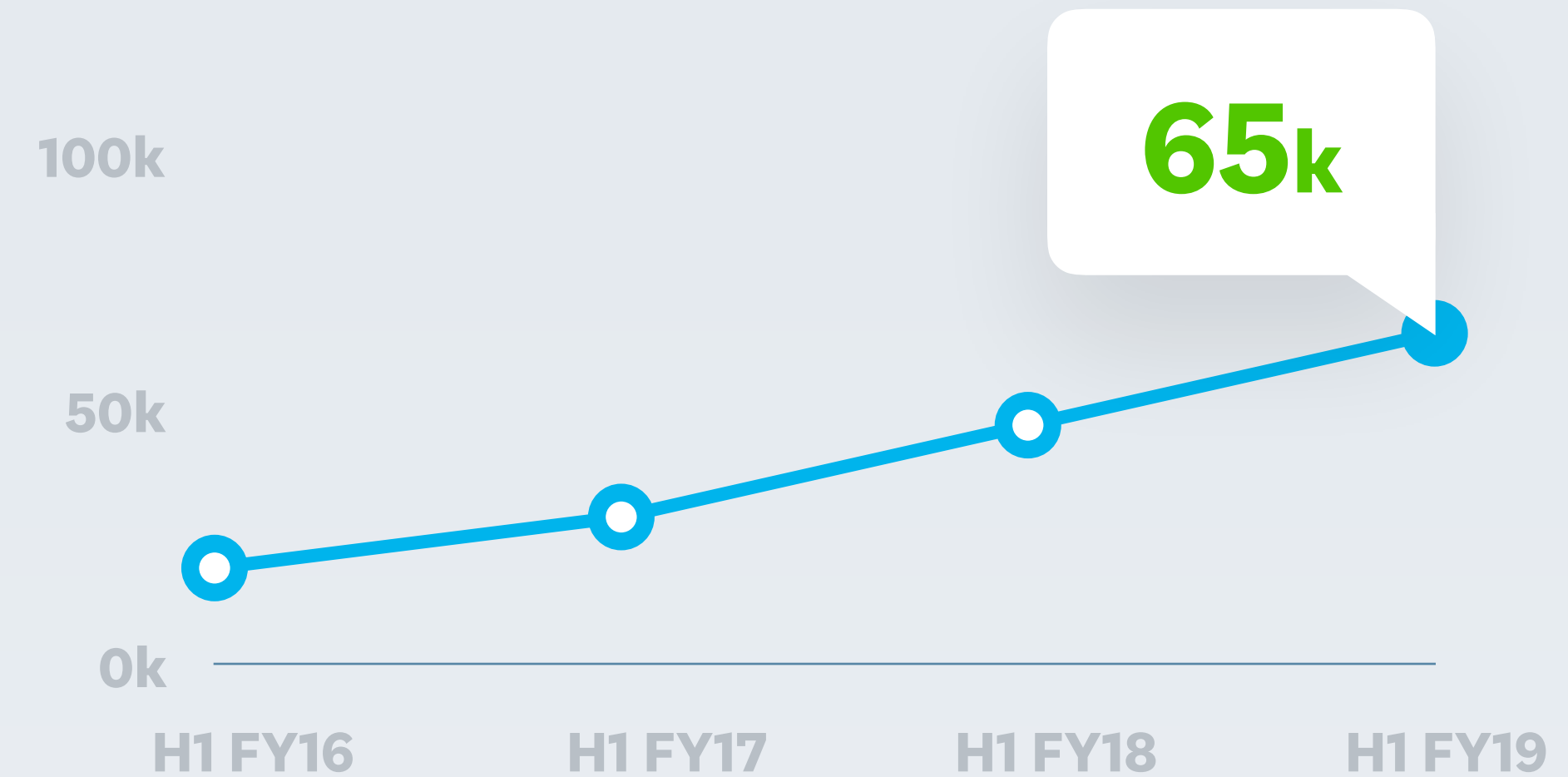
- Enhanced partnership with DBS, Singapore’s largest bank
- More than 1,000 accountants and bookkeepers attended Asia Roadshow
- Established Hong Kong operations in March 2018

## South Africa

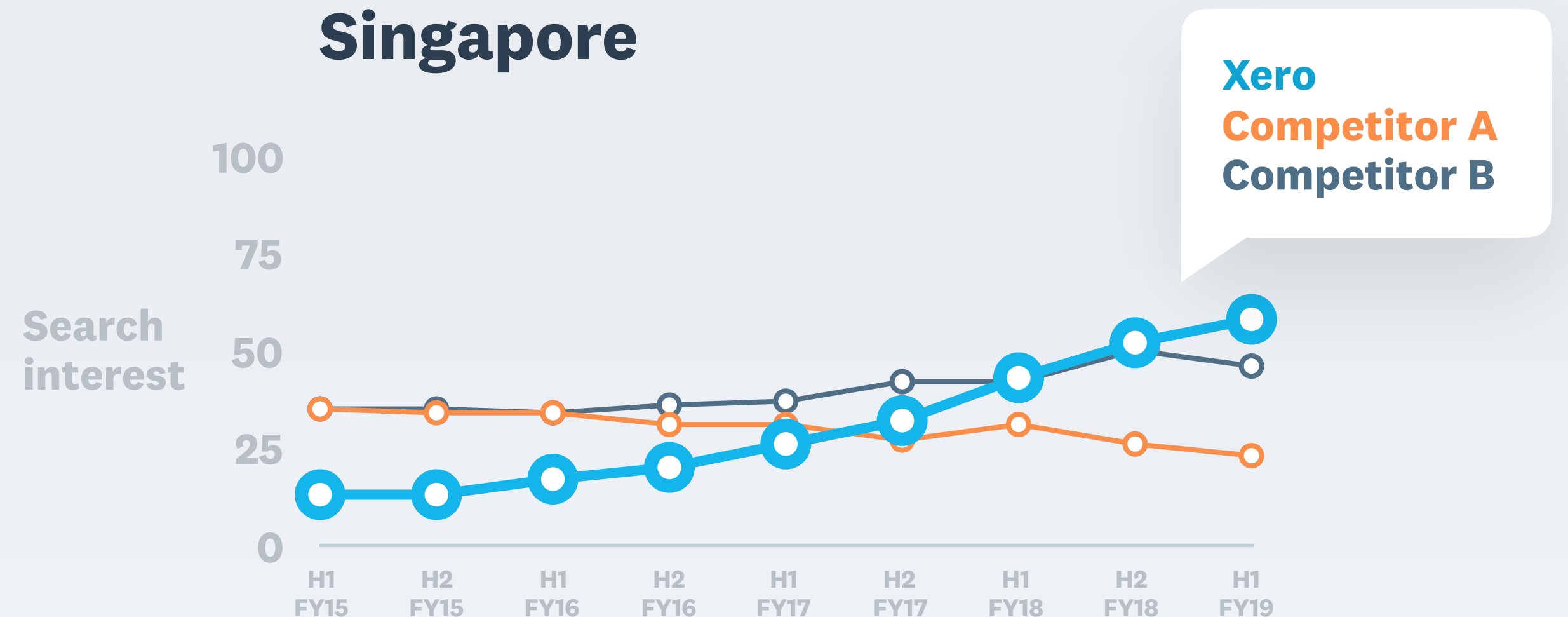
- Market profile developing strongly. First country manager appointed
- Continued utilisation of global market entry playbook including accounting partner engagement and deepening key banking relationships

<sup>1</sup> Constant currency based on FX rates 6 months ended 30 September 2017

## Subscribers



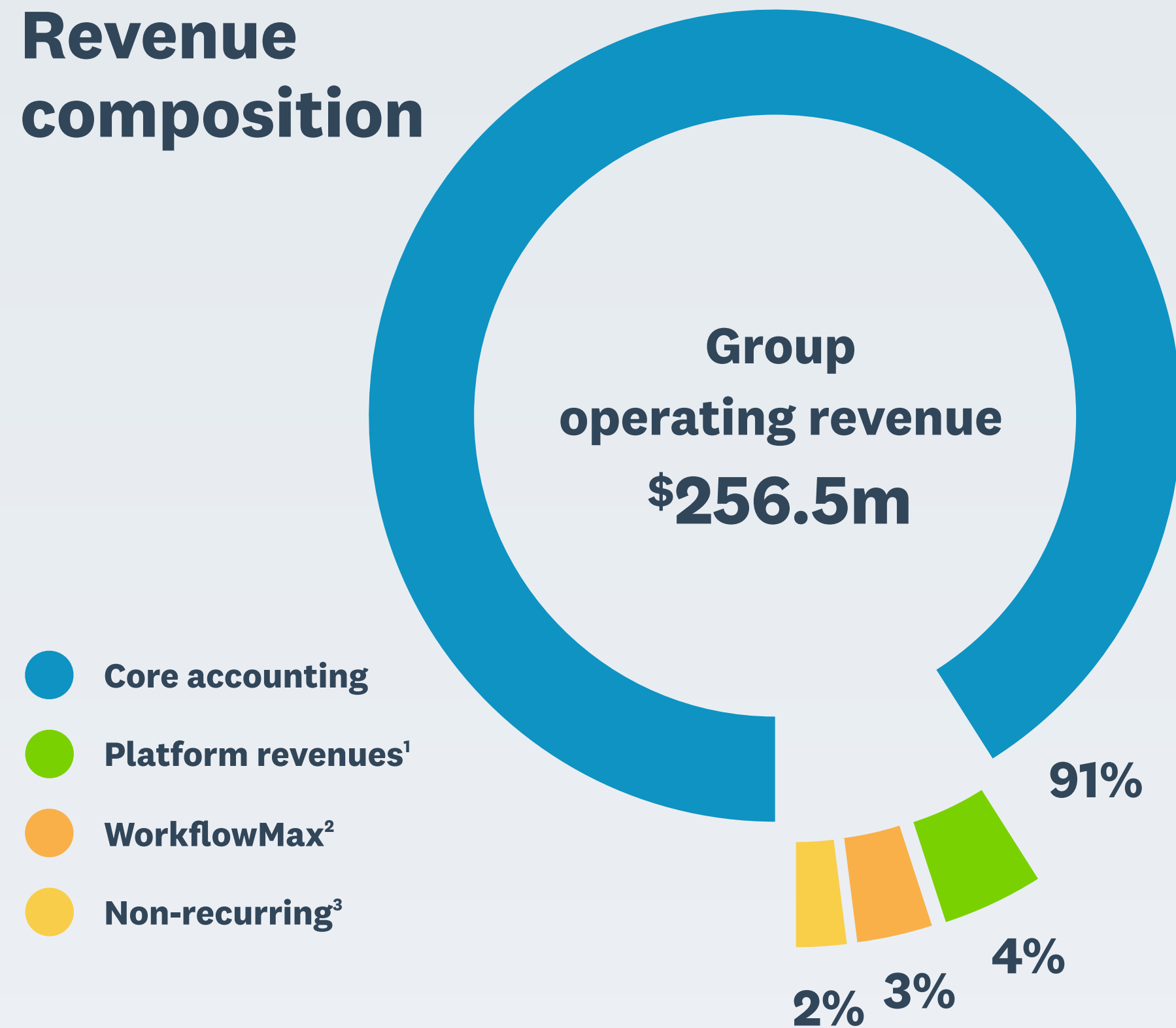
## Google search trends - Singapore



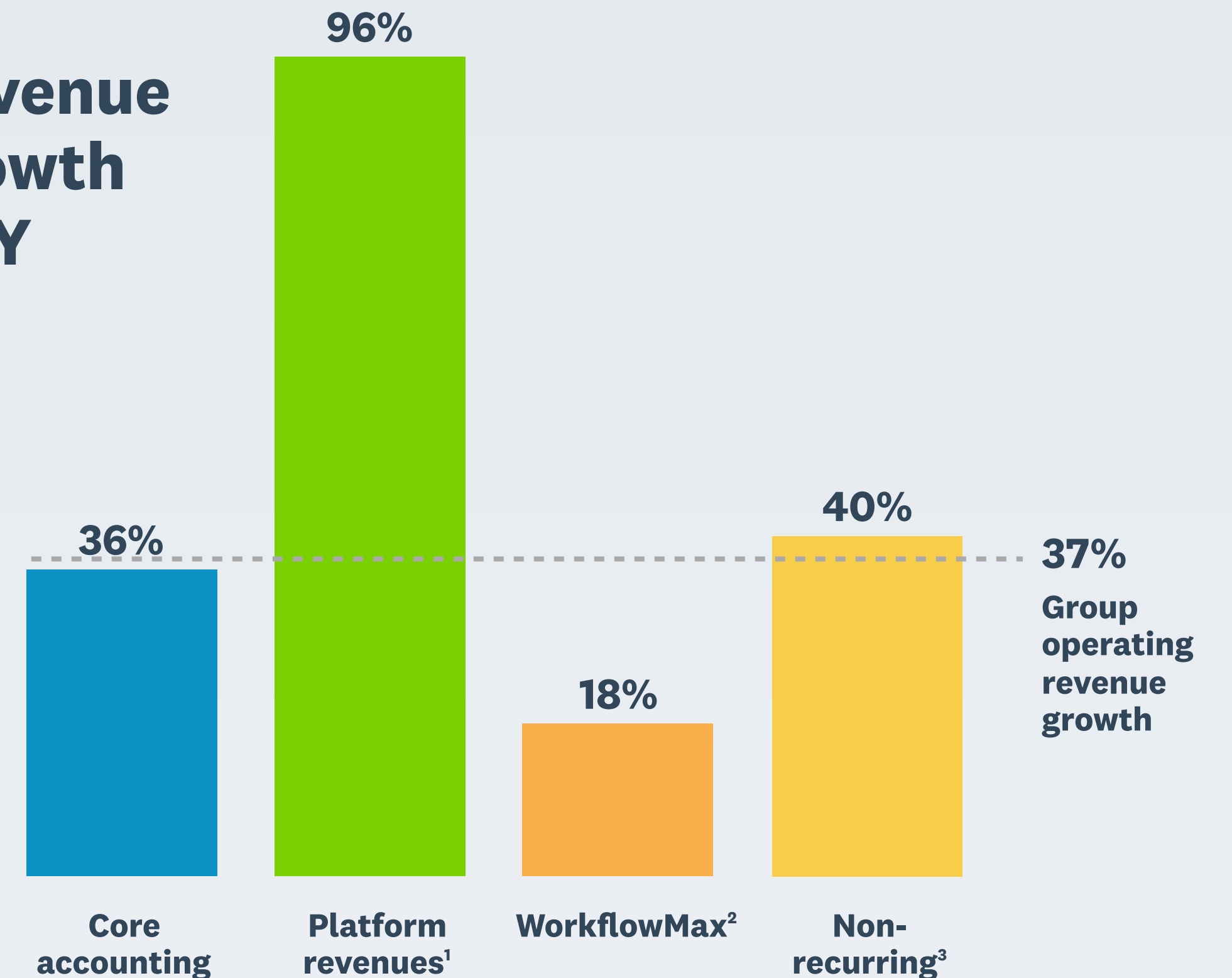
Graph source: Google trends of Xero and competitor products

# Growing the small business platform

## Revenue composition



## Revenue growth YOY



<sup>1</sup> Platform revenues include revenue derived from related services, including adjacent products (such as Hubdoc), add-ons with incremental revenue (such as payroll and expenses modules) and revenue share agreements with partners

<sup>2</sup> Revenues relating to WorkflowMax, online workflow and job management software

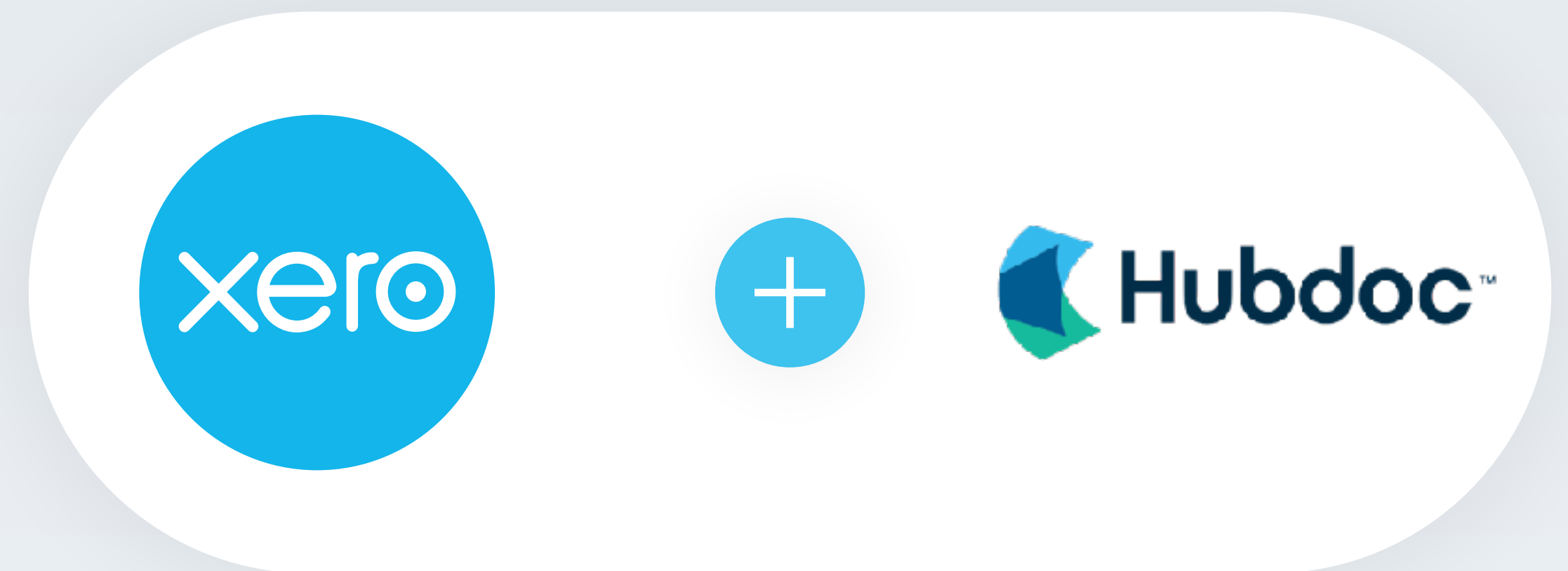
<sup>3</sup> Non-recurring includes revenue from events (such as Xerocons and roadshows), and other non-subscription or platform services

# Extending the small business platform

The recent US\$300m convertible note issue creates financial flexibility to enhance and extend Xero's small business platform and ecosystem capabilities through complementary and targeted acquisitions and investments

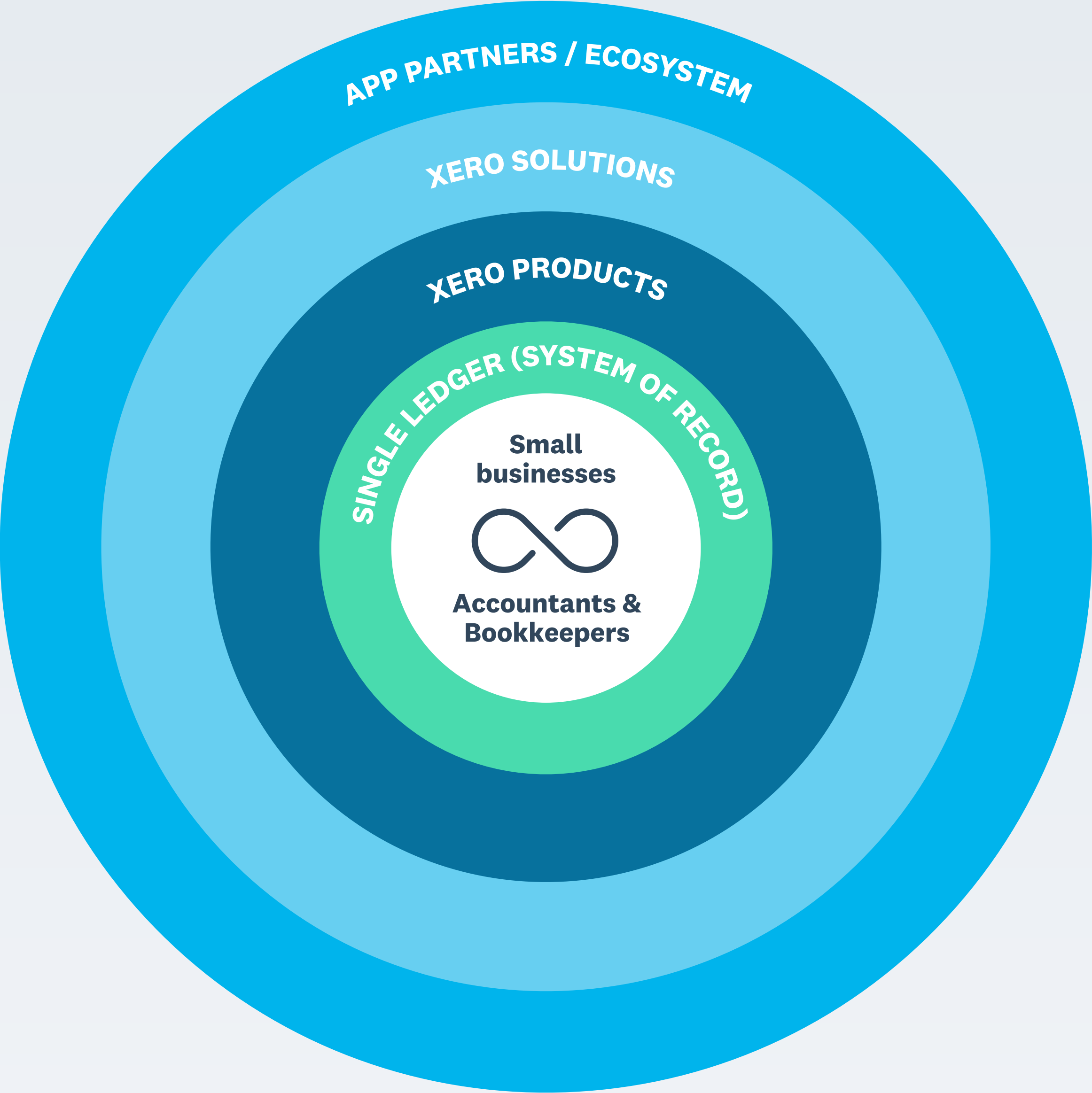
Focus going forward will be to identify opportunities that can drive accelerated adoption of cloud accounting and grow the small business platform

Hubdoc acquisition is an exciting step for Xero's small business platform strategy



# Small business platform

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# Financial results

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**Kirsty Godfrey-Billy**  
CHIEF FINANCIAL OFFICER

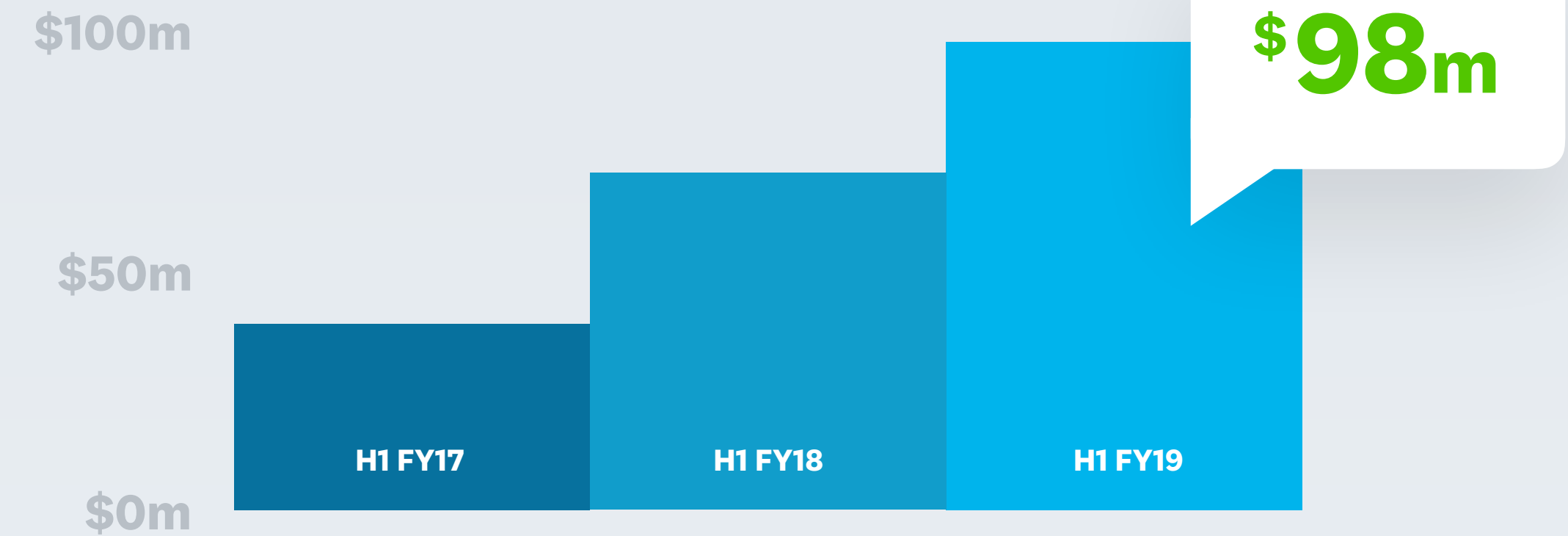


# Contribution margins reflect scalable model

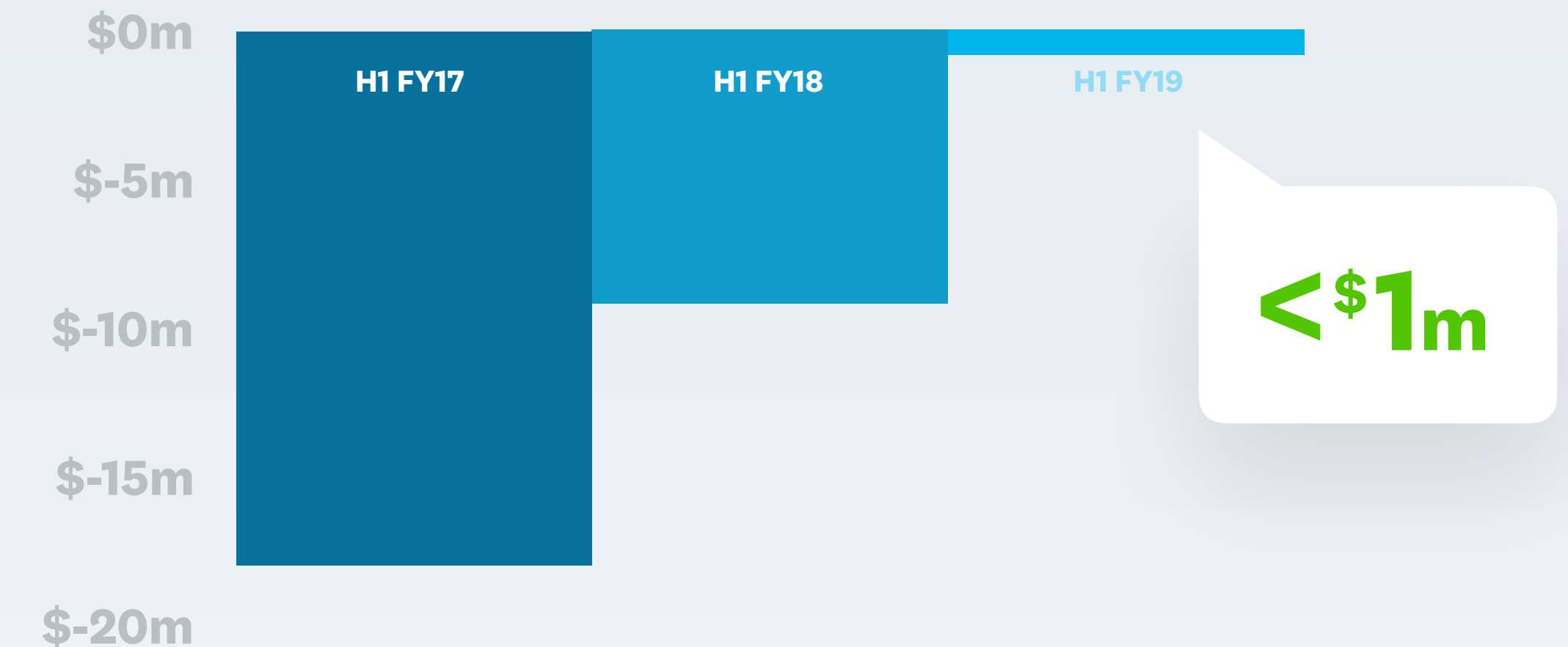
Australia and New Zealand contribution improved 39% YOY, outpacing revenue trends and highlighting continuing efficiencies and operating leverage

International investment loss substantially narrowed despite investment in new geographies

## Australia and New Zealand contribution



## International segment contribution loss

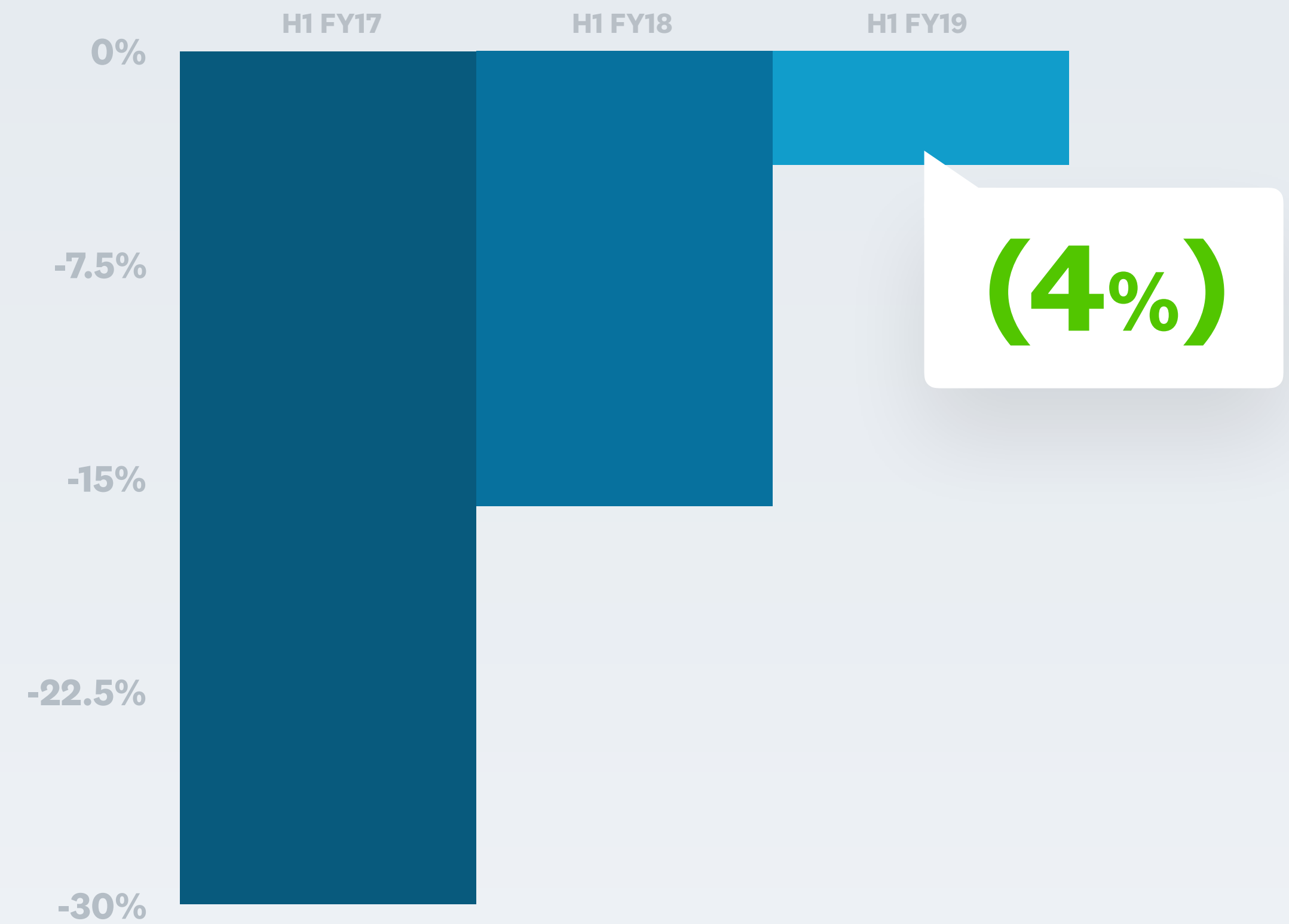


# Strong top-line and bottom-line performance

## Annualised monthly recurring revenue



## Cash outflow<sup>2</sup> as % of revenue



<sup>1</sup> 36% in constant currency terms based on FX rates at 30 September 2017

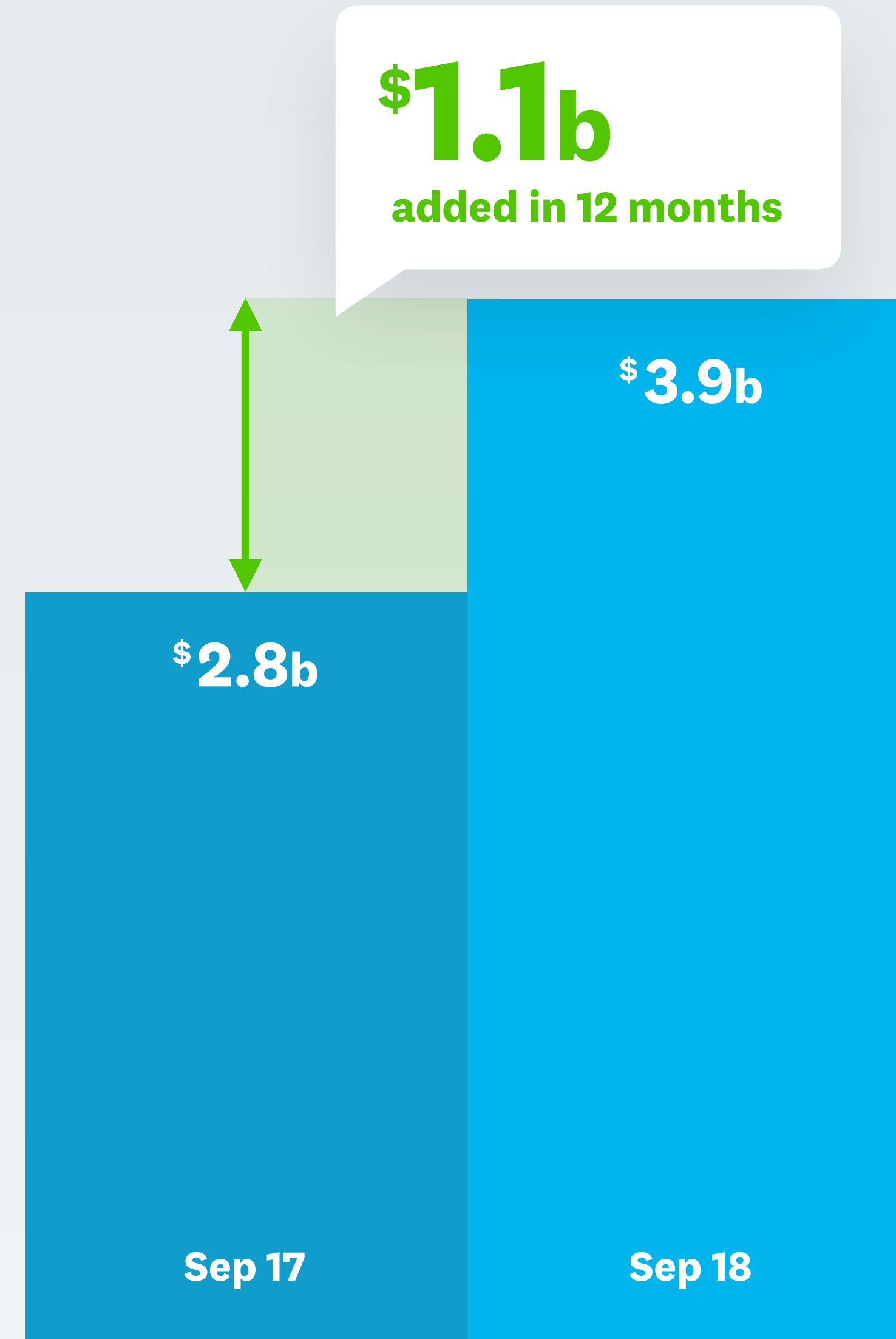
<sup>2</sup> Operating and investing cash flows excluding acquisitions

# Expanding lifetime value

	September 2018	Progress from March 2018
ARPU	\$31.09	↑
Churn %	1.10%	—
Gross margin	83%	↑
LTV per subscriber	\$2,494	+5% <sup>1</sup>

<sup>1</sup> Constant currency based on FX rates 31 March 2018. 8% increase in nominal terms

## Total subscriber lifetime value (LTV)



# Financial performance

Operating revenue growth of 37% YOY (33% constant currency<sup>1</sup>) driven by subscriber growth in all markets and ARPU increased by 6% YOY (3% constant currency<sup>1</sup>)

EBITDA improved by 7% YOY. Excluding impairments and share-based payments, EBITDA climbed 91% YOY as business continues to scale

Net loss impacted by impairments and higher finance costs

	H1 FY18 (\$000s)	H1 FY19 (\$000s)	YOY change (%)
Total operating revenue	187,837	<b>256,527</b>	37%
Gross profit	150,610	<b>212,277</b>	41%
<b>Gross margin</b>	<b>80%</b>	<b>83%</b>	<b>+3pp</b>
EBITDA	15,597	<b>16,759</b>	7%
<b>EBITDA margin</b>	<b>8%</b>	<b>7%</b>	<b>(1)pp</b>
Net loss	(19,590)	<b>(28,565)</b>	46%
EBITDA excl. SBP <sup>2</sup> and impairments	25,789	<b>49,331</b>	91%
<b>EBITDA margin excl. SBP<sup>2</sup> and impairments</b>	<b>14%</b>	<b>19%</b>	<b>+5pp</b>

<sup>1</sup> Constant currency based on FX rates 6 months ended 30 September 2017

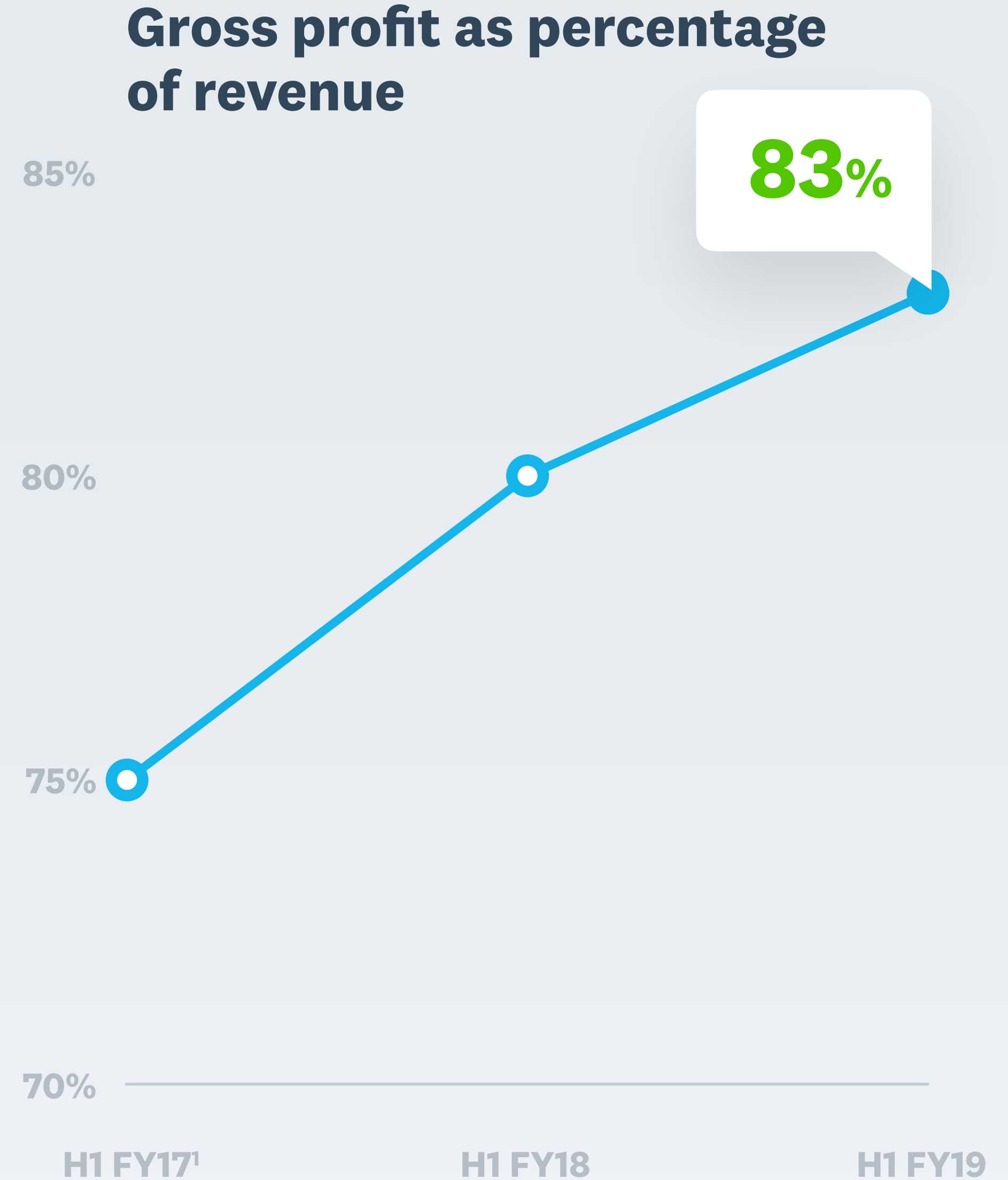
<sup>2</sup> SBP is a non-cash cost to Xero

# Improving gross margin

Gross margin of 83% for H1 FY19, +3pp over prior year

Gross margin further improved via hosting cost and customer support platform efficiencies

Gross margin improvements in both Australia and New Zealand and International segments



<sup>1</sup> Duplicated costs due to transition to AWS

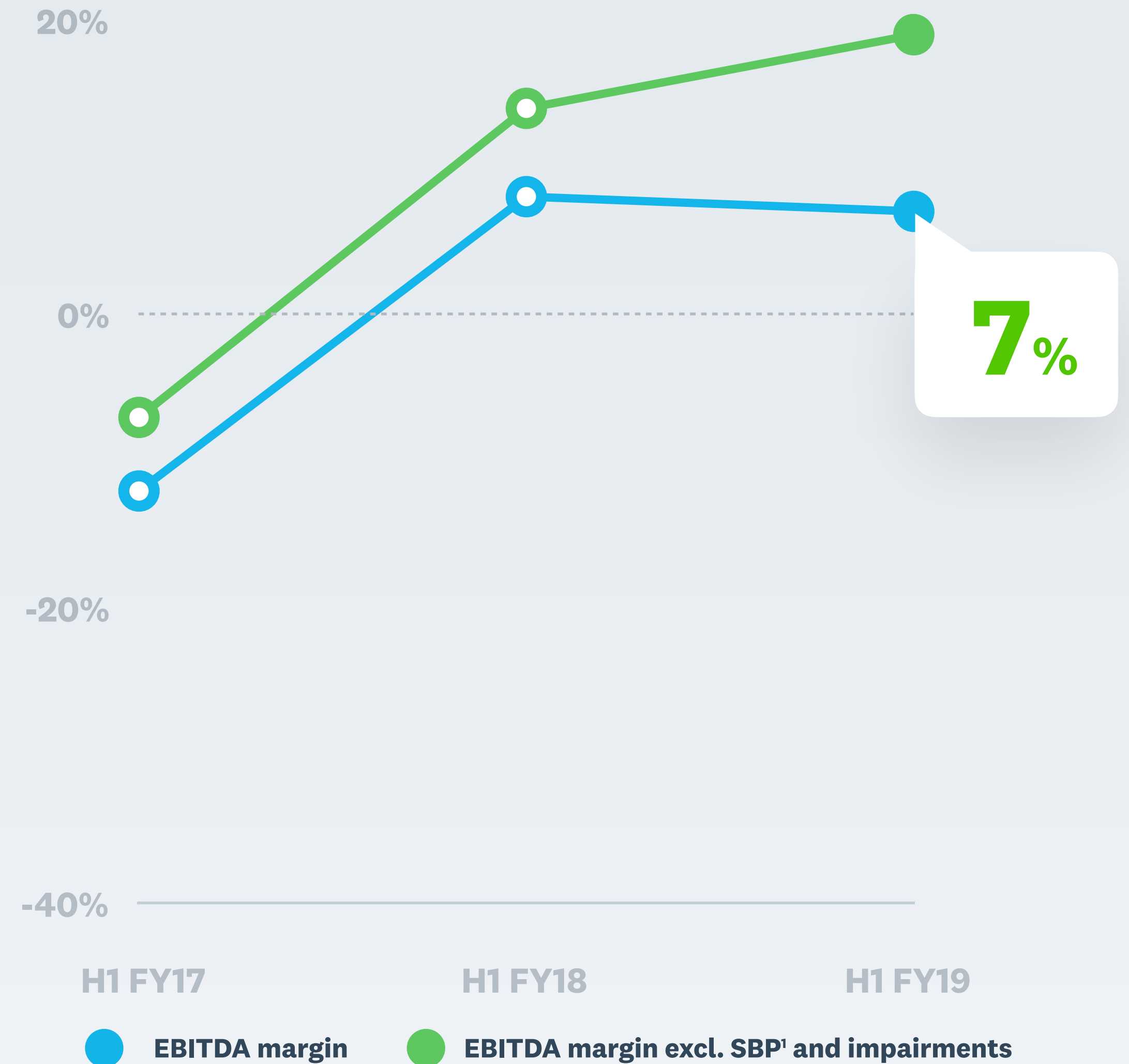
# EBITDA momentum

Continued EBITDA momentum in H1 FY19

EBITDA impacted by \$16.3m of impairment costs relating to the Gusto partnership, \$2.3m of costs from the acquisition of Hubdoc and \$2.8m from a reduction in capitalisation rates (down from 43% in the comparative period to 39% for H1 FY19)

EBITDA excluding SBP and impairment costs increased by \$23.5m to \$49.3m, 91% YOY, in H1 FY19

## EBITDA margin excl. SBP and impairments



<sup>1</sup> SBP is a non-cash cost to Xero

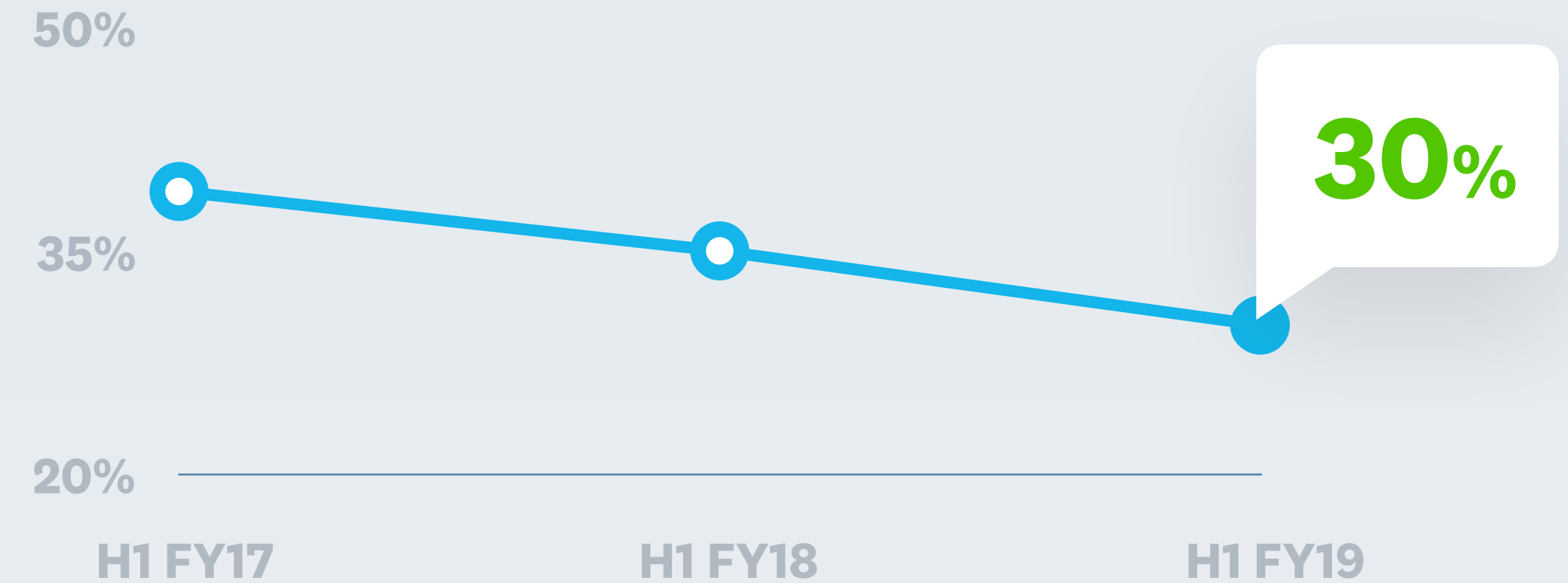
# Further product and CAC efficiencies

Product investment spend has supported launch of further new features that leverage machine learning and automation

Further scale benefits extracted with product costs including opex and capex, as a percentage of revenue, improving by 5pp YOY to 30% in H1 FY19

Continued efficiencies in sales and marketing with 3pp improvement YOY in CAC as % of revenue

### Product costs including opex and capex as % of revenue<sup>1</sup>



### CAC as % of revenue



<sup>1</sup> Net of government grants



# Positive operating cash flow trend

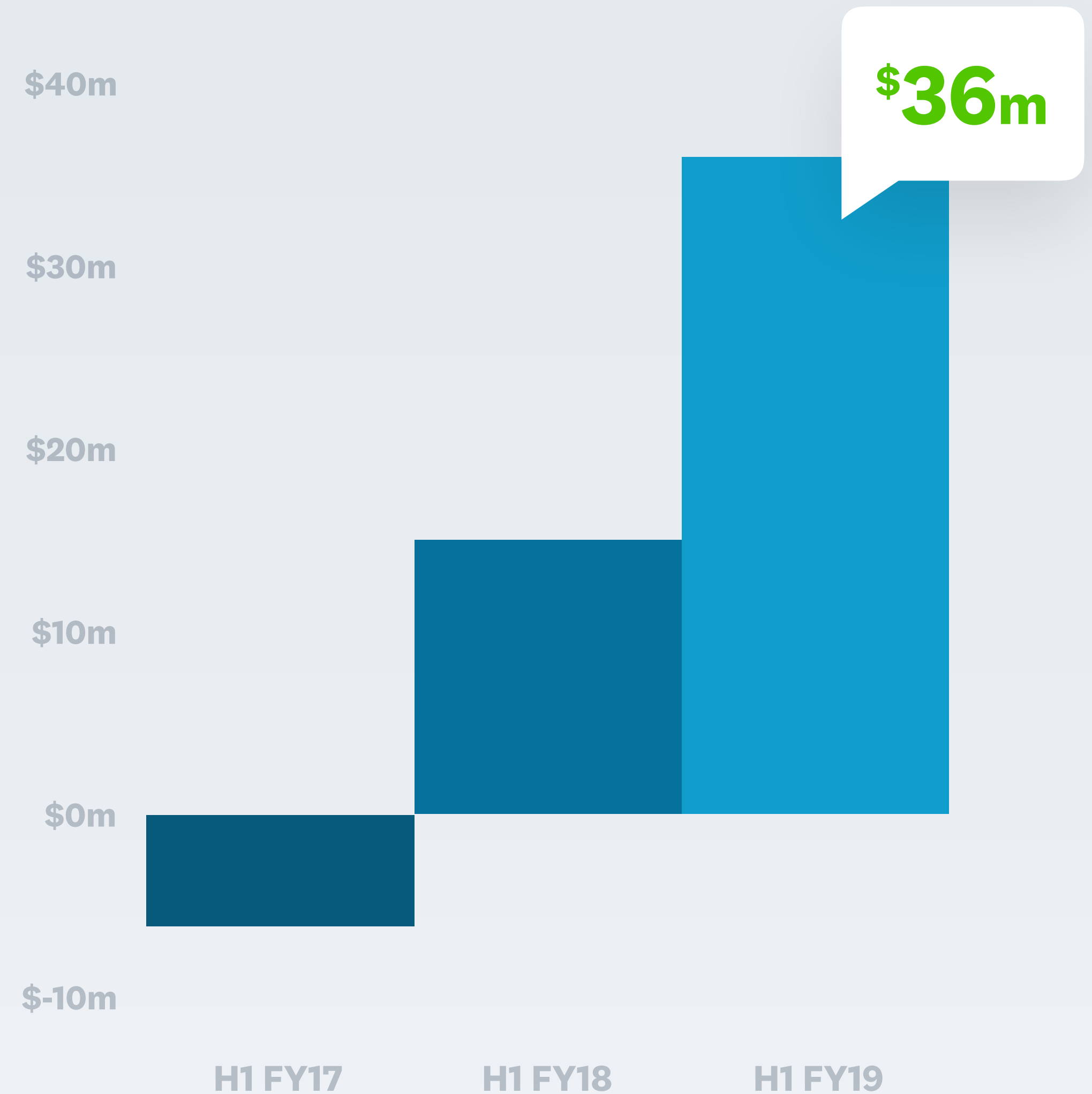
Operating cash flow of \$36.0m for H1 FY19, an improvement of \$20.9m from \$15.1m in H1 FY18

Total operating and investing outflow for H1 FY19 was \$(40.1m) compared to \$(30.9m) in H1 FY18

Excluding Hubdoc acquisition, total operating and investing outflow was \$(9.8m)

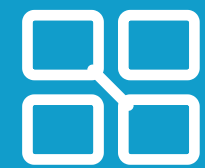
Cash and short-term deposits balance at 30 September 2018 was \$76.2m compared to \$80.0m at 31 March 2018

## Total operating cash flow

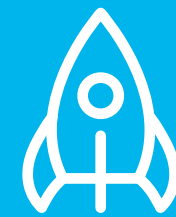


# US\$300m convertible notes offering

Structure designed to achieve right balance between costs of funds and potential shareholder dilution



Groundbreaking for New Zealand and Australian companies not listed in the US. Call spread structure is common amongst US technology companies and supports Xero's growth plans



Optimises the capital structure of the business: bank loans drawn at the time of the Hubdoc acquisition repaid but \$100m stand-by facility retained



# Outlook

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**Xero will continue to focus on growing its global small business platform**

**Cash outflow (operating less investing cash flows) in the financial year ended 31 March 2019 (FY19) is forecast to reduce from the financial year ended 31 March 2018 (FY18). Excluding capital outlays for M&A, Xero is managing the business to cash flow break-even within its current cash balance, without drawing on its debt facility or the net proceeds from convertible notes issued in October 2018**

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

# Q&A

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# Appendix

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# New accounting standards

Xero has adopted the following three accounting standards from 1 April 2018:

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## IFRS 15

Revenue from contracts with customers

- Xero's commission costs will be capitalised and expensed over time
- This standard also changes the classification and timing of when revenue is recognised

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## IFRS 16

Leases

- The majority of Xero's leases will be recognised on the balance sheet, with the expense moving from operating expenses to depreciation and finance expense

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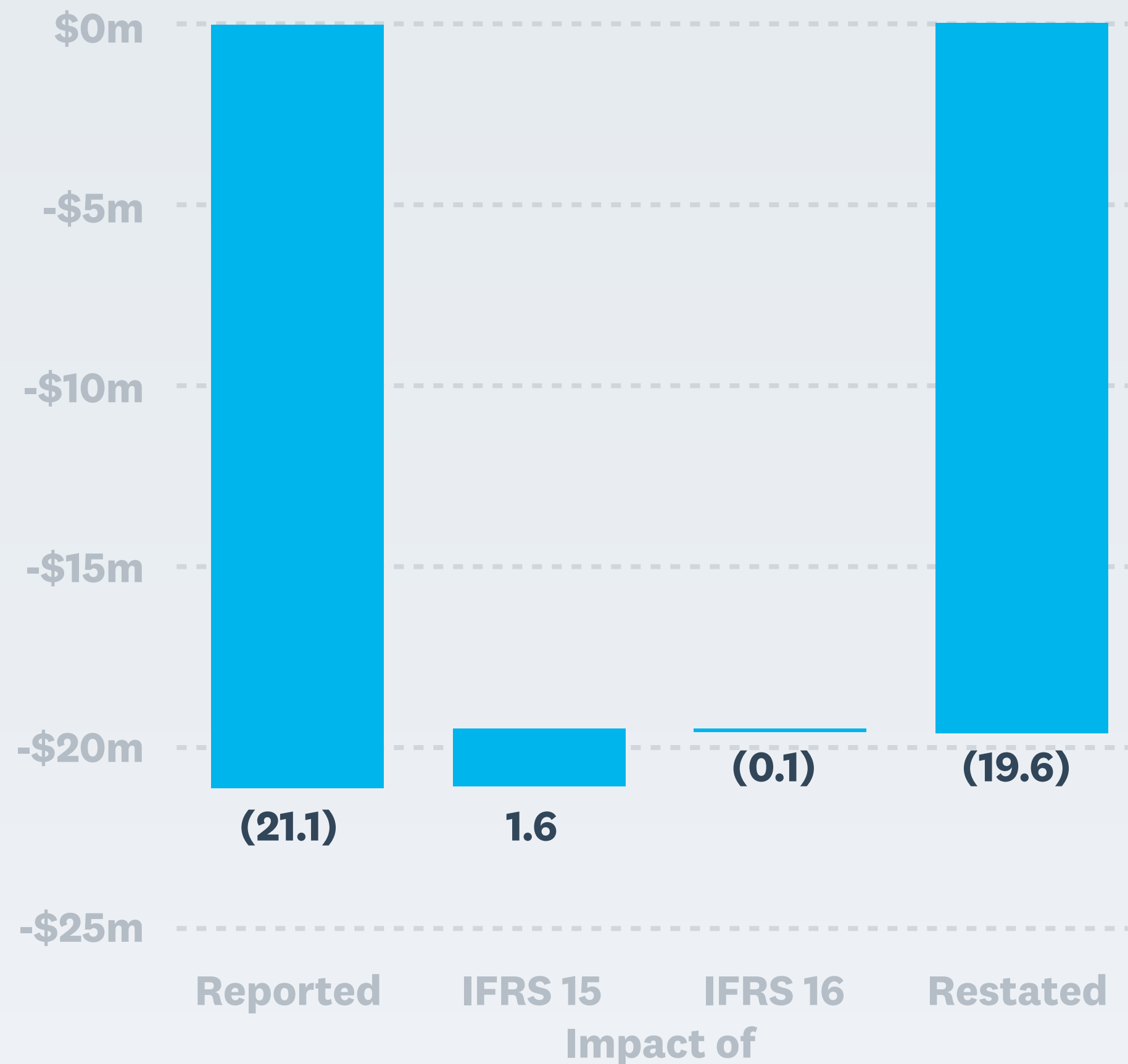
## IFRS 9

Financial instruments

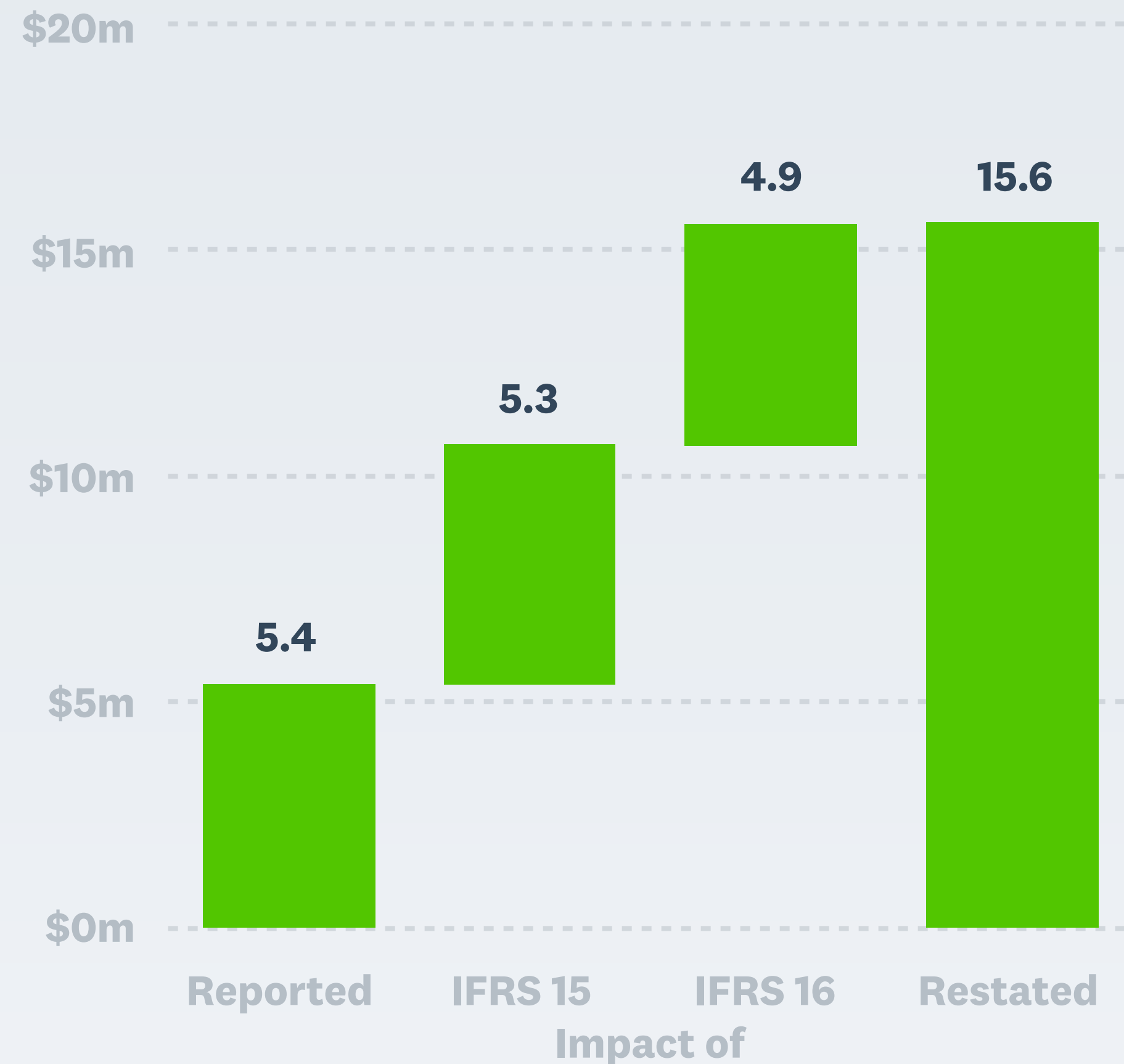
- Amends the classification and measurement of Xero's financial instruments and simplifies its hedge accounting model to align more closely to risk management strategies and objectives

# Impact of new accounting standards

Impact of accounting standard changes on restated H1 FY18 net loss



Impact of accounting standard changes on restated H1 FY18 EBITDA



Note: Impact of IFRS 9 adoption excluded from above charts. Adverse impact on restated H1 FY18 net loss is \$21,000



# Glossary

## Subscribers

Subscriber means each unique subscription to a Xero-offered product that is purchased by an accounting partner or an end-user and which is, or is available to be, deployed. Subscribers that have multiple subscriptions to integrated products on the Xero platform are counted as a single subscriber

## AMRR

Annualised monthly recurring revenue (AMRR) 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, transaction volumes, pricing and foreign exchange remain unchanged during the year

## ARPU

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

## Churn

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

## Lifetime value (LTV)

LTV is the gross margin expected from a subscriber over the lifetime of that subscriber. This is calculated by taking the average subscriber lifetime (1 divided by 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

## CAC months

CAC months are months of ARPU to recover the cost of acquiring each new subscriber. The calculation is sales and marketing costs for the year excluding the deferral and amortisation of commissions paid to sales people, less conference revenue (such as Xerocon), divided by gross new subscribers added during the same period, divided by ARPU

## Finweb

Financial web

## SBP

Share-based payments

## CAC

Customer acquisition costs

## TAM

Total addressable market

## GAAP

Generally accepted accounting principles



**Beautiful business**

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