Appendix 4D

12 November 2020

Xero Limited
ARBN 160 661 183 (incorporated in New Zealand)

Reporting period	6 months to 30 September 2020
Previous corresponding period	6 months to 30 September 2019

Results for announcement to the market

	Amount (000s)	% change
Revenues from ordinary activities	NZ$409,837	up 21%
Net profit from ordinary activities	NZ$34,486	NM*
Net profit attributable to security holders	NZ$34,486	NM

**NM stands for not meaningful*

No dividends are proposed and no dividends were declared or paid for the reporting period.

Net tangible assets per share was NZ$1.02 per share at 30 September 2020 (30 September 2019: NZ$0.44 per share).

For additional Appendix 4D disclosure requirements refer to Xero Limited's Interim Report for the 6 months ended 30 September 2020.

Authorised for release to the ASX by the Chair of the Board and the Chair of the Audit and Risk Management Committee.

Xero Limited

2021 Interim Report

Beautiful business

Contents

Cover images:

Mentorloop, Australia
361 Degree Consultancy, Singapore
noissue, New Zealand

Highlights

OPERATING REVENUE

$409.8m

Up 21% YOY

FREE CASH FLOW

$54.3m

Up $49 million YOY

EBITDA

$120.8m

Increase of $55.9 million YOY

SUBSCRIBERS

2.453m

Up 396,000 YOY

ANNUALISED MONTHLY RECURRING REVENUE

$877.6m

Up 15% YOY

TOTAL AVAILABLE LIQUIDITY

$722.5m

Cash and cash equivalents, short-term deposits, and undrawn committed debt facilities

TOTAL SUBSCRIBER LIFETIME VALUE

$6.2b

Up $0.8 billion YOY

GROSS MARGIN PERCENTAGE

85.7%

Up 0.5 percentage points YOY

Chair & CEO review

David Thodey
Chair

Steve Vamos
Chief Executive

Dear shareholder

The COVID-19 pandemic continues to impact businesses and communities around the world. This remains an unquestionably challenging time for many of our customers and partners in their businesses and personal lives. It is our privilege to support these small business communities. We serve a wonderful and diverse group of committed people, many of whom are doing it tough, and our focus remains on doing everything we can to support them.

Our research shows how resilient small businesses are in the face of challenges. We have also seen many examples of ingenuity and innovation in our communities, as businesses navigate uncharted waters and meet their customers' changing demands. Our accounting and bookkeeping partners have also emerged as trusted advisors, helping small businesses navigate the COVID-19 operating environment.

In the first six months of the 2021 financial year (H1 FY21) Xero continued to deliver top line revenue and subscriber growth, demonstrating the value our customers attribute to their Xero subscription and the demand for our cloud-based products and services globally.

We made significant investments in product development. This has helped to ensure our small business customers and partners have the best tools to manage and monitor their businesses in the COVID-19 environment.

Small businesses make up more than 90% of businesses in the markets Xero operates in and they represent a significant proportion of Gross Domestic Product and employment. We believe small business people will play a critical role in economic recovery, and the increasing adoption of cloud technology will be fundamental to their growth and success.

Customers, partners and our people

To help our customers through the current environment, we have continued to provide targeted information and resources through Xero's Business Continuity Hub. This includes help with accessing government support and our Customer Response Team who are available 24/7 to assist as needed.

This year, we decided to cancel our in-person Xerocon events planned in Sydney and London. Instead, to connect with customers, accountants, bookkeepers and communities, we created Xero On Air. This was a free digital engagement series that featured more than 30 episodes filmed in 15 locations around the globe and incorporated a number of important customer and partner product announcements.

As Xero continues to drive cloud adoption around the world, the opportunity for sustainable long-term growth is clear to see.

To provide a snapshot of small business resilience, at Xero On Air we released our first expanded Xero Small Business Insights (XSBI) Report focused on how small businesses are faring in the pandemic. The XSBI findings were taken from anonymised and aggregated customer data gathered from subscribers across Australia, New Zealand and the UK.

Increasingly, XSBI is becoming a valuable resource for governments and policymakers in some of our largest markets, helping them to assess the impact of stimulus packages and future planning around support for small business.

Looking after the wellbeing of Xero employees is critical to ensure they thrive and do their best work for our customers and communities. We recently appointed a global Head of Wellbeing dedicated to developing and leading programs to support our people, and provide them with specific support needed in the COVID-19 environment.

Product updates

We made a series of major product announcements at Xero On Air aimed at small businesses and their advisors, including:

- Enhanced Starter plan: We are seeing the creation of many new small businesses across our markets as a result of COVID-19. This includes an influx of sole traders such as tradespeople, freelancers and gig-workers taking advantage of evolving market dynamics across our regions. To support these customers we updated and relaunched Xero's Starter plan, which is now tailored to support new small businesses and existing customers who have less complex accounting needs.
- Next Gen Practice vision: Xero's 'Next Gen Practice' product creates a unified place for accountants and bookkeepers to access tools that they use every day to onboard, collaborate and manage client work in the cloud. This is particularly relevant in the COVID-19 environment to enable them to easily complete their workflows remotely.
- Improved payment services: Xero data shows that customers who use online invoice payments get paid up to twice as fast as those who do not. This can make a huge difference to small business cash flow. We announced enhancements to the onboarding experience for our Stripe integration, to make it easier for small businesses to accept card payments for online invoices. We are also building a deeper integration with GoCardless that will launch in the coming months, to create a more seamless experience for small businesses to accept direct debit payments.

Strategy

While we estimate that more than half of small businesses in Australia and New Zealand have adopted cloud accounting, we estimate that adoption in the rest of the world is currently less than 20 percent. As Xero continues to drive cloud adoption around the world, the opportunity for sustainable long-term growth is clear to see.

In H1 FY21 we reached 2.45 million subscribers globally. We also achieved two major subscriber milestones that demonstrate the level of Xero's adoption across a number of markets. In the international segment, which includes all markets outside of Australia and New Zealand, Xero exceeded one million subscribers, and our Australian business also crossed that milestone during the half.

In August, we announced the acquisition of Waddle, a cloud-based invoice lending platform that helps small businesses in Australia and the UK access capital through invoice finance. The transaction was completed on 1 October. This acquisition is part of our strategy to grow the small business platform and solve critical small business financial needs, including managing their cash flow. We are excited about the benefits Waddle can bring to our customers and lending partners around the world.

Xero On Air

Behind the scenes in the Auckland production studio

Strategic trends

COVID-19 has presented many small businesses and their advisors with a strong case for adopting digital technology and moving to the cloud, to enable remote working and real-time collaboration.

Digitisation of tax and compliance is another growing trend in our markets. Governments are moving to online tax filing and recordkeeping, requiring businesses to have secure digital connections to government and government agencies. An example of this is the UK Government's Making Tax Digital initiative. In July, the UK Government reconfirmed its commitment to implementing the next stages of Making Tax Digital, for VAT in 2022 and Income Tax in 2023.

Digital connections on the Xero platform have also played a central role in enabling small businesses and their advisors to apply for and access government stimulus. In Australia, Xero was the first major cloud accounting platform in the market to enable small business customers to access the government subsidy scheme, JobKeeper, through Single Touch Payroll.

Social and environmental impact

Xero's social and environmental impact (SEI) program remains a priority. We recognise our role in contributing to the communities we operate in.

We established our first global, public fundraiser, the Xero Community Appeal, to support charities that help the most vulnerable and marginalised people in our communities to connect to support and improve mental wellbeing. The appeal started on 1 July and will run for six months.

Xero continues to receive recognition for the progress we are making with our SEI program from a number of ESG rating agencies.

For information on all Xero's SEI initiatives, our ongoing commitment to Net Zero @ Xero projects, and our ESG recognition, visit xero.com/socialimpact.

Diversity and inclusion

At Xero, we value diversity and the rich differences and capabilities that having diverse teams can bring. This includes gender and cultural diversity that will help our business thrive in a global environment. Our work in relation to gender diversity was recognised with our inclusion in the 2020 Bloomberg Gender-Equality Index.

In May we launched Xero's first internal diversity survey to build a meaningful global baseline for cultural diversity across our organisation, so we can monitor our progress in this area. Survey results show that our people collectively represent more than 75 countries and speak more than 75 unique languages.

We're developing a strategic action plan to amplify our diversity and inclusion efforts through sustainable programs such as hiring and education to drive progress on racial equity and diversity at Xero. The Black Lives Matter movement reinforced the imperative for organisations to tackle racism and racial inequality. This is something that we take extremely seriously at Xero and is core to our values.

Performance highlights H1 FY21

All figures are in NZD and comparisons are made against H1 FY20

- Operating revenue was up 21% to $409.8 million (19% in constant currency (CC))
- Annualised monthly recurring revenue (AMRR) grew 15% to $877.6 million
- Total subscribers increased by 19% to 2.45 million
- Total subscriber lifetime value (LTV) grew by 15% (in both actual and CC) to $6.2 billion
- Free cash flow was $54.3 million, compared to $4.8 million
- EBITDA of $120.8 million increased 86% from $64.9 million
- Net profit after tax increased by $33.2 million to $34.5 million

Market highlights

Australia subscribers grew by 21% compared to H1 FY20, to 1.01 million subscribers. Revenue was up 18% (17% in CC). The Australian Taxation Office Single Touch Payroll initiative, and the roll-out of JobKeeper stimulus payments by the Australian Government, contributed to continued strong demand for cloud accounting in this market.

UK subscribers grew by 19% compared to H1 FY20, to 638,000 subscribers. Revenue was up 33% (29% in CC), a robust outcome in one of Xero's more COVID-19 affected markets.

New Zealand subscribers increased by 13% compared to H1 FY20, to 414,000, with revenue rising by 13%. An acceleration in net subscriber additions from 16,000 in H1 FY20 to 22,000 net subscriber additions in H1 FY21 demonstrated ongoing demand for Xero in its first and most developed market.

North America subscribers increased by 17% to 251,000 compared to H1 FY20 as Xero continued to focus on the partner channel. Revenue grew 4% (2% in CC). This reflected the bundling of Hubdoc into Xero Business Edition subscriptions towards the end of FY20, with Hubdoc subscriptions most concentrated in North America. The absence of Xerocon-related revenue also contributed to this outcome.

Rest of World continued momentum in subscribers, increasing 37% compared to H1 FY20 at 136,000. Revenue was up 38% (35% in CC). Growth was led by South Africa, and further progress was made in Singapore.

Board and leadership

We were pleased to welcome Steven Aldrich as an independent non-executive director in October. Steven is US-based and his technology and product development expertise and experience in small business services will be of great value to Xero and our Board, especially as we look to serve more small businesses in North America.

In September we expanded Xero's Chief Customer Officer role to lead our global sales and customer functions.

This change aligns the global and regional reporting and operations to ensure there is alignment as Xero's customer base continues to grow globally.

Conclusion

As digitisation of the small business economy continues to gather pace around the world, and small business responds to the realities of operating in a COVID-19 environment, we are focused on making it easier for small business to harness the power of cloud-based technologies.

Xero's Board and leadership team greatly appreciate the support of our people, customers and partners.

Thanks to everyone who supports Xero.

David Thodey

David Thodey, Chair

Steven Vamos

Steve Vamos, Chief Executive

Management commentary

You should read the following commentary with the consolidated 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 include forward-looking statements that involve risks and uncertainties. Actual results and the timing of certain events may differ materially from future results expressed or implied by the forward-looking statements contained in this commentary. All amounts are presented in New Zealand dollars (NZD) except where indicated. References to the period or H1 FY21 are for the six months ended 30 September 2020. References to the comparative period or H1 FY20 are for the six months ended 30 September 2019.

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

As Waddle Holdings Pty Ltd was acquired on 1 October 2020 its performance and position are not included in these results.

Business results

Six months ended 30 September	2020 ($000s)	2019 ($000s)	change
Subscription revenue	401,747	327,937	23%
Other operating revenue	8,090	10,721	-25%
Total operating revenue	**409,837**	**338,658**	**21%**
Cost of revenue	(58,676)	(50,141)	17%
Gross profit	**351,161**	**288,517**	**22%**
Gross margin percentage	85.7%	85.2%	0.5pp*
Total operating expenses	**(288,321)**	**(272,507)**	**6%**
Percentage of operating revenue	70.4%	80.5%	-10.1pp
Other income and expenses	(3,151)	(199)	NM**
Asset impairments	-	(1,071)	-100%
Operating profit	**59,689**	**14,740**	**305%**
Percentage of operating revenue	14.6%	4.4%	10.2pp
Net finance expense	(15,186)	(10,943)	39%
Income tax expense	(10,017)	(2,461)	307%
Net profit	**34,486**	**1,336**	**NM**
Percentage of operating revenue	8.4%	0.4%	8.0pp

**pp stands for percentage points*

***NM stands for not meaningful*

H1 FY21 has seen Xero continue to execute its growth strategy, resulting in resilient financial results. Despite ongoing challenges regarding the impacts of COVID-19, Xero has maintained strong top-line revenue growth, with a continued focus on operational discipline. This has resulted in improvements in EBITDA, free cash flow, and net profit after tax. The resilience of Xero's global business model has meant that, despite the impact of COVID-19 on Xero's financial and operating performance, Xero can continue to invest in scaling its global business, developing new products, and driving quality subscriber growth.

Operating revenue growth was driven by subscriber growth in all markets. Xero reached key milestones in H1 FY21 with both the Australian market and the International segment surpassing 1 million subscribers, bringing Xero's worldwide subscribers to 2,453,000 at 30 September 2020.

Gross margin percentage improved by 0.5 percentage points compared to H1 FY20. This was due to the realisation of continued efficiencies in the costs of hosting Xero's cloud services and further productivity gains from Xero Central (Xero's customer experience and community platform). Total operating expenses increased by 6% against the comparative period, but decreased by 10.1 percentage points as a percentage of operating revenue as Xero temporarily cut back on discretionary costs due to uncertainty related to COVID-19 early in the half. Operating costs increased in the second quarter of the half as the operating environment became clearer in key markets. Growth in total operating revenue of 21% exceeded growth in total operating expenses, resulting in improved operating profit of $59.7 million in H1 FY21, up $44.9 million from $14.7 million in HY1 FY20.

The increase in net finance expense of $4.2 million was primarily driven by a decrease in interest income received on deposits as a result of falling global interest rates.

Net profit after tax for H1 FY21 was $34.5 million, driven by revenue growth and a focus on cost management during the challenges created by COVID-19. This follows net profits of $2.0 million in H2 FY20 and $1.3 million in H1 FY20.

Earnings before interest, tax, depreciation, and amortisation (EBITDA)

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

Six months ended 30 September	2020 ($000s)	2019 ($000s)	change
Net profit	**34,486**	**1,336**	**NM**
Add back: net finance expense	15,186	10,943	39%
Add back: depreciation and amortisation	61,076	50,110	22%
Add back: income tax expense	10,017	2,461	307%
EBITDA	**120,765**	**64,850**	**86%**
EBITDA margin	29.5%	19.1%	10.4pp

EBITDA improved by $55.9 million or 86% in H1 FY21 compared to H1 FY20, resulting in EBITDA as a percentage of revenue increasing from 19.1% in H1 FY20 to 29.5% in H1 FY21. The improvement in EBITDA was driven by revenue growth and cost management in response to the COVID-19 environment. Revenue grew by 21% compared to H1 FY20, as the business continues to deliver the benefits of scale. Total operating expenses as a proportion of operating revenue decreased from 80.5% in H1 FY20 to 70.4% in H1 FY21. This was driven by operational discipline and efficiencies being delivered across the cost of revenue, sales and marketing, and general and administration functions. Xero continues to demonstrate a commitment to invest for the long-term with product design and development investment up 29% compared to the comparative period, and significantly higher than operating revenue growth of 21%. The combination of revenue growth and operational discipline resulted in a large improvement in net profit, further contributing to growth in EBITDA.

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

Six months ended 30 September	2020 ($000s)	2019 ($000s)	change
EBITDA	**120,765**	**64,850**	**86%**
Add back: non-cash share-based payments	21,438	15,775	36%
Add back: non-cash impairments	-	1,071	-100%
EBITDA excluding non-cash share-based payments and impairments	**142,203**	**81,696**	**74%**
Percentage of operating revenue	34.7%	24.1%	10.6pp

EBITDA, excluding non-cash share-based payments and impairments, for H1 FY21 was $142.2 million, an improvement of $60.5 million or 74% compared to H1 FY20. Operating revenue growth of 21% exceeded the growth of cash-based expenses, which grew by $10.7 million, or 4%. This resulted in EBITDA, excluding non-cash share-based payments and impairments, improving as a percentage of operating revenue by 10.6 percentage points.

Cash flows and liquidity

Free cash flow is a non-GAAP financial measure that has been included to show readers net cash generated by, and invested into, the business. Xero defines free cash flow as cash flows generated from operating activities less cash flows used for investing activities, excluding cash used for acquisitions of, and investments into, businesses and strategic assets.

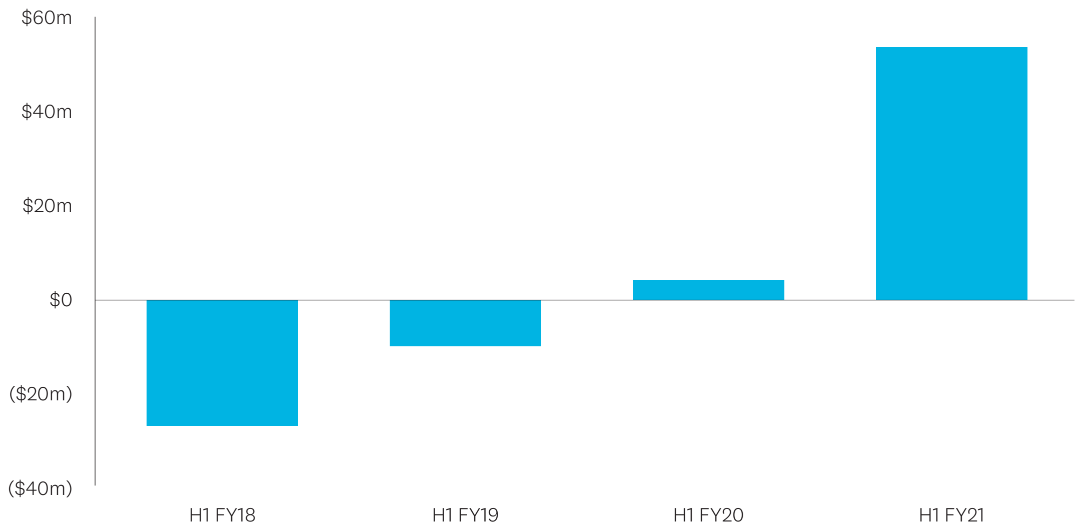
Six months ended 30 September	2020 ($000s)	2019 ($000s)	change
Receipts from customers	409,750	339,565	21%
Other operating cash flows	(282,989)	(268,026)	6%
Total cash flows from operating activities	**126,761**	**71,539**	**77%**
Investing activities	(72,493)	(66,710)	9%
Free cash flows	**54,268**	**4,829**	**NM**
Percentage of operating revenue	13.2%	1.4%	11.8pp

Free cash flows for H1 FY21 increased by $49.4 million to $54.3 million, equating to 13.2% of total operating revenue, compared to $4.8 million, or 1.4% of total operating revenue in H1 FY20. Receipts from customers increased by 21% or $70.2 million to $409.8 million, which is closely aligned with revenue growth (21%).

The uncertainty surrounding the impacts of COVID-19 in the first quarter of H1 FY21 led to strategic reductions in certain operating expenditure, such as sales and marketing, and travel, while continuing to invest in product design and development. During the period, Xero also reduced its payment terms for small business suppliers to 10 working days, which had an impact on trade and other payables. Cash flows from operating activities increased by $55.2 million to $126.8 million as receipts from customers grew at a faster rate (21%) than other operating cash outflows (6%), primarily due to the focus on cost management early in the half.

Cash outflows from investing activities increased by 9% or $5.8 million. The increase was largely driven by higher capitalised product design and development costs, which increased by $11.0 million or 20% compared to H1 FY20. Capitalised contract acquisition costs for the half of $3.8 million was 48%, or $3.5 million less than the comparative period.

Free cash flows



Total available liquidity (defined as *cash and cash equivalents, short-term deposits including proceeds from convertible notes, and undrawn committed debt facilities*) at 30 September 2020 was $722.5 million. This comprised $572.5 million of cash and cash equivalents and short-term deposits as well as access to an undrawn committed debt facility of $150.0 million. The facility is in place to ensure Xero maintains access to prudent levels of operational liquidity, appropriate to the size and maturity of the business. The lender group for this facility consists of ANZ, BNZ, Citibank, and HSBC.

Of the cash and cash equivalents and short-term deposits balance, $366.7 million relates to the convertible notes proceeds that are held in USD for future strategic investments and acquisitions. Neither of Xero's debt or standby debt facilities mature in the next 12 months.

Operating revenue

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

Operating revenue includes subscription revenue as well as revenue from other related services, including attendance fees for conferences and events such as Xerocon, revenue share agreements with financial services providers including fintech partners, and the implementation of online accounting and other software services. Subscription revenue comprises 98% of operating revenue in H1 FY21.

Six months ended 30 September	2020 ($000s)	2019 ($000s)	change	change in constant currency*
Subscription revenue	401,747	327,937	23%	20%
Other operating revenue	8,090	10,721	-25%	-26%
Total operating revenue	**409,837**	**338,658**	**21%**	**19%**

**Constant currency operating revenue (a non-GAAP financial measure) is provided to assist readers in understanding and assessing Xero's financial performance during the year, excluding the impact of foreign currency fluctuations. Constant currency operating revenue is calculated by translating operating revenue for H1 FY21 at the effective exchange rates for H1 FY20.*

Operating revenue growth of 21% compared to H1 FY20 was due to the increase in subscription revenue of 23% (20% in constant currency). The subscription revenue increase was primarily driven by organic subscription growth, with subscriber numbers at 30 September 2020 increasing by 396,000 subscribers, or 19%, compared to 30 September 2019. In addition, uptake of Xero add-ons such as payroll, projects, and expenses modules were higher, contributing to the subscription revenue increase. This reflects the value subscribers place on Xero's platform even during the uncertainties presented by COVID-19.

Other operating revenue decreased by 25%. This was due to the comparative period including two Xerocon conference events (Brisbane and San Diego), which were not held in the current period. In lieu of an in-person conference Xero instead ran Xero On Air, a free digital engagement series, designed to connect, inspire, and share information with accounting and bookkeeping partners and small business customers around the world. The impact from not holding conferences was partially offset by an increase in revenue from fintech partnerships. Xero partners with fintech providers to assist its subscribers in accessing online financial solutions, resulting in an associated share of revenue between Xero and the provider. Other operating revenue excluding conference income increased by 41% compared to H1 FY20.

As 85% of Xero's operating revenue is denominated in currencies other than NZD (the Group's functional currency), changes in foreign exchange rates over the period have influenced reported revenue. The comparatively weaker NZD against the Australian dollar (AUD), US dollar (USD), and Great British pound (GBP) during H1 FY21 compared to H1 FY20 resulted in constant currency operating revenue for the Group being $7.3 million, or 2 percentage points, lower than reported revenue.

Operating revenue by geography

Six months ended 30 September	2020 ($000s)	2019 ($000s)	change	change in constant currency
Australia	183,690	155,177	18%	17%
New Zealand	63,526	56,245	13%	13%
Australia and New Zealand (ANZ) total	**247,216**	**211,422**	**17%**	**16%**
United Kingdom	107,305	80,419	33%	29%
North America	28,641	27,463	4%	2%
Rest of World	26,675	19,354	38%	35%
International total	**162,621**	**127,236**	**28%**	**24%**
Total operating revenue	**409,837**	**338,658**	**21%**	**19%**

Operating revenue for H1 FY21 was 21% higher than the comparative period, primarily due to subscriber growth in all of Xero's geographies. In the ANZ segment, operating revenue increased by 17% (16% in constant currency), marginally lower than the 18% growth in subscribers. Australia's operating revenue grew by 18% (17% in constant currency) compared to subscriber growth of 21% mainly due to the comparative period including Xerocon revenue, with the Sydney conference due to take place in September 2020 cancelled. New Zealand operating revenue grew in line with its subscriber growth of 13%.

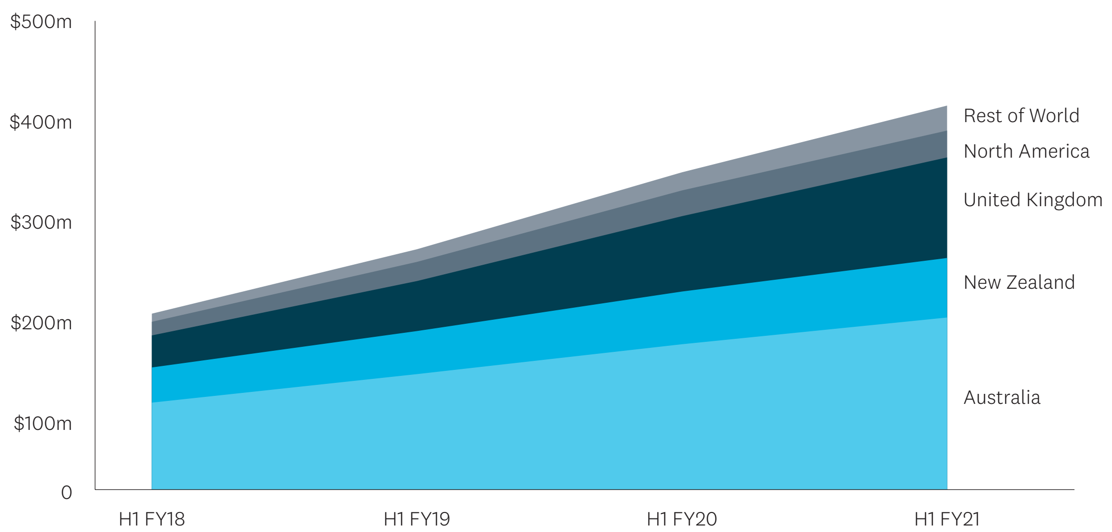
International operating revenue grew by 28% (24% in constant currency) compared to H1 FY20. Operating revenue growth in the UK of 29% (in constant currency) was more than subscriber growth of 19%, due to strong subscriber additions in H2 FY20 being realised in H1 FY21, and greater uptake of Xero add-ons.

North America operating revenue grew by 4%, which is lower than subscriber growth of 17%. Growth was impacted by the comparative period including revenue from a Xerocon conference, as well as the decision to bundle Hubdoc with the Xero business edition product in March 2020. The Hubdoc bundling impacted North America more than other markets due to the majority of Hubdoc subscribers being in this region.

Rest of World's operating revenue grew by 38% (35% in constant currency), mainly driven by subscriber growth of 37%, with South Africa and Singapore being the largest contributors.

Reported revenue benefited from fluctuations in foreign exchange rates. Specifically the NZD was weaker against the GBP, USD, and AUD on average during H1 FY21 compared to H1 FY20. In constant currency, operating revenue for the International segment was $158.0 million, $4.6 million or 2.8% lower than reported revenue.

Total Group operating revenue by geography*



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

Subscriber numbers

The definition of 'subscriber' is: *Each unique subscription to a Xero-offered product that is purchased by a user (e.g. small business or accounting partner) and which is, or is available to be, deployed. Subscribers that have multiple subscriptions to integrated products on the Xero platform are counted as a single subscriber.*

At 30 September	2020	2019	change
Australia	1,014,000	840,000	21%
New Zealand	414,000	367,000	13%
Australia and New Zealand (ANZ) total	**1,428,000**	**1,207,000**	**18%**
United Kingdom	638,000	536,000	19%
North America	251,000	215,000	17%
Rest of World	136,000	99,000	37%
International total	**1,025,000**	**850,000**	**21%**
Total paying subscribers	**2,453,000**	**2,057,000**	**19%**

Subscribers grew by 19% compared to 30 September 2019, bringing total subscribers to 2,453,000. 396,000 net subscribers were added in the 12 months ended 30 September 2020, compared to 478,000 in the 12 months ended 30 September 2019. Of the 396,000 subscribers added in the 12 months ended 30 September 2020, 168,000, or 42% were added in H1 FY21, compared to 228,000 in the immediately preceding six month period. COVID-19 had a material impact in all markets over the period, resulting in lower subscriber additions and higher levels of churn early in the half. However, the resilience of Xero's business model and the value subscribers place on the Xero products, assisted in customer retention and the continued growth in subscribers in all markets.

Significant milestones in the period include surpassing 1 million subscribers in both the Australian market and the International segment. These achievements reflect Xero's well-established presence in Australia and Xero's continued adoption internationally.

Xero continued to strengthen its presence in the established ANZ segment. In ANZ, Xero grew subscribers by 18%, or 221,000 from 30 September 2019, with 55%, or 122,000 added in H1 FY21. New Zealand added 47,000 subscribers in the 12 months ended 30 September 2020, growing 13% over the period.

COVID-19 restrictions in Australia impacted Xero's ability to acquire new customers, as subscribers added during the period declined by 12% compared to H1 FY20. However, Xero's presence and position as a market leader in the region resulted in 100,000 net subscribers added to reach 1 million subscribers late in the half. This result was assisted by Xero continuing to benefit from the previously released payroll-only product. This product, alongside the Australian Taxation Office (ATO) JobKeeper Payment scheme, helped the retention of existing subscribers as well as gaining new subscribers.

The UK led the International segment, adding 102,000 subscribers in the 12 months ending 30 September 2020 to end on 638,000 subscribers, an increase of 19%. Of these, 25,000 subscribers were added in H1 FY21, reflecting the challenging environment. The impact of COVID-19 in the UK restricted opportunities for growth as social distancing restrictions meant in-person events were cancelled.

North America subscriber numbers increased by 17%, or 36,000 from the comparative period. Of these, 10,000 were added in H1 FY21 compared to 26,000 in H2 FY20. The downturn in growth has been driven by the impacts of COVID-19, resulting in higher levels of churn and a difficult operating environment to acquire new customers. Xero's direct and partner channels continue to grow and this has resulted in subscriber numbers increasing in the US and Canada, despite the impacts of COVID-19.

Rest of World markets also performed strongly, given the uncertainty, with 37% growth in the 12 months ended 30 September 2020. The adoption of Xero in South Africa and Singapore continues to gain traction, supported by increased investment into these regions.

Regional subscribers at 30 September 2020*

AUSTRALIA
1,014,000
2019 | 840,000

NEW ZEALAND
414,000
2019 | 367,000

UNITED KINGDOM
638,000
2019 | 536,000

NORTH AMERICA
251,000
2019 | 215,000

**Rest of World subscribers of 136,000 at 30 September 2020 (99,000 at 30 September 2019)*

Annualised monthly recurring revenue

Annualised monthly recurring revenue (AMRR) is a non-GAAP financial measure, which 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.

Constant currency AMRR (also a non-GAAP financial measure) is calculated by translating AMRR at 30 September 2020 at the foreign exchange rates at 30 September 2019 and is provided to assist in understanding and assessing year-on-year growth rates, excluding the impact of foreign currency fluctuations.

At 30 September	2020 ($000s)	2019 ($000s)	change	change in constant currency
ANZ	527,699	458,326	15%	14%
International	349,852	305,770	14%	16%
Total	**877,551**	**764,096**	**15%**	**15%**

Total Group – AMRR grew by 15%, ending H1 FY21 at $877.6 million, up $113.5 million from 30 September 2019. The growth rate of AMRR in H1 FY21, compared to previous periods, slowed as a result of worldwide COVID-19 restrictions and uncertainty, which resulted in fewer subscriber additions. Growth in AMRR was principally driven by subscriber growth in all regions. In constant currency terms, total AMRR growth remained the same, due to subscriber growth of 19%, offset by a 3% decrease in constant currency ARPU.

ANZ – Continued subscriber growth of 18% drove AMRR, which increased 15% to surpass $500 million, ending H1 FY21 at $527.7 million. Constant currency AMRR growth was 1% lower than reported growth, due to the weaker NZD against the AUD at 30 September 2020 compared to 30 September 2019.

International – AMRR in the International segment grew by 14% compared to 30 September 2019, driven by growth in subscriber numbers (21%) and the impact of foreign exchange fluctuations. AMRR at H1 FY21 was $349.9 million, $3.2 million less than at 31 March 2020, due to unfavourable FX movements. Constant currency AMRR using 31 March 2020 exchange rates was 5% higher than at 31 March 2020.

Gross profit

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

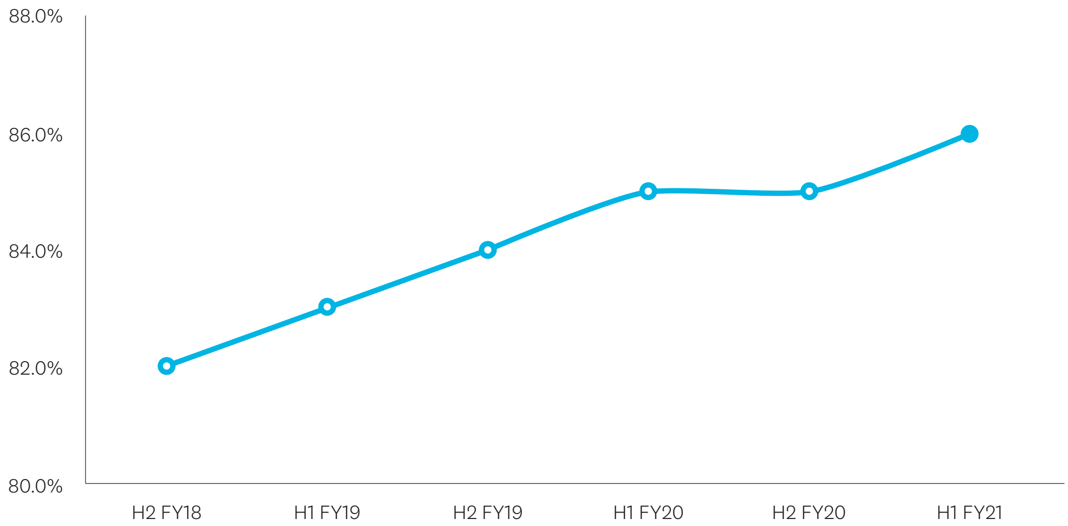
The costs include hosting and content distribution costs, bank feed costs, personnel and related expenses (including salaries, benefits, bonuses, and share-based payments) directly associated with cloud infrastructure and subscriber support, contracted third-party vendor costs, related depreciation and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

Six months ended 30 September	2020 ($000s)	2019 ($000s)	change
Operating revenue	409,837	338,658	21%
Cost of revenue	(58,676)	(50,141)	17%
Gross profit	**351,161**	**288,517**	**22%**
Gross margin percentage	85.7%	85.2%	0.5pp

Gross margin increased 0.5 percentage points to reach 85.7% for H1 FY21. This was driven by operating revenue growth of 21%, as well as efficiencies in cost of revenue as a proportion of revenue. This resulted in gross profit increasing by $62.6 million, or 22%, to $351.2 million. Cost of revenue for the period grew by $8.5 million to $58.7 million, representing a 17% increase when compared to the comparative period.

The increase in subscribers across the Group has driven an increase in cloud hosting costs and increased personnel costs related to higher headcount in Xero's customer support teams. The improvements in gross margin as a percentage of operating revenue is the result of continuing efficiencies in Xero's customer support teams along with minor efficiency gains in security and bank feed costs.

Gross margin percentage



Sales and marketing

Sales and marketing expenses consist of personnel and related expenses (including salaries, benefits, bonuses, the amortisation of capitalised commission costs, and share-based payments) directly associated with the sales and marketing teams, and the cost of educating and onboarding both partners and small business customers. Costs also include relationship management costs incurred to support the existing subscriber base. Other costs included are external advertising costs, marketing costs, and promotional events, as well as allocated overheads.

Six months ended 30 September	2020 ($000s)	2019 ($000s)	change
Sales and marketing expenses	130,750	146,072	-10%
Percentage of operating revenue	31.9%	43.1%	-11.2pp

Sales and marketing costs decreased by $15.3 million, or 10%, compared to the comparative period to $130.8 million for H1 FY21. The majority of sales and marketing costs are incurred in acquiring new subscribers and are expensed in the period, in contrast to the associated revenue from those subscribers, which is recognised over the life of the subscriber (typically more than seven years).

Sales and marketing costs have decreased in H1 FY21 due to disciplined cost management in response to the uncertainties presented by COVID-19. As a result, Xero carefully managed its variable costs during the first half of H1 FY21 until the impacts of COVID-19 became clearer. Xero also had higher levels of marketing spend in the comparative period to take advantage of the introduction of Australia's Single Touch Payroll and the UK's Making Tax Digital initiatives. Despite the reduction, Xero experienced positive subscriber performance in all regions, highlighting the resilience of Xero's go-to-market business model.

The average cost of acquiring a subscriber increased to $445 per gross subscriber added in H1 FY21 compared to $382 in H1 FY20. This 16% increase reflects lower subscriber additions compared to the comparative period, as well as the effects of foreign exchange fluctuations.

As a percentage of operating revenue, sales and marketing costs decreased by 11.2 percentage points, from 43.1% in H1 FY20 to 31.9% in H1 FY21. This is due to a focus on spending based on the opportunities in the current environment and is not expected to be sustained at these levels over the next few years.

Product design and development

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

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

Six months ended 30 September	2020 ($000s)	2019 ($000s)	change
Total product design and development costs (including amounts capitalised)	**139,938**	**108,828**	**29%**
Percentage of operating revenue	34.1%	32.1%	2.0pp
Less capitalised development costs	(62,859)	(49,295)	28%
Product design and development expense (excluding amortisation of amounts capitalised)	**77,079**	**59,533**	**29%**
Less government grants	(3,149)	(2,474)	27%
Add amortisation of capitalised development costs	36,724	28,238	30%
Product design and development expenses	**110,654**	**85,297**	**30%**
Percentage of operating revenue	27.0%	25.2%	1.8pp

During H1 FY21, Xero invested in product and platform updates that supported businesses during COVID-19. These included:

- Making updates to Xero Payroll to support small businesses quickly accessing government subsidies during COVID-19. This included allowing Australian subscribers to enrol their employees for JobKeeper payments directly with the ATO. Xero was the first major cloud accounting provider to market with this solution, which included building an employee eligibility calculator and enabling direct filing with the ATO through Single Touch Payroll (STP). In the UK, Xero also supported furlough leave and reporting to HMRC within Xero Payroll
- Enhancing the Starter plan (Early plan in the US), which removed the limits on bank reconciliation and increased the invoice limit to 20 per month to support small businesses with less complex accounting needs
- Accelerating the roll-out of the business snapshot and short-term cash flow pilots to all Xero business edition plans to provide better visibility into cash flow and business performance
- Launching e-invoicing functionality in AU and NZ, allowing small businesses to send invoices directly from Xero into government customers' accounting systems
- Releasing the Pay with Transferwise integration, allowing UK businesses to pay and manage multiple bills through Xero regardless of which bank customers use, and reconcile transactions easily
- Improving the search functionality on the app marketplace, using machine learning powered by Coveo, to give subscribers a more personalised experience for app suggestions
- Releasing practice management updates, including new functionality such as a unified client list across Xero HQ and XPM, enabling businesses to sign documents with Docupacks in AU, enhancements to the Advisor Directory, and updates to Xero Tax in the UK

Total product design and development costs were $139.9 million in H1 FY21, $31.1 million or 29% higher than H1 FY20. Of this, $62.9 million was capitalised, with the balance of $77.1 million included in the Income Statement within total product design and development expenses. The amount capitalised represents a capitalisation rate of 44.9% of total product design and development costs for H1 FY21, which is 0.4 percentage points lower than H1 FY20.

As a proportion of operating revenue, total product design and development costs for H1 FY21 (including amounts capitalised) increased by 2.0 percentage points to 34.1%. This highlights the continued investment in Xero's global platform as product design and development costs exceed subscription revenue growth due to the continued focus on investment into the product during the uncertainty of COVID-19.

The amortisation of previously capitalised product design and development expenditure of $36.7 million was included as a non-cash expense in the Income Statement, giving total net expenses (after the netting of government grants) of $110.7 million for H1 FY21. Amortisation of capitalised development costs increased due to higher intangibles balances than in H1 FY20.

General and administration

General and administration expenses consist of personnel and related expenses (including salaries, benefits, bonuses, and share-based payments) for executive, finance, billing, legal, human resources, strategy, and corporate development employees, and the Xero Board. It also includes legal, accounting, and other professional services fees, insurance premiums, other corporate expenses, and allocated overheads.

Six months ended 30 September	2020 ($000s)	2019 ($000s)	change
General and administration expenses	46,917	41,138	14%
Percentage of operating revenue	11.4%	12.1%	-0.7pp

General and administration costs were $46.9 million for H1 FY21, $5.8 million or 14% higher than H1 FY20. The main growth area was personnel related expenses, which were largely attributable to the growth in Xero's employee headcount over the last quarter of FY20. In particular the strategy and corporate development teams were expanded to drive future growth.

General and administration costs as a proportion of operating revenue reduced compared to H1 FY20, decreasing 0.7 percentage points to 11.4%.

Employees

At 30 September	2020	2019	change
Total Group	3,220	2,706	19%

Full-time equivalent (FTE) employees increased by 514, or 19% in the 12 months ended 30 September 2020, taking total FTEs to 3,220. This compares to a 19% increase in subscribers and 21% increase in operating revenue (19% in constant currency). The consistent growth in FTEs compared to revenue and subscribers reflects the continued increase in investment in product design and development, as well as strategic investment to prepare for future growth.

Net finance expense

Six months ended 30 September	2020 ($000s)	2019 ($000s)	change
Interest income on deposits	3,425	7,424	-54%
Total finance income	**3,425**	**7,424**	**-54%**
Interest on convertible notes	(14,681)	(13,681)	7%
Bank standby facility costs	(862)	(836)	3%
Lease liability interest	(2,919)	(3,714)	-21%
Other finance expense	(149)	(136)	10%
Total finance expense	**(18,611)**	**(18,367)**	**1%**
Net finance expense	**(15,186)**	**(10,943)**	**39%**

Finance income in H1 FY21 was $3.4 million, a decrease of $4.0 million from the comparative period. This was driven by a significant decrease in interest rates globally.

Finance expense increased slightly by 1%, driven by interest on the convertible notes, offset with a 21% decrease in lease liability interest compared to H1 FY20. Of the $14.7 million of interest on convertible notes, $5.6 million relates to coupon payments, a cash cost, with the remainder being the non-cash amortisation of the related debt liability discount. Lease liability interest decreased by $0.8 million, largely due to the continued reduction in lease liability on pre-existing leases.

Segment information

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

	ANZ ($000s)	International ($000s)	Total ($000s)
Six months ended 30 September 2020			
Operating revenue	247,216	162,621	409,837
Expenses	(78,202)	(111,224)	(189,426)
Segment contribution	**169,014**	**51,397**	**220,411**
Contribution margin percentage	68.4%	31.6%	53.8%
Six months ended 30 September 2019			
Operating revenue	211,422	127,236	338,658
Expenses	(80,378)	(115,835)	(196,213)
Segment contribution	**131,044**	**11,401**	**142,445**
Contribution margin percentage	62.0%	9.0%	42.1%

ANZ – Operating revenue for H1 FY21 increased by 17% (16% in constant currency) compared to the comparative period, highlighting the resilience of Xero's platform as a market leader in ANZ. Australia experienced operating revenue growth of 18% while New Zealand grew by 13%. These are both encouraging trends even in the highly penetrated ANZ segment. Australia surpassed the milestone of 1 million subscribers in H1 FY21.

The operating revenue growth paired with a focus on expenses resulted in a segment contribution of $169.0 million. This was an increase of 29% on H1 FY20 and represents 68.4% of operating revenue, up 6.4 percentage points from the comparative period. AMRR for the ANZ segment increased by 15% to $527.7 million compared to 30 September 2019, surpassing $500 million.

International – International operating revenue for H1 FY21 grew by 28%, or 24% in constant currency, driven by subscriber growth of 21%. The International segment had a 351% increase in contribution margin compared to the comparative period, with a contribution of $51.4 million, compared to $11.4 million in H1 FY20.

As a percentage of revenue, the contribution margin improved from 9.0% to 31.6% due to the combination of greater focus on cost management and revenue growth. The contribution margin remained comparatively lower than that of ANZ, reflecting the emphasis on investment in subscriber additions in the UK, North America, Asia, and South Africa, as Xero continues to develop brand recognition and build distribution channels in these markets.

Key SaaS metrics

SaaS companies like Xero operate on many of the same performance metrics as traditional companies, such as revenue, cash flow, and customer numbers. However, understanding the performance of SaaS companies and being able to benchmark them is assisted by an understanding of SaaS-specific metrics. Below are some of the headline metrics Xero uses to manage and drive its performance.

Average revenue per user (ARPU) is calculated as AMRR (see definition on page 13) at 30 September, divided by subscribers at that time (and divided by 12 to get a monthly view).

CAC months are the months of ARPU to recover the cost of acquiring (customer acquisition costs: CAC) each new subscriber. The calculation represents the sales and marketing costs for the year excluding the capitalisation and amortisation of contract acquisition costs, less conference revenue (such as Xerocon), divided by gross new subscribers added during the same period, divided by ARPU.

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

Lifetime value (LTV) is the gross margin expected from a subscriber over the lifetime of that subscriber. This is calculated by taking the average subscriber lifetime (one divided by churn), multiplied by ARPU, multiplied by the gross margin percentage. Group LTV is calculated as the sum of the individual segment LTV, multiplied by their respective segment subscribers, divided by total Group subscribers.

LTV/CAC is the ratio between the LTV and the cost to acquire that subscriber. For example, the LTV derived from a subscriber in ANZ is currently on average 11.4 times the cost of acquiring that subscriber.

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

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

At 30 September 2020	ANZ	International	Total
ARPU ($)	30.79	28.44	29.81
CAC months	9.1	22.0	14.9
Churn	0.83%	1.53%	1.11%
LTV per subscriber ($)	3,182	1,587	2,516
LTV/CAC	11.4	2.5	5.7

At 30 September 2019	ANZ	International	Total
ARPU ($)	31.64	29.98	30.96
CAC months	8.6	16.0	12.3
Churn	0.82%	1.58%	1.10%
LTV per subscriber ($)	3,362	1,563	2,619
LTV/CAC	12.3	3.3	6.9

ANZ – ARPU within the ANZ segment decreased by 3% compared to 30 September 2019, due to product mix impacts in H2 FY20. This was impacted by the ATO JobKeeper Payment scheme, which contributed to the continued uptake of lower ARPU Single Touch Payroll focused products in Australia. In constant currency terms, ANZ ARPU was broadly flat to 31 March 2020.

CAC months at 30 September 2020 was moderately higher than at 30 September 2019 as subscriber additions were lower than the comparative period. Xero continues to invest in its small business platform, ecosystem, and financial services strategies that target existing customers, as well as investing to drive growth to further increase market share in the ANZ segment.

Churn increased early in the half normalising to close to normal levels later in the half. Lower subscriber additions in the half had a positive impact on churn, as new subscribers are most at risk to cancel their subscription. Churn is also supported by government stimulus supporting small businesses across ANZ.

The decrease in ARPU and gross margin, and a marginal increase in churn, led to a 5% decrease in LTV per subscriber (a 6% decrease in constant currency) within ANZ. Total ANZ subscriber LTV increased by $0.5 billion, or 12% to $4.5 billion at 30 September 2020 compared to $4.1 billion at 30 September 2019.

International – ARPU across the International segment decreased by 5% (4% in constant currency) from 30 September 2019. This was driven by a shift towards the more efficient but lower ARPU partner channel in H2 FY20. The comparatively weaker USD against the NZD also had a negative effect on ARPU within North America and Rest of World. In constant currency ARPU was slightly more than at 31 March 2020.

CAC months increased from 16.0 months to 22.0 months at 30 September 2020. This was due to lower subscriber additions due to the operating environment under COVID-19 meaning the average cost of acquiring each new subscriber increased by 30% (a 26% increase in constant currency). The decrease in ARPU compared to the comparative period also contributed to the increase.

As in the ANZ segment churn increased early in the half normalising to close to normal levels after government stimulus in key regions took effect. Lower subscriber additions in the half had a positive impact on churn, as new subscribers are most at risk to cancel their subscription.

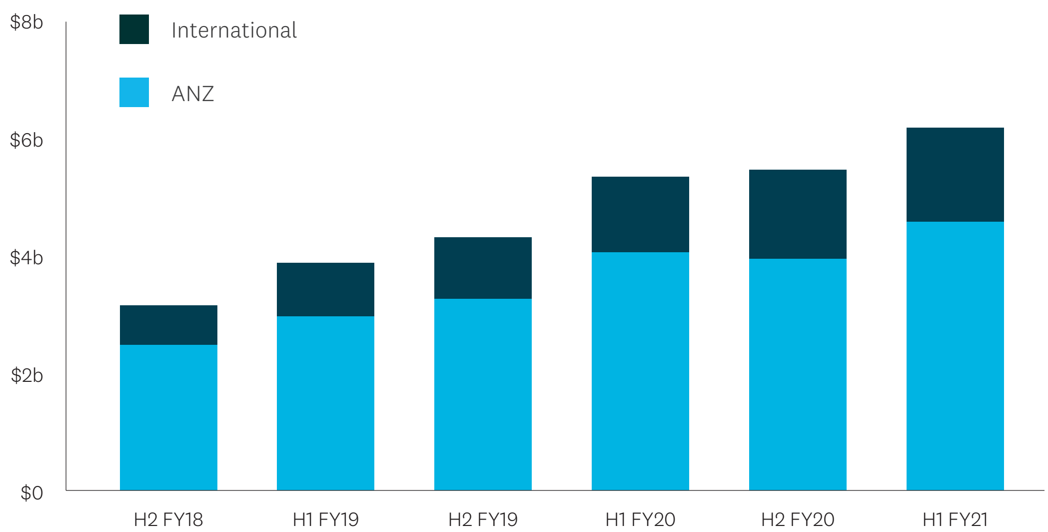
LTV per subscriber increased by 2% at 30 September 2020 compared to the comparative period (an increase of 3% in constant currency). This was despite a decrease in ARPU, due to higher gross margin and lower churn. Total LTV for the International segment increased by 22% to $1.6 billion at 30 September 2020 compared to 30 September 2019 due to subscriber growth, particularly in the UK market.

Total Group – Group ARPU decreased by 4% compared to 30 September 2019. This was due to a combination of uptake of lower ARPU products in both segments, as well as the weaker USD against the NZD. ARPU decreased 3% in constant currency compared to 30 September 2019, however it was consistent in constant currency with 31 March 2020.

LTV per subscriber decreased 4% from the comparative period to $2,516. This was despite improved gross margin, due to decreased ARPU and a slight increase in churn compared to H1 FY20. Group constant currency LTV per subscriber at 30 September 2020 was 4% lower than at 30 September 2019.

Total subscriber LTV at 30 September 2020 was $6.2 billion, an improvement of $0.8 billion compared to 30 September 2019. CAC months increased 21% to 14.9 months when compared to 30 September 2019, due to a 16% increase in the cost of acquiring each new subscriber and the decrease in ARPU.

Total lifetime value



Independent Review Report

To the Shareholders of Xero Limited

OPINION

We have reviewed the interim financial statements of Xero Limited ("the Company") and its subsidiaries (together "the Group") on pages 22 to 33, which comprise the statement of financial position of the Group as at 30 September 2020 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.

Ernst & Young has provided R&D tax credit advice and other assurance services related to the Group's compliance with ISO 27001 and Callaghan grant funding. Partners and employees of our firm may deal with the Group on normal terms within the ordinary course of trading activities of the business of the Group. Ernst & Young uses the Group's platform in delivering services to some clients. We have no other relationship with, or interest in, the Group.

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 22 to 33, do not present fairly, in all material respects, the financial position of the Group as at 30 September 2020 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 12 November 2020 and our findings are expressed as at that date.

Ernst + Young

Ernst & Young
Chartered Accountants
Wellington

Income Statement

Six months ended 30 September	Notes	2020 Unaudited ($000s)	2019 Unaudited ($000s)
Subscription revenue		401,747	327,937
Other operating revenue		8,090	10,721
Total operating revenue	**4**	**409,837**	**338,658**
Cost of revenue	5	(58,676)	(50,141)
Gross profit		**351,161**	**288,517**
Operating expenses			
Sales and marketing		(130,750)	(146,072)
Product design and development		(110,654)	(85,297)
General and administration		(46,917)	(41,138)
Total operating expenses	**5**	**(288,321)**	**(272,507)**
Asset impairments		-	(1,071)
Other income and expenses		(3,151)	(199)
Operating surplus		**59,689**	**14,740**
Finance income		3,425	7,424
Finance expense		(18,611)	(18,367)
Net profit before tax		**44,503**	**3,797**
Income tax expense		(10,017)	(2,461)
Net profit		**34,486**	**1,336**
Basic and diluted earnings per share	6	$0.24	$0.01

Statement of Comprehensive Income

Six months ended 30 September	Note	2020 Unaudited ($000s)	2019 Unaudited ($000s)
Net profit		34,486	1,336
Other comprehensive income*			
Movement in cash flow hedges (net of tax)	8	(3,014)	197
Translation of foreign operations		1,625	(531)
Total other comprehensive loss for the period		**(1,389)**	**(334)**
Total comprehensive income for the period		**33,097**	**1,002**

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

Statement of Financial Position

	Note	At 30 Sep 2020 Unaudited ($000s)	At 31 Mar 2020 Audited ($000s)
Assets			
Current assets			
Cash and cash equivalents		222,016	108,027
Short-term deposits		350,516	428,052
Trade and other receivables		57,232	55,877
Derivative assets		308,366	124,698
Other current assets		1,006	1,856
Total current assets		**939,136**	**718,510**
Non-current assets			
Property, plant and equipment		119,226	86,638
Intangible assets	7	368,932	342,246
Deferred tax assets		6,439	3,751
Derivative assets		151	-
Other non-current assets		1,333	2,543
Total non-current assets		**496,081**	**435,178**
Total assets		**1,435,217**	**1,153,688**
Liabilities			
Current liabilities			
Trade and other payables		29,935	42,954
Employee entitlements		49,036	39,893
Lease liabilities		12,858	11,755
Income tax payable		1,786	2,679
Derivative liabilities		1,352	3,157
Other current liabilities		12,007	15,694
Total current liabilities		**106,974**	**116,132**
Non-current liabilities			
Term debt		394,873	424,587
Derivative liabilities		312,967	121,972
Lease liabilities		91,226	60,871
Deferred tax liabilities		1,025	1,114
Other non-current liabilities		13,150	6,646
Total non-current liabilities		**813,241**	**615,190**
Total liabilities		**920,215**	**731,322**
Equity			
Share capital		724,757	677,540
Reserves		96,295	85,362
Accumulated losses		(306,050)	(340,536)
Total equity		**515,002**	**422,366**
Total liabilities and shareholders' equity		**1,435,217**	**1,153,688**

The accompanying notes form an integral part of these interim financial statements

Statement of Changes in Equity

Unaudited	Note	Share capital ($000s)	Treasury shares ($000s)	Share-based payment reserve ($000s)	Accumulated losses ($000s)	Foreign currency translation reserve ($000s)	Cash flow hedge reserve ($000s)	Premium on call spread options ($000s)	Total equity ($000s)
Balance at 1 April 2020		**687,341**	**(9,801)**	**49,479**	**(340,536)**	**(2,489)**	**3,111**	**35,261**	**422,366**
Net profit		-	-	-	34,486	-	-	-	34,486
Other comprehensive income/(loss)		-	-	-	-	1,625	(3,014)	-	(1,389)
Total comprehensive income		**-**	**-**	**-**	**34,486**	**1,625**	**(3,014)**	**-**	**33,097**
Transactions with owners:									
Share-based payments	11	14,135	(3,500)	22,858	-	-	-	-	33,493
Exercising of share options	11	36,582	-	(10,536)	-	-	-	-	26,046
Balance at 30 September 2020		**738,058**	**(13,301)**	**61,801**	**(306,050)**	**(864)**	**97**	**35,261**	**515,002**
Balance at 1 April 2019		**638,234**	**(10,386)**	**30,902**	**(343,872)**	**904**	**2,266**	**35,261**	**353,309**
Net profit		-	-	-	1,336	-	-	-	1,336
Other comprehensive income /(loss)		-	-	-	-	(531)	197	-	(334)
Total comprehensive income		**-**	**-**	**-**	**1,336**	**(531)**	**197**	**-**	**1,002**
Transactions with owners:									
Share-based payments	11	9,327	(4,308)	12,712	-	-	-	-	17,731
Exercising of share options	11	10,869	-	(3,122)	-	-	-	-	7,747
Balance at 30 September 2019		**658,430**	**(14,694)**	**40,492**	**(342,536)**	**373**	**2,463**	**35,261**	**379,789**

The accompanying notes form an integral part of these interim financial statements

Statement of Cash Flows

Six months ended 30 September	Note	2020 Unaudited ($000s)	2019 Unaudited ($000s)
Operating activities			
Receipts from customers		409,750	339,565
Other income		3,285	2,773
Interest received		4,882	8,014
Payments to suppliers and employees		(270,127)	(264,459)
Interest paid		(15,040)	(10,320)
Income tax paid		(5,989)	(4,034)
Net cash flows from operating activities	**10**	**126,761**	**71,539**
Investing activities			
Capitalised development costs		(64,773)	(53,782)
Capitalised contract acquisition costs		(3,788)	(7,258)
Purchase of property, plant and equipment		(4,044)	(5,305)
Other investing activities		112	(365)
Net cash flows from investing activities		**(72,493)**	**(66,710)**
Financing activities			
Payment of lease liabilities		(5,946)	(5,330)
Receipt of lease incentive		490	-
Exercising of share options		26,046	7,747
Payments for short-term deposits		(347,075)	(440,213)
Proceeds from short-term deposits		395,637	415,298
Net cash flows from financing activities		**69,152**	**(22,498)**
Net increase/(decrease) in cash and cash equivalents		**123,420**	**(17,669)**
Foreign currency translation adjustment		(9,431)	7,040
Cash and cash equivalents at the beginning of the period		**108,027**	**121,527**
Cash and cash equivalents at the end of the period		**222,016**	**110,898**

The accompanying notes form an integral part of these interim financial statements

1. REPORTING ENTITY AND STATUTORY BASE

Xero Limited ('the Company') is registered under the New Zealand Companies Act 1993 and is listed on the Australian Securities Exchange. The Company is required to be treated as an FMC Reporting Entity under the Financial Markets Conduct Act 2013 and the Financial Reporting Act 2013.

The unaudited interim financial statements of the Company and its subsidiaries (together 'the Group' or 'Xero') for the six months ended 30 September 2020 were authorised in accordance with a resolution of the directors for issue on 12 November 2020.

2. BASIS OF ACCOUNTING

(a) Basis of preparation

The unaudited interim financial statements of the Group have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP) and comply with the requirements of New Zealand Equivalent to International Accounting Standard 34: *Interim Financial Reporting*, and International Accounting Standard 34: *Interim Financial Reporting*. The Group is a for-profit entity for the purposes of complying with NZ GAAP.

(b) 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 with, the financial statements and related notes included in the Group's annual report for the year ended 31 March 2020.

(c) 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 2020 have been applied to these interim financial statements.

In March 2020, the World Health Organization declared the outbreak of the novel coronavirus (COVID-19) a pandemic, that continues to spread globally. The Group has considered the impact of COVID-19 on the judgements, estimates, and assumptions used, and determined there were no material adverse impacts on the interim financial statements. As events continue to evolve and additional information becomes available, the Group’s judgements, estimates, and assumptions may change in future periods.

3. SEGMENT INFORMATION

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

Xero has two operating segments: Australia and New Zealand (ANZ) and International. These segments have been determined based on how the Xero leadership team (the chief operating decision-maker) reviews financial performance.

Segment operating expenses represent sales and marketing costs and service delivery costs, including both in-country costs and an allocation of centrally managed costs.

Unaudited	ANZ ($000s)	International ($000s)	Total ($000s)
Six months ended 30 September 2020			
Operating revenue	247,216	162,621	409,837
Expenses	(78,202)	(111,224)	(189,426)
Segment contribution	**169,014**	**51,397**	**220,411**
Six months ended 30 September 2019			
Operating revenue	211,422	127,236	338,658
Expenses	(80,378)	(115,835)	(196,213)
Segment contribution	**131,044**	**11,401**	**142,445**

Reconciliation from segment contribution to net profit before tax

Six months ended 30 September	2020 Unaudited ($000s)	2019 Unaudited ($000s)
Segment contribution	220,411	142,445
Product design and development	(110,654)	(85,297)
General and administration	(46,917)	(41,138)
Asset impairments	-	(1,071)
Other income and expenses	(3,151)	(199)
Finance income	3,425	7,424
Finance expense	(18,611)	(18,367)
Net profit before tax	**44,503**	**3,797**

4. REVENUE

Operating revenue by geographic location

Six months ended 30 September	2020 Unaudited ($000s)	2019 Unaudited ($000s)
Australia	183,690	155,177
United Kingdom	107,305	80,419
New Zealand	63,526	56,245
North America	28,641	27,463
Rest of World	26,675	19,354
Total operating revenue	**409,837**	**338,658**

5. EXPENSES

Cost of revenue and operating expenses

Six months ended 30 September	2020 Unaudited ($000s)	2019 Unaudited ($000s)
Employee entitlements	215,010	183,737
Employee entitlements capitalised	(56,731)	(53,973)
Share-based payments	28,060	21,148
Share-based payments capitalised	(6,622)	(5,373)
Advertising and marketing	27,052	50,089
Platform costs	24,990	18,842
Computer equipment and software	14,559	11,216
Consultants and contractors	8,883	6,310
Superannuation costs	8,809	7,061
Communication, insurance and office administration	3,069	3,976
Rental costs	2,904	2,575
Staff recruitment	651	1,396
Travel-related costs	86	8,122
Other operating expenses	15,201	17,412
Total cost of revenue and operating expenses excl. depreciation and amortisation	**285,921**	**272,538**

Depreciation and amortisation

Six months ended 30 September	2020 Unaudited ($000s)	2019 Unaudited ($000s)
Relating to:		
Amortisation of development costs	42,002	32,574
Amortisation of other intangible assets	6,839	6,215
Depreciation of property, plant and equipment	12,235	11,321
Total depreciation and amortisation	**61,076**	**50,110**
Total cost of revenue and operating expenses	**346,997**	**322,648**
Depreciation and amortisation included in function expenses as follows:		
Product design and development	41,333	32,235
Sales and marketing	13,361	12,664
Cost of revenue	4,334	3,467
General and administration	2,048	1,744
Total depreciation and amortisation	**61,076**	**50,110**

6. EARNINGS PER SHARE

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

Basic EPS is calculated by dividing the net profit attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares on issue during the period, excluding shares held as treasury shares.

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

Six months ended 30 September	2020 Unaudited (000s)*	2019 Unaudited (000s)*
Net profit after tax	$34,486	$1,336
Add back: foreign exchange revaluation on contingent consideration included in ordinary shares for basic calculation before the date of share issue, net of tax	-	$246
Net profit attributable to equity holders of the Group, used in calculating basic and diluted EPS	**$34,486**	**$1,582**
Weighted average number of ordinary shares for basic EPS	141,165	140,685
Effect of dilution from:		
Share options	1,478	1,395
Restricted shares	239	433
Restricted stock units	392	329
Weighted average number of ordinary shares adjusted for the effect of dilution	**143,274**	**142,842**
Basic earnings per share	**$0.24**	**$0.01**
Diluted earnings per share	**$0.24**	**$0.01**

** Except for per share amounts*

For the period ended 30 September 2020, 6,474,084 shares that would be issued on conversion of the convertible notes are excluded from the diluted weighted average number of shares because their effect would be anti-dilutive. The shares resulting from the notes are anti-dilutive as a result of the corresponding adjustments that would be required to be made to net profit attributable to ordinary shareholders.

7. INTANGIBLE ASSETS

Unaudited	Software development ($000s)	Contract acquisition asset ($000s)	Other intangible assets ($000s)	Goodwill ($000s)	Total ($000s)
Six months ended 30 September 2020					
Opening net book value	227,151	33,078	3,244	78,773	342,246
Additions*	72,217	4,089	83	-	76,389
Amortisation expense	(42,002)	(6,006)	(833)	-	(48,841)
Foreign exchange adjustment	-	(862)	-	-	(862)
Closing net book value	**257,366**	**30,299**	**2,494**	**78,773**	**368,932**
At 30 September 2020					
Cost	420,473	54,447	6,153	78,773	559,846
Accumulated amortisation	(163,107)	(24,148)	(3,659)	-	(190,914)
Closing net book value	**257,366**	**30,299**	**2,494**	**78,773**	**368,932**

** Included in software development additions is $13.6 million of externally purchased assets (2019: $7.8 million)*

Unaudited	Software development ($000s)	Contract acquisition asset ($000s)	Other intangible assets ($000s)	Goodwill ($000s)	Total ($000s)
Six months ended 30 September 2019					
Opening net book value	177,695	28,727	4,536	78,773	289,731
Additions	58,944	7,454	114	-	66,512
Amortisation expense	(32,574)	(5,403)	(812)	-	(38,789)
Impairments	(1,278)	-	-	-	(1,278)
Foreign exchange adjustment	-	1,117	-	-	1,117
Closing net book value	**202,787**	**31,895**	**3,838**	**78,773**	**317,293**
At 30 September 2019					
Cost	325,691	53,115	5,847	78,773	463,426
Accumulated amortisation	(122,904)	(21,220)	(2,009)	-	(146,133)
Closing net book value	**202,787**	**31,895**	**3,838**	**78,773**	**317,293**

8. HEDGE ACCOUNTING

The Group uses derivatives in the form of forward exchange contracts and vanilla foreign exchange options (outright purchased options and vanilla collars) to reduce the risk that movements in foreign exchange rates will affect the Group's NZD cash flows. Whenever possible, these hedges have been designated as a hedge of a highly probable forecast transaction (a cash flow hedge under NZ IFRS 9: *Financial Instruments*). The Group's policy is to hedge a portion of the next 18 months' forecasted cash flows.

During the period, a net hedging loss of $3.7 million (before taxation) was recognised in other comprehensive income (2019: gain of $3.7 million). During the period, a gain of $0.5 million (before taxation) was reclassified out of other comprehensive income to the Income Statement (2019: gain of $3.4 million). The remaining balance will be reclassified to the Income Statement in the 18 months following 30 September 2020.

9. FINANCIAL INSTRUMENTS

Financial instruments recognised in the Statement of Financial Position include cash and cash equivalents, short-term deposits, receivables and payables, contingent consideration, term debt, and derivative financial instruments.

The Group's foreign exchange hedging derivatives are recognised at fair value. Fair value is determined using forward exchange rates that are quoted in an active market (level two on the fair value hierarchy).

The fair values of the conversion feature and call option derivative asset relating to the convertible notes are determined using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity-specific techniques (level two on the fair value hierarchy). Inputs into the valuation include share price volatility and time to expiration.

At initial recognition, the fair value of the convertible notes was determined using a market interest rate for an equivalent non-convertible bond. The notes are subsequently recognised at amortised cost. The carrying value and the fair value of the debt component of the convertible notes at 30 September 2020 were $394.9 million and $451.5 million, respectively. The fair values of the conversion feature and call option derivative asset at 30 September 2020 were $312.9 million and $307.0 million, respectively.

For the period ended 30 September 2020, a revaluation gain of $197.9 million was recognised on the call option derivative asset, and a revaluation loss of $199.7 million was recognised on the conversion feature derivative liability. Revaluations are reflective of an increase in the share price.

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

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

10. RECONCILIATION OF OPERATING CASH FLOWS

Six months ended 30 September	2020 Unaudited ($000s)	2019 Unaudited ($000s)
Net profit	34,486	1,336
Adjustments:		
Depreciation	12,235	11,321
Amortisation	48,841	38,789
Share-based payments	21,438	15,775
Amortisation of debt discount and issuance costs	9,102	8,248
Tax losses utilised and current taxes recognised in equity	5,246	(76)
Deferred tax	(2,106)	(889)
Impairment of assets	-	1,071
Bad debts	723	814
Other non-cash items	3,136	269
Changes in working capital:		
Increase in trade receivables and prepayments	(1,388)	(5,723)
Decrease in interest receivable	1,458	590
Increase/(decrease) in trade payables and other related items	(17,016)	2,060
Increase/(decrease) in employee entitlements	11,499	(1,425)
Decrease in income tax payable	(893)	(621)
Net cash flows from operating activities	**126,761**	**71,539**

11. SHARE-BASED PAYMENTS

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

Employee restricted share plan

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

Unaudited	2020 Weighted average grant date fair value ($)	2020 Number of shares (000s)	2019 Weighted average grant date fair value ($)	2019 Number of shares (000s)
Outstanding restricted shares at 1 April	53.11	313	39.78	371
Granted	99.38	127	65.42	130
Forfeited	60.35	(7)	40.30	(39)
Settled	46.94	(132)	37.21	(2)
Outstanding restricted shares as at 30 September - allocated to employees	**75.17**	**301**	**46.99**	**460**
Forfeited shares not yet reallocated - held by Trustee		3		16
Total		**304**		**476**
Percentage of total ordinary shares		0.2%		0.3%
Ageing of unvested shares				
Vest within one year		174		275
Vest after one year		127		185
Total unvested shares at 30 September		**301**		**460**

The number of shares awarded under the restricted share plan does not equal the number of shares created for the scheme as forfeited shares are held in the trust and reissued. Of the 126,716 shares granted during the period, 97,131 were new shares issued, and 29,585 were the reissue of shares held as treasury shares (2019: 130,354 shares granted, 66,823 new shares issued and 63,531 reissued treasury shares).

Share options scheme

Movements in the number of options outstanding were as follows:

Unaudited	2020 Weighted average exercise price ($)	2020 Options (000s)	2019 Weighted average exercise price ($)	2019 Options (000s)
Outstanding at 1 April	42.04	2,861	31.91	2,995
Granted	85.53	192	60.50	603
Forfeited/expired	52.02	(87)	37.18	(258)
Exercised	32.36	(804)	20.82	(373)
Outstanding at 30 September	**49.10**	**2,162**	**38.64**	**2,967**
Exercisable at 30 September	38.61	348	20.66	376

Restricted stock units

Movements in the number of RSUs outstanding were as follows:

Unaudited	2020 Weighted average grant date fair value ($)	2020 RSUs (000s)	2019 Weighted average grant date fair value ($)	2019 RSUs (000s)
Outstanding at 1 April	60.16	379	38.89	370
Granted	98.63	326	65.08	400
Forfeited	72.34	(23)	49.41	(61)
Converted to shares	52.51	(92)	37.14	(154)
Surrendered to settle payroll withholding obligations	45.90	(19)	33.24	(55)
Outstanding at 30 September	**83.34**	**571**	**59.74**	**500**

The Company withholds shares under certain circumstances to settle tax withholding obligations on vesting. Based on the market share price on 30 September 2020, future cash payments to meet tax withholding obligations on the vesting of RSUs are expected to be $0.9 million (2019: $1.5 million).

12. EVENTS AFTER THE BALANCE SHEET DATE

On 1 October 2020, Xero acquired 100% of the ordinary shares in cloud-based lending platform business Waddle Holdings Pty Ltd ('Waddle') and subsidiaries, under an agreement dated 25 August 2020. The combined operations are expected to create significant operational synergies, and will enable Xero to continue its strategy to grow the small business platform and to address critical small business financial needs.

Consideration for the acquisition comprised an upfront cash payment of AUD$31 million, plus an adjustment for working capital and net debt, with further contingent consideration of up to AUD$49 million payable subject to achievement of certain product and revenue milestones.

At the date these interim financial statements were authorised for issue, the initial accounting for the business combination had not been completed.

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

Directors' declaration

The unaudited interim financial statements of the Xero Group for the six months ended 30 September 2020 were authorised for issue on 12 November 2020 in accordance with a resolution of the directors. In accordance with ASX Listing Rule 4.2A.2A, the directors declare that, as at that date, and in the directors' opinion:

1. there are reasonable grounds to believe that Xero will be able to pay its debts as and when they become due and payable; and
2. the relevant interim financial statements and notes comply with accepted accounting standards in New Zealand.

For and on behalf of the Board

David Thodey	Mark Cross
Chair	Director
Xero Limited	Xero Limited
12 November 2020	12 November 2020

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Steven Aldrich
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Lee Hatton
Dale Murray, CBE
Susan Peterson
Craig Winkler

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Steve Vamos
Chief Executive Officer

Anna Curzon
Chief Product Officer

Kirsty Godfrey-Billy
Chief Financial Officer

Craig Hudson
Managing Director,
New Zealand &
Pacific Islands

Trent Innes
Managing Director,
Australia & Asia

Rachael Powell
Chief Customer Officer

Mark Rees
Chief Technology Officer

Nicole Reid
Chief People Officer

Chaman Sidhu
Chief Legal Officer
& Company Secretary

Damien Tampling
Chief Strategy & Corporate
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Gary Turner
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