Beautiful business

MARKET RELEASE

Xero Limited - Results for Announcement to the Market

Appendix 4D and FY23 Interim Report

WELLINGTON, 10 November 2022 - Xero Limited (ASX: XRO), in accordance with the ASX Listing Rules, attaches its Appendix 4D and FY23 Interim Report.

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

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About Xero

Xero is a global small business platform with 3.5 million subscribers which includes a core accounting solution, payroll, workforce management, expenses and projects. Xero also has an extensive ecosystem of connected apps and connections to banks and other financial institutions helping small businesses access a range of solutions from within Xero's open platform to help them run their business and manage their finances. For three consecutive years (2020-2022) Xero was included in the Bloomberg Gender-Equality Index. In 2021, Xero was included in the Dow Jones Sustainability Index (DJSI), powered by the S&P Global Corporate Sustainability Assessment. Xero is a FIFA Women's Football partner under FIFA's new commercial structure.

Appendix 4D

10 November 2022

Xero Limited

ARBN 160 661 183 (incorporated in New Zealand)

Reporting period	6 months to 30 September 2022
Previous reporting period	6 months to 30 September 2021

Results for announcement to the market

	Amount (000s)	% change
Revenues from ordinary activities	NZ$658,512	up 30%
Net loss from ordinary activities	NZ$(16,130)	up 172%
Net loss attributable to security holders	NZ$(16,130)	up 172%

The Company does not propose to pay a dividend and no dividends were declared or paid for the reporting period.

Net tangible assets per share was NZ$0.39 per share at 30 September 2022 (30 September 2021: NZ$0.83 per share).

For additional Appendix 4D disclosure requirements refer to Xero Limited's 2023 Interim Report which contains the interim financial statements and accompanying notes for the six months ended 30 September 2022.

XERO LIMITED

Interim Report FY23

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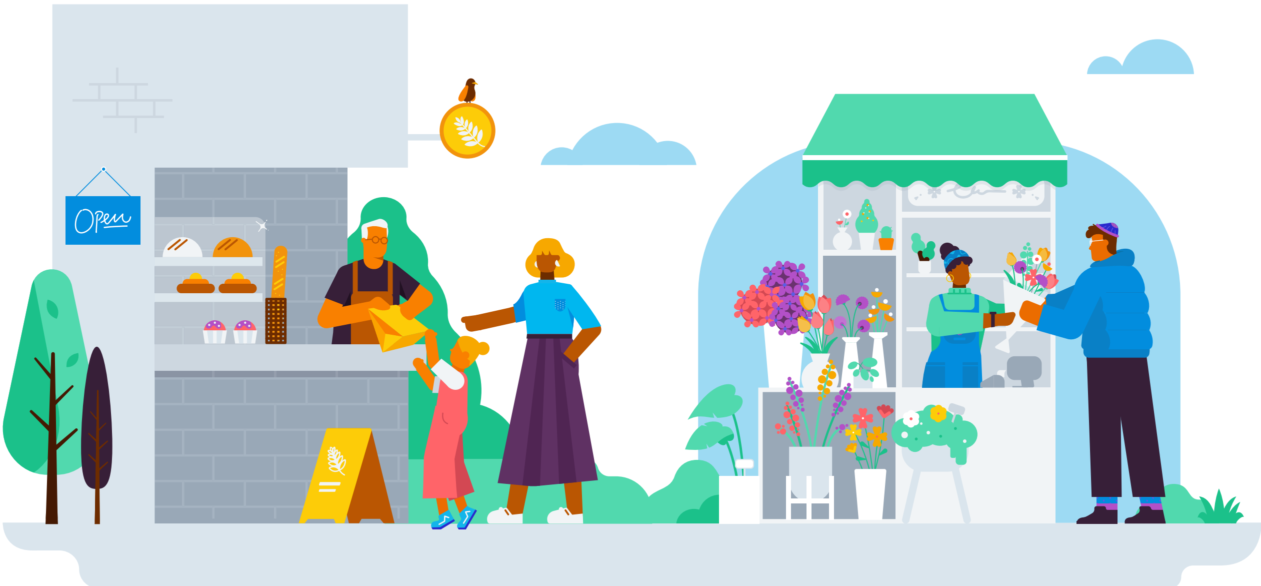


Highlights

Operating revenue
$658.5m
▲ Up 30% YoY

Annualised monthly recurring revenue
$1.5b
▲ Up 31% YoY

Gross margin percentage
87.0%
▼ Down 0.1pp YoY

Total available liquidity
$1.1b
Cash on hand, short-term deposits and undrawn committed debt facilities

Subscribers
3.496m
▲ Up 483,000 YoY

Total subscriber lifetime value
$13.0b
▲ Up $3.1b YoY

Free cash flow
$15.6m
▲ Up $9.2m YoY

EBITDA
$108.6m
▲ Up 11% YoY

Chair and CEO Review

David Thodey AO
Chair

Steve Vamos
Chief Executive Officer

Dear shareholder,

Xero has continued to deliver strong growth momentum during the first half of our 2023 financial year (H1 FY23) with more small businesses placing their trust in our cloud technology and digital platform to run their business and meet critical compliance needs.

Our H1 FY23 performance highlights include operating revenue growing by 30% (27% in constant currency) to $658.5 million, total customer lifetime value increasing 30% (23% in constant currency) to $13 billion, and subscribers up 16% to 3.5 million. This demonstrates the value Xero delivers for our customers. Our progress supports our strategy to invest, with discipline, to take advantage of the significant opportunity ahead as we continue to drive efficiencies in our business.

The environment small businesses are operating in around the world remains complex. They continue to navigate and adapt through increasing inflationary and interest rate pressures and challenges in accessing talent, while responding to the evolving needs of their customers. Times like these strengthen the case for small businesses to adopt cloud technology that enables their businesses to be more efficient and effective.

Xero's EBITDA increased 11% against the comparative period to $108.6 million. This result reflects the impact of a $25.9 million non-cash impairment due to changed operational and market conditions for the Waddle business (see note 7 of the Financial Statements), which was partially offset by non-cash revaluation gains of $10.8 million. Excluding these adjustments, EBITDA would have been $123.7 million up 28% against the comparative period, reflecting strong revenue growth and cost discipline.

While Xero delivered strong revenue growth in H1 FY23 and subscriber growth across all our markets, the subscriber outcome in some geographies was subdued. Net subscriber additions in the UK were subdued due to slower than expected uptake of the final stage of MTD for VAT, a less than buoyant macro backdrop, and changes we implemented to our partner sales approach. Net subscriber additions in North America were impacted by seasonality, related to the timing of the tax year end.

We expect Xero's momentum in subscriber additions in both the UK and North America to improve over the remainder of FY23, with performance in H2 FY23 expected to be similar or better than the prior comparable period.

Total operating expenses increased slightly as a percentage of operating revenue from 83.4% to 83.9% due to the resumption of three Xerocon events. Excluding the impacts of three Xerocon conferences in the half, total operating expenses as a percentage of operating revenue would have been 82.0% for H1 FY23.

Product design and development expenses increased $63.9 million from H1 FY22, increasing from 33.0% to 35.0% of operating revenue. This reflected Xero's investment in global product innovation and platform delivery, and the impact of new hires who joined in FY22, while managing inflationary cost pressures.

Above: *Xerocon in London, New Orleans and Sydney*

Product expenses as a proportion of operating revenue for FY23 are now expected to be slightly higher than in FY22. However, Xero remains committed to its FY23 operating expenses outlook and will continue to manage its cost base to invest with discipline to scale the platform.

Our purpose is to make life better for people in small business, their advisors and communities around the world. We remain focused on the large opportunity to drive digital adoption in the small business sector, while responding to the external environment as we continue to grow our business for the long term.

To make informed decisions, people in small business need real-time access to information, along with insights that digital tools can provide. Xero helps small businesses save time, reduce complexity, manage compliance, and better manage their cash flow.

Small business cloud adoption is low in many countries around the world, particularly in Xero's international markets. We estimate in the regions where Xero currently operates, the Total Addressable Market for cloud accounting software is more than 45 million small businesses[1].

Government initiatives encouraging businesses to move to the cloud are important contributors to the digitisation of the small business economy. For example, governments around the world are moving taxation and compliance online – albeit at different rates – and there is growing interest in encouraging the use of e-invoicing. These changes help to drive productivity benefits as small businesses shift to a digital economy.

During the half, our teams were able to reconnect in person with our accounting, bookkeeping and app partner communities at our Xerocon events in London, New Orleans and Sydney. The success of these events highlights the strength of our relationships with customers and partners.

Executing our strategy

We made strong progress in executing our strategy in the half, advancing Xero's three strategic priorities:

- Drive cloud accounting adoption
- Grow the small business platform
- Build for global scale and innovation

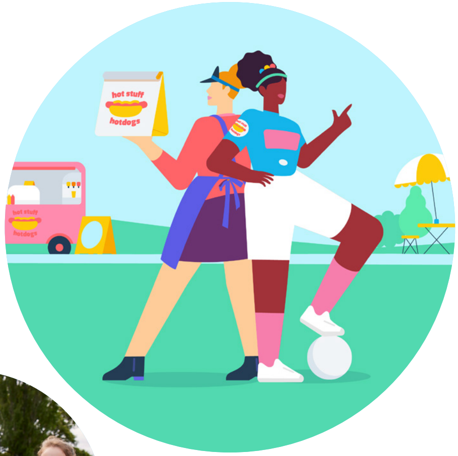
Drive cloud accounting adoption

Australia and New Zealand lead the world in the penetration of small business cloud accounting adoption. The momentum we generate in these markets reflects the value Xero can continue to deliver. There remains room for further growth in these markets, shown by our performance in the half. In our international markets, including the US, Canada and the UK, there is substantial opportunity for growth, and we are focused on delivering value to customers in those markets.

We delivered a number of strategic initiatives in the half to drive further uptake of our products. Our accountant and bookkeeper partnerships remain at the core of our efforts to drive cloud accounting adoption. One element of our strategy is to extend relationships with large accounting firms, such as our global partner agreement with PKF, a global network of accounting firms, and subsequent local adoption agreements with a number of PKF member firms, including in Canada, the UK and Hong Kong.

Following our partnership announcement with DFK in 2021, a global association of more than 200 independent firms across 100 countries, all of DFK's firms in Australia and New Zealand joined the agreement in June 2022. We also extended our existing strategic partnerships with multinational firms during the half, including BDO and Grant Thornton in Australia.

[1] *Estimated TAM across English speaking addressable cloud accounting markets, based on publicly available data*



Above: *FIFA Women's Football partnership*

In April we evolved our relationship with Azets, the UK's largest regional accounting firm and specialist business advisor to small and medium enterprises, to enable digitisation and support clients on their journey towards Making Tax Digital.

In July we launched Xero Go, a new mobile product for UK customers with less complex accounting needs. We are learning from our experiences in the UK and will use these insights to consider other markets in the future.

Strategic partnerships are an important component of Xero's strategy to drive cloud accounting adoption. Earlier this year we announced a strategic partnership with Avalara, an automated tax compliance software specialist, which will provide an improved sales tax workflow for US customers. The product's closed-beta trial will be available next year.

In April, Xero was named a FIFA Women's Football partner under FIFA's new commercial partnership structure. This sponsorship is an example of targeted marketing activity to accelerate our brand awareness in new and existing markets, while championing women's football and their communities. In September we announced two commercial partnerships with The English Football Association (The FA) making Xero the Official Partner of both the England women's senior team and England Football. Both partnerships go beyond brand placement. Xero will work with The FA to provide access to a comprehensive range of educational resources and access to expertise to help build clubs' financial resilience.

Market highlights

Australia

Revenue increased by 31% (25% in CC) to $294 million with 126,000 net subscriber additions, a record for any Xero region in a six month period, to reach a total of 1.47 million subscribers.

New Zealand

Revenue increased by 16% to $84 million, with 24,000 net subscriber additions to reach a total of 536,000 subscribers.

UK

Revenue increased by 32% (34% in CC) to $175 million, with 44,000 net subscriber additions taking total subscribers to 894,000. Xero remains well positioned in the UK and, with a large and underpenetrated opportunity, continues to drive and aspire to strong revenue and subscriber growth.

North America

Revenue increased by 44% (30% in CC) to $44 million, with 15,000 net subscriber additions to reach a total of 354,000 subscribers. Xero maintains our focus on localising our product to meet customer needs and further strengthening relationships with accountants and bookkeepers.

Rest of World

Revenue increased by 35% (25% in CC) to $62 million, and subscribers increased to 242,000 with 16,000 net subscriber additions. The Singapore Government's Smart Nation initiative, its approach to digitise government, the economy and society, remains a key opportunity. In South Africa, Xero will soon launch South African Rand billing to assist customers and partners to consistently plan for subscription costs in their local currency.

Xero Small Business Insights

The quality of customer data in the Xero platform allows us to provide insights about the small business economies in many of our customer markets, based on anonymised, aggregated data. We use this data to deliver Xero Small Business Insights (XSBI) to share a perspective on the small business economies in Australia, New Zealand, and the UK, and more recently Canada and the US. This information is provided as part of our engagement with governments, regulators and academics to improve knowledge and awareness of small business issues.

Above: *Xero customer Butter&*

Grow the small business platform

Small businesses can gain benefits from apps and services connected to Xero's open platform that further streamline their business operations. Xero's platform revenue during H1 FY23 grew by 31% (29% in constant currency) to account for 11% of operating revenue.

In line with our plans to expand Planday's employer and employee services offering into our largest customer markets, in September we launched a public beta trial of Planday in Australia for businesses with employees covered by the Retail and Clerks Awards. Planday is an online workforce management platform that streamlines time-tracking, rostering and payroll, all in one place.

We continue to test and refine Planday for the Australian awards system. We plan to launch Planday to Australian customers in early calendar year 2023.

Through our financial services offerings, we help small businesses to take control of their cash flow. We do this by embedding financial tasks, like getting paid and making payments.

With the introduction of the Xero App Store last year, we have been supporting our app partners to join the store. The Xero App Store offers an easier way for small businesses to discover and buy apps on the Xero platform while giving app developers a better way to grow their businesses, providing greater insights, tools, and billing payment capabilities.

Build for global scale and innovation

People

During the half, we continued to invest in our people, while we also tempered the pace of hiring across Xero to reflect external operating conditions.

We seek to foster an inclusive environment where our people feel they belong, so they can do the best work of their lives. This half we delivered a global series of education workshops to foster greater inclusion. Developing strong people leadership capabilities is also an important area of focus. We hold regular forums to bring our global people leaders together to deepen leadership capabilities.

During the half, we surveyed our team to inform enhancements to our employee value proposition. We aim to create an employment offering that is competitive, compelling, and drives talent attraction, retention and engagement. As a result, we have introduced a range of employee lifestyle benefits.

> **We seek to foster an inclusive environment where our people feel like they belong, so they can do the best work of their lives.**

We continually look at ways to broaden our ability to attract world-class talent. Our people have the option to work flexibly and we continue to explore new ways to reach talent from a greater geographic base.

Technology

We continue to focus our efforts on delivering Xero's vision to be the most insightful and trusted small business platform. We do this by investing in and continually enhancing the technology that underpins the Xero platform and the open ecosystem that forms an important part of it. The next evolution of our technology platform is focused on improving efficiency and scalability, building new features, increasing our speed to market, and investing in areas to deliver customer value in the future.

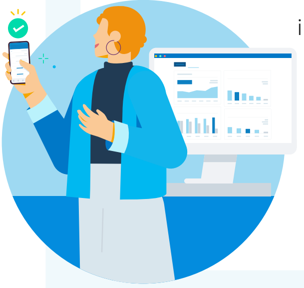
This ensures we can support our customers while also continuing to evolve our product and platform to achieve our long-term vision to take advantage of the significant opportunity ahead.

Through Xero's open platform, we aim to help customers streamline their business operations by providing insights and recommendations, and access to services they need via an extensive range of third party apps, all from within the Xero platform.

Three waves of transformation for small business

We have a clear vision for the future – to be the most insightful and trusted small business platform. We are working to make this a reality for small business by collaborating closely with industry participants in our markets, including governments and regulatory bodies, accountants, bookkeepers, banks, and app partners to drive the following waves of transformation:

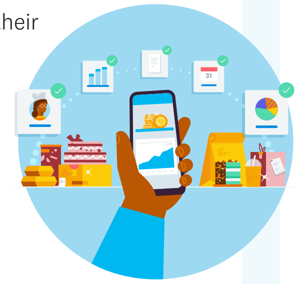
Wave 1 – Small business accounting in the cloud



- Wave one started when Xero innovated with accounting in the cloud and revolutionised the way small business owners accessed and shared financial data with their accountant and bookkeeper
- We introduced big innovations, for example, connecting bank feeds to streamline bank reconciliations into Xero, and this remains one of the most loved tools on the Xero platform today
- Wave one is far from over – our work to bring the benefits of cloud accounting to more accountants, bookkeepers and small businesses around the world continues

Wave 2 – Small business applications and services

- Wave two encourages more small businesses to utilise more cloud apps and services to improve workflows, create efficiencies in business operations and save time so they can focus their efforts on running and growing their business
- Early in our journey, we built an open API to connect and enable a fast growing ecosystem of application partners and financial institutions connected to Xero. Then in 2021 we launched the Xero App Store to make it even easier for our customers to find and attach apps that help solve their critical business problems
- Partnerships we have with companies like Stripe and GoCardless help customers get their Xero invoices paid up to twice as fast as those who don't use online invoice payments



Wave 3 – Trusted insights

- Wave three builds on the quality and breadth of data on the Xero platform with AI capabilities to draw out trends, insights, and next best actions to help our small business customers make timely, better informed, more accurate decisions about the health of their business
- Analytics Plus, which powers Short Term Cash Flow Forecasting, is a great example of how our products are beginning to recommend actions for customers to take
- We will continue to invest in our data and AI capabilities to help small businesses quickly adjust to market dynamics, meet regulatory requirements, operate more efficiently, and ultimately support their long-term success

Sustainability

Xero recognises that every business has a role to play in supporting the transition to a net-zero economy.

We see a significant opportunity to help small businesses take steps in their sustainability journey. In September we announced a partnership with sustainability fintech, Cogo. Starting in Australia, Xero and Cogo are providing small businesses with tools to better understand their carbon footprint and take action to reduce it.

We are committed to taking the next step towards becoming net-zero and are setting company-wide emissions reduction targets in line with climate science, aligned to the goals of the Paris Agreement.

The targets we are committing to were designed with Xero's growth ambitions in mind. They were established through extensive modelling and provide clear direction for us to reduce our greenhouse gas emissions across Scopes 1, 2 and 3. The targets are:

- 42% reduction in Scope 1 and 2 emissions from a FY20 base by FY30
- 17% reduction in Scope 3 emissions from a FY20 base by FY30
- Net-zero no later than FY50 (with fewer than 10% of total emissions that require abatement through offsets)

We are committed to taking the next step towards becoming net-zero, and are setting company-wide emissions reduction targets in line with climate science, aligned to the goals of the Paris Agreement.

Outlook

Xero will continue to focus on growing its global small business platform and maintain a preference for reinvesting cash generated, subject to investment criteria and market conditions, to drive long-term shareholder value.

Total operating expenses (including acquisition integration costs) as a percentage of operating revenue for FY23 are expected to be towards the lower end of a range of 80-85%.

Looking ahead

The global cloud accounting market for small business is still at an early stage, and we remain excited about the opportunities ahead for Xero. We are committed to further progressing our strategic priorities while we help more small businesses discover the benefits of cloud technologies.

We're focused on delivering the world's most insightful and trusted small business platform by driving cloud accounting adoption, growing the small business platform and building for global scale and innovation. We have demonstrated strong growth momentum and we remain committed to investing for the short and long term opportunity and supporting customer needs with a disciplined cost focus.

Xero's Board and leadership team greatly appreciate the trust placed in us by our people, customers, partners and shareholders.

We would like to thank everyone who supports Xero.

David Thodey, Chair

Steve Vamos, Chief Executive Officer

Our Performance

You should read the following commentary with the consolidated interim financial statements and the related notes in this report.

Some parts of this report include information regarding Xero's plans and strategy, and include forward-looking statements about Xero and the environment in which it operates 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 report. All amounts are in New Zealand dollars (NZD) except where indicated. References to the period or H1 FY23 are for the six months ended 30 September 2022. References to the comparative period or H1 FY22 are for the six months ended 30 September 2021. References to H2 FY22 are for the six months ended 31 March 2022.

Non-GAAP measures have been included as Xero believes they provide useful information for readers to assist in understanding the Xero Group's (Xero'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).

Business results

Six months ended 30 September	2022 ($000s)	2021 ($000s)	change
Subscription revenue	622,195	487,802	28%
Other operating revenue	36,317	17,901	103%
Total operating revenue	**658,512**	**505,703**	**30%**
Cost of revenue	(85,600)	(65,286)	31%
Gross profit	**572,912**	**440,417**	**30%**
Gross margin percentage	87.0%	87.1%	-0.1pp*
Total operating expenses	**(552,191)**	**(421,994)**	**31%**
Percentage of operating revenue	83.9%	83.4%	0.5pp
Other income and expenses	12,188	1,398	NM**
Asset impairments and disposals	(26,532)	(2,898)	NM
Operating profit	**6,377**	**16,923**	**-62%**
Percentage of operating revenue	1.0%	3.3%	-2.3pp
Net finance expense	(14,649)	(20,360)	-28%
Income tax expense	(7,858)	(2,485)	216%
Net loss	**(16,130)**	**(5,922)**	**172%**
Percentage of operating revenue	-2.4%	-1.2%	-1.2pp

**pp stands for percentage points*
***NM stands for not meaningful*

In H1 FY23, we continued executing on our strategic priorities to drive cloud accounting adoption, grow the small business platform, and build for global scale and innovation. Xero delivered operating revenue growth of 30% (27% in constant currency) compared to H1 FY22, demonstrating the strength of the Xero proposition across our portfolio.

Gross profit grew 30% in H1 FY23 from the comparative period, in line with our growth in operating revenue as the gross margin percentage remained broadly constant. EBITDA increased by $10.5 million, or 11%, to $108.6 million. This outcome reflects strong revenue growth, in combination with controlled operating spend amidst the inflationary pressures of the current global economic climate. EBITDA was also impacted by $25.9 million of non-cash impairment relating to the Waddle business, as well as non-cash accounting revaluation gains of $10.8 million. EBITDA margin decreased by 2.9 percentage points, impacted by the Waddle impairment.

Total operating expenses as a proportion of operating revenue increased slightly to 83.9% from 83.4% in the comparative period. Excluding the impacts of three Xerocon conferences in the half, total operating expenses as a percentage of operating revenue would have been 82.0% for H1 FY23. Product design and development expenses increased $63.9 million from H1 FY22, from 33.0% to 35.0% of operating revenue, reflecting the impact of new hires that joined in FY22 and continued investment in global product innovation and platform delivery, while closely managing inflationary cost pressures.

Cash receipts from customers grew 31% from the comparative period, slightly higher than operating revenue growth. Free cash flow increased by $9.2 million, from $6.4 million in H1 FY22, to $15.6 million, reflecting increased cash efficiency.

Xero added 225,000 subscribers during H1 FY23, bringing total subscribers to 3,496,000 at 30 September 2022. Operating revenue growth outpaced subscriber growth mainly driven by price changes, foreign exchange rate movements, and to a lesser extent, increased financial services related revenue such as bill and invoice payments through financial service providers, and revenue from the increased uptake of Xero add-ons such as Payroll, Projects and Expenses. Subscriber and ARPU growth against broadly flat churn and gross margin resulted in a 30% increase in total lifetime value to $13.0 billion.

Net finance expense reduced by 28%, or $5.7 million, to $14.6 million. Finance income increased $6.6 million compared to H1 FY22 due to increased interest rates on deposits. Finance expenses grew $0.9 million due to an increase in amortisation of debt discount mainly due to a weaker NZD against the United States dollar (USD), offset by a reduction in unwind of contingent consideration and bank standby facility costs.

The Group recognised a net loss for H1 FY23 of $16.1 million compared to a net loss of $5.9 million in the comparative period. The H1 FY23 result was impacted by $26.5 million non-cash impairments and disposals, partially offset by a benefit from the combination of non-cash accounting revaluations of derivatives related to Xero's convertible notes of $6.3 million, and revaluation gains on contingent consideration and management incentives of $4.5 million.

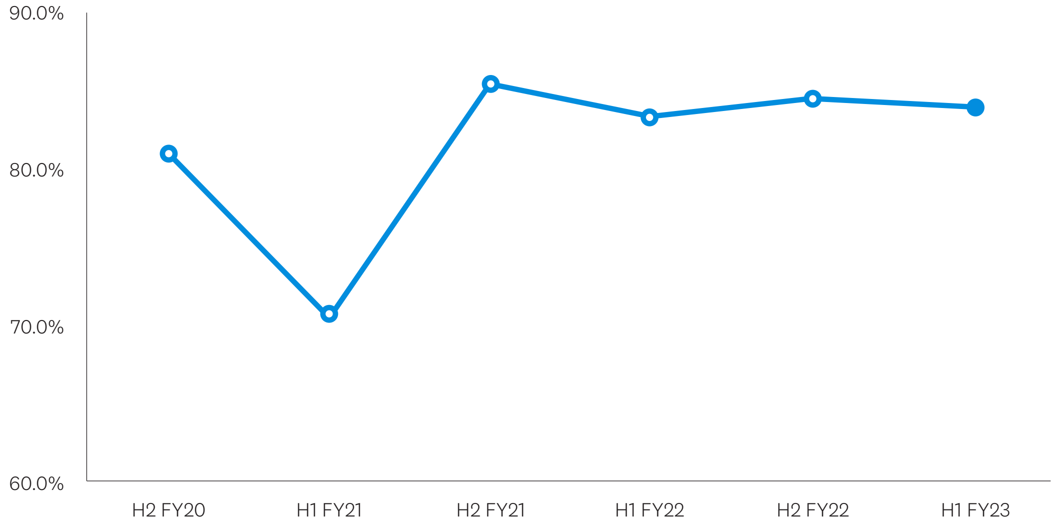
Earnings before interest, tax, depreciation, and amortisation (EBITDA)

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/(loss).

Six months ended 30 September	2022 ($000s)	2021 ($000s)	change
Net loss	**(16,130)**	**(5,922)**	**172%**
Add back: net finance expense	14,649	20,360	-28%
Add back: depreciation and amortisation	102,174	81,157	26%
Add back: income tax expense	7,858	2,485	216%
EBITDA	**108,551**	**98,080**	**11%**
EBITDA margin	16.5%	19.4%	-2.9pp

EBITDA increased by $10.5 million, or 11%, compared to H1 FY22. The improvement in EBITDA was driven by operating revenue growth, controlled operating expenditure growth, alongside $10.8 million in benefits from non-cash accounting adjustments related to Xero's convertible notes and revaluation gains on contingent consideration and revenue incentives. The improvement was partially offset by $26.5 million non-cash impairments and disposals, largely related to a $25.9 million impairment of Waddle. As a result, EBITDA margin decreased 2.9 percentage points from 19.4% to 16.5%.

Operating expenses as a percentage of operating revenue



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

Six months ended 30 September	2022 ($000s)	2021 ($000s)	change
EBITDA	**108,551**	**98,080**	**11%**
Add back: non-cash share-based payments	34,072	29,285	16%
Add back: non-cash impairments and disposals	26,532	2,898	NM
EBITDA excluding non-cash share-based payments and impairments and disposals	**169,155**	**130,263**	**30%**
Percentage of operating revenue	25.7%	25.8%	-0.1pp

EBITDA excluding non-cash share-based payments and impairments and disposals for H1 FY23 was $169.2 million, an increase of $38.9 million, or 30%, compared to H1 FY22. The higher growth compared to EBITDA is a result of an increase in impairments and disposals of $23.6 million, reduced by non-cash share-based payments only increasing by 16%.

Cash flows and liquidity

Free cash flow is a non-GAAP financial measure that has been included to demonstrate 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	2022 ($000s)	2021 ($000s)	change
Receipts from customers	660,200	505,096	31%
Other operating cash flows	(500,486)	(376,660)	33%
Total cash flows from operating activities	**159,714**	**128,436**	**24%**
Investing activities	(145,136)	(257,649)	-44%
Add back: acquisitions	-	135,564	NM
Add back: investment into businesses and strategic assets	991	-	NM
Free cash flows	**15,569**	**6,351**	**145%**
Percentage of operating revenue	2.4%	1.3%	1.1pp

Free cash flows increased by $9.2 million, or 145%, from $6.4 million in H1 FY22 to $15.6 million in H1 FY23. As a percentage of total operating revenue, this was a 1.1 percentage point increase from 1.3% in H1 FY22 to 2.4% in H1 FY23.

Receipts from customers increased by 31%, or $155.1 million, to $660.2 million, which was consistent with operating revenue growth of 30%. Total cash flows from operating activities increased by 24%, or $31.3 million, to $159.7 million as operating cash outflows grew faster (33%) than receipts from customers (31%). This was partially due to an increase in prepayments at 30 September 2022 compared to 30 September 2021.

Cash outflows from investing activities decreased by 44%, or $112.5 million, compared to the comparative period. The decrease reflected that there were no acquisitions in H1 FY23 compared to the acquisitions of Planday and Tickstar during H1 FY22. Investing cash flows excluding acquisitions increased by $23.1 million, or 19%, as capitalised spend on product design and development in H1 FY23 increased by $31.3 million, or 31%, compared to H1 FY22. Investments into businesses and strategic assets include investments into the Waddle direct lending portfolio.

As part of ongoing capital management given Xero's total liquid resources, during the period Xero reduced its short-term debt facilities. This reflected a decision not to renew its undrawn NZD150 million standby debt facility, which matured in August 2022, and to replace the AUD30 million facility in place to support the Waddle direct lending portfolio with a smaller AUD10 million facility to provide short-term liquidity. As a result of these changes, bank standby facility costs decreased by $0.4 million.

Total available liquidity (defined as cash and cash equivalents, short-term deposits, and undrawn committed debt facilities) at 30 September 2022 was $1.1 billion, compared to $1.2 billion at 30 September 2021.

Operating revenue

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

Total operating revenue includes subscription revenue as well as revenue from other related services including revenue share agreements with financial services providers, software licences, and the implementation of online accounting and other software services.

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 FY23 at the effective exchange rates for H1 FY22.

Six months ended 30 September	2022 ($000s)	2021 ($000s)	change	change in constant currency
Subscription revenue	622,195	487,802	28%	24%
Other operating revenue	36,317	17,901	103%	96%
Total operating revenue	**658,512**	**505,703**	**30%**	**27%**

Total operating revenue grew 30% to $658.5 million, compared to H1 FY22 (27% in constant currency) as Xero continued to leverage its scale.

Subscription revenue increased by $134.4 million, or 28%, compared to H1 FY22. Subscriber numbers grew 16%, or 483,000, compared to 30 September 2021 driving a large portion of our revenue growth. The remainder of the growth was due to price changes to reflect the increasing value proposition of the Xero platform and revenue from add-ons such as Payroll, Projects, Expenses, and Analytics Plus. Subscription revenue comprises 94% of operating revenue in H1 FY23 (H1 FY22: 96%).

Other operating revenue increased 103% compared to H1 FY22. Conference revenue contributed to this increase with Xerocons returning in H1 FY23 across the United Kingdom, North America, and Australia. Strong growth in financial services related revenue, such as bill and invoice payments through financial service providers, further drove the increase in other operating revenue.

Reported revenue has been favourably impacted by fluctuations in foreign exchange rates. The comparatively weaker NZD against both the AUD and the USD has favourably impacted reported operating revenue relative to the comparative period. In constant currency, operating revenue growth was 27% compared to reported growth of 30%.

Operating revenue by geography

Six months ended 30 September	2022 ($000s)	2021 ($000s)	change	change in constant currency
Australia	294,258	224,860	31%	25%
New Zealand	83,615	71,985	16%	16%
Australia and New Zealand (ANZ) total	**377,873**	**296,845**	**27%**	**23%**
United Kingdom	174,975	132,847	32%	34%
North America	43,501	30,133	44%	30%
Rest of World	62,163	45,878	35%	25%
International total	**280,639**	**208,858**	**34%**	**32%**
Total operating revenue	**658,512**	**505,703**	**30%**	**27%**

Xero Group – Operating revenue grew 30% (27% in constant currency) to $658.5 million for H1 FY23 compared to $505.7 million in H1 FY22. The primary driver of this growth was a 16% increase in subscriber numbers across all of Xero's markets. Price changes, Xerocon revenue, growth in financial services related revenue and other platform offerings such as Payroll, Planday and TaxCycle also contributed to revenue growth.

ANZ – Operating revenue increased by $81.0 million, or 27% (23% in constant currency) from the comparative period, representing the largest half-on-half increase to ANZ operating revenue in any six-month period.

Australia's operating revenue grew by $69.4 million, or 31% (25% in constant currency), mainly driven by subscriber growth of 19%. The higher growth in revenue compared to subscriber growth was due to price changes in September 2021 for business edition plans, and in March 2022 for partner edition plans; growth in financial services related revenue, revenue from add-ons, and revenue from Xerocon Sydney.

New Zealand operating revenue grew by $11.6 million, or 16%. This was faster than subscriber growth of 12%, driven mainly by price changes in September 2021 for business edition plans, and in March 2022 for partner edition plans.

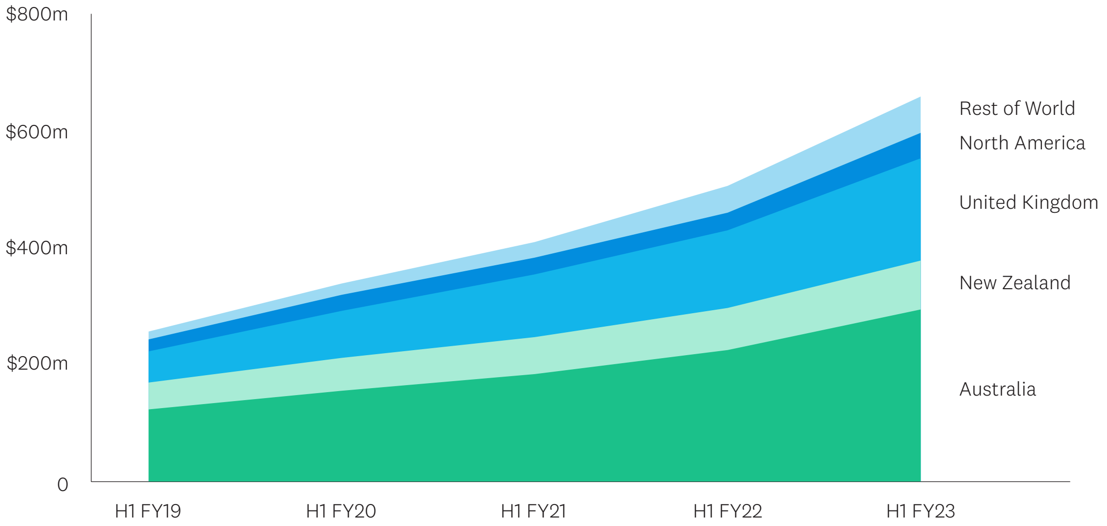
International – Operating revenue grew 34% (32% in constant currency), compared to subscriber growth of 15%. The International segment contributed 43% to total operating revenue, increasing slightly from 41% in the comparative period.

UK operating revenue grew 32% (34% in constant currency), compared to subscriber growth of 14% in H1 FY23 against the comparative period. This was driven by price changes in September 2021, growth in financial services related revenue, revenue from Xerocon London, growth in Planday revenue, and revenue generated through improved product mix such as upgrades to more comprehensive pricing plans and add-ons like Payroll, Expenses and Projects.

North America operating revenue increased by 44% against H1 FY22 (30% at constant currency), faster than subscriber growth of 15% driven by the return of conference revenue generated from Xerocon New Orleans, price changes in November 2021, new revenue from LOCATE Inventory and growth in financial services related revenue.

Operating revenue in Xero's Rest of World markets increased by 35% in H1 FY23 (25% in constant currency), compared to subscriber growth of 20%. South Africa and Singapore were the largest contributing markets for subscriber growth. Revenue growth exceeded subscriber growth mainly due to price changes in November 2021.

Total Group operating revenue by geography*



*Represents each regions' contribution to total Xero 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	2022	2021	change
Australia	1,470,000	1,239,000	19%
New Zealand	536,000	480,000	12%
Australia and New Zealand (ANZ) total	**2,006,000**	**1,719,000**	**17%**
United Kingdom	894,000	785,000	14%
North America	354,000	308,000	15%
Rest of World	242,000	201,000	20%
International total	**1,490,000**	**1,294,000**	**15%**
Total paying subscribers	**3,496,000**	**3,013,000**	**16%**

Xero Group – 225,000 net subscribers were added in H1 FY23, bringing total subscribers to nearly 3.5 million at 30 September 2022. 483,000 net subscribers were added in the 12 months ended 30 September 2022, compared to 560,000 added in the 12 months ended 30 September 2021.

ANZ – Xero strengthened its presence in this well-established segment, surpassing a milestone of 2 million subscribers at 30 September 2022. ANZ subscribers grew by 17%, or 287,000, from 30 September 2021, with 52%, or 150,000, added in H1 FY23. Churn remained low, reflecting the value customers place in Xero's product.

Xero added 126,000 net subscribers in Australia in H1 FY23, a record for any six-month period for this market. 231,000 net subscribers were added in the 12 months ended 30 September 2022 to reach nearly 1.5 million subscribers.

New Zealand added 56,000 net subscribers from 30 September 2021, a 12% increase over the period. Of this, 24,000 were added in H1 FY23, compared to 32,000 added in H2 FY22.

International – The International segment added 196,000 net subscribers from 30 September 2021, bringing total subscribers to nearly 1.5 million.

UK subscribers grew by 14%, or 109,000, from 30 September 2021, compared to 23%, or 147,000, added in the 12 months ended 30 September 2021. Subscriber growth was subdued, impacted by various factors including slower than expected uptake in Making Tax Digital.

North America subscriber numbers increased by 15%, or 46,000, from 30 September 2021. Subscriber growth in H1 FY23 reflected some seasonality associated with tax year end timing.

Rest of World markets grew by 20%, or 41,000 subscribers, from 30 September 2021, ending H1 FY23 with 242,000 subscribers. South Africa and Singapore were the largest contributing markets, reflecting Xero's continued investment to drive growth in these emerging markets.

Net subscriber additions

H1 FY23
Region (% of total net additions)
- Australia (**56%**)
- New Zealand (**11%**)
- United Kingdom (**20%**)
- North America (**6%**)
- Rest of World (**7%**)

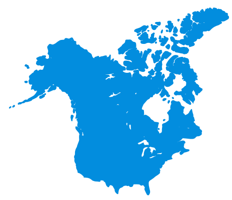
H1 FY22
Region (% of total net additions)
- Australia (**46%**)
- New Zealand (**12%**)
- United Kingdom (**24%**)
- North America (**8%**)
- Rest of World (**10%**)

Regional subscriber numbers at 30 September 2022*

Australia
1,470,000
2021 | 1,239,000
▲ Up 19%

New Zealand
536,000
2021 | 480,000
▲ Up 12%

United Kingdom
894,000
2021 | 785,000
▲ Up 14%



North America
354,000
2021 | 308,000
▲ Up 15%

*Rest of World subscribers at 30 September 2022: 242,000 (30 September 2021: 201,000)

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 2022 at the foreign exchange rates at 30 September 2021 and is provided to assist in understanding and assessing year-on-year growth rates, excluding the impact of foreign currency fluctuations.

At 30 September	2022 ($000s)	2021 ($000s)	change	change in constant currency
ANZ	855,968	647,254	32%	24%
International	624,944	485,211	29%	23%
Total	**1,480,912**	**1,132,465**	**31%**	**23%**

Total Group – AMRR grew by 31% (23% in constant currency), to $1.5 billion at 30 September 2022. This was an increase of $348.4 million over the 12 months ended 30 September 2022, driven by subscriber growth, as well as a 13% (or 6% in constant currency) increase to average revenue per user (ARPU). Price changes were the main driver of the ARPU increase, as the value of Xero's offering was further realised.

ANZ – AMRR grew 32% (24% in constant currency), or $208.7 million, during the 12 months ended 30 September 2022, to $856.0 million. Growth in AMRR was primarily driven by subscriber growth, price changes and increased use of financial service related products, with ARPU improving by 13%. AMRR growth in constant currency was 8 percentage points lower than reported growth, due to the stronger AUD against the NZD at 30 September 2022 compared to 30 September 2021.

International – AMRR increased 29% (23% in constant currency), or $139.7 million, to $624.9 million at 30 September 2022. This was due to continued subscriber growth (15%), increased ARPU from price changes, and improved product mix such as upgrades to more comprehensive pricing plans and add-ons like Payroll, Expenses and Projects. In constant currency terms, the stronger USD against the NZD at 30 September 2022 compared to the prior period had a favourable impact on reported AMRR for the International segment.

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.

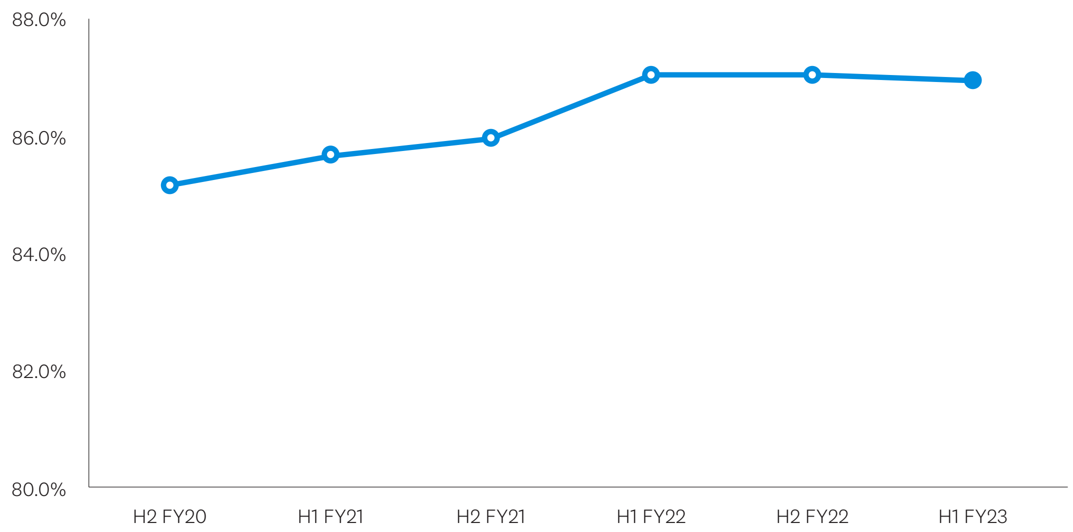
The costs include hosting costs, bank feed costs, personnel and related expenses (including salaries, benefits, bonuses, and share-based payments) directly associated with cloud infrastructure and subscriber support, contracted third-party vendor costs, related depreciation and amortisation, and allocated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

Six months ended 30 September	2022 ($000s)	2021 ($000s)	change
Operating revenue	658,512	505,703	30%
Cost of revenue	(85,600)	(65,286)	31%
Gross profit	**572,912**	**440,417**	**30%**
Gross margin percentage	87.0%	87.1%	-0.1pp

Gross profit increased by $132.5 million, or 30%, to $572.9 million. Gross margin percentage remained high at 87.0%, decreasing by 0.1 percentage points from H1 FY22.

Operating revenue increased by 30%, while cost of revenue increased by $20.3 million to $85.6 million, representing a 31% increase when compared to the same period last year. This increase was primarily driven by greater cloud hosting costs to support more subscribers and products on the platform, as well as increases in our customer support function to keep pace with subscriber growth.

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 event costs, as well as allocated overheads.

Six months ended 30 September	2022 ($000s)	2021 ($000s)	change
Sales and marketing expenses	238,980	189,017	26%
Percentage of operating revenue	36.3%	37.4%	-1.1pp

Sales and marketing costs increased by 26%, to $239.0 million for H1 FY23, compared to operating revenue growth of 30% (27% constant currency). The sales and marketing costs increase of $50.0 million reflected the resumption of Xerocon, inflationary pressures, and a return to travel and events following the opening up of international borders. Xerocon was held after a three-year pandemic-related break, with conferences in the UK, Australia, and the US. External advertising and marketing costs increased by $27.2 million, or 43% compared to the comparative period, reflecting the Xerocon events.

Sales and marketing expenses as a percentage of operating revenue decreased by 1.1 percentage points to 36.3% compared to 37.4% in H1 FY22. Excluding the impacts of Xerocon revenue generated and expenses incurred, sales and marketing costs as a percentage of operating revenue would have been 2.6 percentage points lower at 33.7%.

Sales and marketing costs include costs incurred in acquiring new subscribers, as well as costs associated with upselling to existing customers and reducing churn. These costs are expensed in the period. This is in contrast to the associated revenue from those subscribers, which is recognised over the life of the subscriber (currently expected to be more than nine years on average). The average cost of acquiring a subscriber has increased to $566 per gross subscriber added, compared to $450 in H1 FY22. This reflects a focus on the international markets, which are less mature and less efficient than the ANZ markets.

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, teams building and enhancing the platform and related infrastructure, 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 capitalised 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	2022 ($000s)	2021 ($000s)	change
Total product design and development costs (including amounts capitalised)	**291,929**	**215,592**	**35%**
Percentage of operating revenue	44.3%	42.6%	1.7pp
Less capitalised development costs	(131,324)	(99,995)	31%
Product design and development expense (excluding amortisation of amounts capitalised)	**160,605**	**115,597**	**39%**
Less government grants	(1,617)	(2,153)	-25%
Add amortisation of capitalised development costs	71,722	53,389	34%
Product design and development expenses	**230,710**	**166,833**	**38%**
Percentage of operating revenue	35.0%	33.0%	2.0pp

Xero constantly invests in product innovation and development to deliver new products, features and experiences for customers. Delivery highlights in the half included products like Xero Go - a mobile product designed to ease the burden of financial administration for self-employed businesses and their advisors in the UK; establishing new partnerships, for example with Avalara in the US to automate sales tax compliance for US customers within the Xero platform, and broadening our partnership with Yodlee to access new direct bank feeds in North America. Xero also regularly enhances existing products to improve the experience of our customers, or to localise for individual markets. Examples include charting the 'Expenses by contact' report providing valuable insights for US, updated tax mapper for Canada, and a Hubdoc bank statement extraction feature for both US and Canada. For updates on our enhancements and releases, see the product updates section of our website (https://central.xero.com/s/article/Xero-Releases). Investment in product innovation and development is alongside investment in platform delivery to make Xero's platform faster, more functional and more flexible, as well as to support future platform growth and strategy delivery.

Total product design and development costs, including amounts capitalised, were $291.9 million in H1 FY23, $76.3 million or 35% higher than in the comparative period. Of this, $131.3 million was capitalised, with the balance of $230.7 million total product and design expenses included in the Income Statement. The amount capitalised represents a capitalisation rate of 45.0% of total product design and development costs for H1 FY23, a decrease of 1.4 percentage points compared to H1 FY22.

As a percentage of operating revenue, total product design and development costs for H1 FY23 (including amounts capitalised) increased by 1.7 percentage points to 44.3%, compared to 42.6% in H1 FY22, reflecting the impact of new hires that joined in FY22 and continued investment in global product innovation and platform delivery while managing inflationary cost pressures.

The amortisation of previously capitalised product design and development expenditure of $71.7 million was included as a non-cash expense in the Income Statement, resulting in total net expenses (after the netting of government grants) of $230.7 million for the period. As a percentage of operating revenue, product design and development expenses were 35.0%, an increase of 2.0 percentage points compared to H1 FY22.

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, corporate communications, 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	2022 ($000s)	2021 ($000s)	change
General and administration expenses	82,501	66,144	25%
Percentage of operating revenue	12.5%	13.1%	-0.6pp

General and administration expenses were $82.5 million for H1 FY23, $16.4 million, or 25% higher than H1 FY22. The main contributor was personnel costs due to higher employee headcount compared to H1 FY22. Higher travel costs also contributed to the increase as we resumed national and international travel.

General and administration costs as a percentage of operating revenue fell 0.6 percentage points to 12.5% compared to H1 FY22. The reduction in expenses as a percentage of operating revenue highlights some scale benefit from the past investment to extend important capabilities in strategy, corporate development, and other support functions.

Employees

At 30 September	2022	2021	change
Xero Group	4,915	4,187	17%

Full-time equivalent (FTE) employees increased by 728, or 17%, in the 12 months from 30 September 2021. Of the 728 FTEs added in the 12-month period, 131 were added in H1 FY23 as Xero tempered the pace of hiring in order to integrate the 1,142 FTEs who joined in FY22 and manage the inflationary pressures of the current economic environment.

Net finance expense

Six months ended 30 September	2022 ($000s)	2021 ($000s)	change
Interest income on deposits	8,011	1,406	NM
Total finance income	**8,011**	**1,406**	**NM**
Amortisation of discount and debt issuance costs	(16,970)	(14,341)	18%
Lease liability interest	(4,080)	(3,221)	27%
Unwind of contingent consideration	(679)	(2,926)	-77%
Bank standby facility costs	(651)	(1,037)	-37%
Other finance expense	(280)	(241)	16%
Total finance expense	**(22,660)**	**(21,766)**	**4%**
Net finance expense	**(14,649)**	**(20,360)**	**-28%**

Finance income increased by $6.6 million to $8.0 million in H1 FY23, due to higher global interest rates.

Total finance expense increased by 4% to $22.7 million in H1 FY23, driven by an increase in amortisation of debt discount and issuance costs, offset by a reduction in unwind of contingent consideration. Amortisation of discount and issuance costs increased by $2.6 million mainly due to the impact of the weaker NZD against the USD. In constant currency, amortisation of debt discount and issuance costs increased by 5%, or $0.8 million, from H1 FY22 as the principal balance increased. The unwind of contingent consideration decreased by $2.2 million due to a lower contingent consideration liability relating to the Waddle, Planday and Tickstar acquisitions.

Bank standby facility costs decreased by $0.4 million as a result of the standby debt facility not being renewed in August 2022.

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 2022			
Operating revenue	377,873	280,639	658,512
Expenses	(126,915)	(197,665)	(324,580)
Segment contribution	**250,958**	**82,974**	**333,932**
Contribution margin percentage	66.4%	29.6%	50.7%
Six months ended 30 September 2021			
Operating revenue	296,845	208,858	505,703
Expenses	(97,554)	(156,749)	(254,303)
Segment contribution	**199,291**	**52,109**	**251,400**
Contribution margin percentage	67.1%	24.9%	49.7%

ANZ – Segment contribution increased $51.7 million, or 26% to $251.0 million in H1 FY23. The segment contribution margin percentage was impacted by Xerocon Sydney, but remained broadly consistent with the comparative period.

Operating revenue for H1 FY23 grew by $81.0 million or 27% (23% in constant currency) compared to H1 FY22. This was driven by strong subscriber growth, price changes and higher financial services related revenue.

Expenses in the ANZ segment increased by 30% from H1 FY22. This was primarily due to an increase in sales and marketing spend, which increased 30% driven by the return of events such as Xerocon. Excluding Xerocon, sales and marketing spend increased 19%.

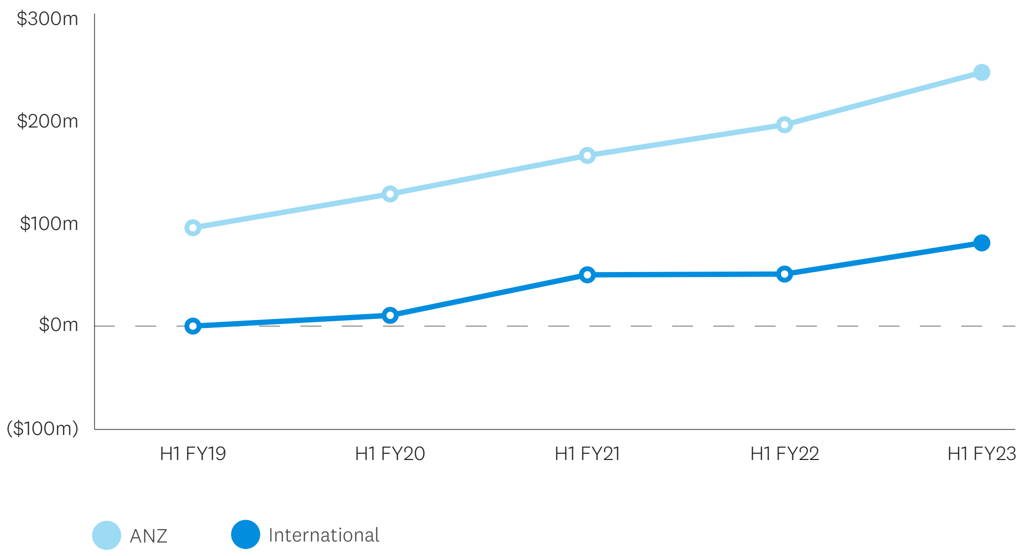
International – The International segment's contribution for H1 FY23 was $83.0 million, an increase of $30.9 million, or 59%, compared to $52.1 million in H1 FY22. This resulted in a contribution margin of 29.6% for H1 FY23, up 4.7 percentage points on the comparative period.

Operating revenue for H1 FY23 grew by $71.8 million or 34% (32% in constant currency) compared with H1 FY22. This was a result of continued subscriber growth, price changes, and strong performances in financial services and add-on revenue streams such as Payroll, Expenses and Analytics Plus.

Expenses in the International segment increased by 26% from H1 FY22, primarily due to a 25% increase in sales and marketing spend. The increase in sales and marketing spend was largely related to Xerocon. Excluding Xerocon expenses, total expenses for the segment increased 17%.

Although the International segment contribution margin is increasing, it remains comparatively lower than that of ANZ, reflecting Xero's investment in International subscriber additions through developing brand recognition and stronger distribution channels in these markets.

Segment contribution



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, evaluating 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 16) 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. Xero Group LTV is calculated as the sum of the individual segment LTV, multiplied by their respective segment subscribers, divided by total Xero Group subscribers.

LTV/CAC is the ratio between the LTV per subscriber and the cost to acquire that subscriber. For example, the LTV derived from a subscriber is currently on average 6.9 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 2022	ANZ	International	Total
ARPU ($)	35.56	34.95	35.30
CAC months	8.7	22.8	15.3
Churn	0.66%	1.26%	0.91%
LTV per subscriber ($)	4,664	2,416	3,706
LTV/CAC	15.1	3.0	6.9
At 30 September 2021	ANZ	International	Total
ARPU ($)	31.38	31.25	31.32
CAC months	9.1	19.5	14.2
Churn	0.67%	1.20%	0.88%
LTV per subscriber ($)	4,080	2,262	3,299
LTV/CAC	14.3	3.7	7.4

Xero Group – Xero Group ARPU increased by 13% (6% in constant currency) compared to 30 September 2021, driven by price increases and favourable foreign exchange impacts.

Churn for the Xero Group increased slightly to 0.91% in H1 FY23 from 0.88% in the comparative period driven by a small increase in churn in the International segment.

CAC months increased by 8% from 14.2 months to 15.3 months at H1 FY23, as Xero invested a higher proportion of sales and marketing into its international markets. Year on year comparisons are impacted by sales and marketing spend including the resumption of sales spend, inflationary pressure, and a return to travel. Sales and marketing investment increased in H1 FY23 as opportunities allowed with the return of events such as Xerocon.

Total subscriber LTV at 30 September 2022 increased by $3.1 billion, or 30% (23% in constant currency), to $13.0 billion compared to 30 September 2021. With the increased sales and marketing spend in H1 FY23, Xero Group LTV/CAC ratio decreased to 6.9 at 30 September 2022, from 7.4 at 30 September 2021.

Subscriber LTV is sensitive to recent churn levels and assumes these levels will remain constant over an extended future period. Using the average churn levels for the past 3 years (0.94%), total Xero Group subscriber LTV would be $1.6 billion, or 12%, lower at $11.4 billion.

ANZ – ARPU increased by 13% to $35.56 compared to H1 FY22. This was primarily driven by price increases in both Australia and New Zealand, foreign exchange rate fluctuations and increased uptake in ecosystem and financial services related products. In constant currency terms, ANZ ARPU was 6% higher than the comparative period.

CAC months decreased to 8.7 months in H1 FY23 from 9.1 months in H1 FY22, despite increased sales and marketing costs per gross subscriber added. This was primarily due to higher ARPU combined with higher subscriber additions year on year.

Churn decreased to 0.66% at 30 September 2022 from 0.67% at 30 September 2021 and remains consistent with the historically low churn reported in FY22.

Lower churn and the increase in ARPU resulted in a 14% (7% in constant currency) increase in LTV per subscriber from $4,080 at 30 September 2021 to $4,664. Total ANZ subscriber LTV increased by $2.4 billion, or 33% (25% in constant currency), to $9.4 billion at 30 September 2022. The increase in LTV during the year drove an increase in the LTV/CAC ratio from 14.3 to 15.1 (14.2 in constant currency).

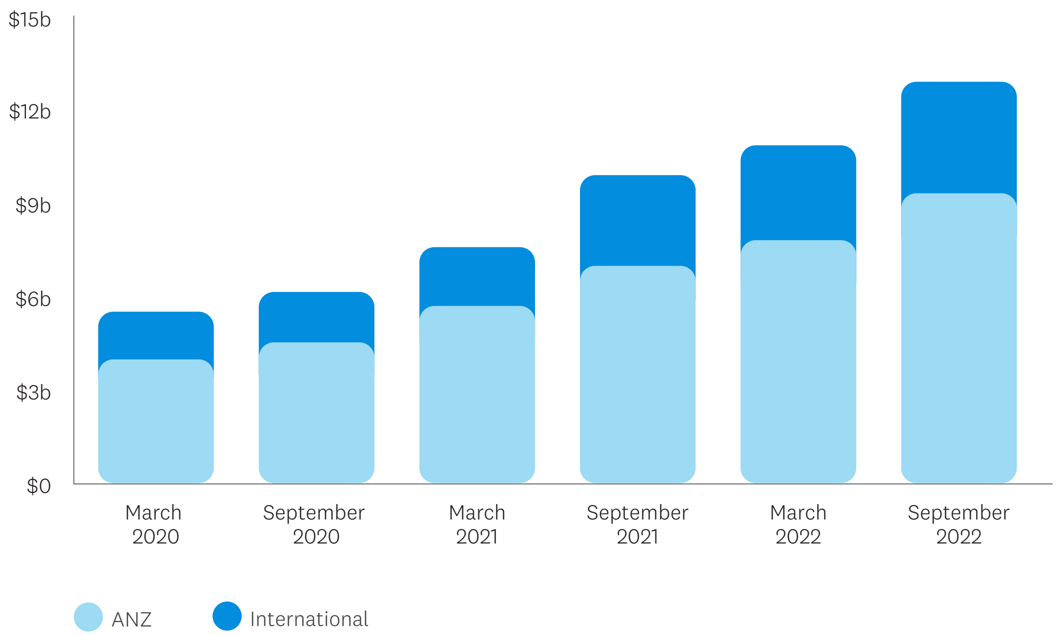
International – ARPU increased by 12% to $34.95 (6% in constant currency) compared to H1 FY22. Price increases in the UK in September 2022, and North America and Rest of World markets in November 2021, and a favourable product mix had a positive impact on International ARPU.

CAC months increased from 19.5 months in H1 FY22 to 22.8 months for H1 FY23, primarily driven by a 31% increase in CAC per gross subscriber addition compared to H1 FY22. Excluding the impact of Xerocons in London and New Orleans, CAC months would have been 21.8 months in H1 FY23.

Total International subscriber LTV increased by $0.7 billion, or 23% (17% in constant currency), to $3.6 billion at 30 September 2022 from the comparative period due to higher ARPU, coupled with subscriber growth which offset a small increase in churn.

LTV/CAC decreased from 3.7 to 3.0 in H1 FY23 compared to the H1 FY22 period as increased sales and marketing expenditure in the International segment has resulted in acquisition cost per subscriber growing at a greater rate than subscriber LTV as we continue to invest for the long term opportunity in these markets.

Total lifetime value



Independent Auditor's Review Report

To the Shareholders of Xero Limited

Conclusion

We have reviewed the interim financial statements of Xero Limited ("the company") and its subsidiaries (together "the Group") on pages 25 to 35, which comprise the statement of financial position as at 30 September 2022 and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the six-month period ended on that date, and a summary of significant accounting policies and other explanatory information. Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial statements on pages 25 to 35 of the Group do not present fairly, in all material respects, the financial position of the Group as at 30 September 2022, and its financial performance and its 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*.

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 procedures, for this report, or for the conclusion we have formed.

Basis for Conclusion

We conducted our review in accordance with NZ SRE 2410 (Revised) Review of Financial Statements Performed by the Independent Auditor of the Entity. Our responsibilities are further described in the Auditor's Responsibilities for the Review of the Interim Financial Statements section of our report. We are independent of the Group in accordance with the relevant ethical requirements in New Zealand relating to the audit of the annual financial statements, and we have fulfilled our other ethical responsibilities in accordance with these ethical requirements.

Ernst & Young has provided other assurance services related to the Group's compliance with ISO 27001. 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.

Directors' Responsibilities for the Interim Financial Statements

The Directors are responsible, on behalf of the entity, 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.

Auditor's Responsibilities for the Review of the Interim Financial Statements

Our responsibility is to express a conclusion on the interim financial statements based on our review. NZ SRE 2410 (Revised) requires us to conclude whether anything has come to our attention that causes us to believe that the interim 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*.

A review of interim financial statements in accordance with NZ SRE 2410 (Revised) is a limited assurance engagement. We perform procedures, 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) and consequently do not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly we do not express an audit opinion on those interim financial statements.

The engagement partner on the review resulting in this independent auditor's review report is Simon O'Connor.

Ernst & Young

Ernst & Young
Chartered Accountants
Wellington
10 November 2022

Interim Financial Statements

Income Statement

Six months ended 30 September	Notes	2022 Unaudited ($000s)	2021 Unaudited ($000s)
Subscription revenue		622,195	487,802
Other operating revenue		36,317	17,901
Total operating revenue	**4**	**658,512**	**505,703**
Cost of revenue	5	(85,600)	(65,286)
Gross profit		**572,912**	**440,417**
Operating expenses			
Sales and marketing		(238,980)	(189,017)
Product design and development		(230,710)	(166,833)
General and administration		(82,501)	(66,144)
Total operating expenses	**5**	**(552,191)**	**(421,994)**
Other income and expenses		12,188	1,398
Asset impairments and disposals	7	(26,532)	(2,898)
Operating surplus		**6,377**	**16,923**
Finance income		8,011	1,406
Finance expense		(22,660)	(21,766)
Net loss before tax		**(8,272)**	**(3,437)**
Income tax expense		(7,858)	(2,485)
Net loss		**(16,130)**	**(5,922)**
Basic and diluted loss per share	6	($0.11)	($0.04)

Statement of Comprehensive Income

Six months ended 30 September	Note	2022 Unaudited ($000s)	2021 Unaudited ($000s)
Net loss		(16,130)	(5,922)
Other comprehensive income*			
Movement in cash flow hedges (net of tax)	9	2,492	6,859
Translation of foreign operations (net of tax)		(6,164)	(4,728)
Total other comprehensive income/(loss)		**(3,672)**	**2,131**
Total comprehensive loss		**(19,802)**	**(3,791)**

** 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

	Notes	At 30 September 2022 Unaudited ($000s)	At 31 March 2022 Audited ($000s)
Assets			
Current assets			
Cash and cash equivalents		395,092	404,192
Short-term deposits		730,470	531,866
Trade and other receivables		110,716	112,311
Derivative assets		16,350	6,233
Income tax receivable		5,164	8,551
Other current assets		10,436	8,601
Total current assets		**1,268,228**	**1,071,754**
Non-current assets			
Property, plant and equipment		160,321	158,317
Intangible assets	7	1,022,863	959,354
Derivative assets		14,432	56,269
Deferred tax assets		114,983	97,069
Other non-current assets		1,143	577
Total non-current assets		**1,313,742**	**1,271,586**
Total assets		**2,581,970**	**2,343,340**
Liabilities			
Current liabilities			
Trade and other payables		74,422	55,461
Employee entitlements		75,277	82,727
Lease liabilities		18,298	14,292
Income tax payable		793	936
Derivative liabilities		9,093	2,511
Other current liabilities		59,179	40,563
Total current liabilities		**237,062**	**196,490**
Non-current liabilities			
Term debt		1,101,523	884,839
Derivative liabilities		9,651	56,624
Lease liabilities		122,223	121,926
Contingent consideration	8	8,405	13,817
Deferred tax liabilities		8,913	13,377
Other non-current liabilities		12,564	22,344
Total non-current liabilities		**1,263,279**	**1,112,927**
Total liabilities		**1,500,341**	**1,309,417**
Equity			
Share capital		1,618,450	1,580,858
Reserves		(190,815)	(217,059)
Accumulated losses		(346,006)	(329,876)
Total equity		**1,081,629**	**1,033,923**
Total liabilities and shareholders' equity		**2,581,970**	**2,343,340**

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)	Call spread options reserve ($000s)	Total equity ($000s)
Balance at 1 April 2022		**1,576,762**	**4,096**	**81,623**	**(329,876)**	**(411)**	**2,985**	**(301,256)**	**1,033,923**
Net loss		–	–	–	(16,130)	–	–	–	(16,130)
Other comprehensive income/(loss)		–	–	–	–	(6,164)	2,492	–	(3,672)
Total comprehensive loss		**–**	**–**	**–**	**(16,130)**	**(6,164)**	**2,492**	**–**	**(19,802)**
Transactions with owners:									
Share-based payments	12	2,345	47	40,742	–	–	–	–	43,134
Share options exercised	12	35,200	–	(10,826)	–	–	–	–	24,374
Balance at 30 September 2022		**1,614,307**	**4,143**	**111,539**	**(346,006)**	**(6,575)**	**5,477**	**(301,256)**	**1,081,629**
Balance at 1 April 2021		**1,295,211**	**(1,891)**	**80,758**	**(320,762)**	**(2,495)**	**(3,619)**	**(301,256)**	**745,946**
Net loss		–	–	–	(5,922)	–	–	–	(5,922)
Other comprehensive income/(loss)		–	–	–	–	(4,728)	6,859	–	2,131
Total comprehensive loss		**–**	**–**	**–**	**(5,922)**	**(4,728)**	**6,859**	**–**	**(3,791)**
Transactions with owners:									
Share-based payments	12	2,105	86	42,089	–	–	–	–	44,280
Share options exercised	12	40,310	–	(12,558)	–	–	–	–	27,752
Issue of shares – deferred consideration for acquisition of Waddle		2,486	–	–	–	–	–	–	2,486
Issue of shares – acquisition of Planday		119,283	–	–	–	–	–	–	119,283
Issue of shares – acquisition of Tickstar		4,924	–	–	–	–	–	–	4,924
Balance at 30 September 2021		**1,464,319**	**(1,805)**	**110,289**	**(326,684)**	**(7,223)**	**3,240**	**(301,256)**	**940,880**

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

Statement of Cash Flows

Six months ended 30 September	Note	2022 Unaudited ($000s)	2021 Unaudited ($000s)
Operating activities			
Receipts from customers		660,200	505,096
Other income		1,309	1,425
Interest received		4,927	1,547
Payments to suppliers and employees		(495,585)	(368,819)
Interest paid		(4,882)	(4,446)
Income tax paid		(6,255)	(6,367)
Net cash flows from operating activities	**11**	**159,714**	**128,436**
Investing activities			
Capitalised development costs		(130,097)	(100,517)
Capitalised contract acquisition costs		(9,063)	(8,399)
Purchase of property, plant and equipment		(2,738)	(11,115)
Other investing activities		(3,238)	(2,054)
Business acquisitions, net of cash acquired		–	(135,564)
Net cash flows from investing activities		**(145,136)**	**(257,649)**
Financing activities			
Proceeds from short-term deposits		457,754	575,035
Payments for short-term deposits		(562,261)	(656,208)
Share options exercised		24,374	27,752
Payment of lease liabilities		(7,976)	(6,450)
Proceeds from borrowings		1,477	–
Repayment of borrowings		(3,469)	(788)
Payments for buyback of convertible notes		–	(5,455)
Net cash flows from financing activities		**(90,101)**	**(66,114)**
Net decrease in cash and cash equivalents		**(75,523)**	**(195,327)**
Foreign currency translation adjustment		66,423	7,543
Cash and cash equivalents at the beginning of the period		**404,192**	**657,849**
Cash and cash equivalents at the end of the period		**395,092**	**470,065**

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

Notes to the 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 (ASX). 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 2022 were authorised in accordance with a resolution of the directors for issue on 10 November 2022.

2. Basis of accounting

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.

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 2022.

The preparation of financial statements requires judgements and estimates that impact the application of policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

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 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 2022			
Operating revenue	377,873	280,639	658,512
Expenses	(126,915)	(197,665)	(324,580)
Segment contribution	**250,958**	**82,974**	**333,932**
Six months ended 30 September 2021			
Operating revenue	296,845	208,858	505,703
Expenses	(97,554)	(156,749)	(254,303)
Segment contribution	**199,291**	**52,109**	**251,400**

Reconciliation from segment contribution to net loss before tax

Six months ended 30 September	2022 Unaudited ($000s)	2021 Unaudited ($000s)
Segment contribution	333,932	251,400
Product design and development	(230,710)	(166,833)
General and administration	(82,501)	(66,144)
Other income and expenses	12,188	1,398
Asset impairments and disposals	(26,532)	(2,898)
Finance income	8,011	1,406
Finance expense	(22,660)	(21,766)
Net loss before tax	**(8,272)**	**(3,437)**

4. Revenue

Operating revenue by geographic location

Six months ended 30 September	2022 Unaudited ($000s)	2021 Unaudited ($000s)
Australia	294,258	224,860
United Kingdom	174,975	132,847
New Zealand	83,615	71,985
North America	43,501	30,133
Rest of World	62,163	45,878
Total operating revenue	**658,512**	**505,703**

5. Expenses

Cost of revenue and operating expenses

Six months ended 30 September	2022 Unaudited ($000s)	2021 Unaudited ($000s)
Employee entitlements	374,284	284,839
Employee entitlements capitalised	(110,304)	(82,882)
Share-based payments	45,521	37,942
Share-based payments capitalised	(11,449)	(8,657)
Advertising and marketing	90,278	62,869
Platform costs	45,801	33,897
Platform costs capitalised	(5,491)	(4,428)
Consultants and contractors	39,986	40,011
Consultants and contractors capitalised	(25,193)	(22,377)
Computer equipment and software	24,374	19,464
Superannuation costs	18,329	12,916
Travel-related costs	9,925	908
Recruitment and other personnel costs	6,109	5,450
Communication, insurance and office administration	5,767	4,848
Rental costs	5,476	4,067
Other operating expenses	22,204	17,256
Total cost of revenue and operating expenses excl. depreciation and amortisation*	**535,617**	**406,123**

** Net of $152.4 million of costs capitalised as intangible assets (2021: $118.3 million) and grant income of $1.7 million (2021: $2.3 million)*

Depreciation and amortisation

Six months ended 30 September	2022 Unaudited ($000s)	2021 Unaudited ($000s)
Relating to:		
Amortisation of development costs	78,980	59,450
Amortisation of other intangible assets	8,548	8,098
Depreciation of property, plant and equipment	14,646	13,609
Total depreciation and amortisation	**102,174**	**81,157**
Total cost of revenue and operating expenses	**637,791**	**487,280**
Depreciation and amortisation included in function expenses:		
Product design and development	79,399	59,023
Sales and marketing	15,468	15,104
Cost of revenue	4,588	4,240
General and administration	2,719	2,790
Total depreciation and amortisation	**102,174**	**81,157**

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 loss 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 loss 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	2022 Unaudited (000s)*	2021 Unaudited (000s)*
Net loss after tax	($16,130)	($5,922)
Add back: foreign exchange revaluation and interest on contingent consideration included in ordinary shares for basic calculation before the date of share issue, net of tax	–	$8
Net loss attributable to equity holders of the Group, used in calculating basic and diluted EPS	**($16,130)**	**($5,914)**
Weighted average number of ordinary shares for basic EPS	149,709	148,061
Effect of dilution from:		
Share options	413	–
Restricted stock units	832	–
Restricted shares	61	–
Weighted average number of ordinary shares adjusted for the effect of dilution	**151,015**	**148,061**
Basic and diluted loss per share	**($0.11)**	**($0.04)**

** Except for per share amounts*

The weighted average number of shares outstanding used in computation of diluted earnings per share does not include the effect of share options, RSUs, restricted shares, contingent consideration, convertible notes and call spread options, where their impact would be anti-dilutive.

7. Intangible assets

Unaudited	Software development ($000s)	Contract acquisition asset ($000s)	Other intangible assets ($000s)	Goodwill ($000s)	Total ($000s)
Six months ended 30 September 2022					
Opening net book value	490,171	35,997	13,252	419,934	959,354
Additions*	143,345	7,869	1,223	–	152,437
Amortisation expense	(78,980)	(6,979)	(1,569)	–	(87,528)
Impairments and disposals	(7,379)	–	(2,151)	(16,977)	(26,507)
Foreign exchange adjustment	5,598	3,237	540	15,732	25,107
Closing net book value	**552,755**	**40,124**	**11,295**	**418,689**	**1,022,863**
At 30 September 2022					
Cost	851,457	74,104	15,798	418,689	1,360,048
Accumulated amortisation	(298,702)	(33,980)	(4,503)	–	(337,185)
Closing net book value	**552,755**	**40,124**	**11,295**	**418,689**	**1,022,863**
At 31 March 2022					
Cost	741,874	77,932	16,973	419,934	1,256,713
Accumulated amortisation	(251,703)	(41,935)	(3,721)	–	(297,359)
Closing net book value	**490,171**	**35,997**	**13,252**	**419,934**	**959,354**

** Included in additions is $30.7 million of external costs capitalised (2021: $26.5 million)*

Impairment considerations

An indicator of impairment was identified for the Waddle CGU, due to changed operational and market conditions for the Waddle business post 31 March 2022. As a result an impairment test was performed over the Waddle CGU.

The recoverable amount of the Waddle CGU of $23.9 million at 30 September 2022 was calculated based on a value in use valuation using a discounted cash flow model. This valuation methodology yields a higher recoverable amount than that obtained using a fair value less costs of disposal approach and therefore is required to be used in impairment testing calculations under NZ IAS 36 *Impairment of Assets*.

The major inputs and assumptions used in performing the assessment that require judgement include cash flow forecasts, discount rate, and terminal growth rate. Future cash flows are projected for a period of five years, the average annual cash flow growth rate over the forecast period was 43% for revenue and 22% for expenditure. Growth in cash flows reflects the fact that revenues are expected to increase at a much higher rate than expenses as economies of scale are achieved. The forecast financial information is based on both past experience and future expectations of CGU performance. A terminal growth rate of 4% and a post-tax discount rate of 16% were applied. The terminal growth rate is determined based on the long-term anticipated growth rate of the business. A sensitivity analysis was performed over the key inputs to the value in use valuation being the discount rate, terminal growth rate and cash flow forecasts. With all other variables held constant a 1 percentage point increase in discount rate, or a 1 percentage point decrease in terminal growth rate would result in an additional impairment of $4.1 million and $3.0 million respectively. A 10% reduction in forecasted cash flows would result in an additional $5.5 million impairment.

As the recoverable amount determined using the value in use valuation methodology is less than the carrying amount of the Waddle CGU of $49.8 million, an impairment of $25.9 million has been recognised in the current period. Of this impairment $17.0 million, $2.2 million and $6.8 million was recognised against goodwill, customer contracts and capitalised software respectively. The impairment charge is recorded within asset impairments and disposals in the Income Statement for the period ended 30 September 2022.

For the year ended 31 March 2022, the recoverable amount of the Waddle CGU was calculated on the basis of fair value less costs of disposal. The comparable company revenue multiple used in determining the recoverable amount under the fair value less cost of disposal valuation approach was 5.7. No impairment indicators were identified during the period ended 30 September 2021, and therefore no impairment testing was performed in the comparative period.

8. Contingent consideration

Six months ended 30 September	2022 Unaudited ($000s)
Opening balance	24,216
Unwinding of discount	679
Change in fair value estimate	(1,646)
Foreign exchange adjustment	1,040
Closing balance	**24,289**
Current	15,884
Non-current	8,405

Contingent consideration comprises the Group's probability-weighted assessment of discounted amounts payable to vendors in respect of business acquisitions.

$12.1 million of the contingent consideration balance at 30 September 2022 is expected to be settled in cash, with the remaining expected to be settled in shares of Xero Limited.

The non-current portion of contingent consideration is expected to become payable following the achievement of specified product and revenue milestones between November 2023 and June 2024.

9. 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 derivatives have been designated as a hedging instrument in a cash flow hedge of a highly probable forecast transaction 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 gain of $5.0 million (before taxation) was recognised in other comprehensive income (2021: gain of $10.2 million). During the period, a gain of $1.6 million (before taxation) was reclassified out of other comprehensive income to the Income Statement (2021: gain of $0.6 million). The remaining balance will be reclassified to the Income Statement in future reporting periods as the relevant hedging instruments mature.

10. 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 derivatives, conversion feature, call option derivative assets, and contingent consideration liabilities are recognised at fair value. Fair value of foreign exchange derivatives are 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 assets 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 estimates (level two on the fair value hierarchy). Inputs into the valuation include share price volatility and time to expiration.

The fair value of contingent consideration is determined using valuation techniques such as probability-weighted forecasts of meeting certain product development and revenue targets (level three on the fair value hierarchy). Contingent consideration is discounted using the acquired entity's weighted average cost of capital.

At initial recognition, the fair value of the debt component 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 2022 were $1,101.5 million and $946.1 million, respectively. At 30 September 2022, the fair value of the conversion feature derivative liability was $8.2 million and the fair value of the call option derivative assets was $14.4 million.

For the six months ended 30 September 2022, a revaluation loss of $52.0 million was recognised on the call option derivative assets, and a revaluation gain of $58.3 million was recognised on the conversion feature derivative liability. Revaluations reflect a decrease in the Xero Limited share price over the period.

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.

11. Reconciliation of operating cash flows

Six months ended 30 September	2022 Unaudited ($000s)	2021 Unaudited ($000s)
Net loss	(16,130)	(5,922)
Adjustments:		
Depreciation	14,646	13,609
Amortisation	87,528	67,548
Share-based payments	34,072	29,285
Amortisation of discount and debt issuance costs	16,970	14,341
Deferred tax and current taxes recognised in equity	(21,410)	2,363
Asset impairments and disposals	26,532	2,898
Bad debts	2,338	1,059
Other non-cash items	(10,653)	2,431
Changes in working capital:		
(Increase)/decrease in trade receivables and prepayments	(2,256)	4,649
(Increase)/decrease in interest receivable	(3,084)	141
Increase/(decrease) in trade payables and other related items	24,622	(227)
Increase/(decrease) in employee entitlements	2,858	(1,711)
(Increase)/decrease in current tax receivable	3,681	(2,028)
Net cash flows from operating activities	**159,714**	**128,436**

12. Share-based payments

The Group operates equity-settled, share-based compensation plans under which employees provide services in exchange for non-transferable options, RSUs, or 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.

Restricted stock units

Movements in the number of RSUs outstanding and their related weighted average grant prices were as follows:

Unaudited	2022 Weighted average grant date fair value (AUD)	2022 RSUs (000s)	2021 Weighted average grant date fair value (AUD)	2021 RSUs (000s)
Six months ended 30 September				
Opening balance	128.37	450	84.36	351
Granted	83.26	1,049	138.34	590
Forfeited	108.32	(80)	101.04	(53)
Converted to shares	123.65	(18)	64.18	(26)
Closing balance	**95.80**	**1,401**	**120.44**	**862**

Share options scheme

Movements in the number of options outstanding and their related weighted average exercise prices are as follows:

Unaudited	2022 Weighted average exercise price (AUD)	2022 Options (000s)	2021 Weighted average exercise price (AUD)	2021 Options (000s)
Six months ended 30 September				
Opening balance	74.45	1,606	55.27	2,277
Granted	88.15	184	136.17	242
Forfeited/expired	124.85	(116)	68.91	(48)
Exercised	42.53	(516)	40.69	(643)
Closing balance	**85.81**	**1,158**	**70.74**	**1,828**
Exercisable at 30 September	55.30	509	48.68	439

Employee restricted share plan

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

Unaudited	2022 Number of shares (000s)	2021 Number of shares (000s)
Six months ended 30 September		
Opening balance	36	126
Granted	–	1
Forfeited	(4)	(13)
Settled	(1)	(1)
Closing balance – allocated to employees	**31**	**113**
Forfeited shares not yet reallocated – held by Trustee	30	19
Total	**61**	**132**
Percentage of total ordinary shares	0.0%	0.1%
Ageing of unvested shares		
Vest within one year	31	74
Vest after one year	–	39
Total unvested shares at 30 September	**31**	**113**

13. Standby facilities

As part of ongoing capital management Xero reduced its short term debt facilities during the period. This reflected a decision not to renew its undrawn NZD150 million standby debt facility which matured in August 2022 and to replace the AUD30 million facility in place to support the Waddle direct lending portfolio with a smaller AUD10 million facility to provide short term liquidity. At 30 September 2022, AUD0.7 million of the AUD10 million facility was drawn.

14. Group entities

During the period, Trilogy Software Inc. was amalgamated with Xero Software (Canada) Ltd and Hubdoc Pty Limited was voluntarily deregistered. There were no other changes to the entities over which the Group has control during the period.

15. Events after the balance sheet date

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

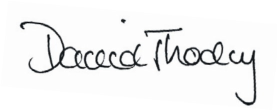
Directors’ Declaration

The unaudited interim financial statements of Xero Limited and its subsidiaries (‘the Group’) for the six months ended 30 September 2022 were authorised for issue on 10 November 2022 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 the Group 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
Chair
Xero Limited
10 November 2022

Mark Cross
Director
Xero Limited
10 November 2022

Corporate Directory

Registered offices

New Zealand
19-23 Taranaki Street
Te Aro, Wellington 6011
New Zealand

Contact:
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Australia
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Hawthorn, Vic 3122
Australia

Contact:
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Directors

David Thodey AO
(Chair)

Steven Aldrich

Mark Cross

Rod Drury

Lee Hatton

Brian McAndrews

Dale Murray CBE

Susan Peterson

Company secretary

Damien Coleman

Leadership team

Steve Vamos
Chief Executive Officer

Damien Coleman
Acting Chief Legal Officer

Anna Curzon
Chief Product Officer

Kirsty Godfrey-Billy
Chief Financial Officer

Chris O'Neill
Chief Growth Officer

Rachael Powell
Chief Customer Officer

Mark Rees
Chief Technology Officer

Nicole Reid
Chief People Officer

Damien Tampling
Chief Strategy & Corporate Development Officer

Other company information

Company numbers
183 0488 (New Zealand)
ARBN 160 661 183 (Australia)

Web address
www.xero.com

Auditor
Ernst & Young

Stock exchange
Xero's ordinary shares are listed on the ASX

Share registrar
Link Market Services Limited

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