



XERO LIMITED (XRO) MARKET RELEASE

Xero's momentum continues in all markets

20 November 2014

(Note: All currency is in New Zealand dollars)

Xero Limited (XRO) continues to deliver high growth as the business builds capability to serve millions of small businesses on its financial platform.

Following the \$180m capital raise in October 2013, this past year has been a period of high investment for Xero, as staff numbers grew 70% from September 2013, to 993 at 30 September 2014. The business had \$170.8m of cash at 30 September 2014 to continue to invest to create long term shareholder value. The Company will continue to invest to fuel growth while architecting a high margin business model as it achieves scale.

Highlights of the first half of the financial year ended 30 September 2014:

- Subscription revenue of \$52.0 million, up 85% from \$28.1 million for the same period last year.
- 371,000 paying customers globally compared to 211,000 at the same period last year, a 76% increase.
- Annualised committed monthly revenue (ACMR) of \$132.3 million at 30 September 2014, an 87% increase on the same period last year.
- Net loss after tax of \$24.5 million, reflecting the investment in product development and sales and marketing.
- \$170.8 million cash at 30 September 2014 to fund future growth.

Paying customers	At 30 September 2014	At 30 September 2013	% change
New Zealand	119,000	86,000	38%
Australia	158,000	79,000	100%
United Kingdom	61,000	30,000	103%
North America	22,000	10,000	120%
Rest of World	11,000	6,000	83%
Total	371,000	211,000	76%

Subscription revenue (\$m)	6 months ended 30 September 2014	6 months ended 30 September 2013	% change
New Zealand	15.1	10.6	42%
Australia	23.9	11.1	115%
United Kingdom	8.0	4.0	100%
North America	3.0	1.3	131%
Rest of World	2.0	1.1	82%
Total	52.0	28.1	85%

Commentary

Xero's exceptional growth in New Zealand, Australia and the United Kingdom continues to extend its leadership in cloud accounting, validating the Company's business model and providing the experience to similarly scale in the US. The US is a significant and addressable opportunity with the majority of small businesses unserved by cloud accounting software, and Xero is well positioned to meet this need directly through Xero.com and its accounting partners.

Adding to this momentum, the US leadership has been strengthened with the appointment of three senior executives:

- **John Forrester, VP of US Marketing** – Forrester has 20+ years of marketing experience from product and content to brand and digital with a mix of startup and corporate experience. Most recently, John was VP Marketing at RingCentral.
- **James Maiocco, GM of Business and Corporate Development** – Maiocco joins Xero from Microsoft, where he led the investment and partnership efforts for Microsoft Ventures globally. Bringing over 15 years experience in business and corporate development at SaaS-based, Cloud-first technology companies with him, James' focus will be on the US and United Kingdom.
- **Angus Norton, Senior Vice President/Chief Product Officer** – Norton joins Xero after 14 years of hi-tech experience in the US. Most recently, he was with Microsoft where he led product management for the entire Office business in the US, and drove Microsoft's successful transition to the Cloud with Office 365.

Further appointments will be announced over the coming months.

CEO Rod Drury says, "We're thrilled at the growth we're achieving in our initial three markets and are now focussed on execution in the important US market and are making good progress on building our leadership team there. Our investment over the last year, combined with our clean Cloud-first platform, will allow us to further increase the rate of innovation. It will be an exciting next few years for small businesses and accountants."

Xero previewed its soon-to-be-launched business performance dashboard at a major US accounting conference. Using "Big Data for Small Business" Xero will help small businesses to get visibility, to measure and attain insights that will help them become even more successful, while empowering their accountants, bookkeepers and advisers to have deeper conversations based on meaningful data and information.

"This is just the first step in how we'll be looking to use big data from our global accounting platform to put small businesses in control and grow," added Drury.

Additional commentary is included in Xero's 2014 Interim Report, which has also been released today.

For more information contact:

Rod Drury
Xero CEO
rod.drury@xero.com
+64 27 6000 007

Ross Jenkins
Xero CFO
ross.jenkins@xero.com
+1 415 860 3910

About Xero

[Xero](#) is beautiful, easy to use online [accounting software](#) for small businesses and their advisors. The Company has over 370,000 paying customers in more than 180 countries around the world. Xero is listed on the NZX and ASX. See www.xero.com



APPENDIX 4D RELEASE

20 November 2014

Xero Limited

ARBN 160 661 183

Incorporated in New Zealand

This document and Xero Limited's 2014 Interim Report contains half-year information given to ASX under ASX Listing Rule 4.2A.

Interim Report

<i>Reporting period</i>	6 months to 30 September 2014
<i>Previous reporting period</i>	6 months to 30 September 2013

Results for announcement to the market

	Amount (ooos)	% change
Revenues from ordinary activities	NZ\$54,295	up 79%
Profit (loss) from ordinary activities after tax attributable to security holder	NZ\$(24,471)	up 50%
Net profit (loss) attributable to security holder	NZ\$(24,471)	up 43%

Dividends - Ordinary shares*	Amount per security NZD	Imputed amount per security NZD
Interim dividend	Not applicable	Not applicable
Payment date	Not applicable	Not applicable

* No dividends have been declared for the reporting period.

Net tangible assets per share was NZ\$1.49 per share at 30 September 2014 (30 September 2013: NZ\$0.54 per share).

Commentary on results

For commentary on the results please refer to the Chairman and Chief Executive Report in the 2014 Interim Report. Additional Appendix 4D disclosure requirements can be found in the 2014 Interim Report.

Financial information

This Appendix 4D should be read in conjunction with the unaudited Consolidated Condensed Financial Statements for the six months ended 30 September 2014 as contained in the 2014 Interim Report, and in conjunction with the 2014 Annual Report generally.



Beautiful accounting software

The results have been prepared in accordance with the accounting policies set out on page 17 of the Interim Report.

Copies of Xero's prior Annual Reports and Interim Reports (including Xero's 2013 Interim Report) can be found on Xero's website, at www.xero.com/about/investors/reports.

Interim Report

For the six months ended
30 September 2014

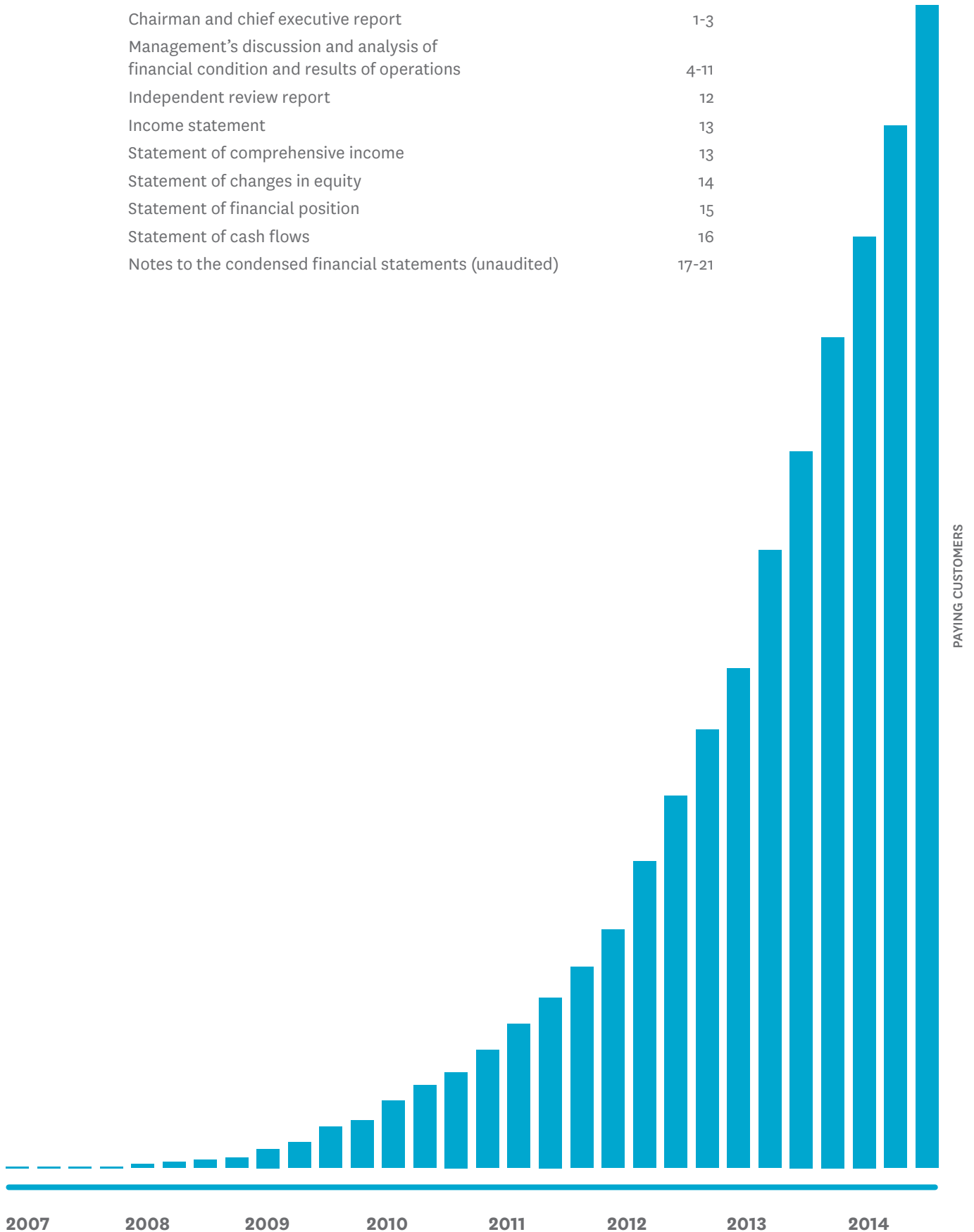


Beautiful accounting software
www.xero.com



XERO LIMITED INTERIM REPORT 2014

Chairman and chief executive report	1-3
Management's discussion and analysis of financial condition and results of operations	4-11
Independent review report	12
Income statement	13
Statement of comprehensive income	13
Statement of changes in equity	14
Statement of financial position	15
Statement of cash flows	16
Notes to the condensed financial statements (unaudited)	17-21



CHAIRMAN AND CHIEF EXECUTIVE REPORT

Xero's high growth continued during the first half of the financial year as the business builds its capability to serve millions of small businesses on its financial platform.

Financial highlights for the six months to 30 September 2014 were:

- Subscription revenue of \$52.0 million, up 85% from \$28.1 million for the same period last year.
- 371,000 paying customers globally compared to 211,000 at the same time last year, a 76% increase.
- Annualised committed monthly revenue (ACMR) of \$132.3 million at 30 September 2014, an 87% increase on the same period last year.
- Net loss after tax of \$24.5 million reflecting the investment in product development and sales and marketing.
- \$170.8 million cash at 30 September 2014 to fund future growth.

High growth is expected to continue with the Company providing market guidance of approximately 80% subscription revenue growth on a constant dollar basis for the full year to 31 March 2015.

INVESTMENT

Xero is one of the first Small Business SaaS companies to achieve \$US100 million ACMR with the majority of revenue across four geographies.

Positive product feedback, strong results against incumbents, combined with the large and expanding total addressable software as a service (or cloud) market provides the Board with continued confidence in the Company's growth strategy. The past year has been a period of high investment as Xero grew staff 70% from September 2013. With this capacity now in place, the Company expects its staff growth rate to slow and to see continued scaling of its customer base, resulting in higher margins in the future.

Sales and marketing

Xero has created a network of accountants, small businesses and add-on partners working together in a vibrant ecosystem. Investment continues on the automation of the Company's sales and marketing channels to drive efficiency and deliver outstanding support to channel partners and customers. Xero's partner channel currently generates around 70% of its customers.

The Company recently appointed Andy Lark as Chief Marketing Officer and added key marketing resources in the United States and the United Kingdom to drive customer acquisition directly as well as through existing and new channels.

Product development

Xero continues to set the pace for accounting innovation, releasing over 115 new features across all customer-facing products for the half year ending 30 September 2014 and demonstrating the power of the Xero Cloud over legacy desktop solution providers. The release of payroll in the United Kingdom, United States, and New Zealand will drive increased revenue per user in 2015. Completing the move to globally distributed product teams has provided Xero with greater access to critical talent and the insights needed to drive innovation. Focus remains on delivering the best customer experience, capitalising on emerging revenue opportunities and delivering new data driven services, such as the recently announced business performance dashboards.

Service delivery

With 99.99% uptime for the last 12 months, Xero is delivering world class uptime, performance, security and redundancy as the platform evolved quickly while handling substantially higher volumes each year. Investment will ensure that high quality service continues as Xero looks to onboard millions of customers and that the Company can take advantage of the rapid innovation and commoditisation of cloud computing and storage.

Customer experience

Xero continues its leadership in customer and partner education and support. The Company launched Xero U, a customised one-to-many learning experience, and Xero TV, a rich video platform for engaging accountants and business owners alike. These innovations, coupled with next generation knowledge and customer support tools, will further deliver exceptional customer service while reducing per user service delivery costs.

The Company was proud to win an international customer service award for its innovative support model. A proactive focus on education encourages self learning and any issues are lodged through the application and routed efficiently to expert Xero staff. Xero's high customer satisfaction ratings support Xero's view that this is a superior and more scalable approach to the inefficient transactional call centre model.

REGIONAL ACTIVITY

North America

Xero’s continued growth in New Zealand, Australia and the United Kingdom extended its leadership in cloud accounting, validating the Company’s business model and providing the leverageable experience to similarly scale in the United States. The United States is a significant and addressable opportunity with the majority of small businesses unserved by accounting software. Xero is well positioned to meet this need directly online and through its accounting partners.

As previously announced, our recent performance in the United States did not meet expectations resulting in the relocation of Ross Jenkins, Chief Financial Officer to the United States and appointment of three senior executives:

- John Forrester, VP of US Marketing – Forrester has more than 20 years of marketing experience from product and content to brand and digital with a mix of startup and corporate experience. Most recently John was VP Marketing at RingCentral.
- James Maiocco, GM of Business and Corporate Development (US/UK) – Maiocco joins Xero from Microsoft, where he led the investment and partnership efforts for Microsoft Ventures globally, bringing over 15 years experience in business and corporate development at SaaS-based, cloud-first technology companies.
- Angus Norton, Senior Vice President/Chief Product Officer – Norton joins Xero after 14 years of hi-tech experience in the United States. Most recently he was with Microsoft where he led product management for the entire Office business in the United States, and drove Microsoft’s successful transition to the Cloud with Office 365.

Over recent months the Company has seen strong indicators of future growth, including: expansion of the accounting partner channel driven largely by next generation accountants; positive customer feedback; positive reviews; and increased market influencer commentary. New channels are gaining traction as the Company builds strategic partnerships across key verticals, financial services and banks.

The online channel remains a key focus to reach the large unserved market of millions of small businesses not benefitting from accounting software. The Company is seeing improved metrics and is increasing investment in this area.

Australia

Xero is the leading online accounting provider in the competitive Australian market, doubling customer numbers over the last year. Momentum continues to build with Xero ranked as the most innovative company in Australia for 2014 by BRW and Inventium. Xerocon 2014 was the largest accounting technology event in Australia this year, with over 1,300 attendees. Over 1,500 accountants and bookkeepers attended the most recent national roadshows and Xero is now a nationally recognised brand working with Government, Telstra and developing strategic partnerships with major financial institutions.

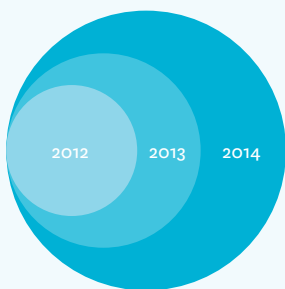
United Kingdom

Xero has doubled its customer base for the sixth consecutive year and is now the number one cloud accounting application for small businesses. Xero has established a key strategic alliance with KPMG and now has direct bank feeds with RBS, NatWest, HSBC and Silicon Valley Bank. A priority remains to secure technical and commercial relationships with the remaining banks. The overall team has grown from 45 to 98 and the brand is now firmly established with the accounting profession in preparation for the peak selling season in February/March 2015. The introduction of integrated payroll in 2015 is expected to drive further growth.

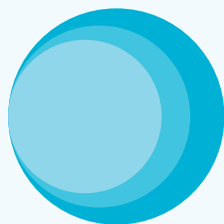
New Zealand

The New Zealand market is seeing the effects of achieving scale with over 20% of small businesses using Xero. The visibility of seeing \$65 billion of transactions on the platform over the last 12 months is creating unique insights into how small business drives the economy. The focus is now on getting entire accounting practices and their customers on the Xero platform and connecting small businesses with large enterprises, financial institutions, and government. New services, such as integrated payroll in 2015, will increase revenue per customer.

Regional revenue growth



Australia



New Zealand



United Kingdom



North America



Rest of World

Performance highlights

6 months ended 30 September	2014	2013	% Increase
Total operating revenue	\$54.3m	\$30.3m	79%
Net loss after tax	(\$24.5m)	(\$17.1m)	43%
At 30 September	2014	2013	
Cash and cash equivalents	\$170.8m	\$55.3m	209%
Paying customers	371,000	211,000	76%

OUTLOOK

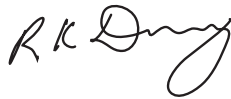
The small business segment presents a massive opportunity that can support extended high growth rates for many years.

The Company expects to continue its strong growth, providing guidance of approximately 80% subscription revenue growth on a constant dollar basis for the full year to 31 March 2015 with operating losses for the rest of the year as it continues to invest. The Company is focused on building a high-margin business as it achieves scale.

With cash reserves at 30 September 2014 of \$170.8 million the Board is continuing to follow a growth agenda focussed on creating longer term shareholder value.



Chris Liddell
Chairman



Rod Drury
Chief Executive

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of Xero's financial condition and results of operations together with the consolidated financial statements and the related notes in this report. Some of the information contained in this discussion and analysis includes information with respect to the plans and strategy for the business, and includes forward-looking statements that involve risks and uncertainties. Actual results and the timing of certain events may differ materially from future results expressed or implied by the forward-looking statements contained in the following discussion and analysis.

COMPONENTS OF RESULTS OF OPERATIONS

Subscription and other operating revenue

Xero's main revenue source is recurring monthly fees from customers who subscribe to its online accounting software services. Within a subscription, customers also receive support services, data backup and recovery, along with system upgrades.

The quantum of subscription revenue is driven by the number of customers and the services subscribed which determines the monthly amount payable by the customer. A range of online accounting software services can be accessed through the partner channel (accountants, bookkeepers and similar) or directly from the online channel, with pricing dependent on the functionality required.

Operating revenue also includes other operating revenue from related services such as education and the implementation of the online accounting software services, along with conference income. However, subscription revenue comprises around 95% of operating revenue.

Overhead allocation

The costs associated with Xero's facilities, internal IT and non-product related depreciation and amortisation are allocated to the cost of revenues, sales and marketing, product design and development, and general and administration based on headcount. Recruitment costs are allocated based on the number of employees hired during the period.

The total headcount at 30 September within facilities, internal IT and recruitment was 79 for 2014 and 47 for 2013. All costs associated with these employees are allocated as outlined, but the headcount is not recorded against the relevant function in the tables provided below.

Cost of revenues

Cost of revenues consists of expenses directly associated with securely hosting Xero's services, sourcing relevant customer data from banks and providing support to customers. The costs include hosting and content distribution costs, bank feed costs, personnel and related expenses (including salaries, benefits, bonuses and share-based compensation) directly associated with cloud infrastructure and customer support, contracted third-party vendor costs, related depreciation and amortisation, and allocated overheads.

Sales and marketing

Sales and marketing expenses consist of personnel and related expenses (including salaries, benefits, bonuses, commissions and share-based compensation) directly associated with sales and marketing teams, the costs of the education department, and costs in the implementation of our subscription services. Other costs included are external advertising, marketing costs and promotional events, including Xerocon conferences and roadshows, as well as allocated overheads.

Product design and development

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

Under New Zealand equivalents to International Financial Reporting Standards, the proportion of product design and development expenses that creates a benefit in future periods is capitalisable as an intangible asset and is then amortised to the Income Statement over the estimated life of the asset created. The amount amortised is included as a product design and development expense.

General and administration

General and administration expenses consist of personnel and related expenses (including salaries, benefits, bonuses and share-based compensation) for our executive, finance, billing, legal, human resources and administrative employees. It also includes legal, accounting and other professional services fees, insurance premiums, other corporate expenses and allocated overhead.

HEADCOUNT

Headcount at 30 September 2014 and 2013 is summarised as follows:

At 30 September	2014	2013	% change
Cost of revenues	175	116	51%
Sales and marketing	300	195	54%
Product design and development	373	186	101%
General and administration	66	40	65%
Overhead	79	47	68%
Total	993	584	70%

In the last 12 months headcount has increased by 409, or 70%, taking total headcount to 993. The largest increase was in product design and development, which more than doubled to 373 representing 38% of total headcount.

BUSINESS RESULTS

The consolidated performance of Xero Limited for the six months ended 30 September 2014 and 2013 is summarised as follows:

Six months ended 30 September	2014 (\$000s)	2013 (\$000s)	% change
Subscription revenue	51,973	28,110	85%
Other operating revenue	2,322	2,214	5%
Total operating revenue	54,295	30,324	79%
Other income	1,480	713	108%
Total revenue and other income	55,775	31,037	80%
Cost of revenues	18,016	10,112	78%
Gross profit	37,759	20,925	80%
<i>Percentage of operating revenue</i>	70%	69%	
Total operating expenses	65,679	38,225	72%
<i>Percentage of operating revenue</i>	121%	126%	
Operating deficit	(27,920)	(17,300)	61%
<i>Percentage of operating revenue</i>	-51%	-57%	
Net loss after tax	(24,471)	(17,145)	43%
<i>Percentage of operating revenue</i>	-45%	-57%	

The strong growth in operating revenue has been driven by customer growth in all markets. The total operating expenses and the net loss after tax have increased as Xero continued to invest in scaling its global business and delivering significant revenue growth.

The net cash outflow from operating and investing activities for the six months was \$39.9 million. In a SaaS business a significant portion of the cash outflow during a period will drive revenue in future periods. In particular, the sales and marketing costs of \$38.3 million will deliver subscription revenue over the life of each customer acquired.

OPERATING REVENUE

Six months ended 30 September	2014 (\$000s)	2013 (\$000s)	% change
Subscription revenue	51,973	28,110	85%
Other operating revenue	2,322	2,214	5%
Total operating revenue	54,295	30,324	79%

The 85% increase in subscription revenue during the six month period was primarily driven by the increase in customers from 211,000 at 30 September 2013 to 371,000 at 30 September 2014, an increase of 76%. An increase in the average revenue per user (ARPU) was a lesser factor in subscription revenue growth. ARPU increased due to strength in the online channel (which has a higher ARPU than the partner channel) and price changes effective in periods subsequent to 30 September 2013. Foreign exchange rates adversely affected revenue given the strength of the New Zealand Dollar compared with the previous period.

With a market share of less than 10% in the major markets outside New Zealand, Xero expects strong revenue growth to continue for the foreseeable future.

OPERATING REVENUE – CONSTANT CURRENCY

As more than 70% of operating revenue is denominated in foreign currencies, the strong New Zealand dollar during the period adversely affected reported revenue. On a constant currency basis, Xero grew operating revenue by 85% and subscription revenue by 91% during the period.

Six months ended 30 September	2014 (\$000s)	2013 (\$000s)	% change
Subscription revenue – constant currency	53,804	28,110	91%
Operating revenue – constant currency	56,186	30,324	85%

This analysis is a non-GAAP financial measure, which has been provided to assist in understanding and assessing the Company's financial performance during the year, excluding the impact of foreign currency fluctuations. The constant dollar revenue translates revenue for the period ended 30 September 2014 at the effective exchange rates used for the period ended 30 September 2013.

CUSTOMER NUMBERS

At 30 September	2014	2013	% change
Australia	158,000	79,000	100%
New Zealand	119,000	86,000	38%
United Kingdom	61,000	30,000	103%
North America	22,000	10,000	120%
Rest of World	11,000	6,000	83%
Total paying customers	371,000	211,000	76%

The total customers at 30 September 2014 grew by 160,000 or 76% to 371,000 with nearly 50% of the growth in Australia. This strong performance was complemented by 103% growth in United Kingdom and 38% growth in New Zealand. North America grew by 120% with further developments in that market continuing to strengthen the platform for growth.

ANNUALISED COMMITTED MONTHLY REVENUE AND ARPU

Annualised committed monthly revenue (ACMR) represents monthly recurring revenue as at 30 September, multiplied by 12. Accordingly, it provides a twelve month view on revenue assuming any promotions have ended and other factors such as customers, pricing and foreign exchange remain unchanged during the period.

Six months ended 30 September	2014 ACMR (\$000s)	2014 ARPU Actual*	2014 ARPU Constant FX**	2013 ACMR (\$000s)	2013 ARPU Actual*	ACMR % change
Australia	63,931	33.7	33.8	30,243	31.9	111%
New Zealand	34,003	23.8	23.8	23,915	23.2	42%
United Kingdom	20,881	28.5	26.6	10,163	28.2	105%
North America	8,250	31.3	29.3	3,717	31.0	122%
Rest of World	5,212	39.5	37.1	2,573	35.7	103%
Total	132,277	29.7	29.3	70,611	27.9	87%

* ARPU (average revenue per user) based on annualised committed monthly revenue and closing customers.

** ARPU applying foreign exchange rates applicable in the calculation of ARPU as at 30 September 2013.

Foreign exchange affects the comparability of ACMR and ARPU. To assist comparability, ARPU at 30 September 2014 is also presented using 30 September 2013 exchange rates.

The strong growth in ACMR across all regions is, as previously outlined, largely driven by customer growth with an increase in ARPU a factor but to a lesser degree. The following is noted when comparing 'ARPU Constant FX' as at 30 September 2014 with ARPU as at 30 September 2013:

- ARPU for Australia has increased by 6% due to a strong performance in the online channel (which has a higher ARPU than the partner channel) and price increases that were effective in periods subsequent to 30 September 2013.
- ARPU for New Zealand has increased slightly, due to a simplification of the pricing structure, which saw prices adjusted by a minimal amount.
- ARPU for United Kingdom has decreased due to lower ARPU products forming a greater proportion of total product subscriptions. A significant factor leading to this was the strategic alliance with KPMG under which it acquired 4,000 lower ARPU subscriptions.
- ARPU for North America has decreased slightly due to changes in the product mix with the main impact due to a reduction of WorkflowMax products as a proportion of total product subscriptions.
- ARPU for Rest of World has increased due to the simplification of the pricing structure, which saw prices adjusted by a minimal amount.

As Xero's product offering broadens with new features, it is expected that ARPU will increase, particularly in markets where Xero is more established.

COST OF REVENUES

Six months ended 30 September	2014 (\$000s)	2013 (\$000s)	% change
Cost of revenues	18,016	10,112	78%
Percent of operating revenue	33%	33%	

At 30 September	2014	2013	% change
Headcount	175	116	51%

The cost of revenues increased by \$7.9 million or 78% to \$18.0 million for the half year ended 30 September 2014. This increase is driven by customer growth which generates additional hosting costs, headcount requirements and bank feed costs. Incremental hosting costs of \$1.4 million were also incurred during the period upon implementing a significantly enhanced data protection system.

When measured as a percentage of operating revenue, the cost of revenues has remained constant compared with the previous period despite the incremental data protection costs (cost of revenues would be 31% of operating revenue if these costs had not been incurred).

A number of work programmes have been initiated to drive efficiencies in this area, while continuing to increase service robustness and performance. It is expected that the cost of revenues will reduce significantly as a percentage of operating revenue thereby increasing the gross margin. The aspirational target for the gross margin percentage is 80%.

SALES AND MARKETING

Six months ended 30 September	2014 (\$000s)	2013 (\$000s)	% change
Sales and marketing	38,329	24,448	57%
<i>Percent of operating revenue</i>	71%	81%	
At 30 September			
Headcount	300	195	54%

Sales and marketing costs increased by \$13.9 million or 57% to \$38.3 million for the half year ended 30 September 2014. The increase partly related to employee costs increasing by \$7.2 million compared to the previous period due to increased headcount. The remaining increase is due to incremental marketing activity across all segments compared to the previous period, particularly in North America, Australia and the United Kingdom.

Sales and marketing costs will increase in absolute terms as Xero continues to accelerate growth. However, these costs are expected to continue to decrease as a percentage of operating revenue in future periods.

PRODUCT DESIGN AND DEVELOPMENT

Six months ended 30 September	2014 (\$000s)	2013 (\$000s)	% change
Total product design and development costs (including capitalised development costs)	26,648	15,889	68%
<i>Percent of operating revenue</i>	49%	52%	
Less capitalised development costs	(12,848)	(9,688)	33%
Product design and development expenses excluding amortisation of capitalised development costs	13,800	6,201	123%
Add amortisation of capitalised development costs	4,706	2,469	91%
Product design and development expense	18,506	8,670	113%
<i>Percentage of operating revenue</i>	34%	29%	
At 30 September			
Headcount	373	186	101%

The total product design and development expenses were \$26.6 million for the period ended 30 September 2014, \$10.8 million higher than in the previous period. Of this, \$12.8 million was capitalised, with the balance of \$13.8 million included as an expense in the Income Statement. The amortisation of product design and development expenditure capitalised in prior periods of \$4.7 million was also included as an expense in the Income Statement, giving a total expense for the period of \$18.5 million.

The increase in total costs was driven by a 101% growth in the product design and development headcount, increasing personnel expenditure by \$9.5 million to \$19.4 million and resulting in an increase of allocated overheads. This reflects the ongoing commitment to product innovation. A decrease in the overall capitalisation rate resulted in an increase in the Income Statement expense as a percentage of operating revenue.

Product design and development costs will increase in absolute dollar terms. However they are expected to remain constant or reduce slightly as a percentage of operating revenue in the short term as Xero continues to deliver innovation.

GENERAL AND ADMINISTRATION

Six months ended 30 September	2014 (\$000s)	2013 (\$000s)	% change
General and administration	8,844	5,107	73%
Percentage of operating revenue	16%	17%	

At 30 September	2014	2013	% change
Headcount	66	40	65%

The general and administration costs were \$8.8 million for the period ended 30 September 2014, \$3.7 million higher than in the previous period. This increase was due to higher personnel related expenses of \$1.8 million as headcount increased by 65%, and general increases in costs as the Company continues to grow. These increases ensure there are sufficient resources to support the business as it continues to scale rapidly and to deliver key projects which will provide significant value to the business in coming periods.

General and administration costs reduced to 16% of operating revenue from 17% in the previous period. These costs will increase in absolute dollar terms but are expected to continue to decline as a percentage of operating revenue.

OTHER INCOME AND INTEREST INCOME

Six months ended 30 September	2014 (\$000s)	2013 (\$000s)	% change
Government grant income	1,285	713	80%
Rent income	195	-	NM*
Total other income	1,480	713	108%
Interest income	4,128	1,209	241%

*NM stands for not meaningful.

Government grants are receivable from Callaghan Innovation relating to Xero's research and development investment. Grant income for the period ended 30 September 2014 was \$1.3 million, which was 80% higher than the previous period due to an increase in qualifying costs incurred during the year.

The interest income for the period ended 30 September 2014 was \$4.1 million, an increase of \$2.9 million or 241% on the previous period due to higher cash balances following the \$180 million capital raise in October 2013 and higher interest rates.

SEGMENT INFORMATION

	Australia (\$000s)	New Zealand (\$000s)	United Kingdom (\$000s)	North America (\$000s)	Rest of World (\$000s)	Corporate (\$000s)	Total (\$000s)
Six months ended 30 September 2014							
Operating revenue, other income and interest income	25,561	15,277	8,294	3,260	1,998	5,513	59,903
Cost of revenues	(8,292)	(5,235)	(2,764)	(1,036)	(689)	-	(18,016)
Sales and marketing	(14,800)	(3,688)	(8,014)	(11,216)	(611)	-	(38,329)
Other expenses	-	-	-	-	-	(27,350)	(27,350)
Segment contribution	2,469	6,354	(2,484)	(8,992)	698	(21,837)	(23,792)

**Six months ended
30 September 2013**

Operating revenue, other income and interest income	12,346	10,816	4,447	1,522	1,099	2,016	32,246
Cost of revenues	(3,980)	(3,820)	(1,456)	(464)	(392)	-	(10,112)
Sales and marketing	(9,838)	(2,371)	(3,161)	(8,755)	(323)	-	(24,448)
Other expenses	-	-	-	-	-	(13,777)	(13,777)
Segment contribution	(1,472)	4,625	(170)	(7,697)	384	(11,761)	(16,091)

Subscription and other revenue is allocated to each country based on where the paying customers reside. The cost of revenues and sales and marketing costs include direct in-country costs along with an allocation of centrally managed costs and overheads.

Revenue for Corporate comprises interest and grant income. All costs related to product design and development and general and administration costs are recognised in Corporate.

Australia – Doubling customer numbers was the key driver for the 116% increase in subscription revenue (or 107% increase in total revenue) compared with the six months ended 30 September 2013. Higher ARPU due to a strong performance in the online channel and price changes also supported revenue growth. This is against a 50% increase in sales and marketing costs which totaled \$14.8 million for the period. This investment will continue to drive higher contributions in future periods.

New Zealand – The increased contribution reflects the ability to build a highly profitable model. As the partner channel matures revenue will continue to grow faster than sales and marketing costs.

United Kingdom – The increased investment in sales and marketing activities reflects the focus on further accelerating subscription revenue growth as Xero takes advantage of its online accounting leadership position in this market. This investment not only supported the significant revenue growth during the current period but will continue to drive improved contributions in future periods.

North America – Xero did not execute to plan during the period. Key leadership changes are being made in the region and Xero expects to accelerate growth over future periods.

KEY SaaS METRICS

The table below outlines key metrics across the markets Xero operates in. The metrics are less relevant or insightful in early stage markets such as North America.

	Australia	New Zealand	United Kingdom	North America	Rest of World	Total
At 30 September 2014						
ARPU (\$)	33.7	23.8	28.5	31.3	39.5	29.7
CAC months	8.2	6.5	11.4	36.1	3.7	11.4
Customer churn (monthly)	1.1%	0.9%	1.2%	4.2%	2.0%	1.3%
Life-time value (\$)	2,011	1,768	1,539	498	1,300	1,554
Life-time value/CAC	7.3	11.4	4.7	0.4	8.8	4.6
At 30 September 2013						
ARPU (\$)	31.9	23.2	28.2	31.0	35.7	27.9
CAC months	8.1	5.7	9.8	38.8	2.8	10.3
Customer churn (monthly)	1.8%	1.4%	1.8%	3.9%	2.3%	1.7%
Life-time value (\$)	1,170	1,103	1,063	552	1,000	1,095
Life-time value/CAC	4.5	8.4	3.8	0.5	10.1	3.8

ARPU is, as previously outlined, calculated as annualised committed monthly revenue at 30 September divided by customers at that time. Comments are provided on ARPU under "Annualised Committed Monthly Revenue and ARPU".

CAC months or months of ARPU to recover CAC ("cost of acquiring customers") represents the number of months of revenue required to recover the cost of acquiring each new customer. The calculation is sales and marketing costs for the twelve months to 30 September divided by new customers added during the same period, divided by monthly ARPU. This metric is best viewed over a twelve month period due to the seasonality of the business.

CAC months for the Group increased from 10.3 to 11.4 months given the ongoing focus on accelerating growth through sales and marketing activities. Excluding North America, CAC months for the Group at 30 September 2014 reduces to 8.5 months.

Australia and New Zealand CAC months increased slightly as activities were undertaken to further build brand and develop new future revenue streams via connections to enterprise and Government. Benefits from these activities are expected to be ongoing. This metric should not increase materially for these segments during the second half of the financial year.

United Kingdom CAC months increased due to incremental investment during the period. This reflects the market size and stage with Xero continuing to solidify its leadership position. This metric may increase slightly during the next six months as investment continues.

Metrics such as CAC months are currently not considered relevant in the North American market. This market is still at very early stages with Xero applying appropriate resources to build the platform toward future growth.

Customer churn is the number of customers who leave Xero in a month as a percentage of the total customers at the start of that month. The percentage provided is the average of the monthly churn for the twelve months to 30 September for each year.

There has been a significant improvement in customer churn rates in New Zealand, Australia and United Kingdom which reflects the ability to create "stickiness" where Xero has a longer term presence and greater product awareness in the market. The comparatively high churn rate in North America is not unexpected given the stage of the market and is in line with other markets at the same time.

Lifetime value is the gross margin expected from a customer over the lifetime of that customer. This is calculated by taking the average customer lifetime (1 divided by customer churn) multiplied by ARPU multiplied by the percentage of gross margin.

Once again the established markets being New Zealand, Australia and United Kingdom reflect improvement in this metric to 30 September 2014 which is driven by lower churn rates and an increase in ARPU as previously outlined. This metric currently provides little insight for North America given the early market stage.

Lifetime value/CAC is the ratio between the gross margin derived over the life of a customer and the cost to acquire that customer, e.g. the gross margin derived from a customer in New Zealand is currently on average 11.4 times the cost of acquiring that customer. This is an additional measure of sales and marketing efficiency, with industry commentators suggesting a ratio of over 3 is satisfactory.

INDEPENDENT REVIEW REPORT

To the shareholders of Xero Limited

Report on the Interim Financial Statements

We have reviewed the accompanying financial statements of Xero Limited ("the Company") and the entities it controlled at 30 September 2014 or from time to time during the period ("the Group"), which comprise the condensed Statement of Financial Position as at 30 September 2014, and the condensed Income Statement, the condensed Statement of Comprehensive Income, the condensed Statement of Changes in Equity and the condensed Statement of Cash Flows for the period ended on that date, and a summary of significant accounting policies and selected explanatory notes.

Directors' Responsibility for the Financial Statements

The Directors of the Company are responsible for the preparation and fair presentation of these financial statements in accordance with the New Zealand Equivalent to International Accounting Standard 34 Interim Financial Reporting ("NZ IAS 34") and for such internal controls as the Directors determine are necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

Our Responsibility

Our responsibility is to express a conclusion on the accompanying financial statements based on our review. We conducted our review in accordance with the New Zealand Standard on Review Engagements 2410 Review of Financial Statements Performed by the Independent Auditor of the Entity (NZ SRE 2410). NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements, taken as a whole, are not prepared in all material respects, in accordance with the NZ IAS 34. As the auditors of the Company, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.

A review of financial statements in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand). Accordingly we do not express an audit opinion on these financial statements.

Other than in our capacity as assurance practitioner and providers of assurance, taxation and other services we have no relationship with, or interests in, Xero Limited. These services have not impaired our independence.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that these financial statements of the Group are not prepared, in all material respects, in accordance with NZ IAS 34.

Restriction on Use of Our Report

This report is made solely to the Company's shareholders as a body. Our review work has been undertaken so that we might state to the Company's shareholders those matters which we are required to state to them in our 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 shareholders, as a body, for our review procedures, for this report, or for the conclusion we have formed.



Chartered Accountants

Wellington, New Zealand
20 November 2014

XERO LIMITED – INCOME STATEMENT – FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2014			
		6 months 2014 Unaudited (\$000s)	6 months 2013 Unaudited (\$000s)
Subscription revenue		51,973	28,110
Other operating revenue		2,322	2,214
Total operating revenue		54,295	30,324
Other income		1,480	713
Total revenue and other income		55,775	31,037
Cost of revenues		18,016	10,112
Gross profit		37,759	20,925
<i>Operating expenses</i>			
Sales and marketing		38,329	24,448
Product design and development		18,506	8,670
General and administration		8,844	5,107
Total operating expenses		65,679	38,225
Operating deficit		(27,920)	(17,300)
Interest income		4,128	1,209
Net loss before tax		(23,792)	(16,091)
Income tax expense		(679)	(263)
Net loss from continuing operations		(24,471)	(16,354)
Net loss from discontinued operations		-	(791)
Net loss after tax for the period attributable to the shareholders of the Company		(24,471)	(17,145)
<i>Earnings per share</i>			
Basic and diluted loss per share		(\$0.19)	(\$0.14)

XERO LIMITED – STATEMENT OF COMPREHENSIVE INCOME – FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2014			
		6 months 2014 Unaudited (\$000s)	6 months 2013 Unaudited (\$000s)
Net loss after tax		(24,471)	(17,145)
Other comprehensive income*			
Movement in cash flow hedges	6	2,089	-
Exchange difference on translation of international subsidiaries		71	-
Total other comprehensive income for the period, net of tax		2,160	-
Total comprehensive loss for the period attributable to the shareholders of the Company		(22,311)	(17,145)

* Items of other comprehensive income may be reclassified to the Income Statement.
The accompanying notes form an integral part of these financial statements.

XERO LIMITED – STATEMENT OF CHANGES IN EQUITY – FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2014

	Share capital (\$000s)	Treasury stock (\$000s)	Share-based payment reserve (\$000s)	Accumulated losses (\$000s)	Foreign currency translation reserve (\$000s)	Cash flow hedging reserve (\$000s)	Total equity (\$000s)
Unaudited							
Balance as at 1 April 2014	341,436	(5,128)	4,682	(85,940)	(112)	-	254,938
Net loss after tax	-	-	-	(24,471)	-	-	(24,471)
Other comprehensive income	-	-	-	-	71	2,089	2,160
Total comprehensive loss	-	-	-	(24,471)	71	2,089	(22,311)
<i>Transactions with owners:</i>							
Issue of shares – employee restricted share plan	5,824	(5,824)	-	-	-	-	-
Accrual of share-based benefits	-	-	2,926	-	-	-	2,926
Vesting of shares – employee restricted share plan	-	154	(154)	-	-	-	-
Exercising of share options	463	-	(96)	-	-	-	367
Accrual for equity portion of purchase of Max Solutions Holdings Limited	-	-	222	-	-	-	222
Accrual for equity portion of purchase of Paycycle assets	-	-	84	-	-	-	84
Vesting of shares – purchase of Paycycle assets	-	431	(431)	-	-	-	-
Balance as at 30 September 2014	347,723	(10,367)	7,233	(110,411)	(41)	2,089	236,226
Unaudited							
Balance as at 1 April 2013	155,551	(5,529)	3,096	(50,394)	(72)	-	102,652
Net loss after tax	-	-	-	(17,145)	-	-	(17,145)
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive loss	-	-	-	(17,145)	-	-	(17,145)
<i>Transactions with owners:</i>							
Issue of shares – key management	1,550	-	-	-	-	-	1,550
Issue of shares – employee restricted share plan	3,418	(3,418)	-	-	-	-	-
Accrual of share-based benefits	-	-	1,531	-	-	-	1,531
Vesting of shares – employee restricted share plan	-	33	(33)	-	-	-	-
Exercising of share options	332	-	(64)	-	-	-	268
Accrual for equity portion of purchase of Max Solutions Holdings Limited	-	-	555	-	-	-	555
Accrual for equity portion of purchase of Paycycle assets	-	-	140	-	-	-	140
Vesting of shares – purchase of Paycycle assets	-	431	(431)	-	-	-	-
Balance as at 30 September 2013	160,851	(8,483)	4,794	(67,539)	(72)	-	89,551

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

XERO LIMITED – STATEMENT OF FINANCIAL POSITION – AS AT 30 SEPTEMBER 2014

	Notes	2014 Unaudited (\$'000s)	31 March 2014 Audited (\$'000s)
Assets			
<i>Current assets</i>			
Cash and cash equivalents		9,768	14,886
Short-term deposits		161,000	195,000
Trade and other receivables		19,528	14,374
Short-term derivative assets	6	3,456	-
Total current assets		193,752	224,260
<i>Non-current assets</i>			
Property, plant and equipment	5	14,369	9,856
Intangible assets	5	45,575	34,828
Deferred tax benefit		968	486
Other receivables		3,011	2,371
Total non-current assets		63,923	47,541
Total assets		257,675	271,801
Liabilities			
<i>Current liabilities</i>			
Trade and other payables		9,056	7,105
Employee entitlements		10,311	9,026
Income tax payable		715	732
Short-term derivative liabilities	6	554	-
Total current liabilities		20,636	16,863
<i>Non-current liabilities</i>			
Deferred tax liability		813	-
Total non-current liabilities		813	-
Total liabilities		21,449	16,863
Equity			
Share capital	8	337,356	336,308
Share based payment reserve		7,233	4,682
Accumulated losses		(110,411)	(85,940)
Foreign currency translation reserve		(41)	(112)
Cash flow hedging reserve		2,089	-
Total equity		236,226	254,938
Total liabilities and shareholders equity		257,675	271,801

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

XERO LIMITED – STATEMENT OF CASH FLOWS – FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2014

	6 months 2014 Unaudited (\$000s)	6 months 2013 Unaudited (\$000s)
Note		
Operating activities		
<i>Cash was provided from/(applied to):</i>		
Receipts from customers	51,373	28,729
Other income	402	481
Interest received	5,151	1,166
Payments to suppliers and employees	(74,137)	(39,119)
Income tax paid	(695)	(136)
Net cash flows from operating activities	9	(8,879)
Investing activities		
<i>Cash was applied to:</i>		
Purchase of property, plant and equipment	(6,168)	(2,524)
Capitalised development costs	(15,050)	(10,582)
Intangible assets	(190)	(26)
Rental bonds	(598)	(822)
Net cash flows from investing activities	(22,006)	(13,954)
Financing activities		
<i>Cash was provided from/(applied to):</i>		
Exercising of share options	367	-
Payments for short-term deposits	(253,000)	(31,300)
Proceeds from short-term deposits	287,000	66,050
Net cash flows from financing activities	34,367	34,750
Net increase/(decrease) in cash and cash equivalents held	(5,545)	11,917
Foreign currency translation adjustment	427	(79)
Cash and cash equivalents at the beginning of the period	14,886	6,194
Cash and cash equivalents at the end of the period	9,768	18,032

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

NOTES TO THE CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION

These unaudited consolidated condensed interim financial statements of Xero Limited ('the Company') and its subsidiaries (together 'the Group') have been prepared in accordance with New Zealand Generally Accepted Accounting Practice and comply with the requirements of the New Zealand Equivalent to International Accounting Standard 34: Interim Financial Reporting. The Company is a profit oriented entity.

The unaudited consolidated condensed interim financial statements of the Group have been prepared in accordance with the requirements of the Financial Reporting Act 2013 and the Companies Act 1993. Xero Limited is registered under the Companies Act 1993 and will become a FMC Reporting Entity under the Financial Markets Conduct Act 2013 on 1 December 2014.

2. ACCOUNTING POLICIES

Apart from the changes noted below, the unaudited consolidated condensed interim financial statements of the Group for the six months ended 30 September 2014 have been prepared using the same accounting policies and methods of computation as, and should be read in conjunction with, the financial statements and related notes included in the Group's Annual Report for the year ended 31 March 2014.

Xero has elected to change the definition of cash and cash equivalents to include bank account balances and term deposits with original maturities of 90 days or less. Term deposits with original maturities of greater than 90 days that mature within one year are presented in the Statement of Financial Position as short-term deposits. The comparative Statement of Financial Position has been re-presented with \$195.0 million as at 31 March 2014 transferred from cash and cash equivalents to short-term deposits. The comparative Statement of Cash Flows has also been re-presented to reflect this change.

The changes below were enacted in Xero's annual report for the year ended 31 March 2014 and affect the comparative Income Statement and comparative segment results.

Xero has changed how expenses are presented in the Income Statement from a nature view to a function view. The comparative Income Statement and comparative segment results for the six months ended 30 September 2013 have been reclassified, with operating expenses of \$48.3 million for the Group reclassified into cost of revenues, sales and marketing, product design and development and general and administration. There is no change to the total reported loss as a result of this change.

Xero has re-presented its comparative segment results to separate the North American operations previously aggregated with the Rest of World segment. This change reflects the growing importance of North America to the Group's operations and changes to management accountabilities during the period. There is no change to the overall Group reported loss as a result of these changes.

The same significant judgements, estimates and assumptions included in the notes to the financial statements in the Group's Annual Report for the year ended 31 March 2014 have been applied to these consolidated condensed interim financial statements.

3. SEGMENT INFORMATION

As noted in note 2, the comparative segment results have been reclassified to present expenses by function. There is no change to the total Group reported loss as a result of this change.

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

Xero has five operating segments based on geographical locations. These segments have been determined based on reports reviewed by the Global Executive team (the chief operating decision maker).

Segment operating expenses represent sales and marketing costs and service delivery costs including both in-country and an allocation of centrally managed costs. Operating expenses for Corporate represent all product design and development and general and administration expenses.

Unaudited	Australia (\$000s)	New Zealand (\$000s)	United Kingdom (\$000s)	North America (\$000s)	Rest of World (\$000s)	Corporate (\$000s)	Total (\$000s)
<i>For the six months ended 30 September 2014</i>							
Subscription revenue	23,919	15,102	7,974	2,990	1,988	-	51,973
Other operating revenue	1,642	175	320	75	10	100	2,322
Other income	-	-	-	195	-	1,285	1,480
Interest income	-	-	-	-	-	4,128	4,128
Total	25,561	15,277	8,294	3,260	1,998	5,513	59,903
Cost of revenues	(8,292)	(5,235)	(2,764)	(1,036)	(689)	-	(18,016)
Sales and marketing	(14,800)	(3,688)	(8,014)	(11,216)	(611)	-	(38,329)
Product design and development	-	-	-	-	-	(18,506)	(18,506)
General and administration	-	-	-	-	-	(8,844)	(8,844)
Total expenses	(23,092)	(8,923)	(10,778)	(12,252)	(1,300)	(27,350)	(83,695)
Segment contribution	2,469	6,354	(2,484)	(8,992)	698	(21,837)	(23,792)
<i>For the six months ended 30 September 2013</i>							
Subscription revenue	11,065	10,619	4,048	1,290	1,088	-	28,110
Other operating revenue	1,281	197	399	232	11	94	2,214
Other income	-	-	-	-	-	713	713
Interest income	-	-	-	-	-	1,209	1,209
Total	12,346	10,816	4,447	1,522	1,099	2,016	32,246
Cost of revenues	(3,980)	(3,820)	(1,456)	(464)	(392)	-	(10,112)
Sales and marketing	(9,838)	(2,371)	(3,161)	(8,755)	(323)	-	(24,448)
Product design and development	-	-	-	-	-	(8,670)	(8,670)
General and administration	-	-	-	-	-	(5,107)	(5,107)
Total expenses	(13,818)	(6,191)	(4,617)	(9,219)	(715)	(13,777)	(48,337)
Segment contribution	(1,472)	4,625	(170)	(7,697)	384	(11,761)	(16,091)

4. COST OF REVENUES AND OPERATING EXPENSES

For the six months ended 30 September	2014 Unaudited (\$000s)	2013 Unaudited (\$000s)
Employee entitlements	47,448	27,667
Employee entitlements – share-based payments	4,987	2,350
Employee entitlements capitalised	(13,286)	(8,890)
IT infrastructure costs	8,203	5,103
Advertising and marketing	11,001	7,686
Consulting and subcontracting	3,111	1,725
Lease/rental	3,669	1,763
Travel related	2,649	1,523
Communication and office administration	1,541	1,132
Staff recruitment	1,621	1,036
Superannuation costs	1,686	783
Loss/(gain) on foreign exchange transactions	(768)	259
Directors' fees	241	125
Other operating expenses	3,879	2,347
Total cost of revenues and operating expenses excl. depreciation and amortisation	75,982	44,609

Depreciation and amortisation

Relating to:

Amortisation of development costs	5,772	2,707
Amortisation of other intangible assets	156	126
Depreciation of property, plant and equipment	1,785	895
Total depreciation and amortisation	7,713	3,728
Total cost of revenues and operating expenses	83,695	48,337

Included in:

Cost of revenues	907	368
Sales and marketing expenses	906	430
Product design and development expenses	5,699	2,840
General and administration expenses	201	90
Total depreciation and amortisation	7,713	3,728

5. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

Additions to property, plant and equipment were \$6.8 million for the period, with \$4.7 million relating to office space fit-outs (six months ending 30 September 2013: \$2.2 million, \$1.4 million).

\$16.5 million of software development costs were capitalised during the period (six months ending 30 September 2013: \$11.0 million).

6. HEDGE ACCOUNTING

Xero is exposed to currency risk from the operations of foreign subsidiaries and foreign currency denominated expenses in the Parent company. The significant exposures are United States dollar ('USD') outflows and Australian dollar ('AUD') inflows.

During the period Xero began using derivatives in the form of forward exchange contracts (FEC's) to reduce the risk that movements in the exchange rate will affect Xero's New Zealand dollar ('NZD') cash flows. These hedges have been designated as a hedge of a highly probable forecast transaction (a cash flow hedge under NZ IAS 39: Financial instruments recognition and measurement). Xero's policy is to hedge a portion of the next twelve months forecast cash flows.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the Income Statement. Amounts accumulated in equity are reclassified to the Income Statement in the periods when the hedged transaction affects profit and loss.

During the period \$2.9 million (before taxation) was recognised in other comprehensive income and will be reclassified to the Income Statement over the next twelve months. A gain of \$7,000 was reclassified from equity to the Income Statement during the six months.

Hedge position at 30 September 2014:

Unaudited	Buy currency	Sell currency	Fair value (\$'000s)	Notional amount hedged (NZD) (\$'000s)
Short-term derivative assets	USD	NZD	3,456	40,356
Short-term derivative liabilities	NZD	AUD	(554)	10,597

7. FINANCIAL INSTRUMENTS AND FAIR VALUE

Xero's hedging derivatives are recognised at fair value. Fair values are calculated using forward exchange rates that are quoted in an active market (level 2 on the fair value hierarchy).

Xero's other financial instruments are carried at amortised cost. The carrying amounts of these assets and liabilities do not materially differ from their fair values.

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

8. SHARE CAPITAL**Movement in ordinary shares on issue**

	2014 Unaudited ('000s)	2013 Unaudited ('000s)
Balance as at 1 April	127,610	117,219
Issue of ordinary shares – employee restricted share plan	183	214
Issue of ordinary shares – exercising of share options	64	76
Issue of ordinary shares – loans to key management	–	97
Ordinary shares on issue at the end of the period	127,857	117,606
Treasury stock	(975)	(1,841)
Ordinary shares on issue at the end of the period	126,882	115,765
As at 30 September	2014	2013
Net tangible assets per share	\$1.49	\$0.54

All shares have been issued, are fully paid and have no par value.

During the period the Company issued 182,728 shares under the employee restricted share plan, at an average price of \$31.87.

During the period, 63,837 options were exercised under the share option scheme, with an average exercise price of \$5.75.

9. RECONCILIATION OF OPERATING CASH FLOWS

For the six months ended 30 September	2014 Unaudited (\$000s)	2013 Unaudited (\$000s)
<i>Reconciliation of net loss after tax to net cash from operating activities</i>		
Net loss after tax	(24,471)	(17,145)
<i>Adjustments:</i>		
Depreciation	1,785	895
Amortisation	5,928	2,833
Deferred tax	(482)	215
Loss/(gain) on foreign exchange transactions	(768)	259
Share-based employee entitlements	3,638	2,350
Bad debts	137	65
Discontinued operations	-	953
<i>Changes in working capital items:</i>		
(Increase)/decrease in trade receivables and prepayments	(5,608)	(2,862)
(Increase)/decrease in interest receivable	1,075	(36)
Increase/(decrease) in trade payables and accruals	1,544	2,504
Increase/(decrease) in current tax payable	(17)	343
Increase/(decrease) in employee entitlements	(697)	690
Increase/(decrease) in income in advance	30	57
Net cash flows from operating activities	(17,906)	(8,879)

10. COMMITMENTS AND CONTINGENCIES

There were capital commitments for building fit-outs of \$1,420,000 at 30 September 2014 (31 March 2014: \$158,000).

There were no contingent liabilities at 30 September 2014 (31 March 2014: Nil).

11. EVENTS AFTER BALANCE DATE

On 6 November Xero announced that it had acquired 100% of the shares in online payroll company Monchilla Inc. The consideration for the acquisition was cash of \$5.3 million and 238,490 shares. 50% of the shares will vest on 6 November 2016 if the owners of Monchilla remain employees of Xero. The acquisition will enable Xero to rapidly accelerate the extension of its payroll offering across North America.

There were no other significant events between balance date and the date on which these financial statements were authorised for issue that require disclosure in these interim financial statements.

REGISTERED OFFICE:

NEW ZEALAND
3 MARKET LANE
PO BOX 24 537
WELLINGTON 6011
NEW ZEALAND
TELEPHONE: +64 4 819 4800
FACSIMILE: +64 4 819 4801
AUSTRALIA
UNIT 1, 6 ELIZABETH STREET
HAWTHORN, VIC 3122
AUSTRALIA

NEW ZEALAND
COMPANY NUMBER: 183 0488
AUSTRALIAN REGISTERED
BODY NUMBER (ARBN):
160 661 183

DIRECTORS:

CHRIS LIDDELL
CHAIRMAN
ROD DRURY
CRAIG ELLIOTT
LEE HATTON
SAM MORGAN
GRAHAM SHAW
BILL VEGHTE
CRAIG WINKLER

MANAGEMENT:

ROD DRURY
CHIEF EXECUTIVE, CO-FOUNDER
ROSS JENKINS
CHIEF FINANCIAL OFFICER
DUNCAN RITCHIE
CHIEF PLATFORM OFFICER
STUART MCLEAN
CHIEF REVENUE OFFICER
ANDY LARK
CHIEF MARKETING OFFICER
CHRIS RIDD
MANAGING DIRECTOR
AUSTRALIA
VICTORIA CRONE
MANAGING DIRECTOR
NEW ZEALAND
GARY TURNER
MANAGING DIRECTOR
UNITED KINGDOM

COMPANY SECRETARY:

MATT VAUGHAN

AUDITOR:

PRICEWATERHOUSECOOPERS

LEGAL ADVISOR:

BELL GULLY

BANKERS:

ASB BANK LIMITED
BANK OF NEW ZEALAND LIMITED
HSBC LIMITED
NATIONAL AUSTRALIA BANK LIMITED
SILICON VALLEY BANK

SHARE REGISTRAR:

NEW ZEALAND
LINK MARKET SERVICES LIMITED
LEVEL 7, ZURICH HOUSE
21 QUEEN STREET
PO BOX 91 976, AUCKLAND 1142
TELEPHONE: +64 9 375 5998
FACSIMILE: +64 9 375 5990
AUSTRALIA
LINK MARKET SERVICES LIMITED
LEVEL 12, 680 GEORGE STREET
SYDNEY, NSW 2000
LOCKED BAG A14
SYDNEY SOUTH, NSW 1235
TELEPHONE: +61 1300 554 474
FACSIMILE: +61 2 9287 0303



Beautiful accounting software
www.xero.com