

July 28th 2021

Xero Ltd (XRO)

The company will hold its Annual Shareholders Meeting at **11.00am Thursday 12 August 2021**.

You can join the meeting at <https://agmlive.link/agm/xero2021/register>

Company Overview

The company was listed on the NZX in 2006 and subsequently moved its listing to the ASX. It is a provider of online accounting software to small business. It has 2.74 million subscribers; 1.12 million Australia, 466,000 New Zealand, 720,000 UK, 285,000 North America and 175,000 rest of the world.

Current Strategy

To be a leading supplier of online accounting software to small business.

Key

The following sections calculate an objective rating against criteria contained within NZSA policies.

Colour	Meaning
G	Strong adherence to NZSA policies
A	Part adherence or a lack of disclosure as to adherence with NZSA policies
R	A clear gap in expectations compared with NZSA policies
n/a	Not applicable for the company

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Governance

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Directors Fees	G	Good disclosure
Director share ownership	G	Good disclosure
Executive Remuneration	A	See comments below
Golden parachutes/handshakes	A	Not fully disclosed
Director Independence	G	Majority of independent and good disclosure
Board Composition	A	See comments below
Director Tenure	G	Good disclosure
ASM Format	R	See comments below
Company Sec independence	G	Good disclosure

Executive Remuneration: The remuneration report provided by XRO is more aligned to the level expected by ASX investors, with some good detail provided. NZSA appreciates the clear disclosures around incentive measures, targets and achievement.

It is unclear whether any golden parachutes or similar payments are offered, although the treatment of incentive awards in the event of termination is clearly disclosed.

Elements of the CEO Remuneration, while disclosed, are not aligned with NZSA's preferred approach – including an options-based long-term incentive (LTI) plan. We also note the relatively short vesting period – 1 year - for restricted share units (RSU's) issued as part of the short-term incentive (STI). We note that Xero has 'claw back' provisions for both vested and unvested options, "to ensure that no unfair benefit" is gained, although these provisions do not appear to be linked to performance.

Board Composition: The company does not disclose a skills matrix detailing each Directors' functional skills and their importance to the company, although we note a summary of the 'collective' skills of the Board is disclosed in the annual report. Given the status of XRO in both the NZ and Australian business community, NZSA feels that the XRO Board should consider participation in a 'future directors' programme to support emerging talent in either country.

ASM Format: The company is holding a virtual-only ASM. NZSA expects companies to hold hybrid meetings (ie, physical and virtual) to ensure as many shareholders as possible can attend while ensuring that the opportunity for direct contact between directors and the shareholders they represent is maximised.

In XRO's case, we appreciate that directors are geographically spread around the globe, while the opportunity for a physical meeting has also been impacted by the Covid-19 lockdowns in Australia. While this would not normally represent our policy position (hence the criteria rating in the table above), we understand and accept the requirement for a virtual meeting in these circumstances.

Audit

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Audit independence	G	Good disclosure
Audit rotation	A	See comments below.

Audit Rotation: The company ensures the Lead Audit Partner is rotated at 5 years but does not rotate the Audit Firm at 10 years. Like many other listed companies, Xero does not disclose the appointment date of the Audit Firm nor the Lead Audit Partner.

Ethical and Social

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Whistleblowing	G	Good disclosure
Political donations	G	No donations made.

NZSA appreciates the disclosures made in these areas. We note that XRO continues to be focused on ESG policies as both good business practice and ensuring it can continue to attract capital.

Financial & Performance

Policy Theme	Assessment	Notes
Dividends and Imputation	n/a	No dividend paid
Capital Raise process	A	See comments below

NZSA's current policy is focused around forms of capital raise that allow shareholders to participate on a pro-rata basis, to avoid dilution of holdings.

During the year, XRO issued US\$700m of convertible notes, issued at a (favourable) zero coupon rate. This is a less-common method of raising capital in Australia and New Zealand compared with other forms of capital raise.

Some of the proceeds were used to repay previously-issued convertible notes, which would have resulted in greater dilutionary impact to shareholders. Should the notes convert to equity, this will still result in shareholder dilution. In discussion, XRO noted to NZSA that the terms of conversion are such that dilution would be more than offset by total shareholder return.

Xero's share price rose from \$99.74 (adjusted to NZD) to \$151.60 (NZD) (as of July 26th) over the last 12 months – a 52% return. This compares favourably with the NZX50 which increased by 10% in the same period. The Performance Factor for XRO is 5.30.

XRO is a NZ-based, ASX-listed company. Its share price is listed in AUD, however its financials are all in NZD.

Metric	2021	2020	Change
Revenue	\$848.8m	\$718.2m	18%
NPAT	\$19.8m	\$3.3m	493%
EPS ¹	\$0.134	\$0.024	469%
PE Ratio	1134	4242	
Current Ratio	7.13	6.19	15%
Debt Equity (adjusted)	1.44	1.39	4%
Operating CF	\$218.6m	\$166.6m	31%
NTA Per Share ¹	\$1.77	\$0.56	214%
Equity Per Share ¹	\$5.04	\$2.98	69%

¹ per share figures based off actual shares at balance date (not weighted average)

Revenues increased by 18% to \$848.8m during the year, driven by 2.74 million subscribers (up by 456,000 vs previous). NPAT increased to \$19.8m

EPS similarly increased to \$0.134. The stock trades on extremely high PE multiples of 1,134 although reduced from 2020's 4,242. This implies that investors are continuing to expect spectacular earnings growth over many years.

Cashflow from operations was up 31% to \$218.6m. Of note when reconciling this to NPAT, amortisation accounts for \$104.6m.

NTA per share is \$1.77 - a substantial discount from its share price of \$151.60, reflecting investors expectations of continued growth and increased net cashflow.

Their debt levels are adequate with an adjusted debt equity ratio of 1.44, which may not leave much headroom for debt-funded acquisition. However, a high share price places XRO in a strong position to issue shares for potential acquisitions, as it has done in the past.

Resolutions

1. That the Board is authorised to fix the auditor's remuneration for the coming year.

This is an administrative resolution.

We will vote undirected proxies **IN FAVOUR** of this resolution.

2. to re-elect Dale Murray as an Independent Director.

Dale Murray was appointed to the Board in April 2018. She was co-founder of mobile pioneer Omega Logic in 1999. She is currently a Director of The Cranemere Group and LendInvest and a board advisor to Accelerate:Her.

We will vote undirected proxies **IN FAVOUR** of this resolution.

3. To elect Steven Aldrich as an Independent Director.

Steven Aldrich was appointed to the Board in October 2020 so is therefore required to offer himself for election. He is a Director of Blucora a provider of technology enabled financial solutions and Ruby Receptionists a virtual customer engagement solution provider. Prior to that he was chief products officer at GoDaddy the world's largest services platform for entrepreneurs.

We will vote undirected proxies **IN FAVOUR** of this resolution.

4. To increase the Directors Fee Pool by \$500,000 to \$2,700,000.

The current fee pool was approved by shareholders in 2019. The Board reviews the Fee Pool every two years. Full details of the increase are set out in the Notice of Meeting.

The Board has engaged Guerdon Associates to prepare an independent report but has not published the report. The reasons given are that the methodology used by Guerdon is their Intellectual Property (IP) so cannot be disclosed and that disclosure of independent reports is not common by Australian companies.

NZSA's concern is that not publishing an independent report is not aligned with the governance principles of disclosure and transparency. We feel that a fee increase proposal should be accompanied by a duty to the shareholders to provide independent evidence supporting the quantum of the increase being sought.

We have met with both the company and Guerdon Associates on this matter. The company has stated that the increase in fee pool is underpinned by a requirement for a future non-Australasian director. In our meeting with Guerdon Associates, while Guerdon re-iterated the confidentiality of their IP, they also stated that Xero may have had more options in terms of disclosing the comparator groups and the relationship of XRO's proposed fees within that group.

We therefore remain disappointed at the lack of detail made by XRO. The option of contacting the provider of an independent report to validate a proposal simply does not exist for most shareholders. Nonetheless, we believe the quantum of fee pool increase sought is appropriate

We will therefore vote undirected proxies **IN FAVOUR** of this resolution.

Proxies

You can vote online or appoint a proxy at <https://www.linkmarketservices.com.au/>

Instructions are on the Proxy/voting paper sent to you.

Voting and proxy appointments close **11.00am Tuesday 10 August 2021**.

Please note you can appoint the **Australian Shareholders Association as your proxy. They will have a representative attending the meeting on our behalf.**

STANDING PROXIES - AUTOMATICALLY APPOINT NZSA AS YOUR PROXY

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<http://www.nzshareholders.co.nz/shareholders-standing-proxies.cfm>



The Team at NZSA