

August 2nd 2024

Xero Limited



The company will hold its Annual Shareholders Meeting at **11.00am Thursday 22 August 2024**.

It will be a virtual -only meeting. You can join the meeting online [at this link](#).

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 over 4.2 million subscribers in over 180 countries with offices in Australia, New Zealand, UK, USA, Canada, Singapore, and South Africa.

Current Strategy

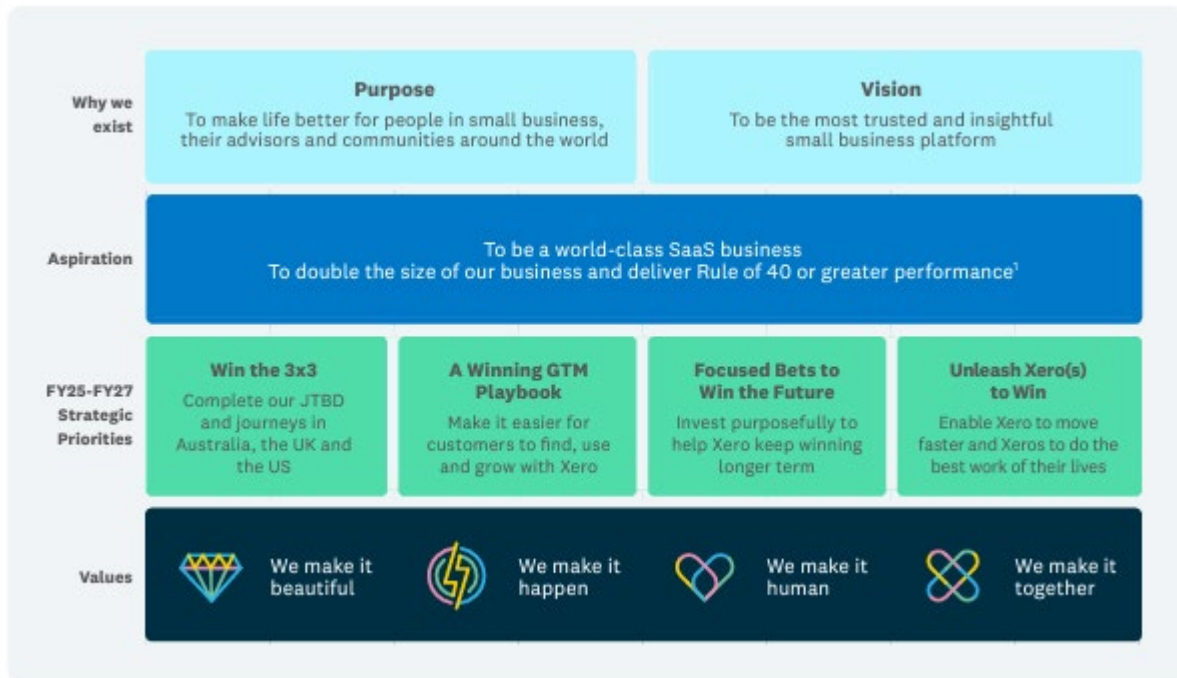
Xero aims to be a leading supplier of online accounting software to small business.

The vision is to be the most insightful and trusted small business platform. Xero platforms aim to provide meaningful insights to their customers, drive meaningful discussions with advisors and help their customers make informed decisions.

The company has outlined four key strategic priorities until FY27;

1. Xero is primarily focused on providing complete products for the three core 'Jobs to be Done' (JTBD) - Accounting, Payments and Payroll - in the three large markets of Australia, UK and United States.
2. Make it easier for customers to find, use and grow with Xero
3. Purposeful investment to keep Xero winning longer-term
4. "Unleash Xero's (Xero staff) to win"

The company has expressed an intention to be more balanced in its focus between subscriber growth and continuing average revenue per user (profitability).



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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 |

Governance

NZSA assessment against its key policy criteria is summarised below:

| Policy Theme | Assessment | Notes |
|--|------------|---|
| Directors Fees | G | See below. |
| Director share ownership | G | Directors are not required to own shares. |
| Executive Remuneration | G | See below. |
| Golden parachutes/handshakes | A | See below. |
| Director Independence | G | All Directors are independent. |
| Board Composition | A | See below. |
| Director Tenure | G | See below. |
| ASM Format | R | Virtual only. See below. |
| Independent Advice for the Board and Risk Management | G | See below. |

Directors Fees: Generally good disclosure, however it is not disclosed if special exertion payments are possible. No such payments have been made in FY24.

Executive Remuneration: The CEO is paid a base salary, a short-term incentive (STI) and a long-term incentive (LTI). The salary and 50% of the STI are paid in cash. The other 50% of the STI is paid by way of restricted stock units, vesting after one year. The LTI is paid by way of restricted stock units, vesting after three years.

NZSA encourages fulsome disclosure in relation to any incentive payments made to the CEO, including disclosure of measures (or measure ‘groups’), weightings, targets, and the level of achievement versus target for each component associated with any awards. This methodology is supported by the new [NZX Remuneration Reporting Template](#).

Xero clearly discloses measures and weightings that comprise the STI and LTI methodology. At the maximum STI and LTI achievement, the weightings are Base Salary 11%, STI 19% and LTI 70%. NZSA policy support this weighting towards LTI to align with shareholders’ long-term interests.

We have commented previously on how the level of absolute payment related to LTI vesting has potential to create some political risk, and that we would encourage Xero to consider applying caps on the value (or number of options) associated with its share-based payments. However, we also note that Xero’s CEO remuneration framework is likely to be comparable with similar companies in the US market.

NZSA applauds the company’s disclosure, amongst the best for a New Zealand company.

Golden parachutes/handshakes: The CEO received an Initial Equity Grant of 463,308 Options upon commencing employment in November 2022. The Options vest in three tranches at the one year, two year and three-year anniversary of employment.

NZSA does not support such payments as they reward tenure rather than actual performance. We also note, however, that Xero’s CEO is based in the US, and that such an award structure is common in US-based companies as a form of remuneration.

Board Composition: The Annual Report includes a skills matrix, but it does not attribute skill sets to individual Directors to demonstrate how they contribute to the governance of the company.

The nature of the company’s board and operations indicates a strong commitment to thought, experiential and social diversity, with relevant experience for Xero. We also note the geographic diversity of XRO’s directors, appropriate for the business.

Director Tenure: NZSA looks for evidence of ongoing succession or ‘staggered’ appointment dates that reduce the risks associated with effective knowledge transfer in the event of succession. We also prefer a term maximum of 9-12 years, unless there are exceptional circumstances that may apply.

Directors’ appointment dates range from 2017 to 2023 indicating a commitment to succession planning.

ASM Format: NZSA prefers ‘hybrid’ ASM’s (i.e., physical, and virtual) as a way of promoting shareholder engagement while maximising participation.

Independent Advice for the Board & Risk Management: NZSA looks for evidence, through disclosures, that a Board has access to appropriate internal and external expertise to support board assurance activities. We also look for evidence that Boards are across their risk management responsibilities.

Directors can, with the consent of the Chair, seek independent external professional advice. The Company Secretary has direct access to the Board but reports to the CEO. This could have a limiting impact on assurance advice. We would prefer the Company Secretary is appointed by and reports directly to the Board. The General Manager of Assurance reports to the Executive General Manager of Risk and Assurance and has direct access to the Chair of the ARM Committee.

Xero provides excellent disclosure on its risk management framework, highlighting the key role played by independent reviews within this framework. There is good disclosure of financial, operational, and business risks provided.

Audit

NZSA assessment against its key policy criteria is summarised below:

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

Audit Rotation: The company ensures the Lead Audit Partner is rotated at 5 years and discloses the rotation date but not the appointment date. It does not disclose if the Audit Firm is rotated at 10 years or the appointment date of the Audit Firm.

Environmental Sustainability

NZSA assessment against its key policy criteria is summarised below:

| Policy Theme | Assessment |
|---------------------------|-------------------|
| Approach | G |
| Sustainability Governance | G |
| Strategy and Impacts | G |
| Risk and Opportunity | G |
| Metrics and Targets | G |
| Assurance | R |

Overall approach: Xero sustainability reporting is included in summary form within the Annual Report and also within a separate FY24 Climate Appendix. This is the first year that the New Zealand Climate Standards take effect and while Xero was already well positioned in 2023, it is pleasing to see that they have improved their environmental sustainability reporting since then and continue to do so. We note that as an ASX-listed company, Xero will also have to comply with Australian climate-related disclosure standards next year.

Sustainability Governance: Xero disclose a skills matrix showing the number of directors with high or moderate capability in nine areas of expertise, although none specifically relate to sustainability. They do dedicate human resource to sustainability issues by way of their ESG Steering Committee.

Strategy and Impact: Xero report that their climate strategy to minimise their net climate impact and grow their business as the climate changes consists of three pillars: mitigation of business-wide climate risk, reducing net climate impact, and harnessing climate-related opportunities. During FY24, Xero conducted their first climate risk scenario assessment to quantify the potential physical and transitional risks associated with the different climate scenarios.

Risk and Opportunity: Xero has now disclosed their first climate risk and opportunity register. It categorises these risks or opportunities as either physical or transitional with the associated management response from Xero, and covers different time horizons.

Metrics and Targets: Xero provides a detailed breakdown of their Scope 1 - 3 GHG Emissions with comparative data from FY2020. They also formally committed to the Science Based Targets Initiative (SBTi) in 2022 and have established emissions reduction targets in accordance with these.

Assurance: The company has utilised the adoption provisions under the Climate Reporting Standards. No indication of external assurance is given for either Xero's GHG inventory or comprehensive non-financial disclosures, however they are working towards "understand[ing] our readiness for formal assurance, identify any gaps and devise a plan of action to address these". NZSA encourages Xero to seek limited assurance for *all* environmental claims made within its sustainability reporting, as well as GHG emissions.

Ethical and Social

NZSA assessment against its key policy criteria is summarised below:

| Policy Theme | Assessment | Notes |
|---------------------|-------------------|-------------------------|
| Whistleblowing | G | Good disclosure. |
| Political donations | G | Donations are not made. |

Financial & Performance

| Policy Theme | Assessment | Notes |
|---------------------|-------------------|--------------|
| Capital Management | G | See below |
| Takeover or Scheme | n/a | |

Xero's share price rose from \$120.80 to \$129.53 (as of 6th August 2024) over the last 12 months – a 7% increase. This compares favourably with the NZX 50 which rose by 3% in the same period. The capitalisation of XRO is \$19.7b placing it 1st by size out of 126 companies, were it listed on the NZX. This makes it a large company.

XRO are a NZ company that trades on the ASX. Its share price is listed in AUD; however, its financials are all in NZD.

| Metric | 2021 | 2022 | 2023 | 2024 | Change |
|------------------------|-------------|-------------|-------------|-------------|---------------|
| Revenue | \$848.8m | \$1,097m | \$1,400m | \$1,714m | 22% |
| Gross Profit | \$730m | \$957m | \$1,222m | \$1,511m | 24% |
| Operating Surplus | \$61.7m | \$41.9m | -\$59.8m | \$239.6m | n/a |
| NPAT | \$19.8m | -\$9.1m | -\$113.5m | \$224.1m | n/a |
| EPS | \$0.134 | -\$0.061 | -\$0.75 | \$1.47 | n/a |
| Subscribers | 2.74m | 3.27m | 3.74m | 4.16m | 11% |
| Capitalisation | | \$12.9b | \$18.8b | \$19.7b | 5% |
| PE Ratio | 1134 | n/a | n/a | 96 | |
| Current Ratio | 7.13 | 5.45 | 4.95 | 6.62 | 34% |
| Debt Equity (adjusted) | 1.71 | 1.27 | 1.36 | 1.12 | -18% |
| Operating CF | \$218.6m | \$236.4m | \$390.4m | \$591.8m | 52% |
| NTA Per Share | \$1.77 | \$0.50 | \$0.60 | \$2.68 | 347% |
| Equity Per Share | \$5.04 | \$6.91 | \$6.96 | \$9.14 | 31% |

Although well established, cash flow positive and profitable, XRO continue on a path of growth. Revenues were up by 22% to \$1,714m and an improved Gross Profit of \$1,511m (up 24%) was recorded. The company gained 420,000 subscribers and has 4.16 million subscribers at balance date (3.74 million)

XRO continue to invest in sales and marketing, albeit at a lower rate than in the past operating expenses were kept in check and fell 1% to \$1,271m which gave an operating surplus of \$240m. Last year operating expenses were up 40%.

NPAT was \$224.1m and EPS were \$1.47. Operating cashflows increased by 52% to \$592m and when measured in cents per share are \$3.88.

The company is in sound financial position with a high current ratio of 6.62. The company has over \$1b in cash and short-term deposits but also over \$1b in interest bearing debt, providing relatively comfortable debt equity ratio of 1.12. Although unusual, the debt is long-term convertible debt with a zero-interest coupon and the company managed to achieve net finance **income** of \$22.4m for FY24.

There is an emerging case to be made that the company could return some excess funds to shareholders, although this may be dependent on growth funding requirements.

The company has an NTA of \$2.68. XRO trades on extremely high premiums to its NTA, reflecting future cashflow expectations from its intangible assets.

Shares are tightly held, with the top 20 shareholders holding 89.1% of shares.

The company provided a detailed [investor presentation](#) in conjunction with their annual results.

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 elect Steven Aldrich as an Independent Director.

Steven Aldrich was appointed to the Board in October 2020. He is a Director of Semrush an online visibility management SaaS platform and a former Director at Avantax. 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.

3. 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.

4. To adopt the Remuneration Report.

The Notice of Meeting outlines the context for this resolution: *“Xero is incorporated in New Zealand and subject to New Zealand law. Under Australian law, listed companies incorporated in Australia must prepare a Remuneration Report and put an advisory resolution to shareholders at the Annual General Meeting that the Remuneration Report be adopted. This law does not apply to Xero but, as a matter of good governance, Xero voluntarily publishes a Remuneration Report each year and this year will be voluntarily putting an advisory resolution to its shareholders.*

We will 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 20 August 2024.**

Please note you can appoint the Association as your proxy. We will have a representative attending the meeting.

The Team at NZSA