

NZX IPO Master Class

The Xero Listing Story

23 May 2012



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Introductions

Welcome by Andrew Harnos – Chairman, NZX

The presentation team:

1 Rod Drury
CEO & Founder, Xero

2 Ross Christie
Partner, Cameron Partners – Independent Investment Bank

3 Dean Oppenhuis
Partner, Bell Gully – Leading New Zealand law firm

Now is a good time to consider an IPO

The IPO market window is currently “open”

1. Global markets remain volatile, but investors have appetite for strong investment propositions in a low interest rate environment
2. The IPO market in New Zealand has improved markedly as evidenced by the successful IPOs of Summerset and TradeMe – these lay a good platform for further successful listings
3. Listing on the stock market is not just for large cap companies:
 - The Capital Markets Development Taskforce recently identified that NZ has a funding gap for growth businesses seeking to raise between \$2 million and \$20 million – liquidity via an NZX listing helps to remedy that gap for both investor demand and growth companies seeking capital
 - Overseas markets have developed successful platforms for growth companies – Nasdaq, AIM
 - Growth stocks have been some of the best performers on the NZX in the last couple of years – e.g. Xero, Diligent, A2 Milk
 - Global investment literature suggests that growth stocks should form a part of nearly every investors portfolio – yet there has been a dearth of (growth) company listings on the NZX in recent times
4. If investors have liquidity, they are more likely to invest providing a greater opportunity for companies to raise growth capital. Liquidity also helps to improve the overall valuation of a company

Agenda

Intended to be an interactive panel discussion – please ask questions ...

1. Why undertake an IPO?
2. The IPO process
3. Life after listing
4. Questions?
5. Closing comments – Tim Bennett

TradeMe and Summerset IPOs

Both have performed well and created investor appetite for new issues

Trade Me and Summerset IPOs were for stakes of 34% and 42%, respectively

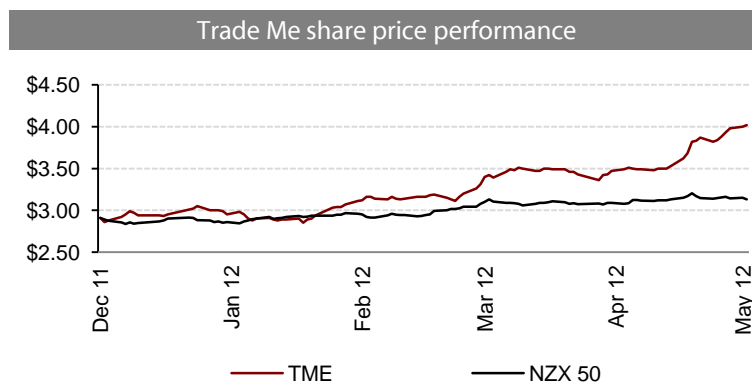
Summerset's enterprise valuation was around NZ\$300 million and Trade Me's around NZ\$1.2 billion

Both of these businesses have conservative gearing ratios and Trade Me had a 7% forecast dividend yield

Trade Me was over-subscribed and priced near the top end of its book-build range

Trade Me	
Issue size	\$363.4 million
Date	13-Dec-11
Bookbuild	\$2.50 - \$2.70
Offer price	\$2.70
Number of shares	134.6 million
Net debt	164.0 million (13.5%)
Dividend yield at IPO	7.1%
Free float	34%*
Offer structure	Institutional Offer+ Broker Firm Offer
	118.8 million shares
	Priority offer
	15.5 million shares
	Executive share offer
	0.3 million shares
Subscription	3x oversubscribed by institutions At least 2x oversubscribed by retail
Initial Premium	7.4%

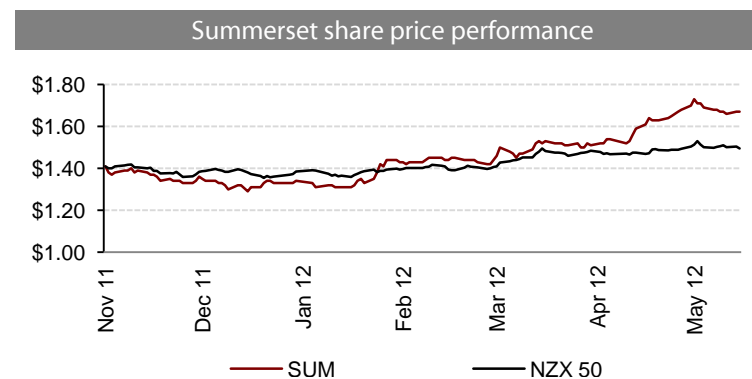
* Fairfax Media holds 261.4m shares, 66% of shares on offer following the issue



Source: Capital IQ, 16 May 2012
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Summerset	
Issue size	\$122.5 million
Date	28-Nov-11
Bookbuild	\$1.40 - \$1.60
Offer price	\$1.40
Number of shares	87.5 million
Net debt	92.2 million (30%)
Dividend yield at IPO	1.4%
Free float	42%
Offer structure	Retail offer Institutional offer
Subscription	Fully subscribed
Initial Premium	3.6%

* Quadrant Private Equity holds 58% of shares on offer following the issue



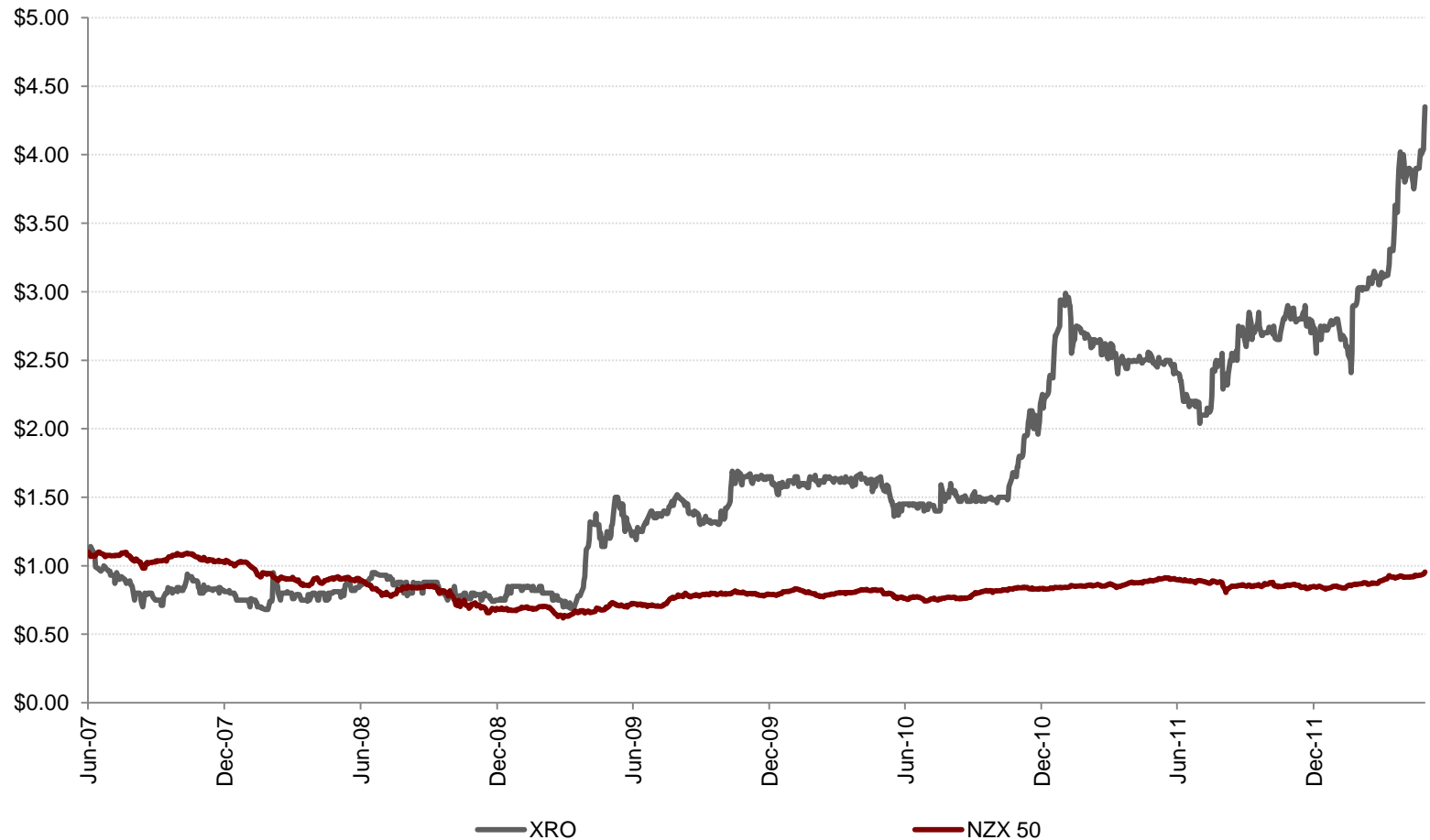
Source: Capital IQ, 16 May 2012

Growth companies like Xero have out-performed the market

Annualised return of 33% since listing in 2007 – through the GFC period

In Xero's recent capital raising of \$35 million, around \$15 million came from free float investors willing to invest more in the company

This shows strong retail support for a good growth story in the current market

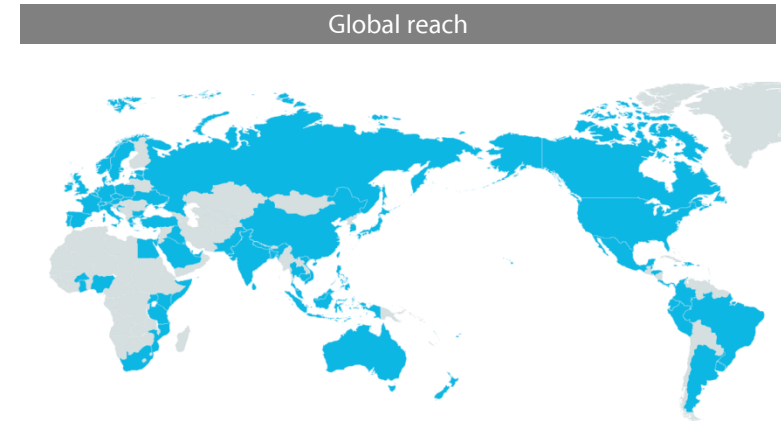
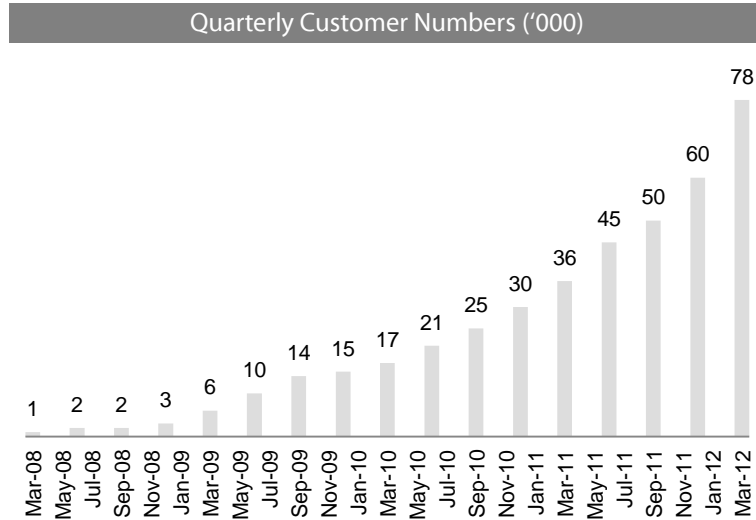


Xero's growth record

Xero has 78,000+ customers, 200,000 users in over 100 countries and has processed over \$100 billion in transactions on behalf of customers

Customer numbers have been growing exponentially year on year

March 2012 annualised revenue run rate over NZ\$25 million



A SELECTION OF COUNTRIES OF XERO'S PAYING CUSTOMERS

Paying customers doubled in the 12 months to 31 March 2012

- | | | | | |
|----------------|-------------|----------------------|-----------------------|----------------------|
| ARGENTINA | FIJI | JAMAICA | OMAN | SPAIN |
| AUSTRALIA | FRANCE | JAPAN | PAKISTAN | SWITZERLAND |
| BELGIUM | GERMANY | JERSEY | PANAMA | THAILAND |
| BRAZIL | GIBRALTAR | KENYA | PHILLIPINES | TRINIDAD AND TOBAGO |
| BULGARIA | HONDURAS | KUWAIT | PUERTO RICO | TURKEY |
| CANADA | HONG KONG | LUXEMBOURG | ROMANIA | UNITED ARAB EMIRATES |
| CAYMAN ISLANDS | INDIA | MALAYSIA | RUSSIAN FEDERATION | UNITED KINGDOM |
| CHILE | IRELAND | MEXICO | SAINT KITTS AND NEVIS | UNITED STATES |
| CHINA | ISLE OF MAN | NETHERLANDS | SAUDI ARABIA | |
| COSTA RICA | ISRAEL | NETHERLANDS ANTILLES | SINGAPORE | |
| ESTONIA | ITALY | NEW ZEALAND | SOUTH AFRICA | |

Why undertake an IPO?

Why undertake an IPO?

Joining a public market is a way to grow and enhance your business

Why List?	Xero's Experience
1. Provides access to capital for growth	<ul style="list-style-type: none">• Raising growth capital in NZ is challenging – especially in the \$2m to \$20m range• Xero has raised over \$85 million of growth capital – including a further \$29 million in 2009 and \$35 million in 2012. Unlikely to have achieved this without the initial IPO
2. Place an objective market value on the business and create a market for the company's shares	<ul style="list-style-type: none">• Xero listed at \$1.00 per share and the current share price is around \$4.30 per share
3. Encourage employee commitment and incentivise their long term motivation and performance	<ul style="list-style-type: none">• Xero implemented an employee share scheme post listing to incentivise employees
4. Raise corporate profile <ul style="list-style-type: none">- Public awareness- Increased press coverage- Analysts reports	<ul style="list-style-type: none">• Xero's profile has been greatly enhanced by being on the NZX• A strong PR strategy has also been key
5. Enhance the company's status and credibility with customers and suppliers <ul style="list-style-type: none">- Transparency of stability and performance	<ul style="list-style-type: none">• Xero's access to capital and financial transparency has helped to instil customer confidence, especially in international markets
6. Provides the ability to make future acquisitions and access to raise further capital	<ul style="list-style-type: none">• Xero has undertaken two key fundraisings following the IPO as well as two small bolt-on acquisitions

Getting ready for an IPO

Some early issues to get your head around

1. Are the members of the management team prepared for the greater disclosure, openness and accountability that investors and the market require?
2. Is the management team and board ready to invest the time and effort to plan and execute the IPO? It requires a strong team effort to make an IPO a success
3. Will the growth business plan have a high chance of being delivered – not just a “pipe” dream?
4. Is the current structure of your company, including the management team and Board, appropriate for life as a publicly traded company?
5. Is there a credible IPO “story” – easily understood by investors?
6. Do you believe you can convince an investment bank, or a broker, to come on board to help you prepare for and promote the IPO?

Developing your IPO “story”

Every IPO needs a unique and convincing “story”

Xero’s “Story” was clearly articulated and laid out in its IPO Prospectus

It is key to continue to re-emphasise a clear and concise message

An early PR strategy is essential – social media can be helpful

Elements of a good “Story”	Xero’s Story
1. Proven business model with strong growth prospects	<ul style="list-style-type: none"> • Accepted technology shift to software-as-a-service (“SaaS”) model was proven e.g. Salesforce.com in CRM market. No credible online player in ERP (accounting) market • SaaS business model enabled a NZ company to genuinely play in a global market • Xero had paying customers at the time of the IPO
2. Growing market opportunity	<ul style="list-style-type: none"> • Large market opportunity with over 5 million SMEs in NZ, Australia and UK. US much larger • SaaS model ideal for the fragmented SME market • Large incumbent providers were desktop software constrained
3. Compelling product offering	<ul style="list-style-type: none"> • Low cost accounting system – online, easy to use, continuous innovation, cost effective, real time access, assists decision making, easy to switch to Xero
4. Credible, capable management team	<ul style="list-style-type: none"> • Management had depth and had built, scaled and sold businesses previously
5. Experienced Board of Directors (including independents with public markets experience)	<ul style="list-style-type: none"> • A mixture of public company and international technology experience who were willing to put their reputations on the line and invest at the IPO price of \$1.00 per share
6. Clear reasons for raising money (growth vs. sell down)	<ul style="list-style-type: none"> • To raise sufficient growth capital (\$15m initially) to quickly scale the business – no sell down at IPO • To achieve a market leading position in the global online accounting space ahead of others
7. Timing <ul style="list-style-type: none"> - Clear reasons for “Why now?” - Market dynamic 	<ul style="list-style-type: none"> • Technology shift to the SaaS model was happening and proven • IPO window was open in early/mid 2007

Key criteria for an IPO on the NZX

Some key rules

1. Generally, no minimum amount of capital to be raised
 - However, directors/advisors/investors will want comfort that the business will raise sufficient working capital to trade for at least 24 months
2. At least 25% of free-float shares in public hands post listing
3. At least 500 shareholders
4. Prospectus and disclosure requirements
5. Board structure requirements with a minimum number of independent directors
6. Embargos from key shareholders (e.g. founders) from selling shares for a period after the IPO
7. Sponsor / Organising Participant to sponsor the company to the market – typically an investment bank, approved by the NZX, that is willing to put their credibility/reputation on the line

The IPO Process

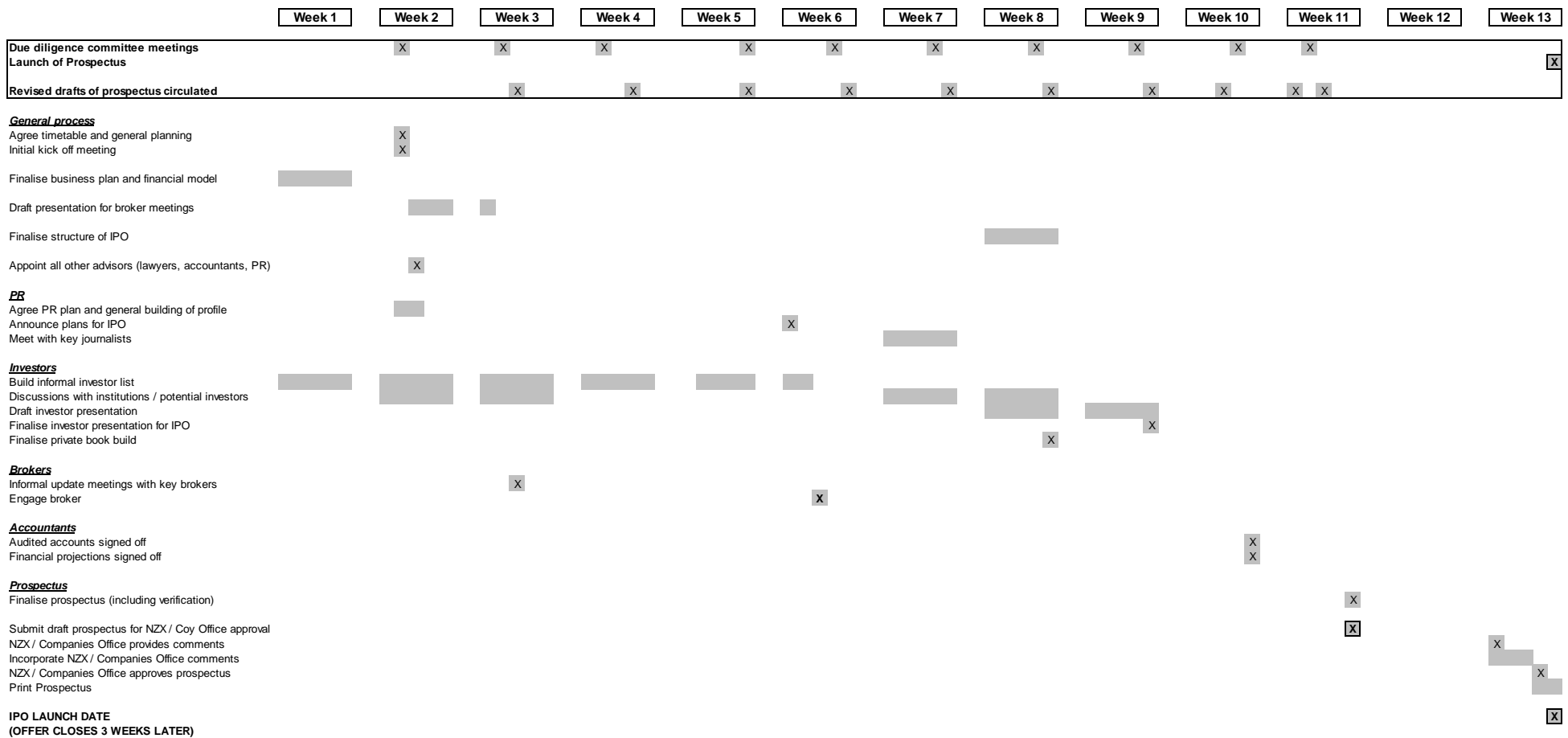
Pre-IPO planning

As always, preparation and planning is key

1. Ensure a high-quality management team is in place
2. Solve any key outstanding business issues ahead of the IPO process
3. Develop a PR strategy early – build company profile and awareness well ahead of the IPO
 - Once the IPO process is formally underway there are legal restrictions about what can and cannot be said about the IPO
4. Appoint capable and experienced advisors with market standing – initially the investment bank and law firm
5. Assemble a credible Board
 - Directors need to be willing to be involved in the IPO process (e.g. due diligence committee etc)
 - Identify gaps at Board level – the investment bank can probably assist
6. Establish an IPO timeline and process – look to deliver to the plan

Indicative IPO timeline – for a growth company

3-4 months+ of preparation to be in a position to launch the IPO



IPO Process – Due Diligence Committee

An issues driven, bottom up due diligence approach is best

The law firm and investment bank guide the due diligence process, as observers on the due diligence committee

1. The law firm and investment bank can advise on the best practice due diligence approach to maximise efficiency, whilst ensuring it meets Prospectus legal and marketing requirements
2. A thorough due diligence process helps to identify issues and provides protection and comfort for directors and promoters of the issue. All statements in the Prospectus ultimately need to be formally verified

The due diligence committee meets on a regular basis to ensure that all key issues are being addressed and that a rigorous IPO process is being conducted to ensure the Company is "investor" ready

Due diligence overview

Legal due diligence

A review by Company and legal counsel of material contracts, corporate structure, litigation and other legal diligence items



Corporate

- Material contracts
- Related party transactions
- Risk factors
- "Other information" disclosure in prospectus

Business and regulatory due diligence

Analysis by Company, advisers and legal counsel of specific business related and operational performance (current and historic), including regulation



Business

- Business description
- Growth strategy
- Board and Management
- Risk factors
- Regulation

Financial and tax due diligence

Analysis by Company, advisers, accountants and legal counsel of the historic/ current / forecast trading of Company and key tax issues



Financial and tax

- Management discussion and analysis
- Historical financials
- Forecast financials
- Tax implications for investors
- Independent Accountants Report

Market specific due diligence

Issues related specifically to the offering, offer structure etc. Usually compiled by the advisers and legal counsel



Structure / Markets

- Offer structure
- Market Information
- Management
- Underwriting

The role of advisors

An IPO needs motivated advisors that can work as a team

Advisors	Functions in the IPO
• Investment bank / broker	<ul style="list-style-type: none">• Primary responsibilities include managing and driving the IPO timeline/process, prospectus drafting, offer structuring and marketing the IPO, arrangement of research (if possible), selling effort, distribution and management of brokers• Helps to certify the IPO to the market and potential investors
• Legal advisor	<ul style="list-style-type: none">• Management of the due diligence process and offer document verification process, assisting with offer document preparation and lodgement, ensure compliance with NZX and other regulatory bodies and undertake all legal due diligence work
• Accounting/tax advisor	<ul style="list-style-type: none">• Corporate structure for listing, audit pro-forma historical financials, review prospectus forecasts and pro-forma balance sheet• Prepare investigating accountant's report for prospectus• Provide specialist tax structuring advice and tax due diligence
• Public Relations advisor	<ul style="list-style-type: none">• Promote positive media coverage of the company during the IPO marketing phase and post listing• Help ensure correct messaging is delivered through various media outlets, including social media
• Technical consultants (if required)	<ul style="list-style-type: none">• Provide specialist reports as required by the Due Diligence Committee, such as asset condition or environmental reports
• Logistical providers	<ul style="list-style-type: none">• Share registry, printers, website application providers, designers, advertising agency

Some key issues to manage

An appropriate offer structure is key to success

	Issues likely to arise	Xero experience
Offer structure	<ul style="list-style-type: none">▪ Sell downs by founders / key existing investors▪ Balance to be obtained between maximising offer sizing, potentially to the detriment of price▪ Institutional investors versus retail investor balance▪ Fixed price (e.g. Xero, Summerset) versus book build process to determine the price (e.g. Trade Me)	<ul style="list-style-type: none">▪ Xero set a fixed price IPO of \$1.00 per share▪ No sell downs; independent directors invested at IPO▪ Raise was set at \$15 million with the ability to take \$3 million of over-subscriptions. The IPO minimum was \$10 million to enable it to proceed▪ High net worth and retail subscribers – over 1,000 shareholders at IPO. Over 25% free float post IPO▪ Today there are more funds/institutions in the market looking for growth opportunities
Financial information	<ul style="list-style-type: none">▪ Too long a forecast period, may increase Prospectus risk for Directors▪ Detailed financial disclosure of assumptions and key value drivers which may be commercially sensitive to the Company	<ul style="list-style-type: none">▪ Xero only forecast one year ahead, given early stage nature of the business▪ Minimum forecast disclosure period has now changed to approximately 2 years with key forecast assumptions stated▪ Forecasts to be reviewed by reporting accountants
Capital structure and dividend policy	<ul style="list-style-type: none">▪ Investors will want conservative capital structures versus what is the optimal capital structure for the Company▪ Dividend yield may enhance the ability to sell to retail and institutional investors, versus what is reasonable having regard to the Company's capital structure and growth outlook	<ul style="list-style-type: none">▪ Xero was a growth company, thus offered investors a conservative capital structure (no debt), but equally no dividend yield▪ Technology companies globally tend to have net cash on their balance sheets and are typically capital gain plays

Some key issues to manage

Momentum is key to building investor appetite and valuation

Issues likely to arise

Xero experience

Valuation and equity story

- It is key to have a strong IPO “story” that is clearly conveyed to build investor demand
- Brokers are often more aggressive on pricing at the outset and less so once the Company is fully committed to the process
- Often a “valuation vacuum” in the process, so valuation momentum needs to be maintained



- Xero achieved a pre money valuation of \$40 million (and a post money valuation of \$55 million)
- Independent directors invested at the IPO price of \$1.00 per share, which was key certification
- Valuation was also certified to the market by Cameron Partners and held firm with the brokers
- The full \$15 million was obtained – achieving balance between price and size of offer

Pre-marketing

- Develop IPO “story”
- Ensure that presentation materials are properly prepared and reviewed ahead of broker/analyst presentations
- Need to judge time of meetings with key brokers in the market place – need to visit them 2-3 times to build the “story”
- Key to convey momentum is building, the opportunity is real and the investor book is building
- Try to achieve analyst coverage of the stock (and a brokers note) to use in the IPO – often difficult in a small IPO
- Other tactics – see next slide



- Xero carefully prepared an investor presentation
- Xero met with key brokers 2-3 times during the process to build the “story”
- Xero also built its own investor book, which comprised several million dollars, which was key to success
- First NZ Capital pushed the offering to its retail investor base
- No broker research was obtained. However, there are now independent research houses in the market which will assist the process to provide investors with an independent view of the opportunity

Launching the IPO

It is key to launch an IPO already knowing it will be successful

1. There needs to be a high degree of confidence that the IPO will be successful before it is launched – strong pre-marketing should deliver that certainty

2. Other tactics to generate investor support, include:
 - Asking investors to pre-subscribe to the IPO and sign up to receive the Prospectus
 - Writing to the share registers of other listed companies (with their approvals) to reach a wide investor base
 - Getting pre-commitments from ‘lead steer’ investors prior to the Prospectus being launched – industry insiders, key institutions, independent directors etc.
 - Broker support and independent research
 - Broker firm commitments to buy stock – usually off the back of their client indications
 - Scarcity of shares on offer – institutional versus retail pools
 - Further investor presentations and road shows

3. A strong and consistent PR strategy is key from the outset – continue to market the IPO (social media, newspapers)
 - Need to get key market commentators across the story and generate their support

4. Set a realistic minimum amount to raise as the default position (often lower than the targeted amount)

Costs of IPO

- Costs of an IPO vary with the amount of capital raised:
 - A large IPO – total costs in the order of 3% of funds raised
 - A smaller IPO – total costs might be in the order of 6% - 7% of funds raised
- Some costs can be weighted towards success – for example, the investment bank is typically paid a modest retainer and then a success fee on completion
- Some other advisor costs can be weighted towards the back end of the process when there is certainty of success – printing, registry, brokerage
- Thus, costs can largely be paid out of the fundraising proceeds

Key success factors for Xero's IPO in 2007

1. The founders wanted to do it
2. Recruited a high quality management team at the outset
3. Engaged an experienced board early
4. Developed the IPO story
5. Engaged advisors early
6. Developed a PR strategy early – built company profile and awareness well ahead of the IPO
7. Established an IPO timeline and determinedly delivered to it
8. “Dug deep”, but had fun along the way

Life After Listing

Maintaining the vision ...

Consumer



Non direct monetisation

Small business



Direct monetisation
Low price
Smart sales model
Complex applications
focused on usability

Enterprise



High price
Expensive sales
model

Xero's vision to be the global leader in online accounting for small businesses – small business is a big monetisable, internet opportunity

Xero – a one page snapshot of achievements

Xero is the leading emerging international SaaS based accounting platform

Xero was one of the first companies to create a solely online accounting product and has quickly established itself as one of the leaders in its field

Business description

- Xero (XRO) is a New Zealand based developer of online accounting software, targeting Small and Medium Enterprises (SME's - businesses with fewer than 20 staff) and, more recently, individuals
- The company was founded in 2006 and is headquartered in Wellington, New Zealand. Xero employs over 190 staff with 44 based in offshore markets
- The company listed on the New Zealand Stock Exchange in June 2007, with an initial market capitalisation of \$60m, following a successful \$15m IPO at \$1 per share

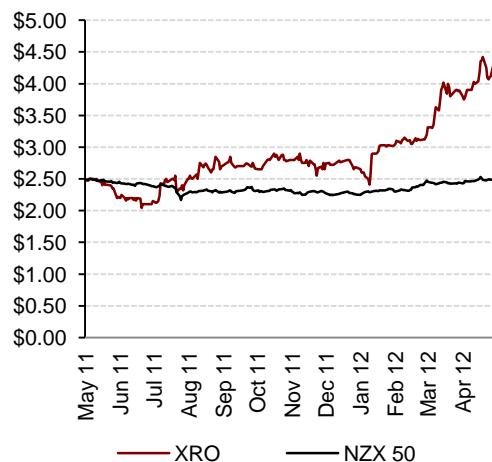
Xero's market positioning

- **Client accounting software** – online accounting for small businesses
- **Accountant side accounting software** – practice accounting software for the accounting including extended reporting tools
- **Modern practice software** – a set of integrated cloud solutions allowing accountants to run their practice entirely without on premise hardware
- **Personal financial management** – untangle personal and business expenses for the small business owner

Recent news

- Xero recently acquired Paycycle – an Australian online payroll company for AUD\$1.5m as well as WorkflowMax – a time and cost application for professionals for NZ\$6m (\$2m cash, \$4m shares)
- In February 2012, Xero raised NZ\$35m through a private placement to existing investors followed by a SPP to assist in accelerating its growth in large overseas markets
- Xero was New Zealand's fastest growing exporter in the 2011 Deloitte Fast 50 Index

Share price graph



Source: Capital IQ, 15 May 2012
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Financial overview

NZ\$ million	FY09A	FY10A	FY11A	FY12A
Operating Revenue	1.0	3.2	9.3	19.0
growth		229%	196%	103%
Reported Net Loss before Tax	(6.8)	(8.5)	(7.5)	nd
EBITDA (forecast format)	(8.2)	(10.2)	(10.2)	nd
EV/Revenue	464x	141x	48x	23x
As at 15 May 2012:				
Share price (NZ\$)				4.34
Market cap				457
Total debt				-
Minority interest				-
Cash				25
Enterprise value				445

Source: Capital IQ, 15 May 2012 and Xero Limited Annual Reports

Customer split

	FY11	FY12	Growth
New Zealand	23,000	47,000	104%
Australia	6,000	16,000	167%
UK	5,000	11,000	120%
US/Global	2,000	4,000	100%
Total	36,000	78,000	

- Significant growth is expected in international markets and the company has publicly said it is targeting 1 million customers in the medium term

Maintaining market leading position



“Startups”



Startups don't have resources to be successful in this market

Category now also requires client accountant software

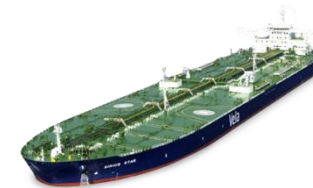
“Nimble, funded, global”



Expected competitors have not really emerged

No one else has significant funding

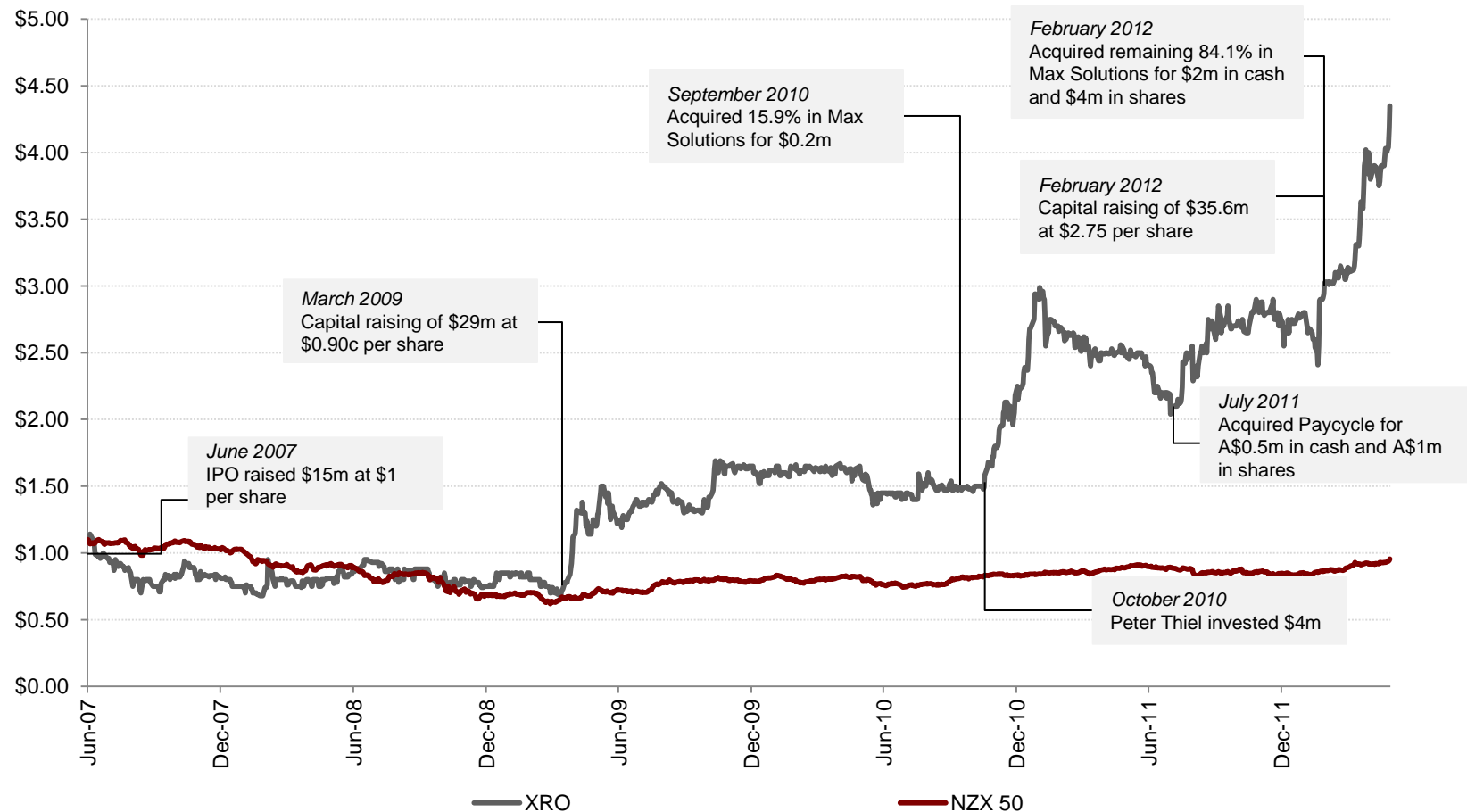
“Incumbents”



Incumbents (MYOB, Sage, Intuit) continue to struggle to deliver online accounting given their legacy desktop offering

Share price performance post listing

Compounded annualised return of 33% since listing in 2007



Capital raisings post IPO

Xero has undertaken three subsequent capital raisings

1. March 2009 – raised \$29 million at \$0.90 per share

- Craig Winkler (ex founder of MYOB) invested \$20 million
- Share purchase plan of up to \$5,000 offered to all other shareholders – raised \$7 million

2. October 2010 – raised an additional \$4 million from Peter Thiel (ex founder of Paypal and investor in Facebook)

- Key US investor to assist expansion in the US market
- Price was based on the volume average weighted share price for prior 20 days – around \$1.50 per share

3. February 2012 – raised \$35 million at \$2.75 per share

- Raised \$20 million from existing, larger shareholders plus institutions
- Share purchase plan of up to \$15,000 offered to all other shareholders – raised \$15 million

A listing on the NZX has provided Xero with direct ability to raise further capital – liquidity has helped to attract key international investors and institutions

Key capital raising rules

Some key considerations

1. Shareholder approval not required for placements of new shares up to 20% of the current issued share capital in any 12 month period
2. Shareholder disclosure required once a shareholding reaches 5%
3. Employee share schemes of up to 3% of current issued share capital in any 12 month period (without shareholder approval)
4. Share purchase plan rules – refer next slide

Share purchase plan (“SPP”)

A cost-effective way to raise more capital from existing shareholders

- An efficient way to raise new capital – avoids “Prospectus” process for a rights issue
- Can offer up to \$15,000 of new shares offered per shareholder, irrespective of shareholding (without shareholder approval)
- Often undertaken following a larger placement to raise new capital
- Largely ensures that minority shareholders are not diluted from the larger capital raising
- No Prospectus required – simple 3-4 page document only
- Typically open for 21 days
- Take-up rate typically above 30-40%, depending on other strategic initiatives announced at the time and nature of shareholder base

It is important to look after the minority shareholders, especially in dilutive capital raisings that introduce new shareholders

Acquisitions

A listing gives a “currency” to make bolt-on acquisitions



- Xero’s strategy is not acquisition led, however being listed on the NZX has enabled it to undertake in-fill product acquisitions, where:
 - the acquisition was core to the Xero product in a specific geography or globally
 - it gains Xero a development “leg-up”
 - the acquisition is cost-effective



- In July 2011, Xero acquired Paycycle, an Australian online payroll company, given payroll is seen as an integral part of the accounting system in the Australian market. Price was A\$0.5 million in cash and A\$1 million in shares
- In September 2010, Xero also acquired 16% of MaxSolutions Ltd., a company that offers a SaaS practise management platform (Workflow Tax) and provides on-line tax filing in New Zealand
- In February 2012, Xero acquired the remaining 84% of MaxSolutions for \$2 million in cash and \$4 million in shares
- Xero may or may not consider other small, product-led, bolt-on acquisitions in the future

Investor relations

1. It's your job to get coverage
2. NZX announcements get covered – think about Market Release vs. Media Release
3. Annual Meetings are an opportunity
4. Blogs allow you to extend the message
5. Continually thank shareholders and make them feel part of the team. They are the business owners
6. No matter what you do, there are still millions who have never heard of you

Measuring the success of an IPO

1. Strong share price and investor returns
2. Successful employee incentive plan
3. Enhances corporate profile – analyst and financial press coverage
4. Business momentum – customer and supplier confidence
5. Follow on capital raisings
 - Attracting institutions and overseas investors
 - Strong SPP take-up from existing investors
6. Acquisitions
 - Vendors willing to take shares as consideration
7. Strong financial performance

Xero ticks these boxes

Questions?

1. What haven't we covered?
2. Call any of us for an informal and confidential chat – we are very happy to discuss further

There exists a significant opportunity for you to list your business on the NZX – go for it!

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