



First Quarter Report

Three months ended December 31, 2006

To Our Shareholders:

Xenos Group Inc. reported a return to profitability on year over year growth in its first quarter financial results.

Xenos revenues for the first quarter ended December 31, 2006 rose to \$3,931,000 compared to revenues of \$3,619,000 for the same quarter last year. Xenos reported EBITDA of \$226,000, compared to negative EBITDA of \$828,000, for the same period last year.

In October, Xenos announced senior management changes designed to “support its refocused strategic direction, enhance operating efficiency and reduce or eliminate its cash burn in the fiscal first quarter.” Operating efficiencies have been gained by centralizing management of the corporation at the Company’s head office in Richmond Hill, Ontario. We exceeded our financial objectives for the first quarter by posting a small profit. We have continued to rationalize and right size our operations in the second quarter with a view to building a platform for consistent quarterly profitability and long term revenue growth. Xenos’ staff complement has been reduced from a high of 110 in September, 2006 to a current staffing level of 80.

Total operating expenses in the first quarter decreased 21% to \$3,258,000, from \$4,102,000 in the first quarter of fiscal 2006. Sales and marketing expenses were cut to \$1,542,000 from \$2,281,000. We completed an expensive marketing and market development program in 2006. Now that we have created greater awareness of Xenos in our chosen markets we are able to reduce our marketing budget and focus on programs and strategies that are delivering measurable financial returns.

Xenos reported first quarter net earnings of \$16,000, or \$0.002 per share, compared with a net loss of \$927,000, or (\$0.09) per share, for the first quarter of fiscal 2006.

Xenos’ solid first quarter revenues were achieved through significant new license revenues and consistent performance in professional services. A number of important contracts were in hand at the end of the quarter and these will contribute to revenue in the current quarter and beyond. We are particularly encouraged by the success we are enjoying in the enterprise content management (ECM) systems consolidation and document migration aspect of our Information Supply Chain business.

Indicative of the kind of transactions we are currently engaged in, we recently announced that Xenos has been selected by a major U.S. healthcare insurance organization to complete a major regulatory compliance initiative. The contract for Xenos d2e™ transformation and repurposing software and implementation services is worth in excess of CDN\$600,000.

The customer required a solution that presented all documents for Explanation of Benefits (EOB), Remittance Statements (REMITTS), and Insurance Claim Documents (CLAIMS) in Tagged Imaged File Format (TIFF) so that they could be natively viewed by a Windows operating system.

In order to meet the compliance requirements, the customer needed to convert all historical documents from IBM AFP format into TIFF format. It also required the documents be indexed for sorting and retrieval based on index information. To maintain future compliance, Xenos has provided a system that enables the capture, index extraction, transformation and loading of all EOB, Remits, and Claims documents for storage into a 70 terabyte compliance repository.

Our customer was able to meet its compliance obligations within the very strict timelines of the project with an optimum architecture and rapid implementation provided by Xenos consultants.

We are currently marketing this solution to the specific audience that potentially faces this specific compliance issue.

At December 31, 2006, Xenos held cash of \$6,555,000, or \$0.66 per common share and no significant long-term debt.

A handwritten signature in black ink that reads "Stuart Butts". The signature is written in a cursive style with a large initial 'S'.

Stuart Butts
Chairman of the Board,
Chief Executive Officer
and President

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the three months ended December 31, 2006

This Management's Discussion and Analysis of Financial Condition and Results of Operations of Xenos Group Inc. ("Xenos" or the "Company") has been prepared as of February 13, 2007 and should be read in conjunction with the unaudited Consolidated Financial Statements and Notes included in this Quarterly report for the three months ended December 31, 2006 and should be read in conjunction with the audited Consolidated Financial Statements and Notes, and Management's Discussion and Analysis contained in the Company's Annual Report for the fiscal year ended September 30, 2006.

The financial data contained in this Management's Discussion and Analysis has been prepared in accordance with Canadian generally accepted accounting principles and, unless otherwise indicated, is reported in Canadian dollars.

Corporate History

Xenos was formed under articles of amalgamation dated October 1, 1989. The Company acquired GenText, Inc. ("Gentext"), a private software development company located in Dallas, on January 1, 1998. Gentext had developed printstream transformation software that formed the basis of Xenos' current d2e Platform™ and d2e Vision™ products. On October 1, 1999, Xenos acquired Geneva Digital Limited ("Geneva"), a private value-added software reseller based in London, which sold and maintained third party document solutions in the U.K. Today, Geneva (now Xenos Europe Limited) is the Company's sales office in Europe selling a combination of Xenos products, services and third party based document solutions. Xenos acquired Rush Creek Software Corporation ("Rush Creek"), a private software developer based in Dallas, on May 17, 2002. Rush Creek brought the infoWEB™ report distribution product to Xenos' suite of products in addition to its important customer base. Finally, on November 17, 2003, Xenos acquired the business assets of XML-Global Technologies, Inc. ("XML Global") which included the GoXML™ data integration suite of products, that now form the basis of Xenos' current terminalONE™ product suite, as well as its customer base.

Overview of Business

Xenos provides high-performance software solutions for real-time information capture, transform, transport and presentment that automate the processing and delivery of data and documents. Xenos solutions enable organizations to reduce costs and increase organizational efficiency, agility and accountability by streamlining and simplifying the transformation and repurposing of data and documents into actionable business information, without reengineering legacy applications.

Xenos solutions are embraced worldwide across a wide variety of industries including financial services, insurance, healthcare, telecommunications, manufacturing, logistics, transportation, retail and government sectors. The majority of Xenos' customers are among the Fortune 1000 or Global 500 leaders. Xenos has offices in Canada, the United States, the United Kingdom and France and sells and supports its solutions through a global network of resellers and partners.

The Xenos product suite fulfils key business objectives by repurposing existing documents and data. Xenos products provide data and document capture, repurposing, transformation, enhancement, storage, retrieval and distribution across the enterprise. Xenos solutions are used to integrate incompatible applications, business processes, enterprise systems, partners, structured data, databases and Web services. Xenos solutions are scalable and meet the needs of high-volume data processing where performance is critical. Its solutions are hardware and platform agnostic, are supported on all popular operating systems, and conform to open standards.

Xenos product technologies include Xenos d2e™ a high-volume document data stream repurposing solution that captures data, transforms, indexes and repurposes document data streams for enterprise content management, enhanced archiving, distribution and printing; Xenos infoWEB™, a secure electronic report distribution and presentment solution; Xenos terminalONE™, a high volume structured data transformation and intelligent routing solution that expedites business transactions over the Internet; and GoXML Transform Designer™, a desktop utility that makes it easy for developers to map and transform a wide variety of industry standard data formats.

The Company has historically had success in a wide range of industry verticals, in particular banking, brokerage and insurance. It now provides its solutions to customers worldwide in key markets including financial services, insurance, telecommunications, ports, healthcare, manufacturing, government, service bureaus, supply chain and retail.

Xenos partners with industry-leading software companies to provide end-to-end solutions for its customers. Key technology partnerships include Oracle, FileNet, IBM, EMC/Documentum and Navis among others. The Company sells primarily through its direct sales force but also partners with value-added resellers in specific markets such as Latin America, Asia and certain countries of continental Europe. To a much lesser extent, the Company continues to sell through a small number of OEM and Service Bureau partners on an application specific basis.

Xenos Document Solutions (marketed principally in the U.K.) use in-house expertise, owned and third party software to enable organizations to automate, personalize and manage their business communications through document creation, content automation and content management.

Overall Performance

Xenos reported revenue in the first quarter of fiscal 2007 of \$3.9 million representing an increase of 18.2% from the previous quarter ended September 30, 2006 and an increase of 8.6% as compared to the first quarter of fiscal 2006. Combined with a reduction in marketing spend and a decrease in staffing levels from 105 employees at September 30, 2006 to 96 at December 31, 2006, the Company recorded its first profitable quarter in the last six quarters. Net profit for the first quarter of fiscal 2007 was \$16,000 as compared to a net loss of \$927,000 in the first quarter of fiscal 2006.

The Company continues to be subject to the risk of material fluctuation in revenue and earnings on a quarterly basis as a result of the timing of significant license sales and related sales cycles. Management is committed to maintaining profitability however to achieve this the Company must grow new license and service revenue by focusing on its core global markets and through the rollout of its ECM migration/consolidation services offering in the rapidly evolving ECM marketplace. Management will continue to align its expenditures with its key strategic objectives. Since September 1, 2006 to the date of this Management Discussion and Analysis, the Company has reduced its staff by 27% and maintains its commitment to reduce the Company's discretionary marketing spend by approximately \$1.7 million for fiscal 2007 as compared to fiscal 2006.

Management Changes

On October 27, 2006 the Company announced the appointment of Paul Walker as Executive Vice President and Chief Operating Officer. Mr. Walker is responsible for customer development, product development, professional services, consulting and sales. Mr. Walker has had extensive customer-facing experience in all of the Company's global markets since joining Xenos in 1999. He has held a variety of key management roles including director of product development, director of presales, director of consulting and shared responsibility for technical and business strategy definition. With 11 years experience in the IT industry, he was previously a software developer at the Insurers'

Advisory Organization where he designed and built online systems for the insurance industry.

Also on October 27, 2006 the Company announced the appointment of Graham Barker as Chief Marketing Officer. With Xenos since 1994, he was most recently director of worldwide strategic alliances, most notably with Oracle, announced in June 2006. At Xenos he has been responsible for EMEA marketing, product marketing, international VAR partner development, North American sales and key account management. Previously he was associate director of IT at one of Canada's largest colleges.

RESULTS OF OPERATIONS

Total sales for the three months ended December 31, 2006 were \$3.9 million as compared to \$3.6 million for the three month period ending December 31, 2005 representing an increase of 8.6%. The increase was largely driven by the increases in both new license revenue and services associated with both its infoWEB product and its third party related software products offered primarily in Europe.

Geographically, 63% of sales in the first quarter of fiscal 2007 were in North America while 34% were in Europe compared to 66% and 29% respectively in the first quarter of fiscal 2006. New license sales remained consistent at approximately 33% of total sales in Q1 of fiscal 2007. In addition, the Company's recurring maintenance revenue for the first quarter of fiscal 2007 represented 45% of its overall sales or \$1.77 million for the quarter which was consistent to the prior year.

Gross profits for the first quarter were down 2% to 81% of sales as compared to the first quarter of fiscal 2006. The marginal decrease was primarily the result of a higher mix of third party software products sold in Europe.

Sales and marketing expenses consist primarily of salaries and related expenses of the Company's sales and marketing personnel, marketing activities including trade show attendance; outbound telemarketing; print advertising in major publications; white paper placement and other web based initiatives. Sales and marketing expenses were \$1.54 million for the first three months of the year as compared with \$2.28 million for the same period in the prior year, a decrease of approximately 32%. New investment in marketing has been significantly reduced with a focus on aligning internal resources to address validated market opportunities qualified in fiscal 2006.

Product research and development expenses consist primarily of costs relating to the development of Xenos' proprietary technology, including salaries and related costs of personnel directly engaged in these activities, and direct materials. Total expenditures on product development, including amounts deferred, for the first quarter were \$916 thousand as compared to \$1.0 million for the first quarter of fiscal 2006. In the first quarter of fiscal 2006, the company engaged a number of contract workers and in temporary help to assist in product development activities. Historically, financial expenditures in this area have been held relatively steady on a year over year basis notwithstanding our focus and commitment to continued product development.

Administrative and general expenses primarily include: salaries and related expenses (including benefits and payroll taxes) of the Company other than salaries and related expenses paid to personnel engaged in research and development, professional services and sales and marketing activities; facility costs, professional fees, insurance costs and public company costs. In addition, the Company allocates common costs to each department based on relative headcount or other relevant measures. These costs include rent and other facility-related costs, communication and infrastructure expenditures.

The Company incurred administrative and general expenses in the first quarter of fiscal 2007 of \$574,000 as compared to \$656,000 in the first quarter of fiscal 2006. The 12% decrease was primarily a result of the restructuring efforts at the end of fiscal 2006 as well as cost containment in the area of professional fees.

Foreign exchange gains were \$71,000 for the first three months of fiscal 2007 as compared to gains of \$119,000 in the same period last year. The change was largely as a result of fluctuations in exchange rates in the period and their impact on U.S. dollar and British pound denominated monetary assets.

Interest and other income was \$32,000 as compared to \$78,000 in the previous year. The decrease was primarily due to interest paid on lower account balances and a loss on the disposal of furniture and equipment.

Quarterly Results

The following table provides a summary of certain financial information of Xenos for each of the eight most recently completed fiscal quarters:

(\$000's except per share amounts)

	Quarters Ended							
	Dec 31 2006	Sept 30 2006	June 30 2006	Mar 31 2006	Dec 31 2005	Sept 30 2005	June 30 2005	Mar 31 2005
Sales	\$3,931	\$3,327	\$3,767	\$3,128	\$3,619	\$3,231	\$4,508	\$3,206
Net income (loss) (i)	16	(7,934)	(1,374)	(1,734)	(927)	(341)	83	(997)
Net income (loss) per share (i)								
Basic	\$.002	(\$0.79)	(\$0.14)	(\$0.18)	(\$0.09)	(\$0.04)	\$0.01	(\$0.10)
Diluted	\$.002	(\$0.79)	(\$0.14)	(\$0.18)	(\$0.09)	(\$0.04)	\$0.01	(\$0.10)

(i) – Net income (loss) is equivalent to income (loss) from continuing operations for the periods disclosed as there were no discontinued operations or extraordinary items.

Fluctuations in quarterly revenue are primarily a result of timing of larger new enterprise licensing sales. In addition, prior to the three months ended December 31, 2006, revenue has been negatively affected by the decline in the U.S. dollar as a majority of the Company's sales are in U.S. denominated currency.

Net losses increased significantly between October 1, 2005 and September 30, 2006 as a result of a significant investment in marketing related expenses including increased personnel and lead focused marketing programs.

For the three months ended September 30, 2006, the Company performed an assessment on goodwill associated with the acquisitions of Rush Creek and XML Global for potential impairment and determined that a non-cash write-down of \$6,375,000 for goodwill was necessary. The triggering event that gave rise to the impairment was the continued losses and lack of significant revenue growth over the last number of years.

LIQUIDITY AND CAPITAL RESOURCES

The Company has recently taken measures in the form of senior management changes, reduced marketing expenditures and reduced staff levels in an effort to enhance the operating efficiency of the Company and to reduce or eliminate the drain on its cash

resources in the coming fiscal quarters. As at December 31, 2006, cash and short-term investments stood at \$6.6 million (September 30, 2006 - \$7.3 million) or \$0.66 per common share (i). The decrease in cash resources was primarily a result of changes in non-cash working capital. Specifically, trade receivables increased to \$2.2 million at December 31, 2006 from \$2.1 million at September 30, 2006 while payables and accruals decreased to \$1.8 million at December 31, 2006 as compared to \$2.3 million at September 30, 2006. The fluctuation in payables and accruals was primarily a result of payments in connection with restructuring costs and pay for performance bonuses, both of which were accrued for in the fourth quarter of fiscal 2006.

The Company currently has an operating line of credit of \$1.0 million of which \$500,000 (September 30, 2006 - \$ 500,000) was unused, bearing interest at bank prime. The Company continues to have no long-term debt other than a small obligation relating to capital leases.

Capital expenditures for the three months ended December 31, 2006 were \$110,000 versus \$143,000 for the three months ended December 31, 2005. The expenditure levels in fiscal 2006 were significantly higher as a result of the need to enhance the Company's network infrastructure and to replace computer equipment. It is expected that the level of expenditure for fiscal 2007 will continue to be lower than fiscal 2006 expenditures.

Development costs capitalized were \$104,000 versus \$137,000 in the corresponding period last year and represent the internal development costs relating to specific products as required by Canadian GAAP. As the product lines mature there is less opportunity for new development and more time directed toward product enhancements. The result is a decrease in development costs eligible for capitalization.

The Company anticipates that its current cash reserves and available credit facilities will be sufficient to fund its anticipated cash requirements for working capital and capital expenditures for at least the next 12 months. If the Company is required to raise additional funds for rapid expansion of its businesses or technologies, it could potentially issue equity or convertible debt which would cause current shareholders to experience dilution.

Outstanding share Data

The authorized share capital of the company consists of an unlimited number of Common shares. As at February 13, 2007, there were 9,936,944 shares issued and outstanding. Stock options for a total of 589,500 shares were outstanding at exercise prices ranging from \$1.26 to \$4.36 with various expiry dates, the latest of which is January 2012.

Commitments and Contractual Obligations

As of December 31, 2006, the Company had future commitments and contractual obligations as summarized in the following table.

	Total	Less than 1 year	1-3 Years	4-5 years	After 5 years
Capital Lease Obligations	\$ 226,654	\$ 97,582	\$ 129,072	\$ -	\$ -
Operating Leases	2,818,964	480,769	763,622	677,229	897,344
Purchase Obligations	286,517	205,953	80,159	405	-
Total Contractual Obligations	\$3,332,135	\$ 784,304	\$972,853	\$ 677,634	\$897,344

Payments Due by Period

Critical Accounting Policies and Estimates

The preparation of the Consolidated Financial Statements and the related notes require by necessity, that the Company make estimates and judgments. The Company reviews

its estimates, including those related to revenues, bad debts, acquired intangibles, deferred development, income taxes, contingencies and litigation. These estimates are based on historical experience and other assumptions believed to be reasonable under the circumstances. Under different assumptions, the reported results will differ, potentially materially, from those previously estimated. Many of the conditions impacting these assumptions and estimates are outside the Company's control.

The Company believes the following critical accounting policies reflect its more significant judgments and estimates.

Revenue

In accordance with Canadian GAAP, license revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed and determinable, and collectibility is probable. The terms of each contract can vary but the Company endeavors to apply consistent and appropriate treatment to them based on the available literature, professional judgment and consultation with its external auditors where deemed necessary.

Allowance for Doubtful Accounts

The Company provides for an allowance for doubtful accounts to reasonably provide for losses resulting from the inability of its customers to make required payments.

Valuation of Intangible Assets

The carrying values of acquired intangibles are compared to their fair value at least annually to determine if a permanent impairment exists, at which time the impairment would be recorded as a charge to earnings. Valuations are inherently subjective and necessarily involve judgments and estimates regarding future cash flows and other operational variables.

Deferred Development

Development costs are deferred only as they relate directly to new products or functionality and where technological feasibility has been established. These deferred amounts are amortized following general release of the products over their estimated useful lives. The assets are also periodically reviewed for impairment by comparison to the expected future undiscounted cash flows that they are expected to generate.

Income, Sales & Other Taxes

Accounting for income taxes, in particular the future benefit of available loss carry forwards is subjective by nature and requires the exercise of judgment. Tax assets are determined using a consistent model which incorporates estimated future earnings, expiry of loss carry forwards and the estimated probability of realization.

Income taxes are framed within a transfer pricing model in which the Canadian parent owns all intellectual property of the software products, the U.S. subsidiary is a service provider and the U.K. subsidiary is a value-added reseller. The model is supported by contemporaneous documentation and advice from independent transfer pricing consultants.

Sales tax practices vary widely in the various jurisdictions into which we sell our products and services. This area requires the exercise of judgment in respect of applicability and determination of rates. The Company has a review process that is applied to every customer billing and also performs regular analytical reviews to assess its compliance from an overall perspective.

Stock-based Compensation

In accordance with new Canadian GAAP requirements, stock options are required to be expensed and incorporated into the financial statements as per certain transitional

timelines (See Notes to Annual Consolidated Financial Statements). The Company uses the Black-Scholes model to establish the fair value of the options granted. The calculation requires the estimation of certain inputs including expected volatility, risk-free interest rates and expected lives of the specific grants.

Litigation

With respect to legal proceedings, the Company assesses the likelihood that a loss will result, as well as the amount of such loss. The financial statements provide for the Company's best estimate of such losses as applicable.

Disclosure Controls and Procedures

As required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, the Chief Executive Officer and Chief Financial Officer will be making certifications related to the information in the annual and interim filings. As part of these certifications, the Chief Executive Officer and Chief Financial Officer must certify that they are responsible for establishing and maintaining disclosure controls and procedures and have designed such disclosure controls and procedures to ensure that material information of Xenos is made known to them and that they have evaluated the effectiveness of the disclosure controls and procedures as of the end of the period covered by these annual and interim filings. The Company has documented and implemented such controls and procedures.

Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the disclosure controls and procedures as at December 31, 2006, have concluded that, as at December 31, 2006, the Company's disclosure controls and procedures were effective.

Internal Controls and Procedures

The Company maintains a set of internal controls over financial reporting which have been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP. The Company evaluated the design of its internal controls and procedures as defined under Multilateral Instrument 52-109 for the three months ended December 31, 2006. This evaluation was performed by the Chief Executive Officer and the Chief Financial Officer with the assistance of other Company employees to the extent necessary and appropriate.

Evaluation of Internal Controls and Procedures

The Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the internal controls and procedures as at December 31, 2006, have concluded that, as at December 31, 2006, the Company's internal controls and procedures were effective.

There were no changes in the Company's internal control over financial reporting that occurred during the first fiscal quarter that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

Corporate Governance

The Company's Board of Directors includes a majority of independent Directors and its Committees include Audit, Compensation, Nominating/Corporate Governance and Disclosure.

The members of the Audit Committee are all independent Board members and are financially literate. The Committee meets regularly to approve the release of financial

information including the MD&A and also to oversee relations with auditors and stewardship issues including compliance with new regulatory requirements.

Key Performance Drivers

In addition to traditional GAAP financial statements, Management monitors numerous key performance indicators (KPI's) to assist in running the business. Some of these include sales pipeline, lead generation, software downloads, response from internet based marketing initiatives, maintenance renewal rates, average deal sizes, revenue by channel and component, professional services utilization rates, costs by department and attrition rates. These factors revolve around building an infrastructure that is scalable and which drives profitability at a rate that exceeds top line revenue growth.

Workplace Environment and Compensation Structures

The Company has designed compensation structures aligned to shareholder interests. Bonus allocations are largely driven by company financial performance, depending on job function, and amounts earned under the plan are placed into departmental pools and allocated to individuals based entirely on merit. The workplace culture of the organization is one in which outstanding performance is rewarded and management time is heavily focused on empowering the success of "A" players rather than incrementally improving the performance of "C" players.

Outlook

The Company's strategy for creating value for shareholders is to drive sustainable and significant top line growth for each of its product lines, and increasingly for its overall market offering of "end to end" solutions particularly in its key vertical markets banking and insurance. Further value will be gained by aligning the structure of the distribution channel accordingly, protecting the recurring revenue base and ultimately driving scalable long-term profitability. The Company will increase its revenue per employee and attain profitability through focused growth oriented activities and cost containment including head count reductions, if warranted.

Additional information regarding the Company is available on SEDAR at www.sedar.com.

Footnotes:

- (i) Cash per share is a non-GAAP measure and is calculated by dividing the cash and short term investments by the number of common shares outstanding.

Forward Looking Information

Certain information provided by Xenos in this Management's Discussion and Analysis, in the Annual Report and in other documents publicly filed throughout the year that are not recitation of historical facts may constitute forward-looking statements. The words "may", "would", "could", "will", "likely", "estimate", "believe", "expect", "plan", "forecast" and similar expressions are intended to identify forward-looking statements. Readers are cautioned that such statements are only predictions and the actual events or results may differ materially. In evaluating such forward-looking statements, readers should specifically consider the various factors that could cause actual events or results to differ materially from those indicated by such forward-looking statements.

Such forward-looking information may involve important risks and uncertainties that could materially alter results in the future from those expressed or implied in any forward-looking statements made by, or on behalf of, Xenos. Some of the factors and

risks and uncertainties that cause results to differ from current expectations discussed in this Management's Discussion and Analysis and elsewhere in the Quarterly Report include, but are not limited to, dependence upon growth in the market for the Company's products, delays in product launches, currency exposure, technology developments by Xenos' competitors and changes in the competitive environment in which Xenos operates.

The foregoing is not an exhaustive list of the factors that may affect Xenos' forward-looking statements. These and other factors should be considered carefully and readers should not place undue reliance on Xenos' forward-looking statements. Xenos assumes no obligation to update the forward-looking statements, or to update the reasons why actual results could differ from those reflected in the forward-looking statements.

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, part 4, subsection 4.3(3)(a), if an auditor does not perform a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying interim consolidated financials statements of the Corporation have been prepared by and are the responsibility of the Corporation's management.

The corporation's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Xenos Group Inc.
Consolidated Statements of Operations
(Unaudited)

	Three Months Ended December 31	
	2006	2005
Sales	\$ 3,931,213	\$ 3,618,854
Cost of sales	749,643	620,092
Gross profit	<u>3,181,570</u>	<u>2,998,762</u>
Expenses		
Sales and marketing	1,542,414	2,280,638
Research and development	812,588	873,344
Administration and general	574,469	655,846
Amortization	288,708	262,892
Stock based compensation	26,051	16,757
Interest and bank charges	13,792	12,218
	<u>3,258,022</u>	<u>4,101,695</u>
Loss before undernoted items	(76,452)	(1,102,933)
Interest and other	31,952	78,158
Foreign exchange gain	71,025	119,478
	<u>102,977</u>	<u>197,636</u>
Income (loss) before income taxes	26,525	(905,297)
Provision for income taxes	10,678	21,851
Net income (loss)	<u>\$ 15,847</u>	<u>\$ (927,148)</u>
Net income (loss) per common share		
- Basic	\$ -	\$ (0.09)
- Fully diluted	\$ -	\$ (0.09)
Weighted average number of shares		
- Basic	9,936,944	9,933,944
- Fully diluted	9,937,053	9,933,944
<hr/>		
Deficit, beginning of year	\$ (36,573,188)	\$ (24,603,941)
Net income (loss)	<u>15,847</u>	<u>(927,148)</u>
Deficit, end of period	<u>\$ (36,557,341)</u>	<u>\$ (25,531,089)</u>

Xenos Group Inc.
Consolidated Balance Sheets
(Unaudited)

	As at	
	December 31	September 30
	2006	2006
ASSETS		
CURRENT		
Cash and short term investments	\$ 6,554,929	\$ 7,308,177
Trade receivables	2,254,793	2,103,212
Other receivables	3,572	3,085
Prepays	693,286	689,491
Income taxes recoverable	-	7,204
	<u>9,506,580</u>	<u>10,111,169</u>
LONG TERM		
Future income taxes	1,174,661	1,164,566
Capital assets	1,340,203	1,346,041
Intangibles and other assets	2,379,550	2,470,274
	<u>4,894,414</u>	<u>4,980,881</u>
TOTAL ASSETS	<u>\$ 14,400,994</u>	<u>\$ 15,092,050</u>
LIABILITIES		
CURRENT		
Bank indebtedness	\$ 500,000	\$ 500,000
Payables & accruals	1,818,658	2,307,340
Income taxes payable	11,528	8,095
Deferred revenue	2,966,760	3,261,751
Current portion - capital lease	88,633	64,893
	<u>5,385,579</u>	<u>6,142,079</u>
LONG TERM		
Capital lease obligations	128,049	95,252
Deferred revenue	10,286	13,371
Deferred lease inducements	167,282	173,448
	<u>305,617</u>	<u>282,071</u>
TOTAL LIABILITIES	5,691,196	6,424,150
SHAREHOLDERS' EQUITY		
Capital stock (Note 3)	44,969,035	44,969,035
Contributed surplus (Note 4)	298,104	272,053
Deficit	(36,557,341)	(36,573,188)
TOTAL SHAREHOLDERS' EQUITY	<u>8,709,798</u>	<u>8,667,900</u>
TOTAL LIABILITIES & EQUITY	<u>\$ 14,400,994</u>	<u>\$ 15,092,050</u>

Xenos Group Inc.
Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended December 31	
	2006	2005
	-----	-----
Operating activities		
Net income (loss)	\$ 15,847	\$ (927,148)
Amortization	288,708	262,892
Loss on disposal of capital assets	21,658	-
Future income taxes	(10,095)	7,613
Stock based compensation	26,051	16,757
Change in non-cash working capital (Note 5)	(938,150)	22,896
	-----	-----
	(595,981)	(616,990)
Financing Activities		
Capital lease payments	(19,198)	(9,552)
	-----	-----
	(19,198)	(9,552)
Investing activities		
Additional consideration paid on acquisitions	-	(3,362)
Purchase of capital assets	(34,325)	(143,343)
Development costs incurred	(103,744)	(137,225)
	-----	-----
	(138,069)	(283,930)
Net decrease in cash and short term investments	(753,248)	(910,472)
Cash and short term investments		
Beginning of period	7,308,177	12,033,741
End of period	\$ 6,554,929	\$ 11,123,269
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Xenos Group Inc.

Notes to the Condensed Consolidated Financial Statements

December 31, 2006 and 2005

1. Nature of operations and Basis of presentation

Xenos has provided high performance enterprise data and document software applications and services for over 25 years. Its products are used worldwide in large organizations across a wide variety of industries to repurpose high volumes of business critical information, often stored in incompatible repositories or disparate departmental systems, and present it through multiple communication channels. Xenos delivers competitive advantage for our Global 2000 customers by increasing their efficiency, agility and accountability. Xenos enables them to dramatically reduce costs, streamline operations, improve information access and simplify regulatory compliance without re-engineering investments in existing IT infrastructures, systems, applications and procedures.

Xenos' products accept many types of input in the form of data, documents or a combination of both and its scalable solutions meet the needs of high-volume data processing where performance is critical. Its solutions are hardware and platform agnostic and are supported on many popular operating systems. Xenos' solutions conform to open standards and readily adapt to in-house applications without changes or custom programming. Xenos Document Solutions use in-house expertise, owned and third party software to enable organizations to automate, personalize and manage their business communications through document creation, content automation and content management.

The Company has offices in Canada, the United States, the United Kingdom and France.

2. Summary of significant accounting policies

The consolidated financial statements of the Company were prepared by management in accordance with Canadian generally accepted accounting principles.

Accounting estimates

In preparing the Company's financial statements, Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses. Significant areas requiring the use of management estimates include the useful lives of capital assets, the amount of investment tax credits to be received, the evaluation of impairment for long term assets, the value of assets acquired and liabilities assumed in business combinations, and the provision for income taxes, including the recording of loss carry-forwards. Actual results could differ from those estimates.

Principles of consolidation

The consolidated financial statements include the accounts of all companies in which the Company has a controlling interest, after the elimination of inter-company transactions and balances.

Revenue recognition

The Company recognizes revenue on the delivery of software licenses when persuasive evidence of an arrangement exists, the fees are fixed and determinable, collection is considered probable, and vendor-specific objective evidence exists to allocate the total fee to the different elements of an arrangement. Customization and implementation revenues

are recognized as the services are rendered. Revenue from maintenance services for licenses sold is recognized ratably over the term of the maintenance contract, after ratification thereof.

3. Capital stock

	December 31, 2006		September 30, 2006	
	Number	Amount	Number	Amount
Balance, beginning of year	9,936,944	\$ 44,969,035	9,933,944	\$ 44,964,085
Issued pursuant to exercise of vested stock options	-	-	3,000	4,950
Balance, end of period	9,936,944	\$ 44,969,035	9,936,944	\$ 44,969,035

4. Contributed surplus

	December 31	September 30
	2006	2006
Balance, beginning of year	\$ 272,053	\$ 148,638
Stock based compensation	26,051	123,415
Balance, end of period	\$ 298,104	\$ 272,053

5. Supplemental cash flow information

	December 31	December 31
	2006	2005
(a) Change in non-cash operating working capital:		
Receivables	\$ (152,068)	\$ (250,367)
Prepays	(3,795)	122,119
Income taxes recoverable	7,204	-
Payables and accruals	(488,682)	126,935
Income taxes payable	3,433	11,134
Deferred lease inducements	(6,166)	29,573
Deferred revenue	(298,076)	(16,498)
	\$ (938,150)	\$ 22,896
b) Cash and short term investments consist of cash on hand, balances with banks, cash equivalents and short term investments		
(c) Interest paid	\$ 13,792	\$ 12,218
(d) Income taxes paid (net of recoveries)	\$ 7,921	\$ 1,115
(d) Reorganization costs paid	\$ 270,496	\$ -

6. Commitments

The Company has entered into future commitments and contractual obligations for operating leases, capital leases and certain purchase obligations. Minimum payments in aggregate and for each of the next five years are as follows:

2007	\$	784,304
2008		565,412
2009		407,441
2010		354,878
2011		322,756
Thereafter		897,344
	\$	<u>3,332,135</u>

7. Stock based compensation plan

The Company has a stock option plan which allows the granting of stock options to employees and service providers up to an aggregate of 1.6 million common shares. Under current company practice the options, which have a five-year term, vest immediately for directors and generally over 3-4 years for all others, commencing on the grant date. The exercise price of each option equals the closing market price of the Company's common shares on the last trading day preceding the date of grant.

A summary of the status of the Company's stock option plan as of December 31, 2006 and September 30, 2006 and any changes during each year-to-date period is presented below:

	Shares		Weighted Average Exercise Price	
	December 31 2006	September 30 2006	December 31 2006	September 30 2006
Outstanding, beginning of year	1,096,138	958,138	\$ 1.87	\$ 2.14
Granted	5,000	544,000	1.26	1.66
Exercised	-	(3,000)	-	1.65
Forfeited	<u>(517,388)</u>	<u>(403,000)</u>	1.79	2.22
Outstanding, end of quarter	<u>583,750</u>	<u>1,096,138</u>	\$ 1.93	\$ 1.87
Options exercisable at quarter end	<u>176,000</u>	<u>364,638</u>		

7. Stock based compensation plan (continued)

The following information applies to options outstanding at December 31, 2006:

Exercise Price	Number outstanding and exercisable	Number outstanding but not exercisable	Weighted average remaining life in months	Weighted average exercise price	Expiry
\$ 1.26	5,000	-	58	\$ 1.26	October, 2011
1.29	-	225,000	57	1.29	September, 2011
1.34	-	25,000	57	1.34	September, 2011
1.36	2,000	-	2	1.36	February, 2007
1.50	2,000	-	1	1.50	January, 2007
1.65	20,000	-	8	1.65	August, 2007
1.65	25,000	-	5	1.65	May, 2007
1.65	-	62,500	48	1.65	December, 2010
1.90	15,000	-	49	1.90	January, 2011
1.99	-	79,000	51	1.99	March, 2011
2.20	8,000	-	15	2.20	March, 2008
2.35	17,000	-	38	2.35	February, 2010
2.40	2,500	-	38	2.40	February, 2010
3.45	3,750	1,250	23	3.45	November, 2008
3.60	15,000	5,000	23	3.60	November, 2008
3.80	48,750	10,000	22	3.80	October, 2008
4.36	12,000	-	27	4.36	March, 2009

8. Segmented information

The Company has determined that it serves one industry segment, information technology.

Geographic information

The following table provides information about geographic segment sales, capital assets and goodwill.

	Sales		Capital Assets	
	December 2006	December 2005	December 2006	September 2006
Canada	\$ 151,548	\$ 245,395	\$ 967,153	\$ 910,547
European Union	277,236	197,835	-	-
United Kingdom	976,454	602,532	288,293	297,694
United States	2,305,817	2,144,774	84,757	137,800
Other	220,158	428,318	-	-
	<u>\$ 3,931,213</u>	<u>\$ 3,618,854</u>	<u>\$ 1,340,203</u>	<u>\$ 1,346,041</u>

9. Comparative figures

Certain of the comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year.

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This report contains forward-looking statements based on current expectations. These forward-looking statements entail various risks and uncertainties that could cause actual results to differ materially from those reflected in these forward-looking statements. Risks and uncertainties about the Company's business are more fully discussed in the Management Discussion and Analysis published in the Company's annual report.

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Trading

Xenos Group Inc. trades on
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and is listed under the symbol TSX:XNS.

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