

Xenos

Second Quarter Report

three and six months ended March 31, 2001

To our Shareholders:

Sales for the second quarter ending March 31, 2001 were \$2.6 million compared to \$3.7 million last year. These results were negatively impacted by the general economic slowdown in our markets where bricks and mortar companies buy projects, not products. As a result, a number of technology deals that we were involved in were deferred at the end of the quarter.

While many other software companies are downsizing during the current slowdown we have already been through this transition. In addition, our cash position remains strong as management's focus on cost control and prudent balance sheet management resulted in positive cash flow from operations, after changes in working capital, for the quarter. Cash and short-term investments as at March 31, 2001 stood at \$17.2 million or \$2.05 per share compared to \$18.5 million at the end of the previous fiscal year, and \$17.3 million at the end of this year's first quarter.

As a result of our investment in the development of the Xenos d2e Platform™, we were pleased to announce the launch of the Xenos d2e Developer Studio™. This new software, the first in a series of new products to be released over the next three months, is an easy-to-use graphical development environment that enables large 'bricks and mortar' organizations, systems integrators, and software providers to quickly build customized solutions for document and data transformation.

Our Alliance strategy continues to proceed well with the strengthening of our IBM relationship and further integration of the Xenos d2e Platform with IBM's Content Manager OnDemand archiving and retrieval software.

In the growing EBPP (Electronic Bill Presentment and Payment) marketplace, we have completed the first phase of sales training for our partner, iPlanet E-Commerce Solutions, an alliance between Sun Microsystems and Netscape. As a result of this partnership, we are now able to develop discussions with other players in the EBPP market. In addition, leading CRM companies are considering entering this space and have realized that Xenos' new technology and expertise can provide a fast-track entry to this potentially lucrative market. We are developing these discussions.

Our strong cash balance together with our emphasis on stringent cost controls puts us in a strong position for the future. We will continue to execute our strategy of developing software products that consolidate our position as the world leader in document and data transformation and of creating strategic alliances with industry leading providers of e-business solutions to produce scaleable revenues.



Glen Manchester
President and Chief Executive Officer

Management's Discussion and Analysis of Financial Results for the Three and Six Months ended March 31, 2001.

The following discussion should be read in conjunction with the Company's unaudited quarterly financial statements contained herein and the notes thereto.

Results of Operations:

Sales in the second quarter of fiscal 2001 were \$2.6 million compared to \$3.7 million for the same period last year. Sales in the second quarter were negatively impacted by the current economic slowdown that resulted in a number of current and new customers deferring the implementation of new technology projects and the delay in a number of new contract awards. For the six months ended March 31, 2001 sales were \$6.7 million compared to \$7.8 million the prior year.

Due to the reduction in sales in the second quarter, gross margin as a percentage of sales declined to 64% from 79% last year. The Company's production efficiency and cost reduction initiatives taken through the last half of fiscal 2000 and continuing this year reduced the negative impact on profitability caused by the drop in sales in the quarter. For the six months ended March 31, 2001 gross margin as a percentage of sales was 75% compared to 77% last year.

Research and development expenses in the second quarter were lower than last year. During the quarter, approximately \$400,000 in R&D costs were required to be deferred as they related primarily to four new products to be released in the coming three months. Administrative and general expenses were down significantly to 28% of sales in the quarter from 44% last year as management has focused its resources in the areas of sales, marketing, customer support and R&D. The Company does not expect any significant increase in administrative costs for the balance of the fiscal year.

Amortization charges in the quarter and year-to-date periods relate primarily to the acquisition of intangible assets made in prior years. These are non-cash charges to the income statement and are being amortized over the next four years.

The net loss was \$2.6 million or \$0.30 per common share and \$4.3 million or \$0.51 per common share for the three and six months ended March 31, 2001 respectively. The adjusted net loss, not including the amortization of acquired intangible assets, was \$1.8 million or \$0.21 per share compared to \$1.4 million or \$0.18 per common share in last year's second quarter. For the six months ended March 31, 2001, the adjusted net loss was \$2.8 million or \$0.33 per common share compared to \$1.6 million or \$0.20 in fiscal 2000.

Financial Condition and Liquidity:

As at March 31, 2001, cash and short-term investments stood at \$17.2 million compared to \$22.0 million at the end of last year's second quarter and \$18.5 million at the end of fiscal 2000.

Despite the increased loss in the quarter and year-to-date periods this year compared to fiscal 2000, the Company generated positive cash from operations, including changes in working capital, of \$493,000 and \$393,758 for the three and six months ended March 31, 2001 respectively compared to a use of cash of \$2.9 million and \$1.2 million in the comparable prior-year periods. The improved cashflow was primarily due to the increased collection of accounts receivable and other balance sheet management initiatives undertaken this year. Capital expenditures in the second quarter were reduced compared to the prior year as part of the Company's continued efforts to conserve cash.

Included in cash disbursements for the six months ended March 31, 2001 was a one-time payment in the first quarter of approximately \$766,000 in advanced royalties made to the former owners of the Company's U.S. subsidiary, and \$576,000 in reorganization costs which had been previously accrued in fiscal 2000.

Outlook:

Due to the economic slowdown currently impacting the Company's markets, at this time management does not anticipate meeting its original target of 25% growth in revenues for the year ended September 30, 2001. However, management remains confident that it will achieve its goal to reach a breakeven point on cash flows during fiscal 2002.

This management's discussion and analysis 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.

Xenos Group Inc.**Consolidated Statements of Operations**

(Unaudited)

	Three Months Ended March 31		Six Months Ended March 31	
	2001	2000	2001	2000
Sales	\$2,625,522	\$3,721,508	\$6,735,889	\$7,825,981
Service integration costs	953,074	782,237	1,672,038	1,821,884
Gross Profit	1,672,448	2,939,271	5,063,851	6,004,097
Expenses				
Sales and marketing	1,679,778	1,438,270	4,235,574	2,765,563
Research and development	836,069	922,924	1,767,480	1,484,522
Administration and general	739,103	1,654,324	1,577,520	2,693,971
Amortization	1,093,923	900,144	2,175,095	1,891,804
Interest expense	7,863	41,090	17,943	61,876
	4,356,736	4,956,752	9,773,612	8,897,736
Earnings (Loss) from operations	(2,684,288)	(2,017,481)	(4,709,761)	(2,893,639)
Other income				
Dividends, interest and other	244,928	82,002	597,646	160,746
Earnings (loss) before income taxes	(2,439,360)	(1,935,479)	(4,112,115)	(2,732,893)
Provision for income taxes	114,099	57,960	165,211	151,002
Net earnings (loss)	\$(2,553,459)	\$(1,993,439)	\$(4,277,326)	\$(2,883,895)
Net earnings (loss) per share				
- Basic & fully-diluted	\$(0.30)	\$(0.26)	\$(0.51)	\$(0.37)
Weighted average number of shares			8,380,465	7,775,912

Xenos Group Inc.
Consolidated Balance Sheets
(Unaudited)

	As at March 31	
	2001	2000
ASSETS		
CURRENT		
Cash & S.T. investments	\$17,180,215	\$22,012,919
Trade receivables	2,244,091	5,143,113
Other receivables	75,328	475,291
Prepays	269,818	532,897
Income taxes recoverable	187,973	124,848
Deferred income taxes	-	282,000
	19,957,425	28,571,068
LONG TERM		
Deferred income taxes	1,942,939	512,449
Capital assets	2,343,520	2,533,268
Other assets	1,261,643	900,640
Goodwill	6,976,143	8,931,547
	12,524,245	12,877,904
TOTAL ASSETS	\$32,481,670	\$41,448,972
LIABILITIES		
CURRENT		
Bank indebtedness	\$470,000	\$406,719
Payables & accruals	2,265,584	2,676,710
Income taxes payable	327,829	-
Deferred revenue	2,133,225	831,852
	5,196,638	3,915,281
LONG TERM LIABILITIES		
Deferred revenue	143,865	191,200
	143,865	191,200
TOTAL LIABILITIES	5,340,503	4,106,481
SHAREHOLDERS' EQUITY		
Capital stock	41,048,098	40,325,761
Retained earnings/(deficit)	(13,906,931)	(2,983,270)
TOTAL SHAREHOLDERS' EQUITY	27,141,167	37,342,491
TOTAL LIABILITIES & EQUITY	\$32,481,670	\$41,448,972

Xenos Group Inc.**Consolidated Statements of Cash Flows**

(Unaudited)

	Three Months Ended March 31		Six Months Ended March 31	
	2001	2000	2001	2000
Operating activities				
Net Earnings (loss)	\$(2,553,459)	\$(1,993,439)	\$(4,277,326)	\$(2,883,895)
Amortization	1,093,923	900,144	2,175,095	1,891,804
Deferred income taxes	(16,943)	-	(17,029)	-
Reorganization costs	(318,931)	-	(576,353)	-
Change in non-cash working capital	2,288,565	(1,824,284)	3,089,371	(160,769)
	493,155	(2,917,579)	393,758	(1,152,860)
Financing Activities				
Bank financing	(50,000)	215,531	154,615	(948,081)
Proceeds on issue of special warrants		18,061,614		18,061,614
Proceeds on issue of shares	16,100	34,000	38,813	53,875
	(33,900)	18,311,145	193,428	17,167,408
Investing activities				
Cash paid on acquisition of subsidiaries	-	(109,251)	(766,985)	(5,642,272)
Purchase of capital assets	(203,322)	(251,182)	(348,041)	(1,835,220)
Development costs incurred	(414,210)	-	(762,035)	-
Other	-	7,313	-	7,313
	(617,532)	(353,120)	(1,877,061)	(7,470,179)
Net (decrease) increase in cash and cash equivalents	(158,277)	15,040,446	(1,289,875)	8,544,369
Cash and cash equivalents				
Beginning of period	17,338,492	6,972,473	18,470,090	13,468,550
End of period	\$17,180,215	\$22,012,919	\$17,180,215	\$22,012,919

Xenos Group Inc.

Notes to the Consolidated Financial Statements

March 31, 2001 and 2000

1. Nature of operations and Basis of presentation

Xenos develops software solutions that transform transactional data and documents into e-content to enable e-business applications. Xenos solutions are deployed by large “bricks and mortar” organizations in key industry segments, including banking and financial services, insurance, telecommunications and utilities. The Company has corporate headquarters in Toronto, Canada supported by global sales, marketing, product development and customer support. Xenos’ leading-edge software is used by alliance partners to provide total e-business solutions.

The unaudited interim financial statements of Xenos Group Inc. and related notes have been condensed and do not contain certain information that will be included in the Company’s annual consolidated financial statements and related notes thereto. For further information, refer to the Company’s annual consolidated financial statements and related notes for the year ended September 30, 2000.

2. Goodwill

	Mar. 31, 2001	Mar. 31, 2000
Cost	\$ 12,443,822	\$ 11,586,314
Accumulated amortization	<u>5,467,679</u>	<u>2,654,767</u>
Net book value	\$ <u>6,976,143</u>	\$ <u>8,931,547</u>

As part of the purchase price, the Company agreed to pay the former principals of Xenos Inc. (formerly GenText, Inc.) royalty fees. The fees will be equal to the lesser of (i) US \$2,500,000 and (ii) 8% of the amount by which the total net selling price of all Xenos Inc. products which use the Gentrans architecture sold by Xenos Inc. from the date of sale to December 31, 2003 exceeds US \$1,750,000.

During the first quarter ending December 31, 2000, the Company made an advanced royalty payment of US \$500,000 to the former owners of Gentext Inc.

3. Segmented information

Management has determined that the Company operates primarily within one dominant business segment, being electronic commerce.

Corporate Addresses

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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.

Shareholder Information

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Auditors

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Trading

Xenos Group Inc. trades on the Toronto Stock Exchange and is listed under the symbol XNS.

Investor Relations

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