



Second Quarter Report

Three and six months ended March 31, 2007

To Our Shareholders:

Xenos Group Inc. today reported an 18.9% year over year revenue gain in the second quarter and an overall revenue gain for the first six months of fiscal 2007 of 13.4%.

Xenos revenues for the second quarter ended March 31, 2007 rose to \$3,720,000 compared to revenues of \$3,128,000 for the same quarter last year. Revenues for the six months ended March 31, 2007 were \$7,651,000 as compared to \$6,747,000 for the first six months of fiscal 2006. Xenos reported a substantial improvement in EBITDA from a loss of \$1,316,000 for the quarter ended March 31, 2006 to a positive EBITDA of \$234,000.

The Company reported a reduced second quarter net loss of \$340,000, or (\$0.03) per share, compared with a net loss of \$1,734,000, or (\$0.18) per share, for the second quarter of fiscal 2006. The loss for the current quarter included a reorganization charge of \$206,000 and a foreign exchange loss of \$98,000.

During the second quarter the Company conducted a corporate reorganization designed to put Xenos on a solid footing for profitable growth. The full effect of these activities will be recognized in the third and subsequent quarters.

Total expenses in the second quarter decreased 21% to \$3,272,000, from \$4,158,000 in the second quarter of fiscal 2006. Sales and marketing expenses were reduced to \$1,387,000 from \$2,377,000. Our broad-based marketing investment in 2006 is being leveraged this year as we grow our revenues, but over a lower cost base. We are targeting a profitable year in fiscal 2007 as we expect to benefit from near-term business opportunities that were seeded during our global marketing efforts.

Xenos' solid six month revenues were achieved through significant new license revenues and stronger performance in professional services.

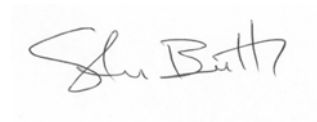
Indicative of the kind of transactions we are currently engaged in, we recently announced that American Safety Insurance (ASI) has implemented a business partner gateway solution for reinsurance with Xenos terminalONE™ software. ASI provides innovative insurance solutions for difficult risks in underserved markets through a national network of agents and program business partners.

ASI selected Xenos to solve a critical requirement to rapidly automate its premiums and claims billing process via an internet gateway for its program business partners. Xenos designed and implemented a solution to intelligently route, apply business rules, extract, normalize, map, transform and re-purpose data from Excel spreadsheets and load it in an SQL Server database. This data is then processed through ASI's reinsurance system and is then fed into their general ledger.

Greg Black, ASI's Chief Information Officer, stated, "With the gateway Xenos implemented, we are increasing our efficiency by eliminating the need to manually map, validate and extract billing information in CSV format from the Excel spreadsheets our program partners submit monthly. We have also significantly improved our service to the internal customer with a centralized database and in a common format providing easier data loads, simpler accounting and reporting. And using the web gateway, our program partners each will typically reduce their administrative overhead for claims and premiums billing, enabling them to focus on new business acquisition."

Innovative companies such as ASI can realize significant business benefits within months, not years, while they transform their business models in response to competitive pressures for reduced billing and claims cycle time with automated business partner gateways for online self-service.

At March 31, 2007, Xenos held cash of \$7,533,000 or \$0.76 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, slightly slanted style.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the three and six months ended March 31, 2007

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 May 4, 2007 and should be read in conjunction with the unaudited Consolidated Financial Statements and Notes included in this Quarterly report for the three and six months ended March 31, 2007 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 fulfills 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; and Xenos terminalONE™, a high volume structured data transformation and intelligent routing solution that expedites business transactions over the Internet.

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, IBM/FileNet, 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 for the six months ended March 31, 2007 of \$7.65 million representing an increase of 13.4% from the six months ended March 31, 2006. Historically, second quarter revenues relating to new license sales and professional services have been typically seasonally low. As a result Management was very pleased with the strong reported revenues for the second quarter of fiscal 2007 of \$3.7 million which represented an increase of 18.9% from the corresponding quarter in fiscal 2006.

In September 2006, Management initiated a right-sizing plan to return the Company to profitability. Since September 2006 the Company has reduced its staff levels from a high of 110 employees to a current level of 80, a reduction of 27%. In December 2006 Management announced its commitment to reduce the Company's discretionary marketing expenditures by approximately \$1.7 million for fiscal 2007 as compared to fiscal 2006. As part of the overall right-sizing plan, the Company's offices in Dallas (U.S.A.) and Vancouver (Canada) were closed and all executive management positions were relocated to the Company's North American head quarters in Richmond Hill (Canada). Management is committed to the goal of profitability in fiscal 2007. To achieve this, the Company must continue to grow new license and professional service revenues 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.

RESULTS OF OPERATIONS

Total sales for the six months ended March 31, 2007 were \$7.65 million as compared to \$6.75 million for the six month period ending March 31, 2006 representing an increase of 13.4%. The increase was largely driven by the increases in both new license revenue and services associated with its infoWEB™ and d2e Vision™ products and its third party related software products offered primarily in Europe.

Geographically, 64% of sales in the first six months of fiscal 2007 were in North America while 34% were in Europe compared to 67% and 30% respectively in the first six months

of fiscal 2006. New license sales remained consistent at approximately 30% of total sales for the six months ended March 31, 2007, while professional service revenue increased as a percentage of revenue from 13% for the first two quarters of fiscal 2006 to 18% in fiscal 2007. In addition, the Company's recurring maintenance revenue for the six months ended March 31, 2007 represented 47% of its overall sales or \$3.6 million for the period as compared to 52% and \$3.5 million for the six months ended March 31, 2006.

Gross profits for the first six months of fiscal 2007 were down 1% to 81% of sales as compared to the first six months 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 \$2.9 million for the first six months of the year as compared with \$4.7 million for the same period in the prior year, a decrease of approximately 37%. 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 six months of the year were \$1.71 million as compared to \$1.93 million for the same period last year, a decrease of 11%. During the first six months 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 during the six months ended March 31, 2007 of \$1.16 million as compared to \$1.27 million in the six months ended March 31, 2006. The 8% decrease was primarily a result of the restructuring efforts at the end of fiscal 2006.

Foreign exchange losses were \$27,000 for the first six months of fiscal 2007 as compared to a gain 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 was \$80,000 as compared to \$158,000 in the previous year. The decrease was primarily due to interest paid on lower account balances and a loss incurred on the disposal of furniture and equipment during Q1 of fiscal 2007.

The Company incurred minimal tax charges in the period as compared to a tax expense of \$217,000 for the six months ended March 31, 2006. The prior year's expense related to lower utilization of tax loss carry-forwards.

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							
	Mar 31 2007	Dec 31 2006	Sept 30 2006	June 30 2006	Mar 31 2006	Dec 31 2005	Sept 30 2005	June 30 2005
Sales	\$3,720	\$3,931	\$3,327	\$3,767	\$3,128	\$3,619	\$3,231	\$4,508
EBITDA (i)	234	226	(622)	(785)	(1,316)	(828)	17	340
Net (loss) income (ii)	(340)	16	(7,934)	(1,374)	(1,734)	(927)	(341)	83
Net (loss) income per share (ii)								
Basic	(\$.03)	\$.002	(\$0.79)	(\$0.14)	(\$0.18)	(\$0.09)	(\$0.04)	\$0.01
Diluted	(\$.03)	\$.002	(\$0.79)	(\$0.14)	(\$0.18)	(\$0.09)	(\$0.04)	\$0.01

(i) – EBITDA - is a non-GAAP measure and is calculated by adding reorganization costs, amortization, and interest and bank charges back to losses before undernoted items on the consolidated statements of operations.

(ii) – Net (loss) income is equivalent to (loss) income 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 and service opportunities. In addition, 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. New investment in marketing was significantly reduced subsequent to September 30, 2006 as were staffing levels resulting in decreases in operating expenditures and decreases in losses.

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 previous two years.

LIQUIDITY AND CAPITAL RESOURCES

The Company has recently taken measures in the form of senior management changes, reduced marketing expenditures and reduced staffing levels in an effort to enhance the operating efficiency of the Company and to reduce or eliminate the drain on its cash resources. As at March 31, 2007, cash and short-term investments stood at \$7.5 million (September 30, 2006 - \$7.3 million) or \$0.76 per common share (i). The Company's cash position improved in the second quarter of fiscal 2007 as several significant payments on annual contracts were received.

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 six months ended March 31, 2007 were \$132,000 versus \$254,000 for the six months ended March 31, 2006. 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 for the six months ended March 31, 2007 were \$141,000 as compared to \$223,000 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 May 4, 2007, there were 9,936,944 shares issued and outstanding. Stock options for a total of 661,250 shares were outstanding at exercise prices ranging from \$1.26 to \$4.36 with various expiry dates, the latest of which is May 2012.

Commitments and Contractual Obligations

As of March 31, 2007, 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	\$ 202,258	\$ 97,582	\$ 104,676	\$ -	\$ -
Operating Leases	2,684,478	474,706	728,421	664,901	816,450
Purchase Obligations	230,535	185,325	45,048	162	-
Total Contractual Obligations	\$3,117,271	\$ 757,613	\$878,145	\$ 665,063	\$816,450

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 March 31, 2007, have concluded that, as at March 31, 2007, 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 six months ended March 31, 2007. 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 March 31, 2007, have concluded that, as at March 31, 2007, 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 six months 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.

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 March 31		Six Months Ended March 31	
	2007	2006	2007	2006
Sales	\$ 3,720,036	\$ 3,127,937	\$ 7,651,249	\$ 6,746,791
Cost of sales	726,415	589,093	1,476,058	1,209,185
Gross profit	<u>2,993,621</u>	<u>2,538,844</u>	<u>6,175,191</u>	<u>5,537,606</u>
Expenses				
Sales and marketing	1,387,398	2,376,549	2,929,812	4,657,187
Research and development	754,283	834,696	1,566,871	1,708,040
Administration and general	584,309	609,185	1,158,778	1,265,031
Reorganization costs	206,016	-	206,016	-
Amortization	291,406	290,382	580,114	553,274
Stock based compensation	34,069	33,931	60,120	50,688
Interest and bank charges	14,798	13,430	28,590	25,648
	<u>3,272,279</u>	<u>4,158,173</u>	<u>6,530,301</u>	<u>8,259,868</u>
Loss before undernoted items	(278,658)	(1,619,329)	(355,110)	(2,722,262)
Interest and other	48,044	80,269	79,996	158,427
Foreign exchange (loss) gain	(98,235)	(85)	(27,210)	119,393
	<u>(50,191)</u>	<u>80,184</u>	<u>52,786</u>	<u>277,820</u>
Loss before income taxes	(328,849)	(1,539,145)	(302,324)	(2,444,442)
Provision for income taxes	<u>11,078</u>	<u>194,668</u>	<u>21,756</u>	<u>216,519</u>
Net loss	<u>\$ (339,927)</u>	<u>\$ (1,733,813)</u>	<u>\$ (324,080)</u>	<u>\$ (2,660,961)</u>
Net loss per common share				
- Basic	\$ (0.03)	\$ (0.18)	\$ (0.03)	\$ (0.27)
- Fully diluted	\$ (0.03)	\$ (0.18)	\$ (0.03)	\$ (0.27)
Weighted average number of shares				
- Basic			9,936,944	9,935,440
- Fully diluted			9,936,944	9,935,440
<hr/>				
Deficit, beginning of year			\$ (36,573,188)	\$ (24,603,941)
Net loss			<u>(324,080)</u>	<u>(2,660,961)</u>
Deficit, end of period			<u>(36,897,268)</u>	<u>(27,264,902)</u>

Xenos Group Inc.
Consolidated Balance Sheets
(Unaudited)

	As at	
	March 31 2007	September 30 2006
ASSETS		
CURRENT		
Cash and short term investments	\$ 7,533,479	\$ 7,308,177
Trade receivables	2,564,104	2,103,212
Other receivables	33,030	3,085
Prepays	705,526	689,491
Income taxes recoverable	7,503	7,204
	<u>10,843,642</u>	<u>10,111,169</u>
LONG TERM		
Future income taxes	1,173,393	1,164,566
Capital assets	1,218,744	1,346,041
Intangibles and other assets	2,222,196	2,470,274
	<u>4,614,333</u>	<u>4,980,881</u>
TOTAL ASSETS	<u>\$ 15,457,975</u>	<u>\$ 15,092,050</u>
LIABILITIES		
CURRENT		
Bank indebtedness	\$ 500,000	\$ 500,000
Payables & accruals	1,756,099	2,307,340
Income taxes payable	14,415	8,095
Deferred revenue	4,407,701	3,261,751
Current portion - capital lease	90,730	64,893
	<u>6,768,945</u>	<u>6,142,079</u>
LONG TERM		
Capital lease obligations	104,563	95,252
Deferred revenue	19,722	13,371
Deferred lease inducements	160,805	173,448
	<u>285,090</u>	<u>282,071</u>
TOTAL LIABILITIES	7,054,035	6,424,150
SHAREHOLDERS' EQUITY		
Capital stock (Note 3)	44,969,035	44,969,035
Contributed surplus (Note 4)	332,173	272,053
Deficit	(36,897,268)	(36,573,188)
TOTAL SHAREHOLDERS' EQUITY	<u>8,403,940</u>	<u>8,667,900</u>
TOTAL LIABILITIES & EQUITY	<u>\$ 15,457,975</u>	<u>\$ 15,092,050</u>

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

	Three Months Ended March 31		Six Months Ended March 31	
	2007	2006	2007	2006
Operating activities				
Net loss	\$ (339,927)	\$ (1,733,813)	\$ (324,080)	\$ (2,660,961)
Amortization	291,406	290,382	580,114	553,274
Loss on disposal of capital assets	46,179	-	67,837	-
Future income taxes	1,268	166,132	(8,827)	173,745
Stock based compensation	34,069	33,931	60,120	50,688
Change in non-cash working capital	1,025,716	877,564	87,566	900,460
	1,058,711	(365,804)	462,730	(982,794)
Financing activities				
Capital lease payments	(21,389)	(9,737)	(40,587)	(19,289)
Proceeds on issue of shares	-	4,950	-	4,950
	(21,389)	(4,787)	(40,587)	(14,339)
Investing activities				
Additional consideration paid on acquisitions	-	(64,326)	-	(67,688)
Purchase of capital assets	(21,657)	(110,843)	(55,982)	(254,186)
Development costs incurred	(37,115)	(85,891)	(140,859)	(223,116)
	(58,772)	(261,060)	(196,841)	(544,990)
Net increase (decrease) in cash and short term investments	978,550	(631,651)	225,302	(1,542,123)
Cash and short term investments				
Beginning of period	6,554,929	11,123,269	7,308,177	12,033,741
End of period	\$ 7,533,479	\$ 10,491,618	\$ 7,533,479	\$ 10,491,618

Xenos Group Inc.

Notes to the Condensed Consolidated Financial Statements

March 31, 2007 and 2006

1. Basis of presentation

The unaudited consolidated interim financial statements are prepared in accordance with Canadian generally accepted accounting principles and follow the same accounting policies and methods of their application as at the most recent audited annual financial statements for the year ended September 30, 2006. These financial statements should be read in conjunction with the audited annual financial statements for the year ended September 30, 2006.

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

	March 31, 2007		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

	March 31 2007	September 30 2006
Balance, beginning of year	\$ 272,053	\$ 148,638
Stock based compensation	60,120	123,415
Balance, end of period	<u>\$ 332,173</u>	<u>\$ 272,053</u>

5. Supplemental cash flow information

	March 31 2007	March 31 2006
(a) Change in non-cash operating working capital:		
Receivables	\$ (490,837)	\$ (220,645)
Prepays	(16,035)	(66,652)
Income taxes recoverable	(299)	-
Payables and accruals	(551,241)	300,706
Income taxes payable	6,320	(1,368)
Deferred lease inducements	(12,643)	23,083
Deferred revenue	1,152,301	865,336
	<u>\$ 87,566</u>	<u>\$ 900,460</u>
b) Cash and short term investments consist of cash on hand, balances with banks, cash equivalents and short term investments		
(c) Interest paid	\$ 28,590	\$ 25,648
(d) Income taxes paid (net of recoveries)	\$ 10,920	\$ 1,106

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:

2008	\$ 757,613
2009	490,683
2010	387,462
2011	348,600
2012	316,463
Thereafter	816,450
	<u>\$ 3,117,271</u>

7. Reorganization costs

During the second quarter of fiscal 2007, the Company incurred a reorganization charge of \$206,016, which included a 13% reduction in headcount and the relocation of the remaining US based head office management functions to Toronto. Of this amount, \$45,860 relates to the loss incurred on disposal of excess capital equipment. The total reorganization costs paid during the six month period ended March 31, 2007 was \$499,856 and includes amounts paid in connection with the reorganization charge incurred during the fourth quarter of fiscal 2006.

8. 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 March 31, 2007 and September 30, 2006 and any changes during each year-to-date period is presented below:

	Shares		Weighted Average Exercise Price	
	March 31 2007	September 30 2006	March 31 2007	September 30 2006
Outstanding, beginning of year	1,096,138	958,138	\$ 1.87	\$ 2.14
Granted	45,000	544,000	1.44	1.66
Exercised	-	(3,000)	-	1.65
Forfeited	<u>(541,138)</u>	<u>(403,000)</u>	1.84	2.22
Outstanding, end of quarter	<u>600,000</u>	<u>1,096,138</u>	\$ 1.87	\$ 1.87
Options exercisable at quarter end	<u>173,500</u>	<u>364,638</u>		

8. Stock based compensation plan (continued)

The following information applies to options outstanding at March 31, 2007:

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	-	55	\$ 1.26	October, 2011
1.29	-	225,000	54	1.29	September, 2011
1.34	-	25,000	54	1.34	September, 2011
1.35	-	25,000	58	1.35	January, 2012
1.65	20,000	-	5	1.65	August, 2007
1.65	25,000	-	2	1.65	May, 2007
1.65	-	62,500	45	1.65	December, 2010
1.65	15,000	-	59	1.65	February, 2012
1.90	12,000	-	46	1.90	January, 2011
1.99	-	79,000	48	1.99	March, 2011
2.20	6,000	-	12	2.20	March, 2008
2.35	14,000	-	35	2.35	February, 2010
3.45	3,750	-	20	3.45	November, 2008
3.60	15,000	2,500	20	3.60	November, 2008
3.80	48,750	7,500	19	3.80	October, 2008
4.36	9,000	-	24	4.36	March, 2009

9. 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	
	March 2007	March 2006	March 2007	September 2006
Canada	\$ 342,159	\$ 433,006	\$ 890,272	\$ 910,547
Europe	778,318	727,664	8,176	7,026
United Kingdom	1,832,251	1,296,696	272,745	290,668
United States	4,519,813	4,071,562	47,551	137,800
Other	178,708	217,863	-	-
	<u>\$ 7,651,249</u>	<u>\$ 6,746,791</u>	<u>\$ 1,218,744</u>	<u>\$ 1,346,041</u>

10. 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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