

Xenos

Third Quarter Report

Three and nine months ended June 30, 2001

To Our Shareholders:

Xenos' revenues in Q3 2001 were \$2.6 million, in line with analyst expectations and consistent with our second quarter revenues this year. Despite current market conditions, our sales pipeline is looking strong and I am confident that we will start to move forward positively in Q4 and see revenue growth.

Our commitment to market leadership has resulted in the launch of three new and exciting products, as scheduled, this quarter. We are designing our software to be future proof for the next generations of technologies and the first of our new Java-based products will be available in September 2001.

In this quarter we continued to add significant new customers including Symcor, Cellular South, Scicom, Lombard, and NCR to an already impressive list of blue-chip customers that includes American Express, Wells Fargo and Bank One. These organizations take our 'out-of-the-box' transformation software and integrate components around it such as workflow, archiving and presentment. They have recognized the 'unique' value of Xenos' software in achieving fast and easy deployment of their e-business applications.

Xenos' alliance strategy is on track, and we are developing our existing relationships and conducting intensive negotiations with new partners. These leading industry players want to partner with Xenos because we are the catalyst for driving tens of millions of dollars of their product sales, especially with our latest software.

The excellent relationship we have with IBM continues and has already produced significant revenues for both companies, including the initial sale this quarter to Symcor mentioned above. This quarter we signed a new alliance agreement with ACI Messaging Direct, a leading international provider of enterprise e-payment solutions. This relationship will enable organizations' to transform critical business documents, such as statements, bills and invoices, so they can be delivered securely via e-mail.

Overall, I am pleased to confirm that Xenos is confident of a return to revenue growth this quarter and beyond. The company is cash strong (our cash value is around \$1.80 per share), and we feel that our current valuation further excludes the fact that it would take tens of millions of dollars and years of development to build what we have.

Our latest software, along with our skilled and talented workforce in North America and Europe, is enabling millions of dollars of e-business applications a year. That's why we are becoming increasingly attractive to partners, who will help maximize Xenos' true growth potential.



Glen Manchester
President & Chief Executive Officer

Management's Discussion and Analysis of Financial Results for the Three and Nine Months ended June 30, 2001.

The following discussion should be read in conjunction with the Company's unaudited quarterly financial statements for the periods ending June 30, 2001 and 2000 contained herein and the notes thereto, as well as the management's discussion of the financial results and financial position for the year ended September 30, 2000.

Results of Operations:

Sales in the third quarter of fiscal 2001 were \$2.6 million, consistent with the second quarter of the year but lower than the \$3.4 million in the same period last year. Sales in the second and third quarters of fiscal 2001 were adversely affected by the current market conditions. For the nine months ended June 30, 2001 sales were \$9.3 million compared to \$11.3 million the prior year.

As a result of the lower sales, gross margins in the quarter as a percentage of sales reduced to 66% from 75% last year, but showed a modest improvement from the 64% in the second quarter of the current year. For the nine months ended June 30, 2001 gross margin as a percentage of sales was 73% compared to 76% last year.

Research and development expenses in the three and nine month periods ended June 30, 2001 were \$0.8 million and \$2.6 million respectively as compared to \$0.9 million and \$2.4 million in the same periods last year. The new development team has enabled the Company to deliver three new products this quarter with another release expected shortly. During the third quarter, approximately \$363,000 in R&D costs were deferred as they related directly to new products as yet unreleased.

Administrative and general expenses were down significantly from last year and marginally from the prior quarter. As a result of the restructuring initiatives undertaken in the fourth quarter of last year and subsequently, the Company's efforts are now focused on sales, marketing, customer support and development.

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 three to four years.

Tax expense was \$127,000 as compared to a recovery of \$151,000 last year as tax loss carrybacks relating to the UK operation were recognized in that period.

The net loss was \$2.4 million or \$0.29 per common share for the three months ended June 30, 2001. This was slightly lower than the loss of \$2.5 million or \$0.31 per share in the third quarter of fiscal 2000 due to lower overhead and R&D costs and reduced amortization charges. For the nine months ended June 30, 2001 the net loss was \$6.7 million or \$0.80 per common share compared to \$5.4 million or \$0.68 per common share in fiscal 2000.

Financial Condition and Liquidity:

As at June 30, 2001, cash and short-term investments stood at \$15.1 million compared to \$19.1 million at the end of last year's third quarter and \$18.5 million at the end of fiscal 2000. The decrease in cash on a year-over-year basis and from the year-end is primarily the result of ongoing losses from the Company's operations. Working capital as at June 30, 2001 was \$12.8 million compared to \$18.8 million as at September 30, 2000. Shareholders' equity stood at \$24.7 million or \$2.94 per common share compared to \$31.4 million or \$3.75 per common share at September 30, 2000.

After two quarters of negligible use of cash in fiscal 2001, a result of significant improvements in accounts receivable and other working capital balances, the Company did use cash in the third quarter. Cash used from operating activities, after changes in non-cash working capital items, was approximately \$1.7 million compared to \$2.6 million last year. For the nine months ended June 30, 2001, cash used in operating activities was \$1.3 million compared to \$3.7 million last year.

Capital expenditures in the third quarter of the current year of \$79,000 were reduced compared to the \$231,000 incurred in the prior year as part of the Company's continued efforts to conserve cash.

Included in cash disbursements for the nine months ended June 30, 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 \$597,000 in reorganization costs which had been previously accrued in fiscal 2000.

Outlook:

Looking ahead, management expects that fourth quarter sales will show a modest improvement from current levels. In addition, management remains confident that the Company will achieve its goal of breaking even on a cashflow basis by the end of 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 June 30		Nine Months Ended June 30	
	2001	2000	2001	2000
Sales	\$2,607,385	\$3,424,364	\$9,343,274	\$11,250,345
Service integration costs	894,227	860,304	2,566,265	2,682,188
Gross Profit	1,713,158	2,564,060	6,777,009	8,568,157
Expenses				
Sales and marketing	1,742,793	1,484,385	5,978,367	4,249,948
Research and development	810,348	906,526	2,577,828	2,391,048
Administration and general	709,533	2,095,179	2,287,053	4,789,150
Amortization	890,252	1,019,749	3,065,347	2,911,553
Interest expense	8,845	21,986	26,788	83,862
	4,161,771	5,527,825	13,935,383	14,425,561
Earnings (Loss) from operations	(2,448,613)	(2,963,765)	(7,158,374)	(5,857,404)
Other income				
Dividends, interest and other	143,666	310,748	741,312	471,494
Earnings (loss) before income taxes	(2,304,947)	(2,653,017)	(6,417,062)	(5,385,910)
Provision for income taxes	127,114	(151,002)	292,325	-
Net earnings (loss)	\$(2,432,061)	\$(2,502,015)	\$(6,709,387)	\$(5,385,910)
Net earnings (loss) per share				
- Basic & fully-diluted	\$(0.29)	\$(0.31)	\$(0.80)	\$(0.68)
Weighted average number of shares			8,385,597	7,871,608

Xenos Group Inc.
Consolidated Balance Sheets
(Unaudited)

	As at June 30	
	2001	2000
ASSETS		
CURRENT		
Cash & S.T. investments	\$15,114,201	\$19,061,819
Trade receivables	2,803,762	5,448,493
Other receivables	38,727	454,862
Prepays	216,871	447,865
Income taxes recoverable	-	890,851
Deferred income taxes	-	336,136
	18,173,561	26,640,026
LONG TERM		
Deferred income taxes	1,933,698	512,449
Capital assets	2,217,377	2,553,913
Other assets	1,295,736	714,342
Goodwill	6,619,651	8,334,521
	12,066,462	12,115,225
TOTAL ASSETS	\$30,240,023	\$38,755,251
LIABILITIES		
CURRENT		
Bank indebtedness	\$500,000	\$391,580
Payables & accruals	2,360,316	2,352,820
Income taxes payable	466,791	-
Deferred revenue	2,079,999	1,105,722
	5,407,106	3,850,122
LONG TERM LIABILITIES		
Deferred revenue	123,811	170,701
	123,811	170,701
TOTAL LIABILITIES	5,530,917	4,020,823
SHAREHOLDERS' EQUITY		
Capital stock	41,048,098	40,219,714
Retained earnings/(deficit)	(16,338,992)	(5,485,286)
TOTAL SHAREHOLDERS' EQUITY	24,709,106	34,734,428
TOTAL LIABILITIES & EQUITY	\$30,240,023	\$38,755,251

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

(Unaudited)

	Three Months Ended June 30		Nine Months Ended June 30	
	2001	2000	2001	2000
Operating activities				
Net Earnings (loss)	\$(2,432,061)	\$(2,502,015)	\$(6,709,387)	\$(5,385,910)
Amortization	890,252	1,019,749	3,065,347	2,911,553
Deferred income taxes	9,241	(54,136)	(7,788)	(54,136)
Reorganization costs	(20,785)	-	(597,138)	-
Change in non-cash working capital	(100,951)	(1,036,441)	2,988,420	(1,197,210)
	(1,654,304)	(2,572,843)	(1,260,546)	(3,725,703)
Financing Activities				
Bank financing	30,000	(15,139)	184,615	(963,220)
Proceeds on issue of special warrants	-	(123,048)	-	17,938,566
Proceeds on issue of shares	-	17,000	38,813	70,875
	30,000	(121,187)	223,428	17,046,221
Investing activities				
Cash paid on acquisition of subsidiaries	-	(77,010)	(766,985)	(5,719,282)
Purchase of capital assets	(78,649)	(230,605)	(426,690)	(2,065,825)
Development costs incurred	(363,061)	-	(1,125,096)	-
Other	-	50,545	-	57,858
	(441,710)	(257,070)	(2,318,771)	(7,727,249)
Net (decrease) increase in cash and cash equivalents	(2,066,014)	(2,951,100)	(3,355,889)	5,593,269
Cash and cash equivalents				
Beginning of period	17,180,215	22,012,919	18,470,090	13,468,550
End of period	\$15,114,201	\$19,061,819	\$15,114,201	\$19,061,819

Xenos Group Inc.

Notes to the Consolidated Financial Statements

June 30, 2001 and 2000

1. Nature of operations and Basis of presentation

Xenos is a world leading provider of transformation software that enables 'bricks and mortar' companies to rapidly produce online bills and statements. Xenos' out-of-the-box software transforms legacy data and printstreams into industry standard e-content formats to drive e-business applications, such as online billing and invoicing, and electronic statement presentment. Xenos' solutions are deployed at over 100 blue-chip companies, in industry sectors including banking, insurance, brokerage and telecommunications. Headquartered in Toronto, Canada, Xenos has global sales, professional services, product development, customer support and marketing operations. The Company has US headquarters in Dallas, Texas, and European headquarters in the UK.

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

	June 30, 2001	June 30, 2000
Cost	\$ 12,443,822	\$ 11,663,323
Accumulated amortization	<u>5,824,171</u>	<u>3,328,802</u>
Net book value	\$ <u>6,619,651</u>	\$ <u>8,334,521</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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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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Chief Financial Officer
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