



Third Quarter Report

Three and nine months ended June 30, 2005

To Our Shareholders:

We are pleased to report on our financial results for the third quarter and nine-month periods ended June 30, 2005.

For the fiscal third quarter ended June 30, 2005, Xenos reported revenues of \$4,508,000, an increase of 17.8% compared to revenues of \$3,825,000 for the same quarter last year. The Company reported EBITDA of \$340,000, compared to EBITDA of \$475,000 for the same period last year and third quarter net income of \$83,000, or \$0.01 per share, compared with net earnings of \$250,000, or \$0.02 per share for the third quarter of fiscal 2004. Xenos maintains a strong balance sheet, with a cash position of \$12.5 million, or \$1.26 per common share and no long-term debt.

For the first nine months of fiscal 2005, Xenos reported revenues of \$11,239,000 and a net loss of \$1,422,000, or (\$0.14) per share. This compares to revenues of \$12,094,000 and net earnings of \$409,000, or \$0.04 per share, for the same period last year.

Cash increased approximately \$700,000 from the Company's prior quarter, primarily resulting from the receipt of certain annual subscription payments and ongoing working capital improvement.

In the third quarter, we demonstrated healthy revenue growth, positive EBITDA and bottom line profitability. Particularly noteworthy in the third quarter was the substantial increase in our services business as synergistic combinations of our technologies are being employed to create unique and powerful solutions for our customers.

We have substantially completed our planned hiring program in sales and marketing and have grown our professional services group during the year. Year-to-date we have added seven new hires to our sales and marketing group and are now executing on targeted marketing campaigns aimed at key vertical markets.

Indicative of the broad applicability of Xenos' solutions are sales during the quarter in the US, Luxembourg and France.

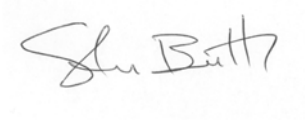
At the start of the quarter, Xenos released infoWEB version 5.1, a report and document distribution solution with expanded data support and enhanced information delivery options. An effective solution for e-government applications, the new release of infoWEB was purchased by Tioga County, New York for the ease with which it integrates data from many sources and its ability to repurpose that data throughout the county information network. Based on our early success in the county government market we are pursuing a significant number of new opportunities generated by our new marketing team.

In May, BCEE (Banque et Caisse d'Epargne de l'Etat du Luxembourg), the leading bank in Luxembourg purchased a d2e solution to facilitate document transformation and indexing as part of the bank's report-management service. The new report-management service at the bank enables agents to have secure electronic access to documents in PDF format originally produced by high-volume print stream legacy applications. Report management is a huge enterprise concern and customers such as BCEE are looking to reduce costs, to rapidly and simply distribute information in the desired format, and to provide it on demand.

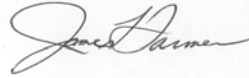
Xenos also announced a d2e sale to the DGCP (Director General for Public Accounts/la Direction Générale de la Comptabilité Publique). The DGCP, the revenue and tax department of the French government, is responsible for auditing the use of public funds and the management of tax forms from French taxpayers. The Xenos d2e solution is now helping the DGCP to meet this requirement and enable efficient archiving of approximately 30 million paper tax form submissions each year.

The Company continues to enhance the functionality and performance of its core technologies through increased development activity. This development effort is laying the foundation for powerful new solutions based on the Company's data and document integration, delivery and work flow solutions.

The Company has been investing in sales and marketing infrastructure to increase the impact of its awareness programs including brand management, market awareness, industry analyst relationships, search engine optimization and software download availability.



Stuart Butts
Chairman of the Board
And Chief Executive Officer



Jim Farmer
President and
Chief Operating Officer

Notice to reader of the interim financial statements

The Company's external auditors, Grant Thornton LLP, have not performed a review of these interim consolidated financial statements. These statements have been prepared by management and include the selection of appropriate accounting principles, judgments and estimates necessary to prepare these financial statements in accordance with Canadian generally accepted accounting principles.

Management's Discussion and Analysis of Financial Condition and Results of Operations for the Three and Nine Months ended June 30, 2005

The following discussion and analysis should be read together with the Company's unaudited quarterly financial statements for the periods ended June 30, 2005 and 2004 and related notes, as well as the audited consolidated financial statements and management's discussion and analysis for the year ended September 30, 2004. The objective of the MD&A is to communicate the Company's vision and core business strategy as executed through key performance drivers. These drivers are enabled by the Company's capability to execute on the strategy through its resources and systems and are manifested in both the historical and prospective results.

Certain statements made in the Management's Discussion and Analysis, elsewhere in the quarterly report, in various filings with Canadian regulators, in reports to shareholders and in other communications, are forward-looking within the meaning of certain securities laws. Such forward-looking statements are based on a number of assumptions and involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company or developments in the Company's business or its industry to differ materially from the anticipated results, performance, achievements or developments expressed or implied by such forward-looking statements. We urge you not to place undue reliance on these forward-looking statements as they are based on management's current plans, estimates, opinions and projections. The Company assumes no obligation to update forward-looking statements if assumptions or these plans, estimates, opinions or projections should change.

Overview

Xenos information management solutions fulfill business objectives by repurposing existing documents and data. Its solutions provide document capture, composition, transformation, enhancement, repurposing, storage, retrieval and distribution across the enterprise. Xenos data solutions are used to integrate incompatible applications, business processes, enterprise systems, partners, structured data, databases and Web services. These solutions improve operational efficiencies and help organizations adhere to regulations and standards while reducing costs.

Xenos' products accept all 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 all popular operating systems. Xenos solutions conform to open standards and readily adapt to in-house applications without changes or custom programming.

Xenos software solutions provide organizations with the speed and agility needed to quickly adapt to evolving data management environments. A key element of Xenos' innovative product direction is the support of open technologies such as XML and Java, critical for enabling the next generation of eBusiness applications. Xenos products are available for direct purchase and through the Xenos distribution channel, internationally.

d2e

d2e is a document enhancement solution that enables the transformation, repurposing, archival, retrieval, printing and Web viewing of documents across the enterprise.

GoXML

GoXML is an integration and transaction-processing solution for structured data such as EDI, EDIFACT, AL3, X12, HL7, FIX/SWIFT and many other industry standards.

infoWEB

infoWEB is a report and document distribution solution that consolidates information from incompatible systems to make them available for Web viewing.

Xenos sells primarily through its direct sales force but also uses Value-Added Resellers in specific markets such as in Latin America, Asia and certain parts 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.

The Company has historically had success in a wide range of industry verticals and in particular banking, brokerage and insurance. The introduction of the GoXML™ products has enabled recent initiatives in other verticals, the healthcare sector and ports in particular. The infoWEB™ product has been promoted into municipal government markets and the recent addition of expanded information delivery options have broadened its future vertical market appeal considerably.

Xenos has offices in Toronto, Dallas, London (U.K.), Paris and Vancouver.

The authorized share capital of the Company consists of an unlimited number of Common Shares. As at June 30, 2005, there were 9,927,278 shares issued and outstanding. Stock options for a total of 1,004,804 shares were outstanding at exercise prices ranging from \$1.36 to \$6.00 with various expiry dates, the latest of which is February, 2010.

Fiscal 2005 Business Highlights

During the third quarter, the Company continued to build its marketing team and to implement an initial phase of product strategies. In addition, an inside sales function was established to further refine the Company's ability to convert sales prospects into qualified leads.

The Company also released an important new version of its infoWEB document management software which incorporates added functionality including expanded information delivery options and electronic collaboration.

RESULTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED JUNE 30, 2005

For the three months ended June 30, 2005, sales were \$4.5 million as compared to \$3.8 million in the previous year. The increase was primarily the result of higher new license sales in North America. On a year-to-date basis, sales were \$11.2 million as compared to \$12.1 million in the previous year.

Geographically, 74% of sales in the quarter were in North America while 25% were in Europe compared to 60% and 38% respectively in fiscal 2004. License sales comprised approximately 39% of total revenues in the quarter compared to 22% in the prior year.

Gross profits for the quarter at 85% were marginally higher than the 82% posted in the prior year. For the year-to-date period ended June 30, 2005 and 2004, gross profit was 83% and 82% respectively.

Sales and marketing expenses at \$2.1 million for the quarter were up from \$1.5 million in the prior year as a result of higher marketing costs and sales commissions. The full cost impact of the incremental staffing and programs will be reflected in the next couple of quarters. Year-to-date, sales and marketing expenses were \$5.7 million vs \$4.7 million in the previous year.

Total expenditures on product development, gross of amounts deferred, increased to \$940,000 from \$829,000 in the prior year as a result of new hires. Year-to-date, these expenditures were \$2.9 million and \$2.7 million respectively.

Administrative expenses increased to \$595,000 from \$493,000 in the prior year as a result of bonus accrual reversals last year. Year-to-date, administrative costs increased to \$1.9 million as compared to \$1.7 million.

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.

Amortization charges of \$278,000 compare to \$367,000 in fiscal 2004. The decrease reflects the fact that certain deferred items became fully amortized at the end of fiscal 2004. For the nine months ended June 30, 2005 and 2004, amortization costs were \$828,000 and \$1.1 million respectively.

Foreign exchange gains were \$36,000 in the quarter as compared to \$106,000 in the prior year. The gains were primarily the result of the impact of fluctuations in the exchange rate on US dollar cash on hand.

The tax expense of \$67,000 (Fiscal 2004 – expense of \$7,000) is primarily related to lower projected utilization of tax loss carry-forwards in the Canadian parent.

Interest income in the quarter increased to \$62,000 from \$51,000 (Year-to-date June 30, 2005 - \$197,000 vs \$173,000 in the prior year).

Net income for the quarter was \$83,000 or \$0.01 per share as compared to \$250,000 or \$0.02 per share in the previous year. For the nine months ended June 30, 2005, the net loss was \$1.4 million as compared to net income of \$409,000 in the prior year.

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, goodwill, 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.

Acquisition of XML Global

On November 17, 2003, Xenos acquired the business assets of XML Global for a combination of cash and stock which came with a price guarantee on the one year anniversary of the transaction. The purchase price equation and allocation between acquired intangible assets and goodwill was determined internally based on a methodology consistent with valuation calculations that had been done for the Company in the past by independent valuers. Although this calculation was reviewed by our external auditors, it was not performed by an independent valuation firm. The Company is scheduled to commission an external valuation for impairment test purposes in this current fiscal year as part of its normal practice.

Revenue

In accordance with GAAP, 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 endeavours 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 value of goodwill and 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.

The Company's practice is to review goodwill for impairment on an annual basis or when an event or a change in facts and circumstances indicates the fair value of a reporting unit may be below its carrying amount. Independent valuation firms are used to test for impairment whenever there are indications of impairment or under other circumstances every three years. The next scheduled external valuation is in this fiscal year. The valuation methodology used includes the performance of a discounted cash flow calculation against projected cash flows for the Company as a whole and also for each of its reporting units, being the North American and EMEA operations.

Based on currently available information, management does not anticipate that an impairment of its goodwill or acquired intangibles exists, although there can be no assurance of this.

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 carryforwards, 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 carryforwards 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 US subsidiary is a service provider and the UK 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 GAAP requirements, stock options are required to be expensed and incorporated into the 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.

LIQUIDITY AND CAPITAL RESOURCES

As at June 30, 2005, cash and short-term investments stood at \$12.5 million (June 30, 2004 - \$12.7 million) or \$1.26 per common share (i). Cash provided from operations was \$972,000 as compared to \$683,000 in the previous year. On a year-to-date basis, cash provided by operations was \$793,000 as compared to \$1.1 million in the prior year.

The Company currently has an operating line of credit of \$1.0 million of which \$500,000 (June 30, 2004 - \$ 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 a capital lease.

Cash on final settlement of the price guarantee mechanism of the XML Global transaction of \$228,625 was paid in the first quarter.

Capital expenditures for the quarter ended June 30, 2005 were \$55,000, versus \$70,000 in the prior year. On a year-to-date basis, capital expenditures were \$164,000 as compared to \$231,000 in the prior year.

Development costs capitalized were \$175,000 versus \$186,000 last year and represent the internal development costs relating to specific products as required by Canadian GAAP. For the nine months ended June 30, 2005, capitalized costs were \$536,000 vs \$459,000 in the prior year.

Shareholders' equity stood at \$20.8 million or \$2.10 per share (ii) compared to \$22.3 million or \$2.25 per share (ii) as at June 30, 2004.

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.

Risk Factors

You should carefully consider each of the following factors as well as the other information in this report in evaluating our business and our prospects. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently consider immaterial may also impair our business.

If the Canadian dollar continues to rise relative to the US dollar, future operating results will be negatively affected

The Company is a net exporter that currently derives about 60% of its revenue in US dollars whereas its cost base is largely in Canadian dollars with smaller proportions in US dollars, UK pounds and Euros. Over the past few years, we have relocated most technical and administrative positions to our Toronto head office where we have a significant employee cost advantage, lower healthcare costs, the synergies of having departments located in the same facility and excellent availability of highly qualified individuals.

The decline of the US dollar therefore has a major impact on the Company's profitability as it negatively impacts revenues and reduces the cost advantage of staffing in Canada. For the past few years, we have entered into forward contracts in order to partially hedge the exposure of our US dollar receipts. Although the Company has been quite successful in reducing the impact of changes in the exchange rate through forward contracts, these measures obviously do not alter the fundamental challenge that the decline of the US dollar represents.

Our products and services may not gain market acceptance or competitors may introduce offerings that surpass those of the Company

The Company has assembled what it believes to be a unique suite of products that will be the basis of future revenue growth, particularly in certain vertical markets. There are numerous competitors in our market spaces, some of whom have significantly more resources than the Company. In addition, the market for the Company's products is subject to rapid technological change. There can be no assurance that the Company will be successful in driving significant revenue growth through its current strategy.

International operations expose the Company to increased business risks

The Company historically does about one-third of its business outside of North America. Operations in Europe, through our UK based subsidiary, are subject to certain risks and costs including the challenge of administering business abroad, compliance with foreign laws, language issues and limitations regarding the repatriation of funds. Sales into Latin America and Asia are through Value-Added Resellers whose performance and sales effort is largely outside of the control of the Company.

The renewal of maintenance revenue on our older software sales may decline

The Company has historically enjoyed a very high retention rate across its various product lines. In addition, recurring revenue has been running at or above 50% of overall revenues. As the products age, these retention rates may not be sustained unless the

Company is successful in providing our customers with more advanced functionality and the levels of support that they require.

The loss of licenses to use or sell third party software or the lack of support or enhancement of such software could adversely affect the Company's business significantly

The Company, specifically its UK based subsidiary, depends on the sale and support of third party software for a significant component of its business. There can be no assurance that these third party products will be available on commercially reasonable terms or they may not be appropriately supported, maintained or enhanced by the licensors. Such occurrences would have significant adverse impacts on the Company although all efforts would be made to mitigate such impacts.

We derive significant recurring annual revenues from one customer and have reliance on individual contracts

Although not greater than 10% of revenues, the Company currently derives significant recurring annual revenue relating to multiple subsidiaries of one large multi-national organization. The current contract was recently negotiated and extends to December 31, 2007. Also, in any given quarter, license sales from individual transactions can be material and in some cases the related sales cycles can be long. Therefore, the Company's revenue and earnings can fluctuate materially between quarters due to the timing of significant license agreements. There is no guarantee or assurance that such timing will remain consistent making year over year comparisons less meaningful than in some other industries.

Other companies may claim that Xenos infringes on their intellectual property

The Company does not believe that its products infringe on the rights of third parties but there can be no assurance that such assertions will not be made resulting in costly litigation or the requirement to source alternate solutions on reasonable terms. By practice, the Company does not patent its intellectual property but rather relies upon a combination of trademark and trade secret laws, confidentiality procedures, contractual provisions and other measures to protect its proprietary information.

The impact of income, sales and other taxes may be higher than the Company believes

The Company is subject to taxes in a variety of jurisdictions and our tax structure is reviewed by domestic and foreign tax authorities. As a matter of practice, we allocate significant external and internal resources towards tax compliance efforts made by the Company. Although we believe our practices and estimates to be reasonable, adverse tax outcomes may differ from our reported results and could impact our financial results.

The Company's products may contain defects that would expose it to liability

The Company's business may subject it to the risk of product liability claims. From time to time, our software may contain design defects or software errors. These risks are mitigated through limitations in our customer contracts as well as the maintenance of Errors & Omissions insurance coverage where available on commercially reasonable terms. There can be no assurance that uninsured product claims will not have an adverse effect on the Company's business.

Financial Instruments can introduce risks to the organization

The Company does not employ the use of financial instruments other than the foreign exchange forward contracts for hedging purposes.

The Company's ability to manage cost containment could have a materially adverse impact on future profitability

The Company is endeavouring to construct a cost structure that will allow profits, if not reinvested, to scale at a much higher rate than revenue growth. Employee costs are by far the single largest expenditure of the organization. The Company recently reduced its level of employee subsidization for US benefits which had been growing at unsustainable double digit rates. Also, non-promotion based salaries were frozen for the current fiscal year and no performance-based bonuses were payable in respect of fiscal 2004. Travel related costs are the second highest expense category and the Company maintains a system of centralized controls and procedures to ensure that only fiscally appropriate travel is undertaken. If the Company should lose control over its cost containment the result could threaten its business model.

Evolving financial reporting standards, regulation of corporate governance and public disclosure may result in additional expenses and continuing uncertainty

Changing financial reporting standards and corporate governance related laws, and regulations, including National Instrument 52-109, are creating challenges for a relatively small company such as ourselves. The application of these new securities laws will evolve over time which in the meantime will result in a period of uncertainty regarding compliance matters, liability of directors and officers, and higher costs. We are committed to maintaining a high standard of corporate governance and public disclosure and are well into our scoped project to meet the required timelines for full certification.

The Company's ability to hire and retain key employees is significant

The Company's business is almost entirely dependent on the performance of its employees and its success on the ability of its managers to continually recruit, train and motivate. Due to financial constraints, the Company has not increased employee base salaries in this fiscal year except in the case of promotions. In addition, given uncertainty in the market regarding appropriate forms of long-term incentives, the Company has deferred the issuance of any stock options to employees to an exception basis only until current trends become more apparent. Management monitors attrition rates carefully in order to assess trends and establish competitive benchmark compensation plans.

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 per employee, employee costs as a percent of sales, maintenance renewal rates, average deal sizes, revenue by channel and component, 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 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 while remaining profitable and efficient. The current focus revolves around generating increased sales activity for each of the products in its portfolio through various means including market analysis, product strategy and lead generation.

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.
- (ii.) Shareholders' equity is a non-GAAP measure and is calculated by dividing the shareholders' equity by the number of common shares outstanding.

Xenos Group Inc.

Consolidated Statements of Operations

(Unaudited)

	Three Months Ended June 30		Nine Months Ended June 30	
	2005	2004	2005	2004
Sales	\$ 4,507,506	\$ 3,824,831	\$ 11,238,567	\$ 12,093,963
Cost of sales	695,371	689,220	1,855,520	2,200,460
Gross profit	3,812,135	3,135,611	9,383,047	9,893,503
Expenses				
Sales and marketing	2,111,249	1,524,854	5,677,254	4,701,322
Research and development	765,568	642,955	2,358,775	2,277,422
Administration and general	594,999	492,960	1,888,871	1,698,973
Amortization	278,453	367,346	828,234	1,074,679
Interest and bank charges	10,423	8,171	30,566	25,617
	3,760,692	3,036,286	10,783,700	9,778,013
Income (loss) from operations	51,443	99,325	(1,400,653)	115,490
Other income				
Interest and other	61,996	51,025	196,606	173,034
Foreign exchange gain (loss)	36,248	106,349	(70,491)	95,454
Income (loss) before income taxes	149,687	256,699	(1,274,538)	383,978
Provision (recovery) of income taxes	67,073	6,576	147,850	(25,045)
Net income (loss)	\$ 82,614	\$ 250,123	\$ (1,422,388)	\$ 409,023
Net income (loss) per common share				
- Basic	\$ 0.01	\$ 0.02	\$ (0.14)	\$ 0.04
- Fully diluted	\$ 0.01	\$ 0.02	\$ (0.14)	\$ 0.04
Weighted average number of shares				
- Basic			9,917,592	9,723,749
- Fully diluted			10,118,324	10,156,969
Deficit, beginning of year as previously stated			\$ (22,775,608)	\$ (23,254,319)
Impact of retroactive adoption of CICA recommendations for stock-based compensation			(65,141)	-
Deficit, beginning of year as restated			(22,840,749)	(23,254,319)
Net (loss) income			(1,422,388)	409,023
Deficit, end of period			\$ (24,263,137)	\$ (22,845,296)

Xenos Group Inc.
Consolidated Balance Sheets
(Unaudited)

	As at June 30	
	2005	2004
ASSETS		
CURRENT		
Cash & S.T. investments	\$ 12,504,738	\$ 12,669,109
Trade receivables	2,218,670	2,560,896
Other receivables	8,995	28,476
Prepays	720,585	665,127
Future income taxes	41,219	325,242
	<u>15,494,207</u>	<u>16,248,850</u>
LONG TERM		
Future income taxes	1,892,955	1,732,368
Capital assets	1,250,570	1,220,750
Intangibles and other assets	3,019,018	3,106,525
Goodwill	6,300,856	6,228,909
	<u>12,463,399</u>	<u>12,288,552</u>
TOTAL ASSETS	<u>\$ 27,957,606</u>	<u>\$ 28,537,402</u>
LIABILITIES		
CURRENT		
Bank indebtedness	\$ 500,000	\$ 500,000
Payables & accruals	2,030,364	1,546,823
Income taxes payable	52,029	74,491
Deferred revenue	4,256,072	4,055,349
Current portion - capital lease	40,263	18,880
	<u>6,878,728</u>	<u>6,195,543</u>
LONG TERM		
Capital lease obligations	123,618	1,676
Deferred revenue	1,581	28,667
Deferred rent	135,416	29,767
	<u>260,615</u>	<u>60,110</u>
TOTAL LIABILITIES	<u>7,139,343</u>	<u>6,255,653</u>
SHAREHOLDERS' EQUITY		
Capital stock	45,081,400	45,127,045
Deficit	(24,263,137)	(22,845,296)
TOTAL SHAREHOLDERS' EQUITY	<u>20,818,263</u>	<u>22,281,749</u>
TOTAL LIABILITIES & EQUITY	<u>\$ 27,957,606</u>	<u>\$ 28,537,402</u>

Xenos Group Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	Three Months Ended June 30		Nine Months Ended June 30	
	2005	2004	2005	2004
Operating activities				
Net income (loss)	\$ 82,614	\$ 250,123	\$ (1,422,388)	\$ 409,023
Amortization	278,453	367,346	828,234	1,074,679
(Gain) loss on sale of capital assets	-	(19)	-	6,369
Future income taxes	55,705	(13,951)	116,636	(76,108)
Stock based compensation	20,334	681	58,179	2,043
Change in non-cash working capital	535,229	78,991	1,211,844	(317,143)
	972,335	683,171	792,505	1,098,863
Financing Activities				
Share issuance costs	-	-	-	(3,500)
Proceeds on issue of shares	-	-	54,313	12,009
	-	-	54,313	8,509
Investing activities				
Cash paid on acquisition of business assets	-	-	(228,625)	(1,669,928)
Additional consideration paid on acquisitions	(41,456)	(17,102)	(57,240)	(52,021)
Purchase of capital assets	(54,963)	(69,865)	(163,932)	(230,637)
Proceeds on disposal of fixed assets	-	241	-	1,272
Development costs incurred	(174,504)	(185,756)	(536,347)	(459,222)
	(270,923)	(272,482)	(986,144)	(2,410,536)
Net increase (decrease) in cash and short term investments	701,412	410,689	(139,326)	(1,303,164)
Cash and short term investments				
Beginning of period	11,803,326	12,258,420	12,644,064	13,972,273
End of period	\$ 12,504,738	\$ 12,669,109	\$ 12,504,738	\$ 12,669,109

Xenos Group Inc.

Notes to the Condensed Consolidated Financial Statements

June 30, 2005 and 2004

1. Nature of operations and Basis of presentation

Xenos provides its customers with access to, enhancement, storage and delivery of mission critical information through its non-invasive middleware products and services. Xenos d2e Vision™ and d2e Platform™ software transforms and repurposes documents, statements and reports into e-content, supporting both e-business and print strategies for electronic statement presentment, enterprise content management, archiving and print automation. Xenos infoWEB™ software securely and rapidly distributes business documents and reports within departments, throughout the enterprise and beyond, to any standard web browser. Xenos GoXML™ Integration Suite enables the integration of business processes, enterprise systems, structured data, databases and web services or service oriented architectures. 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 is headquartered in Toronto with offices in Dallas, London (UK), Paris and Vancouver.

2. Summary of significant accounting policies

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. Actual results could differ from those estimates.

Stock-based compensation

On October 1, 2002, the Company changed its accounting policy with respect to the recognition, measurement, and disclosure of stock-based compensation made in exchange for goods and services provided by employees and non-employees, to be consistent with new rules issued by the Canadian Institute of Chartered Accountants, in December 2001. The new standard requires that a fair value based method of accounting be applied to all stock-based payments to non-employees and to employee awards that are direct awards of stock, that call for settlement in cash or other assets or are stock appreciation rights that call for settlement by the issuance of equity instruments.

The Company has reflected these changes in its financial statements with retroactive application effective October 1, 2004. Compensation expense is being recorded related to employee stock options previously disclosed on a proforma basis. An adjustment to opening retained earnings has been made to reflect the related compensation expense for the period October 1, 2002 to September 31, 2004 on all options granted subsequent to October 1, 2002.

3. Acquisition of assets from XML-Global Technologies Inc.

Effective November 17, 2003, the Company acquired substantially all of the business assets of XML-Global Technologies, Inc. ("XML Global"), a software developer and vendor of XML middleware products. The Company acquired XML Global's intellectual property, customer relationships, and operating assets and retained all employees, for a total purchase price of \$ 5,169,928. The net assets acquired are as follows:

Accounts Receivable (net)	\$ 21,482
Office Furniture and Fixtures	52,400
Intangible Assets	<u>1,054,000</u>
Total identifiable assets	\$ 1,127,882
Total liabilities	<u>81,034</u>
Net assets	<u>\$ 1,046,848</u>
Acquisition price	<u>\$ 5,169,928</u>
Allocation:	
Net assets	\$ 1,046,848
Goodwill	<u>4,123,080</u>
	<u>\$ 5,169,928</u>
Consideration:	
Cash paid on acquisition	\$ 1,669,928
Cash paid subsequently in accordance with the share price guarantee	228,625
	<u>\$ 1,898,553</u>
Shares issued on acquisition	<u>3,271,375</u>
	<u>\$ 5,169,928</u>
Net cash paid:	
Cash, per above	<u>\$ 1,898,553</u>

During the year, as per the terms of the Company's acquisition of substantially all of the business assets of XML Global, the remaining 250,000 common shares were released from escrow and a one-time cash payment of \$228,625 was made to the holders. This payment was reflected as a reduction in Capital Stock.

4. Intangibles and other assets

	As at June 30	
	2005	2004
Cost		
Deferred development costs	\$ 6,252,729	\$ 5,556,759
Acquired intangible assets	1,104,000	1,104,000
	<u>\$ 7,356,729</u>	<u>\$ 6,660,759</u>
Accumulated amortization		
Deferred development costs	\$ 4,150,811	\$ 3,477,734
Acquired intangible assets	186,900	76,500
	<u>\$ 4,337,711</u>	<u>\$ 3,554,234</u>
Net book value		
Deferred development costs	\$ 2,101,918	\$ 2,079,025
Acquired intangible assets	917,100	1,027,500
	<u>\$ 3,019,018</u>	<u>\$ 3,106,525</u>

Included in amortization expense in the income statement for the nine months ended June 30, 2005 is \$ 455,589 (2004 - \$ 654,049) related to amortization of deferred development costs and \$ 82,800 (2004 - \$ 69,625) related to amortization of acquired intangibles.

5. Goodwill

	As at June 30	
	2005	2004
Net book value, beginning of period	\$ 6,243,616	\$ 2,066,578
Additions related to acquisition of business assets	-	4,123,080
Additional consideration paid on acquisitions	57,240	52,021
Realized tax asset benefit	-	(12,770)
Net book value, end of period	<u>\$ 6,300,856</u>	<u>\$ 6,228,909</u>

During the nine month period ended June 30, 2005, the Company paid additional consideration of \$57,240 (nine month period ended June 30, 2004 - \$ 52,021) to the former owners of Rush Creek Software Corporation. At the date of acquisition, a future income tax asset existed but was not recorded in accordance with Management's determination. Generally Accepted Accounting Principles require that when the benefit of this asset is realized it is recorded as a reduction of goodwill previously recognized.

During the year ended September 30, 2004, the Company purchased substantially all of the business assets of XML Global, (see Note 3) and recorded goodwill in the amount of \$4,123,080 pertaining to the acquisition.

6. Capital stock

	June 30, 2005		June 30, 2004	
	Number	Amount	Number	Amount
Balance, beginning of year	9,894,361	\$ 45,132,392	8,883,750	\$ 41,616,493
Issued pursuant to exercise of vested stock options	32,917	54,313	7,278	12,009
Stock based compensation (Note 2)	-	123,320	-	2,043
Share issuance costs	-	-	-	(3,500)
Issued pursuant to acquisition of XML Global business assets	-	-	1,000,000	3,500,000
Reduction due to cash paid subsequently pursuant to the share price guarantee (Note 3)	-	(228,625)	-	-
Balance, end of period	<u>9,927,278</u>	<u>\$ 45,081,400</u>	<u>9,891,028</u>	<u>\$ 45,127,045</u>

7. Stock-based compensation plan

A summary of the status of the Company's stock option plan as of June 30, 2005 and 2004 and any changes during each year-to-date period is presented below:

	Shares		Weighted Average Exercise Price	
	2005	2004	2005	2004
Outstanding, beginning of year	1,112,388	936,833	\$ 4.00	\$ 4.02
Granted	47,000	207,000	2.34	3.68
Exercised	(32,917)	(7,278)	1.65	1.65
Forfeited	<u>(121,667)</u>	<u>(9,500)</u>	17.83	2.98
Outstanding, end of quarter	<u>1,004,804</u>	<u>1,127,055</u>	\$ 2.33	\$ 3.98
Options exercisable at quarter end	<u>863,137</u>	<u>706,454</u>		

The following information applies to options outstanding at June 30, 2005:

<u>Option Price</u>	<u>Number</u>	<u>Expiry</u>
\$ 1.36	2,000	February, 2007
1.50	2,000	January, 2007
1.65	634,804	December, 2006
1.65	20,000	August, 2007
1.65	25,000	May, 2007
2.20	8,000	March, 2008
2.29	20,000	February, 2010
2.35	17,000	February, 2010
2.40	10,000	February, 2010
3.20	20,000	January, 2006
3.25	9,000	December, 2005
3.45	65,000	November, 2008
3.60	20,000	November, 2008
3.80	85,000	October, 2008
4.05	5,000	January, 2006
4.36	12,000	March, 2009
6.00	50,000	July, 2005

Pro forma disclosure of net income and earnings per share as if the Corporation had elected to adopt the fair value based accounting method for all awards granted on or after October 1, 2002:

	Three Months Ended		Nine Months Ended	
	June 30		June 30	
	2005	2004	2005	2004
Net income (loss) for the period				
As reported	\$ 82,614	\$ 250,123	\$ (1,422,388)	\$ 409,023
Pro forma	\$ 82,614	\$ 234,282	\$ (1,422,388)	\$ 363,263
Net income (loss) per share - basic				
As reported	\$ 0.01	\$ 0.02	\$ (0.14)	\$ 0.04
Pro forma	\$ 0.01	\$ 0.03	\$ (0.14)	\$ 0.04
Net income (loss) per share - fully-diluted				
As reported	\$ 0.01	\$ 0.02	\$ (0.14)	\$ 0.04
Pro forma	\$ 0.01	\$ 0.03	\$ (0.14)	\$ 0.04

For options issued, the fair value of each stock option grant is estimated as at the date of grant using the Black-Scholes option pricing model.

8. Foreign exchange contracts

From time to time, the Company uses foreign exchange forward contracts to hedge portions of its forecasted revenues denominated in foreign currencies. As a matter of policy, the Company does not enter into speculative futures contracts or use other derivative financial instruments. These activities serve to minimize, but not eliminate, the risk from fluctuations in the exchange rate between the foreign currencies and the Canadian dollar.

As at June 30, 2005, the Company had foreign exchange forward contracts outstanding to fix the rate at which estimated US dollar revenues are to be recorded in fiscal 2005 and 2006. The Company has committed to sell \$2.0 million US dollars during the balance of fiscal 2005 and \$1.0 million US dollars during the first quarter of fiscal 2006 at an average rate of exchange of CAD 1.2678. The fair market value of those contracts at June 30, 2005 was approximately \$3.104 million in US dollars.

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 and Goodwill	
	2005	2004	2005	2004
Canada	\$ 755,303	\$ 750,744	\$ 4,935,868	\$ 4,793,333
European Union	1,038,527	1,003,203	-	-
United Kingdom	2,270,063	2,901,217	279,623	339,187
United States	6,665,483	6,798,155	2,335,935	2,317,139
Other	509,191	640,644	-	-
	<u>\$ 11,238,567</u>	<u>\$ 12,093,963</u>	<u>\$ 7,551,426</u>	<u>\$ 7,449,659</u>

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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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