

Management's Report

EXFO's management is responsible for the preparation, integrity and objectivity of the consolidated financial statements and other financial information presented in this Annual Report.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include some amounts that are based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly in all material respects.

EXFO's policy is to maintain a system of internal accounting and administrative controls designed to provide reasonable assurance that the financial information is relevant, accurate and reliable, and that our assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that Management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out this responsibility principally through its Audit Committee.

The Audit Committee is appointed by the Board and is comprised of outside directors. The Committee meets periodically with Management and external auditors to review accounting, auditing and internal control matters.

These consolidated financial statements have been reviewed and approved by the Board of Directors on the recommendation of the Audit Committee.

The consolidated financial statements have been audited by PricewaterhouseCoopers LLP, the external auditors, in accordance with generally accepted auditing standards on behalf of the shareholders. The external auditors have full and free access to the Audit Committee.

Chairman, CEO and President



Germain Lamonde

Vice-President, Finance and Chief Financial Officer



Pierre Plamondon, CA

Auditors' Report

To the Shareholders of
EXFO Electro-Optical Engineering Inc.

We have audited the consolidated balance sheets of EXFO Electro-Optical Engineering Inc. as at August 31, 1999 and 2000 and the consolidated statements of earnings, retained earnings and cash flows for each of the years in the three-year period ended August 31, 2000. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at August 31, 1999 and 2000 and the results of its operations and its cash flows for each of the years in the three-year period ended August 31, 2000 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers s.r.l.

Chartered Accountants
Quebec, Quebec, Canada
September 20, 2000

Consolidated Balance Sheets

(in thousands of U.S. dollars) The accompanying notes are an integral part of these consolidated financial statements.

As at August 31,	1999	2000
Assets		
Current assets		
Cash and cash equivalents	\$ 423	\$ 729
Short-term investments (notes 9 and 19)	1,371	162,659
Accounts receivable (note 9)		
Trade	8,869	18,272
Other (note 5)	1,026	2,790
Income taxes receivable (note 9)	381	284
Inventories (notes 6 and 9)	7,591	18,868
Prepaid expenses and deposits	475	1,023
Future income taxes (note 17)	—	995
	20,136	205,620
Capital assets (notes 7 and 9)	2,639	8,694
Goodwill and other assets (notes 8 and 9)	65	2,320
Future income taxes (note 17)	—	3,089
	\$ 22,840	\$ 219,723
Liabilities		
Current liabilities		
Bank advances (note 9)	\$ —	\$ 10
Accounts payable and accrued liabilities (note 10)	5,523	10,353
Dividend payable	51	—
Mandatorily redeemable preferred shares (note 11)	—	543
Loan from a company under common control (note 15)	1,337	—
Deferred revenue	218	395
Current portion of long-term debt	—	152
Future income taxes (note 17)	262	—
	7,391	11,453
Deferred revenue	109	151
Deferred grants	533	1,109
Long-term debt (note 12)	—	16
Future income taxes (note 17)	128	—
	8,161	12,729
Shareholders' equity		
Share capital (note 13)	87	198,459
Cumulative translation adjustment	—	1,555
Retained earnings	14,592	6,980
	14,679	206,994
	\$ 22,840	\$ 219,723

On behalf of the Board:



Germain Lamonde
Chairman, CEO and President



André Tremblay
Chairman, Audit Committee

Consolidated Statements of Earnings

(in thousands of U.S. dollars, except share and per share data)

Years Ended August 31,	1998	1999	2000
	(note 3)	(note 3)	
Sales (note 18)	\$ 31,605	\$ 42,166	\$ 71,639
Cost of sales	11,345	14,998	24,712
Gross margin	20,260	27,168	46,927
Operating expenses			
Selling and administrative	9,898	13,279	24,304
Net research and development (note 15)	3,014	4,315	6,402
Amortization of capital assets	609	857	1,451
Amortization of other assets	48	41	47
Total operating expenses	13,569	18,492	32,204
Earnings from operations	6,691	8,676	14,723
Interest income, net	(40)	(136)	(1,480)
Foreign exchange loss (gain)	(126)	506	684
Earnings before income taxes and amortization of goodwill	6,857	8,306	15,519
Income taxes (note 17)	2,356	2,492	5,298
Earnings before amortization of goodwill	4,501	5,814	10,221
Amortization of goodwill	—	—	297
Net earnings for the year	\$ 4,501	\$ 5,814	\$ 9,924
Basic and fully diluted earnings per share			
Earnings before amortization of goodwill	\$ 0.12	\$ 0.14	\$ 0.26
Net earnings	\$ 0.12	\$ 0.14	\$ 0.25
Basic weighted average number of shares outstanding (000's)	38,000	38,001	39,951

Consolidated Statements of Retained Earnings

(in thousands of U.S. dollars, except per share data)

Years Ended August 31,	1998	1999	2000
	(note 3)	(note 3)	
Balance – Beginning of year	\$ 7,643	\$ 12,044	\$ 14,592
Add			
Net earnings for the year	4,501	5,814	9,924
	12,144	17,858	24,516
Deduct			
Dividends			
Class A shares	—	2,926	17,216
Class C share (note 4)	—	340	—
Class E shares	100	—	—
Class F shares	—	—	320
	100	3,266	17,536
Balance – End of year	\$ 12,044	\$ 14,592	\$ 6,980
Dividends per share			
Class A shares	\$ —	\$ 0.08	\$ 0.45
Class C share	\$ —	\$ 340	\$ —
Class E shares	\$ 0.005	\$ —	\$ —
Class F shares	\$ —	\$ —	\$ 0.45

Consolidated Statements of Cash Flows

(in thousands of U.S. dollars)

Years Ended August 31,	1998	1999	2000
	(note 3)	(note 3)	
Cash flows from operating activities			
Net earnings for the year	\$ 4,501	\$ 5,814	\$ 9,924
Add (deduct) items not affecting cash and cash equivalents			
Amortization of discount on short-term investments	—	—	(807)
Amortization of capital assets	609	857	1,451
Amortization of goodwill and other assets	48	41	344
Future income taxes	289	(42)	(33)
Change in non-cash operating working capital items			
Accounts receivable	(1,297)	(3,875)	(10,476)
Income taxes receivable	—	(381)	2,149
Inventories	(758)	(1,259)	(10,732)
Prepaid expenses and deposits	(117)	(205)	(519)
Accounts payable and accrued liabilities	369	1,965	3,917
Income taxes payable	(490)	(115)	—
Deferred revenue	—	327	215
Deferred grants	—	533	567
	3,154	3,660	(4,000)
Cash flows from financing activities			
Bank advances	(142)	(136)	(357)
Repayment of loan from a company under common control	—	—	(1,349)
Repayment of long-term debt	(21)	(20)	(812)
Issuance of share capital	—	86	209,690
Share issue expenses	—	—	(16,743)
Dividends paid	(100)	(3,215)	(17,587)
	(263)	(3,285)	172,842
Cash flows from investing activities			
Additions to short-term investments	(647)	(33)	(519,645)
Proceeds from disposal of short-term investments	—	—	359,886
Additions to capital and other assets	(1,336)	(1,181)	(7,180)
Business combination, net of cash and cash equivalents acquired (note 4)	—	—	(2,108)
	(1,983)	(1,214)	(169,047)
Change in cash and cash equivalents	908	(839)	(205)
Effect of foreign exchange rate changes on cash and cash equivalents	—	—	511
Cash and cash equivalents – Beginning of year	354	1,262	423
Cash and cash equivalents – End of year	\$ 1,262	\$ 423	\$ 729
Supplementary information			
Interest paid	\$ 145	\$ 148	\$ 480
Interest received	\$ (40)	\$ (98)	\$ (949)
Income taxes paid	\$ 2,032	\$ 2,801	\$ 3,761

Notes to Consolidated Financial Statements

(tabular amounts in thousands of U.S. dollars, except share and per share data and as otherwise noted)

1 · Incorporation and nature of activities

The company, incorporated in 1985 under the Canada Business Corporations Act, designs, manufactures and markets a full line of fiber-optic test, measurement and monitoring equipment and instruments for the telecommunications industry. The company derives substantially all of its revenue from customers located in the United States, Canada, Europe and Asia. Marketing activities outside Canada are carried out by subsidiaries located in the United States and Europe and independent representatives worldwide. The company's customers consist primarily of telecommunications carriers, cable television companies, public utilities, private network operators, third-party installers, equipment rental companies, as well as optical component, value-added optical module, and optical networking system manufacturers.

2 · Summary of significant accounting policies

Basis of presentation

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada. These principles conform, in all material respects, with accounting principles generally accepted in the United States, except as described in note 20. The principal accounting policies of the company, which have been consistently applied, are summarized as follows:

Accounting estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting year. Significant estimates include the allowance for doubtful accounts receivable, tax credits receivable, provisions for obsolete inventories, the useful lives of capital assets and goodwill and certain accrued liabilities. Actual results could differ from those estimates.

Consolidation

These consolidated financial statements include the accounts of the company and its subsidiaries.

Foreign currency translation

Foreign subsidiaries

The company's subsidiaries are considered to be integrated. As a result, the subsidiaries' accounts are remeasured into the functional currency using the temporal method. Under this method, monetary assets and liabilities are remeasured at the exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are remeasured at historical rates. Revenue and expenses are remeasured at the average rate for the year. Gains and losses resulting from remeasurement are reflected in the statement of earnings.

Foreign currency transactions

Transactions denominated in foreign currencies are measured into the functional currency using the temporal method.

Forward exchange contracts

The company enters into forward exchange contracts in order to hedge against potential exchange rate fluctuations on cash flows related to anticipated future revenue streams denominated in foreign currencies. Unrealized gains and losses on these forward exchange contracts are deferred and recognized upon settlement of the related transactions. Accordingly, cash flows resulting from forward exchange contract settlements are classified as cash flows from operating activities along with the corresponding cash flows being hedged.

Furthermore, the company has entered into forward exchange contracts to sell Canadian dollars in exchange for U.S. dollars. These contracts, which are speculative in nature, are carried on the balance sheet at fair value. Any

unrealized gains or losses on these contracts at each balance sheet date are included in earnings for the year.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks and all highly liquid short-term investments with original maturities of three months or less.

Short-term investments

Short-term investments are valued at the lower of cost and market value. Cost is composed of acquisition cost plus amortization of discount or less amortization of premium.

Inventories

Inventories are valued at the lower of cost and net realizable value. The cost of raw materials and work in progress inventories is determined using the first-in, first-out method. The cost of finished goods is determined using the average cost method.

Capital assets and amortization

Capital assets are recorded at cost less related government grants and research and development tax credits. Amortization is provided on a straight-line basis over the estimated useful lives of the capital assets as follows:

	Term
Building	25 years
Equipment	3 to 5 years
Leasehold improvements	Remaining lease term including lease renewal option

The carrying value of capital assets is evaluated whenever significant events occur which may indicate an impairment in value, based upon a comparison of the carrying value to the net recoverable amount.

Goodwill, other assets and amortization

Goodwill, which represents the excess of the purchase price of an acquired business over the net identifiable assets acquired, is amortized on a straight-line basis over the estimated useful life of five years. The company assesses the carrying value of goodwill for future recoverability on an annual basis by estimating the associated net undiscounted future cash flows. The amount of impairment loss, if any, is the excess of the carrying value over the estimated net undiscounted cash flows. Goodwill is written down for any permanent impairment in value of the unamortized portion.

Other assets include the cost of acquired patents, net of accumulated amortization. Patents are amortized on a straight-line basis over the estimated useful lives of four years.

Government grants

Government grants are accrued as a receivable when there is reasonable assurance that the company has complied and will continue to comply with all the conditions related to the grant. Grants related to operating expenses are included in earnings when the related expenses are incurred. Grants related to capital expenditures are deducted from the related asset. Grants related to job creation and training programs for extended periods are deferred and amortized on a straight-line basis over the minimum period for which the created job must be maintained or training provided.

Revenue recognition

For products where the software is incidental, the company recognizes revenue when the products are delivered, with provisions made for estimated returns, warranties and support obligations.

For products where software is not incidental, the revenues are separated into two categories, product and customer support revenues based upon vendor-specific objective evidence of fair value. The product revenues for these sales are recognized when the products are delivered with provisions

made for estimated returns and warranties. The customer support revenues are deferred and recognized ratably over the year of the support arrangement, except where provided within one year of delivery, costs of providing this support is insignificant and accrued at the time of delivery and no upgrades of software are provided. Prior to September 1, 1998, the revenues for support were included in sales upon delivery with a provision for any costs associated with future support obligations. The effect of this accounting change for the years ended prior to 1999 was not determinable by the company. For the year ended August 31, 1999, the company deferred revenues amounting to \$327,000 which had an effect on net earnings of \$226,000. The change resulted in a reduction in net earnings per share for the year ended August 31, 1999 of \$0.01.

Advertising costs

Advertising costs are expensed as incurred.

Income taxes

The company provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement values and tax values of assets and liabilities using enacted income tax rates expected to be in effect for the year in which the differences are expected to reverse.

The company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

Tax credits

The company is entitled to scientific research and experimental development ("SRED") tax credits granted by the Canadian federal government ("Federal") and the government of the Province of Quebec ("Provincial"). Federal SRED tax credits are earned on qualified Canadian SRED expenditures at a rate of 20% and can only be used to offset Federal income taxes otherwise payable. Provincial SRED tax credits, which are refundable, are earned on qualified SRED salaries in the Province of Quebec at a rate of 20%. Additional refundable provincial SRED tax credits are earned at a rate of up to 20%. These additional tax credits are reduced to nil, on a pro-rata basis, as total assets of the company increase from C\$25 million to C\$50 million.

SRED and other tax credits are accounted for as a reduction of the related expenditures. The refundable portion of SRED and other tax credits is recorded in the year in which the related expenditures are incurred. The non-refundable portion of SRED tax credits is recorded in the year in which the related expenditures are incurred, provided the company has reasonable assurance that the credits will be realized.

Research and development expenses

All expenses related to development activities, which do not meet generally accepted criteria for deferral, and research are expensed as incurred. Development expenses which meet generally accepted criteria for deferral are capitalized and amortized against earnings over the estimated period of benefit. As at August 31, 2000, the company had not deferred any development costs.

Stock-based compensation plans

The company maintains two stock-based compensation plans, which are described in note 13. Under accounting principles generally accepted in Canada, no compensation cost is recognized for those plans when stocks or stock options are issued to plan participants. Any consideration received from plan participants upon the purchase of stock or the exercise of stock options is credited to share capital.

Earnings and dividends per share

Basic earnings and dividends per share are determined using the weighted average number of common shares outstanding during the year, as adjusted for the effects of stock splits and other reorganizations of share capital in prior years.

Fully diluted earnings per share are determined using the weighted average number of shares and dilutive share equivalents outstanding during the year.

Earnings for the year are increased by the estimated additional earnings, net of applicable income taxes, on the proceeds, if any, from the exercise of dilutive common share equivalents.

New accounting standard

In 1999, the CICA issued section 3461, "Employee future benefits" which is effective for fiscal beginning on or after January 1, 2000. Adopting this standard will not have a significant impact on the company's earnings or shareholders' equity.

3 · Change in reporting currency

The consolidated financial statements of the company were presented in Canadian dollars up to August 31, 1999. Effective September 1, 1999, the U.S. dollar has been adopted as the reporting currency. The functional currency continues to be the Canadian dollar. The financial statements for the years ended August 31, 1998 and 1999 are presented in U.S. dollars in accordance with a translation of convenience method using the representative exchange rate as at August 31, 1999 of US\$1.00 = C\$1.4958. The translated amount for monetary and non-monetary items as at August 31, 1999 becomes the historical basis for those items in subsequent years.

The financial statements as at August 31, 2000 and for the year then ended have been translated using the current rate method. Under this method, the financial statements are translated into the reporting currency as follows: assets and liabilities are translated at the exchange rate in effect at the date of the balance sheet and revenue and expenses are translated at the average exchange rate for the year. All gains and losses from the translation of the financial statements into the reporting currency are included in the cumulative translation adjustment in shareholders' equity. Changes in the cumulative translation adjustment during each year result solely from the application of this translation method.

4 · Business combinations

Nortech Fibronic Inc.

On February 4, 2000, the company acquired a 100% interest in Nortech Fibronic Inc. ("Nortech"), a company specializing in fiber-optic testing and temperature sensing, in exchange for total consideration valued at C\$4,051,000 (US\$2,799,000). The consideration paid consisted of C\$3,051,000 (US\$2,108,000) in cash, the issuance of 800,000 Class G shares which are mandatorily redeemable, for cash or subordinate voting shares at the option of the company, on November 30, 2000 for an amount of C\$800,000 (US\$553,000) (note 11), and a non-interest-bearing debenture in the amount of C\$200,000 (US\$138,000) due November 30, 2000 (note 12).

This acquisition, which has been accounted for using the purchase method, resulted in goodwill amounting to C\$3,677,000 (US\$2,542,000) based on the following allocation of the purchase price to the identifiable assets acquired and liabilities assumed.

Current assets	\$ 1,842
Capital assets	409
Future income taxes	237
	<u>2,488</u>
Current liabilities	1,933
Long-term debt	298
	<u>2,231</u>
Net identifiable assets acquired	257
Goodwill	2,542
Purchase price	2,799
Less: Class G shares issued	553
Less: Non-interest-bearing debenture	138
Less: Cash and cash equivalents acquired	—
Cash paid net of cash and cash equivalents acquired	<u>\$ 2,108</u>

The net earnings of Nortech have been included in the consolidated statement of earnings of the company from the date of acquisition, February 4, 2000.

Pro forma information

The following unaudited pro forma information regarding the acquisition of Nortech has been prepared by the company's management based upon the audited consolidated financial statements of the company for the years ended August 31, 1999 and 2000 and the unaudited consolidated financial statements of Nortech.

This pro forma information includes adjustments related to the amortization of goodwill as well as the income tax effects of the acquisition. Consequently, such information is not necessarily indicative of the actual results which would have been achieved, nor is it necessarily indicative of future consolidated results of the company.

The following unaudited pro forma information for the year ended August 31, 1999 has been prepared as if the acquisition had occurred on September 1, 1998. The unaudited pro forma information for the year ended August 31, 2000 has been prepared as if the acquisition had occurred on September 1, 1999:

Years Ended August 31,	1999	2000
	(unaudited) (note 3)	(unaudited)
Sales	\$ 44,948	\$ 73,024
Earnings before amortization of goodwill	6,091	10,179
Net earnings	\$ 5,602	\$ 9,716
Basic and fully diluted earnings per share		
Earnings before amortization of goodwill	\$ 0.15	\$ 0.26
Net earnings	\$ 0.14	\$ 0.24

GEXFO Distribution Internationale Inc.

On September 1, 1998, the company acquired from its parent company all the issued and outstanding shares of GEXFO Distribution Internationale Inc. in exchange for 1 Class C share of the company, which was redeemed at a price of C\$509,000 (US\$340,000). This holding company has two wholly-owned subsidiaries, EXFO America Inc. and EXFO Europe S.A.R.L., which market fiber-optic test and measurement and monitoring equipment and instruments for the American and European markets.

Since the exchange was between entities under common control, the exchange has been accounted for in a manner similar to a pooling of interests. The assets, liabilities and shareholders' equity of the company and the other companies have been combined using their respective carrying amounts and financial statements of prior years have been restated as if the companies had always been combined. The statements of earnings and cash flows for 1998 reflect the results of operations and cash flows on a combined basis. The creation, issuance and redemption of the Class C share on September 1, 1998 has been presented as a mandatorily redeemable preferred share and a dividend distribution from the combined retained earnings.

The combined companies' net assets as at August 31, 1998 are as follows:

	EXFO Electro-Optical Engineering Inc.	GEXFO Distribution Internationale Inc.	Eliminations	Total
			(note 3)	
Total assets	\$ 17,384	\$ 639	\$ (380)	\$ 17,643
Total liabilities	(5,679)	(299)	380	(5,598)
Net assets	\$ 11,705	\$ 340	\$ —	\$ 12,045

Consolidated sales and net earnings for GEXFO Distribution Internationale Inc. during the year ended August 31, 1998 were insignificant.

GAP Optique S.A.

On June 1, 2000, the company acquired the 85% interest in GAP Optique S.A. held by its parent company for a cash consideration of \$16,000. The carrying value of the net assets of GAP Optique S.A. was \$19,000 as at December 31, 1999. GAP Optique S.A. did not have any operations in 1998, 1999 or 2000. Since the exchange occurred between entities under common control, the exchange has been accounted for in a manner similar to a pooling of interests. The assets, liabilities and shareholders' equity of the company and GAP Optique S.A. have been combined using their respective carrying amounts and financial statements of prior year have been restated as if the companies had always been combined.

5 · Other receivables

As at August 31,	1999	2000
Grants receivable	\$ 479	\$ 2,046
Company under common control	27	—
Other	520	744
	\$ 1,026	\$ 2,790

6 · Inventories

As at August 31,	1999	2000
Raw materials	\$ 4,005	\$ 12,057
Work in progress	1,177	2,910
Finished goods	2,409	3,901
	\$ 7,591	\$ 18,868

7 · Capital assets

As at August 31, 1999	Cost	Accumulated amortization	Net
Equipment	\$ 4,426	\$ 2,469	\$ 1,957
Leasehold improvements	1,146	464	682
	\$ 5,572	\$ 2,933	\$ 2,639
As at August 31, 2000	Cost	Accumulated amortization	Net
Land	\$ 299	\$ —	\$ 299
Building	3,442	32	3,410
Equipment	8,451	4,158	4,293
Leasehold improvements	1,373	681	692
	\$ 13,565	\$ 4,871	\$ 8,694

8 · Goodwill and other assets

As at August 31,	1999	2000
Goodwill – net of accumulated amortization of \$297,000	\$ –	\$ 2,252
Patents – net of accumulated amortization of \$111,000 and \$159,000 as at August 31, 1999 and 2000, respectively	65	68
	\$ 65	\$ 2,320

9 · Credit facilities

The company has available credit facilities which provide for advances of up to C\$10,000,000 (US\$6,793,000) under a line of credit and C\$3,000,000 (US\$2,038,000) as an operating loan. These facilities, which are renewable annually, bear interest at prime rate. Accounts receivable, inventories and all tangible and intangible assets of the company have been pledged as security against these facilities. Amounts of nil and C\$15,000 (US\$10,000) were drawn against the facilities as at August 31, 1999 and 2000, respectively.

10 · Accounts payable and accrued liabilities

As at August 31,	1999	2000
Trade	\$ 1,884	\$ 6,473
Salaries and social benefits	1,112	1,698
Outstanding cheques in excess of bank balances	1,942	374
Commissions	421	966
Other	164	842
	\$ 5,523	\$ 10,353

11 · Mandatorily redeemable preferred shares

Authorized – unlimited as to number, without par value

Preferred, non-voting, ranking in priority to subordinate and multiple voting shares, each series ranking pari passu with the preferred shares of every other series, issuable in one or more series

Preferred Series 1, non-voting, mandatorily redeemable on November 30, 2000 at their paid-in value, ranking in priority to all other existing and future classes of shares. The company may elect to settle the redemption value by issuing the number of subordinate voting shares obtained by dividing the paid-in value of the preferred shares Series 1, being C\$800,000, by the average trading price of the subordinate voting shares for a period of ten trading days preceding November 30, 2000

On February 7, 2000, the company filed articles of amendment pursuant to which the Class G shares were created.

Prior to June 29, 2000, the company's authorized mandatorily redeemable preferred shares consisted of Class B, C, E and G shares.

On June 29, 2000, the company filed restated articles of incorporation pursuant to which preferred shares issuable in series and preferred shares Series 1 were created, the 800,000 issued and outstanding Class G shares were converted into 800,000 preferred shares Series 1 and Class B, C, E and G shares were cancelled.

The following table summarizes the preferred share activity since August 31, 1997:

	Class C share		Class E shares		Total amount
	Number	Amount	Number	Amount	
Balance as at August 31, 1997 and 1998	–	\$ –	19,000,000	\$ –	\$ –
Business combination (note 4)	1	340	–	–	340
Redemption of Class C share	(1)	(340)	–	–	(340)
Conversion of Class E shares into Class A shares (note 13)	–	–	(19,000,000)	–	–
Balance as at August 31, 1999 and 2000	–	\$ –	–	\$ –	\$ –

	Class G shares		Preferred shares Series 1		Total amount
	Number	Amount	Number	Amount	
Balance as at August 31, 1997, 1998 and 1999	–	\$ –	–	\$ –	\$ –
Business combination (note 4)	800,000	555	–	–	555
Conversion of Class G shares into preferred shares Series 1	(800,000)	(555)	800,000	555	–
Foreign currency translation adjustment	–	–	–	(12)	(12)
Balance as at August 31, 2000	–	\$ –	800,000	\$ 543	\$ 543

12 · Long-term debt

As at August 31,	1999	2000
Unsecured non-interest-bearing debenture due November 30, 2000	\$ –	\$ 136
Unsecured non-interest-bearing loan repayable through July 2002	–	32
	–	168
Less: Current portion	–	152
	\$ –	\$ 16

As at August 31, 2000, minimum principal repayments required in each of the next two years are as follows:

2001	\$ 152
2002	16

13 · Share capital

Authorized – unlimited as to number, without par value

Subordinate voting and participating, bearing a non-cumulative dividend to be determined by the Board of Directors, ranking pari passu with multiple voting shares

Multiple voting and participating, entitling to ten votes each, bearing a non-cumulative dividend to be determined by the Board of Directors, convertible at the holder's option into subordinate voting shares on a one-for-one basis, ranking pari passu with subordinate voting shares

Prior to June 29, 2000, the company's authorized share capital consisted of Class A, D and F shares.

On September 2, 1998, the company filed articles of amendment pursuant to which the Class A shares were split on a 190,000-to-one basis. Pursuant to

articles of amendment dated September 3, 1998, the 100 issued and outstanding Class E shares (note 11) were converted into Class A shares on a 190,000-to-one basis. All references to numbers of shares and per share amounts have been restated in order to reflect the share split and conversion noted above.

On June 29, 2000, the company filed restated articles of incorporation pursuant to which subordinate and multiple voting shares were created, the 38,000,000 issued and outstanding Class A shares were converted into 38,000,000 multiple voting shares, the 707,264 issued and outstanding Class F shares were converted into 707,264 subordinate voting shares and the Class A, D and F shares were cancelled.

The following tables summarize the share capital activity since August 31, 1997:

	Class A shares		Class F shares		Total amount
	Number	Amount	Number	Amount	
Balance as at August 31, 1997 and 1998	19,000,000	\$ 1	–	\$ –	\$ 1
Conversion of Class E shares into Class A shares (note 11)	19,000,000	–	–	–	–
Issued for cash under stock purchase plan	–	–	197,588	86	86
Balance as at August 31, 1999	38,000,000	1	197,588	86	87
Issued for cash under stock purchase plan	–	–	509,676	390	390
Conversion of Class F shares into subordinate voting shares	–	–	(707,264)	(476)	(476)
Conversion of Class A shares into multiple voting shares	(38,000,000)	(1)	–	–	(1)
Balance as at August 31, 2000	–	\$ –	–	\$ –	\$ –

	Multiple voting shares		Subordinate voting shares		Total amount
	Number	Amount	Number	Amount	
Balance as at August 31, 1997, 1998 and 1999	–	\$ –	–	\$ –	\$ –
Conversion of Class F shares into subordinate voting shares	–	–	707,264	476	476
Conversion of Class A shares into multiple voting shares	38,000,000	1	–	–	1
Issued pursuant to the Initial Public Offering	–	–	8,050,000	209,300	209,300
Share issue expenses, net of related income taxes of \$5,425,000	–	–	–	(11,318)	(11,318)
Balance as at August 31, 2000	38,000,000	\$ 1	8,757,264	\$ 198,458	\$ 198,459

Stock purchase plan

The company's stock purchase plan terminated at the time of the Initial Public Offering. In accordance with that plan, officers, directors and key employees could purchase Class F shares up to a maximum of 5% of all participating, issued and outstanding shares of the company. The maximum number of shares held by one person could not exceed 1% of all issued and outstanding shares of the company. The purchase price of shares under that plan was determined as a multiple of the company's equity as at the end of the preceding fiscal year. Shares issued under that plan are restricted as to sale and transferability for a period of at least five years. Prior to June 29, 2000, the date of the Initial Public Offering, the company issued 707,264 Class F shares in exchange for a weighted average cash consideration of C\$0.98 (US\$0.68) per share. As at August 31, 2000, the company has guaranteed the repayment of third party loans totalling C\$270,000 (US\$183,000) obtained by certain employees with respect to the purchase of Class F shares.

Stock option plan

On May 25, 2000, the company established a stock option plan for directors, executive officers, employees and consultants and those of the company's subsidiaries, as determined by the Board of Directors.

The maximum number of subordinate voting shares issuable under the plan shall not exceed 4,470,961 shares. The maximum number of subordinate voting shares that may be granted to any individual shall not exceed 5% of the number of outstanding subordinate voting shares. The exercise price shall be the market price of the common shares on the date of granting. Options granted under the plan generally expire ten years from the date of granting. Options granted under the plan generally vest over a four-year period, with 25% becoming exercisable at the end of each of the first four fiscal years of the company following the date of granting. The number of options which ultimately become exercisable in any given year, and in aggregate, depends on the degree to which the company's financial performance objectives are met. The Board of Directors may accelerate the vesting of any or all outstanding options upon the occurrence of a change of control.

On June 27, 2000, the company granted options to purchase a total of 609,734 subordinate voting shares at the Initial Public Offering price. As at August 31, 2000, there were 3,861,227 shares reserved for issuance under the stock option plan.

The following table summarizes the stock option activity since May 25, 2000:

Year Ended August 31, 2000	Number	Weighted average exercise price
Outstanding – Beginning of year	–	\$ –
Granted	609,734	26
Outstanding – End of year	609,734	\$ 26
Options exercisable – End of year	–	–

As at August 31, 2000, the weighted average remaining contractual life of the outstanding options was 4.83 years.

14 · Commitments

Operating leases

The company has entered into operating leases for its premises, which expire at various dates through to 2003. As at August 31, 2000, the minimum rentals payable during each of the next three years are as follows:

2001	\$ 397
2002	209
2003	49
	\$ 655

During the years ended August 31, 1998, 1999 and 2000, rental expense amounted to \$283,000, \$344,000 and \$579,000, respectively.

15 · Other disclosures

Loan from a company under common control

The loan from a company under common control bearing interest at prime rate plus 1% and unsecured was reimbursed during the year.

During the years ended August 31, 1998, 1999 and 2000, the effective interest rate on this loan was 6.25%, 6.95% and 7.75%, respectively.

Net research and development expenses

Net research and development expenses comprise the following:

Years Ended August 31,	1998	1999	2000
	(note 3)	(note 3)	
Gross research and development expenses	\$ 4,406	\$ 6,390	\$ 9,374
Research and development tax credits	(1,332)	(1,935)	(2,436)
Government grants	(60)	(140)	(536)
	\$ 3,014	\$ 4,315	\$ 6,402

Other grants and tax credits

During 1998, the company entered into an agreement with the Quebec Minister of Industry, Commerce, Science and Technology (the "Minister"). Pursuant to this agreement, the Minister agreed to contribute, in the form of grants, up to a maximum of C\$600,000 (US\$417,000) towards interest costs incurred over the period from January 1, 1998 through December 31, 2002. In addition, the Minister agreed to provide grants up to a maximum of C\$2,220,000 (US\$1,541,000) over the period from January 1, 1998 through December 31, 2002, payable based on the number of full-time jobs created during the period.

The above grants are subject to the condition that the company maintain its Canadian principal place of business within the Province of Quebec until at least December 31, 2002 and that jobs created pursuant to the agreement be maintained for a period of at least five years from the date of creation. Should these conditions not be met by the company, the Minister may enforce various recourse options, which include suspension or cancellation of the agreement or requiring the repayment of amounts received by the company. During the period from January 1, 1998 to August 31, 2000, the company recognized a total of C\$2,396,000 (US\$1,627,000) under this program, of which C\$1,048,000 (US\$712,000) has been credited to earnings with the balance of C\$1,348,000 (US\$915,000) having been included in deferred grants.

Furthermore, in 1999, the company entered into another agreement with the Minister. Pursuant to this agreement, the Minister agreed to provide grants up to a maximum of C\$3,756,000 (US\$2,551,000) over the period from February 1998 to June 2002, payable based on the number of jobs created and certain specific training expenses related to such jobs. The above grant is subject to the condition that 361 jobs be created pursuant to the agreement and that the new employees continue to participate in the specific training program for a period of at least ten consecutive months. Should these conditions not be met by the company, the Minister may enforce various recourse options, which include suspension or cancellation of the agreement or requiring the repayment of amounts received by the company. Since 1998, the company has recognized a total of C\$1,322,000 (US\$898,000) under this program, of which C\$1,037,000 (US\$704,000) has been credited to earnings with the balance of C\$285,000 (US\$194,000) having been included in deferred grants. Should any repayments of amounts received pursuant to these agreements be required, such repayments will be charged to earnings as the amounts of any repayments become known.

Finally, since 2000, companies operating in the Quebec city area are entitled to a refundable tax credit granted by the government of the Province of Quebec. This credit is earned on the increase of production and marketing

salaries incurred in the Quebec City area at a rate of 40%. The company has recognized a total of C\$1,297,000 (US\$881,000) under this program which has been credited to earnings.

Following is a summary of the classification of these and certain other grants and tax credits in the statements of earnings.

Interest income for the years ended August 31, 1998, 1999 and 2000 is net of related government grants of \$66,000, \$126,000 and \$196,000, respectively.

Cost of sales for the years ended August 31, 1998, 1999 and 2000 is net of government grants of \$11,000, \$33,000 and \$915,000, respectively.

Selling and administrative expenses for the years ended August 31, 1998, 1999 and 2000 are net of government grants of \$22,000, \$21,000 and \$386,000, respectively.

Research and development expenses for the years ended August 31, 1998, 1999 and 2000 are net of government grants of \$60,000, \$140,000 and \$536,000, respectively.

Defined contribution employee benefits plans

The company maintains two separate defined contribution employee benefits plans for certain eligible employees. These plans, which are accounted for on an accrual basis, are summarized as follows:

- **Deferred profit sharing plan**

This plan, maintained for eligible Canadian resident employees, requires the company to contribute an amount equal to 1% of an employee's gross salary, provided that the employee has contributed at least 2% of gross salary to a tax-deferred registered retirement savings plan. In addition, at the end of each fiscal year, the company may contribute an additional amount of up to 4% of an employee's gross salary to the employee's tax-deferred registered retirement savings plan. Contributions paid to this plan during the years ended August 31, 1998, 1999 and 2000 amounted to nil, C\$156,000 (US\$104,000) and C\$202,000 (US\$137,000), respectively.

- **401K plan**

The company maintains a 401K plan for eligible U.S. resident employees. Under the plan, the company may elect to contribute an amount of up to 50% of the first 6% of an employee's current compensation, subject to certain legislated maximum contribution limits. During the years ended August 31, 1998, 1999 and 2000, the company made contributions totalling US\$8,000, US\$21,000 and US\$23,000, respectively.

16 · Related party transactions

In the normal course of operations, the company entered into transactions with certain companies under common control. These transactions have been measured at the exchange amount which is the amount of consideration agreed upon by the related parties. These transactions have been reflected in the financial statements as follows:

Years Ended August 31,	1998 (note 3)	1999 (note 3)	2000
Rent	\$ 219	\$ 232	\$ 241
Interest expense	84	92	105

17 · Income taxes

The reconciliation of the income tax provision calculated using the Canadian federal and provincial statutory income tax rates to the provision for income taxes per the financial statements is as follows:

Years Ended August 31,	1998 (note 3)	1999 (note 3)	2000
Income taxes at combined Canadian federal and provincial statutory tax rate (38%)	\$ 2,606	\$ 3,156	\$ 5,897
Increase (decrease) due to:			
Manufacturing and processing deduction	(387)	(519)	(645)
Non-deductible expenses	43	40	57
Other	94	(185)	(11)
	\$ 2,356	\$ 2,492	\$ 5,298
Income taxes consist of:			
Current	\$ 2,067	\$ 2,534	\$ 5,331
Future	289	(42)	(33)
	\$ 2,356	\$ 2,492	\$ 5,298

Significant components of the company's future tax assets and liabilities are as follows:

As at August 31,	1999	2000
Future tax assets		
Provisions and accruals	\$ —	\$ 266
Government grants	18	—
Deferred revenue	101	175
Share issue expenses	—	4,358
Other	4	193
	123	4,992
Future tax liabilities		
Capital assets	(183)	(419)
Research and development tax credits	(330)	(474)
Government grants	—	(15)
	(513)	(908)
	\$ (390)	\$ 4,084
Presented as:		
Current	\$ (262)	\$ 995
Long-term	(128)	3,089
	\$ (390)	\$ 4,084

18 · Segment information

Management has organized the company under one operating segment, that being the development, manufacture and marketing of fiber-optic test, measurement and monitoring equipment and instruments. Substantially all of the company's long-lived assets are located in Canada.

Sales by geographic region are detailed as follows:

Years Ended August 31,	1998 (note 3)	1999 (note 3)	2000
United States	\$ 13,644	\$ 20,755	\$ 36,139
Canada	2,353	2,973	8,006
Europe	6,717	8,721	14,503
Asia	3,229	3,199	6,486
Other	5,662	6,518	6,505
	\$ 31,605	\$ 42,166	\$ 71,639

Sales have been allocated to geographic regions based on the country of residence of the related customers. During all years presented above, there were no customers from which 10% or more of total sales were derived.

19 · Financial instruments

Short-term investments

Short-term investments consist of the following:

As at August 31,	1999	2000
Corporate bonds denominated in Canadian dollars bearing interest at annual rates of 4.9% to 5%	\$ 1,371	\$ —
Commercial paper denominated in Canadian dollars, bearing interest at annual rates of 5.77% to 5.93%, maturing on different dates between November 22, 2000 and February 2, 2001	—	41,872
Commercial paper denominated in U.S. dollars, bearing interest at annual rates of 6.51% to 6.79%, maturing at different dates between November 14, 2000 and March 2, 2000	—	120,787
	\$ 1,371	\$ 162,659

Fair value

Cash and cash equivalents, accounts receivable, bank advances, accounts payable and accrued liabilities, dividend payable, mandatorily redeemable preferred shares, loan from a company under common control and long-term debt are financial instruments whose fair values approximate their carrying values.

The fair value of short-term investments, determined based on market value, amounted to \$1,430,000 and \$162,719,000 as at August 31, 1999 and 2000, respectively.

Credit risk

Financial instruments which potentially subject the company to credit risk consist principally of cash and cash equivalents, short-term investments, accounts receivable and forward exchange contracts. The company's short-term investments consist of debt instruments issued by high-credit quality financial institutions and corporations and the company's cash and cash equivalents and forward exchange contracts are held with or issued by high-credit quality financial institutions; therefore the company considers the risk of non-performance on these instruments to be remote.

Due to the North American and European distribution of the company's customers, there is no particular concentration of credit risk. Generally, the company does not require collateral or other security from customers for trade accounts receivable; however, credit is extended to customers following an evaluation of creditworthiness. In addition, the company performs on-going credit reviews of all its customers and establishes an allowance for doubtful accounts receivable when accounts are determined to be uncollectible.

Interest rate risk

As at August 31, 2000, the company's exposure to interest rate risk is summarized as follows:

Cash and cash equivalents	Non-interest bearing
Short-term investments	As described above
Accounts receivable	Non-interest bearing

Bank advances	Prime rate
Accounts payable and accrued liabilities	Non-interest bearing
Mandatorily redeemable preferred shares	Non-interest bearing
Long-term debt	As described in note 12

Forward exchange contracts

The company is exposed to currency risks as a result of its export sales, substantially all of which are denominated in U.S. dollars, of products manufactured in Canada. These risks are partially hedged by forward exchange contracts and certain operating expenses. As at August 31, 1999 and 2000, the company held contracts to sell U.S. dollars at various forward rates, which are summarized as follows:

	Contractual amounts	Weighted average contractual forward rates
As at August 31, 1999		
September 1999 to August 2000	\$ 5,800	1.4815
September 2000 to June 2001	3,000	1.5014
As at August 31, 2000		
September 2000 to August 2001	\$ 5,400	1.4871
September 2001 to April 2002	1,200	1.4602

As at August 31, 1999 and 2000, these contracts resulted in deferred unrealized losses amounting to US\$35,000 and US\$45,000, respectively.

As at August 31, 2000, the company held forward exchange contracts to buy U.S. dollars at various forward rates which are summarized as follows:

	Contractual amount	Weighted average contractual forward rate
Maturing between November 2000 and January 2001	\$ 40,500	1.4777

As at August 31, 2000, the fair value of these contracts amounted to US\$27,431,000 compared to contractual value of US\$27,407,000, resulting in an unrealized loss of US\$24,000 which has been reflected in the statement of earnings for the year.

20 · United States generally accepted accounting principles

As a registrant with the Securities and Exchange Commission in the United States, the company is required to reconcile its financial results for significant differences between generally accepted accounting principles as applied in Canada (Canadian GAAP) and those applied in the United States (U.S. GAAP).

Additional disclosures required under U.S. GAAP have been provided in the accompanying financial statements and notes. In addition, the following summarizes differences between Canadian and U.S. GAAP and other required disclosures under U.S. GAAP.

Accounting for stock-based compensation

To conform with U.S. GAAP, the company measures stock-based compensation costs using the intrinsic value method (APB 25 "Accounting for Stock Issued to Employees").

Stock purchase plan

Under APB 25, compensation cost related to the stock purchase plan is measured as the difference between the fair value of the purchased stock and the purchase price paid by plan participants. Compensation cost is amortized to expense over a period of five years, being the restriction period.

During the years ended August 31, 1999 and 2000, the weighted average fair value per share under the stock purchase plan amounted to approximately \$0.68 and \$10.80, respectively. The fair value per share since inception of the plan ranged between \$0.68 and \$18.00. As at August 31, 1999 and 2000, the balance of deferred stock-based compensation amounted to \$40,000 and \$2,144,000, respectively.

Stock option plan

In accordance with APB 25, the company's stock option plan is considered to be a variable plan. Accordingly, subsequent increases in the fair value of the underlying stock, in excess of the exercise price of the option, are accounted for as additional compensation costs. Compensation cost is amortized to expense over the estimated vesting period up to a maximum of four years. As at August 31, 2000, the balance of deferred stock-based compensation amounted to \$17,285,000.

Under Canadian GAAP, no compensation cost is recognized for these stock-based compensation plans.

Change in reporting currency

As mentioned in note 3, on September 1, 1999, the company adopted the U.S. dollar as its reporting currency. Under U.S. GAAP, the financial statements, including prior years, are translated according to the current rate method. Under Canadian GAAP, at the time of change in reporting currency, the historical financial statements are presented using a translation of convenience.

Under Canadian GAAP, the statements of earnings for the years ended August 31, 1998 and 1999 were translated into U.S. dollars using an exchange rate of US\$1.00 = C\$1.4958. Under U.S. GAAP, revenue and expenses would be translated at exchange rates prevailing at the respective transaction dates. Average exchange rates for the years ended August 31, 1998 and 1999 were US\$1.00 = C\$1.4390 and C\$1.5068, respectively. The exchange rates as at August 31, 1998 and 1999 were US\$1.00 = C\$1.5722 and C\$1.4958, respectively.

Short-term investments

Under U.S. GAAP, the short-term investments would be classified as "available for sale" securities. Consequently, these securities would be carried at fair value, with any unrealized holding gains or losses at each balance sheet date being reflected in other comprehensive income on a net of tax basis. Under Canadian GAAP, short-term investments are carried at the lower of cost and market value and cost is composed of acquisition cost plus amortization of discount or less amortization of premium.

Impairment of long-lived assets

In accordance with SFAS 121, Accounting for the impairment of long-lived assets and for long-lived assets to be disposed of, the company reviews the carrying value of its long-lived assets, including goodwill associated with assets acquired in a purchase business combination, when events or changes in circumstances indicate that the carrying value may not be recoverable. If this review indicates that the carrying amounts of the assets and goodwill, where applicable, will not be recoverable, as determined based on estimated undiscounted cash flows, an impairment loss is recorded. Impairment losses, if any, are measured as the excess of the carrying values over the fair values of the related assets. In addition, goodwill is reviewed periodically as disclosed in note 2.

Forward exchange contracts

Under U.S. GAAP, in accordance with SFAS 52, certain of the forward exchange contracts held for hedging and other purposes in 1998 and 1999, for which the underlying transactions are not firmly committed, would not

qualify for hedge accounting. Consequently, unrealized gains or losses on these contracts at each balance sheet date would be reflected in earnings for the corresponding year. Under Canadian GAAP, the company's forward exchange contracts held for the purpose of hedging anticipated sales qualify for hedge accounting and any unrealized gains or losses are deferred and recognized in the statement of earnings upon settlement of the related transactions.

Earnings per share

For purposes of earnings per share calculations, the subordinate voting shares and multiple voting shares (previously Class A, E and F shares), collectively, are considered to constitute common shares.

Under U.S. GAAP, diluted net earnings per share is calculated based on the weighted average number of common shares outstanding during the year, plus the effects of potential common shares, such as options, and conversions of senior shares outstanding during the year. This method requires that diluted net earnings per share be calculated, using the treasury stock method, as if all potential common shares had been exercised at the later of the beginning of the period or the date of issue, as the case may be, and that the funds obtained thereby were used to purchase common shares of the company at the average fair value of the common shares during the period.

Under Canadian GAAP, fully diluted earnings per share is calculated based on the current imputed earnings method (note 2).

Under U.S. GAAP, the presentation of per share figures for earnings before amortization of goodwill is not permitted. In addition, under U.S. GAAP, amortization of goodwill would be included in the computation of earnings from operations.

Future income taxes

As a result of adjustments from Canadian GAAP to U.S. GAAP, future income tax liabilities under U.S. GAAP include an adjustment of \$23,000 as at August 31, 1999 and 2000, related to short-term investments and forward exchange contracts carried at fair value.

New accounting standards

In 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard ("SFAS") 133, "Accounting for Derivative Instruments and Hedging Activities". The standard, which must be applied prospectively, is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. The only derivatives held by the company are forward exchange contracts. The new standard is effective September 1, 2000 and will be applied prospectively, as required. On September 1, 2000, the company hedged certain firm sales commitments with forward exchange contracts, as disclosed in note 19. The impact of adopting the standard related to these derivatives will not be material. The other derivatives currently disclosed in note 19 do not qualify as hedging instruments and the method of accounting for these derivatives will not change as a result of the application of SFAS 133.

On December 3, 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") 101, "Revenue Recognition". SAB 101, as amended by SAB101B, is effective no later than the fourth fiscal quarter of the first fiscal year beginning after December 15, 1999. The implementation of this SAB is not expected to have any material effect on the company's financial statements or revenue recognition policy in future years.

In March 2000, the Financial Accounting Standards Board issued Interpretation 44 "Accounting for Certain Transactions Including Stock Compensation", an interpretation of APB 25, which provides guidance on applying APB 25 for certain stock compensation issues. FIN 44 is effective since July 4, 2000. The implementation of this FIN did not have any effect on the company's financial statements.

Reconciliation of net earnings to conform with U.S. GAAP

The following summary sets out the material adjustments to the company's reported net earnings and net earnings per share which would be made to conform with U.S. GAAP.

Years Ended August 31,	1998	1999	2000
Net earnings for the year in accordance with Canadian GAAP		\$ 4,501	\$ 5,814
Non-cash stock-based compensation costs related to stock purchase plan *		–	(10)
Non-cash stock-based compensation costs related to stock option plan under variable accounting *		–	–
Change in reporting currency		178	(44)
Unrealized gains (losses) on forward exchange contracts		(208)	208
Future income taxes on forward exchange contracts		67	(67)
Net earnings for the year in accordance with U.S. GAAP		4,538	5,901
Other comprehensive income (loss)			
Foreign currency translation adjustments		(1,350)	606
Unrealized holding gains on short-term investments, net of related income taxes of \$23,000 in 1999 and nil in 2000		–	36
Comprehensive income		\$ 3,188	\$ 6,543
Basic and diluted net earnings per share in accordance with U.S. GAAP		\$ 0.12	\$ 0.15

*Required under APB 25

Earnings available to common shareholders is reconciled as follows:

Years Ended August 31,	1998	1999	2000
Net earnings for the year	\$ 4,538	\$ 5,901	\$ 7,922
Dividend on Class C share	–	(333)	–
Earnings available to common shareholders	\$ 4,538	\$ 5,568	\$ 7,922

The diluted weighted average number of common shares outstanding calculated according to U.S. GAAP is as follows:

Years Ended August 31,	1998	1999	2000
Weighted average number of common shares outstanding – Basic (000's)	38,000	38,001	39,951
Conversion of preferred shares Series 1	–	–	26
Exercise of stock options	–	–	109
Weighted average number of common shares outstanding –Diluted (000's)	38,000	38,001	40,086

The number of common shares issuable upon the assumed conversion of the preferred shares Series 1 has been determined by dividing the paid-in value of the preferred shares Series 1 (previously Class G shares) by the market value of the former Class A shares as at February 4, 2000 (the date the Class G shares were issued), or \$18.00 per Class A share, weighted from the date of issuance of the Class G shares to the end of the year.

As a result of the above adjustments to net earnings, differences with respect to the shareholders' equity under U.S. GAAP are as follows:

Share capital

As at August 31,	1999	2000
Share capital in accordance with Canadian GAAP	\$ 87	\$ 198,459
Stock-based compensation costs related to stock purchase plan		
Current year	10	538
Cumulative effect of prior years	–	10
Share capital in accordance with U.S. GAAP	\$ 97	\$ 199,007

Other capital

As at August 31,	1999	2000
Other capital in accordance with Canadian GAAP	\$ –	\$ –
Stock-based compensation costs related to stock option plan under variable accounting	–	1,464
Other capital in accordance with U.S. GAAP	\$ –	\$ 1,464

Retained earnings

As at August 31,	1999	2000
Retained earnings in accordance with Canadian GAAP	\$ 14,592	\$ 6,980
Stock-based compensation costs		
Current year	(10)	(2,002)
Cumulative effect of prior years	–	(10)
Change in reporting currency		
Current year		
Net earnings	(44)	–
Dividends	24	–
Cumulative effect of prior years	1,036	1,016
Retained earnings in accordance with U.S. GAAP	\$ 15,598	\$ 5,984

Accumulated other comprehensive income (loss)

As at August 31,	1999	2000
Foreign currency translation adjustments		
Balance – Beginning of year	\$ (1,622)	\$ (1,016)
Change during the year	606	1,555
Balance – End of year	(1,016)	539
Unrealized holding gains on short-term investments, net of income taxes		
Balance – Beginning of year	–	36
Unrealized gains arising during the year, net of related income taxes of \$23,000 in 1999 and 2000	36	37
Reclassification adjustment for amounts included in net earnings, net of related income taxes of \$23,000	–	(36)
Balance – End of year	36	37
Accumulated other comprehensive income (loss)	\$ (980)	\$ 576

Following are condensed statements of earnings for the years ended August 31, 1998, 1999 and 2000 and condensed balance sheets as at August 31, 1999 and 2000 prepared under U.S. GAAP:

Statements of earnings

Years Ended August 31,	1998	1999	2000
Sales	\$ 32,853	\$ 41,858	\$ 71,639
Cost of sales	11,793	14,889	24,712
Gross margin	21,060	26,969	46,927
Total operating expenses	14,105	18,367	34,503 ⁽¹⁾
Earnings from operations	6,955	8,602	12,424
Net earnings for the year	\$ 4,538	\$ 5,901	\$ 7,922

(1) includes the non-cash stock compensation costs totalling \$2,002,000

Balance sheets

As at August 31,	1999	2000
Current assets		
Cash and cash equivalents	\$ 423	\$ 729
Available-for-sale securities	1,430	162,719
Accounts receivable	9,895	21,062
Inventories	7,591	18,868
Other current assets	856	1,307
Future income taxes	–	972
	20,195	205,657
Capital assets	2,639	8,694
Goodwill and other assets	65	2,320
Future income taxes	–	3,089
	\$ 22,899	\$ 219,760

Balance sheets

As at August 31,	1999	2000
Current liabilities		
Bank advances	\$ –	\$ 10
Accounts payable and accrued liabilities	5,523	10,353
Other current liabilities	1,891	1,090
	7,414	11,453
Long-term liabilities	770	1,276
	8,184	12,729
Shareholders' equity		
Share capital	97	199,007
Other capital	–	1,464
Accumulated other comprehensive income (loss)	(980)	576
Retained earnings	15,598	5,984
	14,715	207,031
	\$ 22,899	\$ 219,760

Statement of cash flows

Under Canadian GAAP, the statements of cash flows, which have been prepared on a basis consistent with International Accounting Standards, for the years ended August 31, 1998 and 1999 were translated into U.S. dollars using an exchange rate of US\$1.00 = C\$1.4958. Under U.S. GAAP, the historical exchange rates on the dates of the cash flow activities would be used. Following are summary statements of cash flows under U.S. GAAP:

Years Ended August 31,	1998	1999
Operating activities	\$ 3,278	\$ 3,633
Financing activities	(273)	(3,261)
Investing activities	(2,061)	(1,206)
Change in cash and cash equivalents	944	(834)
Effect of foreign exchange rate changes on cash and cash equivalents	(124)	56
Cash and cash equivalents – Beginning of year	381	1,201
Cash and cash equivalents – End of year	\$ 1,201	\$ 423

For the year ended August 31, 2000, there are no material differences between the statement of cash flows under Canadian GAAP as compared to U.S. GAAP.

Accounting for stock-based compensation

Under U.S. GAAP, the company has elected to measure compensation cost related to awards of stock options using the intrinsic value method of accounting. In this instance, however, under SFAS 123, Accounting for Stock-Based Compensation, the company is required to make pro forma disclosures of net earnings, basic net earnings per share and diluted net earnings per share as if the fair value based method of accounting had been applied.

The fair value of options granted was estimated using the Black-Scholes options pricing model with the following weighted average assumptions: a risk-free interest rate of 6.04%, an expected volatility of 75%, dividends of nil and a weighted average expected life of 32 months. The weighted average grant-date fair value of options granted during the year was \$13.

The Black-Scholes options valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions, and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

If the fair value based method had been used to account for stock-based compensation costs related to stock options issued to employees, directors and executive officers, the net earnings and related net earnings per share figures under U.S. GAAP would be as follows:

Year Ended August 31, 2000

Pro forma net earnings for the year	\$ 8,939
Pro forma basic and diluted net earnings per share	\$ 0.22

Quarterly Summary Financial Information (unaudited)

(in thousands of US dollars, except per share data)

	1st quarter	2nd quarter	3rd quarter	4th quarter	Year Ended August 31,
2000					
Sales	\$ 11,688	\$ 17,423	\$ 19,411	\$ 23,117	\$ 71,639
Cost of sales	\$ 3,733	\$ 5,876	\$ 7,347	\$ 7,756	\$ 24,712
Gross margin	\$ 7,955	\$ 11,547	\$ 12,064	\$ 15,361	\$ 46,927
Earnings from operations	\$ 2,092	\$ 3,640	\$ 3,847	\$ 5,144	\$ 14,723
Net earnings	\$ 1,300	\$ 2,412	\$ 2,748	\$ 3,464	\$ 9,924
Basic and fully diluted net earnings per share*	\$ 0.03	\$ 0.06	\$ 0.07	\$ 0.08	\$ 0.25
1999					
Sales	\$ 9,124	\$ 9,604	\$ 10,916	\$ 12,522	\$ 42,166
Cost of sales	\$ 3,402	\$ 3,619	\$ 3,753	\$ 4,224	\$ 14,998
Gross margin	\$ 5,722	\$ 5,985	\$ 7,163	\$ 8,298	\$ 27,168
Earnings from operations	\$ 1,890	\$ 1,640	\$ 2,417	\$ 2,729	\$ 8,676
Net earnings	\$ 1,175	\$ 1,045	\$ 1,623	\$ 1,971	\$ 5,814
Basic and fully diluted net earnings per share	\$ 0.02	\$ 0.03	\$ 0.04	\$ 0.05	\$ 0.14
1998					
Sales	\$ 7,115	\$ 7,486	\$ 10,069	\$ 6,935	\$ 31,605
Cost of sales	\$ 2,400	\$ 2,421	\$ 3,980	\$ 2,544	\$ 11,345
Gross margin	\$ 4,715	\$ 5,065	\$ 6,089	\$ 4,391	\$ 20,260
Earnings from operations	\$ 1,805	\$ 1,924	\$ 2,488	\$ 474	\$ 6,691
Net earnings	\$ 1,215	\$ 1,255	\$ 1,635	\$ 396	\$ 4,501
Basic and fully diluted net earnings per share	\$ 0.03	\$ 0.04	\$ 0.04	\$ 0.01	\$ 0.12

*Net earnings per share are calculated independently for each of the quarters presented. Therefore, the sum of the quarterly per share information may not equal the annual net earnings per share.