

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of the consolidated financial condition and results of operations of EXFO Electro-Optical Engineering Inc. (EXFO) for the fiscal years ended August 31, 2001, 2000 and 1999 should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report. Our consolidated financial statements are reported in US dollars and have been prepared in accordance with accounting principles generally accepted in Canada, or Canadian GAAP. To the extent applicable to our consolidated financial statements included elsewhere in this annual report, these principles conform in all material respects with accounting principles generally accepted in the United States, or US GAAP, except as described in note 19 to our consolidated financial statements.

Corporate Highlights

EXFO Reports Strong Year-End Financial Results

EXFO announced in October 2001 it had increased sales by 104% to \$146.0 million for the fiscal year ended August 31, 2001 from \$71.6 million in 2000. Net earnings, excluding amortization of goodwill and the after-tax effect of amortization of intangible assets and non-recurring expenses, jumped 139% to \$24.5 million, or \$0.46 per share, for fiscal 2001 from \$10.3 million, or \$0.26 per share, for 2000. Including amortization of intangible assets and goodwill related to acquisitions as well as non-recurring expenses, EXFO's net loss for fiscal 2001 was \$15.3 million, or \$0.29 per share. In comparison, EXFO recorded net earnings of \$9.9 million, or \$0.25 per share, in fiscal 2000.

EXFO Acquires Avantas Networks

EXFO reported in August 2001 it had entered into an agreement to acquire Avantas Networks Corporation for \$68 million, or \$96 million for the equity minus \$28 million of Avantas cash on hand. Consideration paid will consist of 4.4 million EXFO shares and \$36 million in cash. Avantas is a supplier of leading-edge fiber-optic testing and optical network performance management equipment that supports a wide range of protocols and data transmission rates.

EXFO Launches More Than 20 Products in 2001

EXFO announced in August 2001 it had launched more than 20 products in fiscal 2001. Key product launches included the FTB-400 Universal Test System, which is the industry's first modular platform that can perform essential physical layer tests for DWDM long-haul, metro and access networks; the OWA-9500 Optical Waveguide Analyzer, which represents the industry's first and only commercial refractive index profiler for all-important planar and arrayed waveguides; the FR-3000 NanoRobot® Alignment System with multi-axis alignment and 0.1-nanometer resolution for automated component manufacturing applications; and the Novacure® IR, which uses infrared spot-curing on conventional heat-cured adhesives.

EXFO Opens Sales Offices and Service Centers in Asia

EXFO opened sales offices and service centers in Singapore and Beijing during fiscal 2001 to better serve its customers abroad. The expansion into the Asian market proved to be a winning strategy since sales almost tripled from fiscal 2000 to 2001 in this region. EXFO also relocated its Paris office to strengthen sales, application engineering and marketing services throughout Europe.

EXFO Acquires EFOS

EXFO announced in March 2001 it had acquired EFOS Inc., now EXFO Photonic Solutions Inc., for 3.7 million shares valued at \$85 million and \$25 million in cash. EXFO Photonic Solutions is a leader in precision light-based adhesive spot curing technologies as well as curing process control for the global optical component manufacturing market.

EXFO Joins TSE 300

EXFO announced in February 2001 it had been added to the Toronto Stock Exchange (TSE) 300 Composite Index as well as the TSE 300 Capped, S&P/TSE Canadian SmallCap and TSE 200 Indices. The TSE 300 Composite Index is a benchmark used to measure the price performance of the broad Canadian equity market.

EXFO Acquires Burleigh Instruments

EXFO announced in December 2000 it had acquired Burleigh Instruments, Inc. for \$6.5 million shares valued at \$147 million and \$42 million in cash. Burleigh is a leading supplier of DWDM wavelength measurement instruments and precision positioning equipment.