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.

Industry Overview

Optical Networking Market

The past decade has witnessed an explosive growth in the volume of data traffic largely due to the soaring popularity of the Internet and related bandwidth-intensive applications. According to information technology industry analysts, the number of Internet users around the world is expected to increase from 400 million in 2001 to nearly one billion, or 15% of the total population, by 2005. In addition, users are increasingly seeking applications that require a great deal of bandwidth such as video conferencing, video-on-demand, HDTV, e-commerce and rich media streaming.

The dramatic increase in Internet users and in bandwidth-intensive applications has created a tremendous need for high-capacity communication networks. To meet this increasing demand for bandwidth, many telecommunication carriers are designing and installing new networks based on optical fiber, deploying additional fiber within their existing networks or using advances in optical technology such as Dense Wavelength Division Multiplexing, or DWDM. DWDM involves combining beams of light of slightly different wavelengths through a single fiber, with each wavelength carrying its own stream of information. DWDM has wide market acceptance because it incorporates technologies that greatly reduce the cost of optical transmission over long distances and because it provides network flexibility in access and metropolitan areas. According to Kessler Marketing Intelligence (KMI), the global DWDM Transport Equipment Market is expected to increase from $7.1 billion in 2001 to $23.2 billion in 2005.

Although the long-term outlook for the telecommunications industry remains robust, 2001 was marked by a slowdown in the overall economy and reduced capital spending in the optical networking market. On the carrier side, we observed a trend towards maximizing existing networks by increasing transmission rates and adding DWDM channels, while delaying deployment of new fiber cables. For optical component and system manufacturers, the slowdown in the buildout of new networks resulted in excess inventories throughout the industry. Despite this over-supply of optical components, the most established component and system manufacturers did not significantly slash their R&D budgets in order to remain competitive in designing next-generation products. As a result, new production lines are still being rolled out in significant numbers.

Optical Test, Measurement and Automation Equipment Market

Fiber-optic test, measurement and automation equipment is essential for research and development, manufacturing, network installation and maintenance as well as network monitoring.

Conventional test and measurement instruments used by telecommunication carriers and manufacturers of communications equipment were designed for electrical transmission systems and are unsuitable for optical networking. Unlike traditional electrical transmission systems, which transmit electrical signals along copper wires, fiber-optic transmission systems use pulses of light along glass or plastic fiber, often referred to as optical fiber. When light travels along optical fiber and through the optical components and systems that link optical fibers together, it is subject to unwanted effects such as reflection, attenuation, noise and various types of dispersion, all of which degrade signal quality and reduce transmission performance. Fiber-optic test and measurement equipment is critical for measuring these effects and helping carriers and manufacturers of optical components, value-added optical modules and optical networking systems ensure network performance, efficiency and reliability.

Data sent along an optical network must respect transmission protocols, such as ATM, SONET, SDH, Ethernet and Gigabit Ethernet, and fall within accepted data transmission rates from 64 kb/s to 10 Gb/s. Otherwise, the information sent from a transmitter will not be understandable to the receiver. Fiber-optic test and measurement equipment like a bit-error rate tester is used to ensure data integrity.

Optical components and value-added optical modules, which make up an optical network, are typically assembled by hand on the production floor. Yields are inevitably low and costs are high. As a result, optical component vendors are increasingly looking for ways to increase efficiency and reduce costs by adopting automated manufacturing solutions. They either build these complex solutions in-house or turn to equipment manufacturers to help them automate critical steps in the manufacturing process such as alignment, curing and optical testing. The latter option enables optical component vendors to devote their scarce technical resources to developing next-generation products instead of manufacturing tools.

The fiber-optic test, measurement and automation market has not been immune to the challenging conditions in the optical networking sector. However, vendors with extensive product portfolios that include advanced optical test instruments were still able to market their products to carriers, who need to upgrade their networks to higher transmission rates or add DWDM channels. Likewise, test, measurement and automation vendors, whose products increase efficiency and reduce costs on the production floor, still attracted the attention of optical component and system manufacturers, who kept investing in their R&D programs to stay ahead of the competition.

Corporate Overview

EXFO was incorporated on September 18, 1985. Our original products were focused primarily on the needs of installers and operators of fiber-optic networks. These products are marketed in what is known today as our Portable and Monitoring Division. This division markets its products mainly to telecommunication carriers and network service providers. These customers use Portable and Monitoring Division products for installation and maintenance, monitoring and troubleshooting applications. In 1996, we supplemented our product portfolio with an extensive line of Industrial and Scientific products that are dedicated to the research and development as well as manufacturing markets in the fiber-optic industry. Our Industrial and Scientific products tend to be more complex and higher priced than our Portable and Monitoring products. Industrial and Scientific Division customers include optical component and system manufacturers as well and research and development laboratories. In fiscal 1999, we entered the market for remote fiber test systems. Remote fiber test systems, which are marketed through our Portable and Monitoring Division, allow carriers to deploy test equipment throughout their networks in order to monitor the integrity of their fiber-optic networks.

In fiscal 2001, we announced three strategic acquisitions to bolster growth in both of our product divisions. We acquired Burleigh Instruments for its wavelength measurement instruments and nano-positioning alignment systems. We added EFOS (renamed EXFO Photonic Solutions) for its precision light-based, adhesive spot-curing technology. Both of these companies are expected to accelerate growth in our Industrial and Scientific Division. Finally, we reached an agreement to acquire Avantas Networks, 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. Avantas should increase sales in both product divisions, but initially in our Portable and Monitoring Division.

The Avantas acquisition will enable us to enter the critical protocol-layer testing market and, more importantly, almost double our addressable market size to an estimated $3.3 billion, according to reports from Frost and Sullivan. In layman's terms, EXFO products test the highway, or the fiber, optical components and value-added optical modules that make up the physical layer of an optical network. Our products also cover the numerous lanes along the highway, or the DWDM wavelengths carrying bandwidth within the optical layer of a network. With the Avantas acquisition, EXFO products will also test the traffic, or the bits and bytes, running through the protocol layer of a network.

We sell our products to more than 2000 customers through our direct sales force and indirectly through distribution channels. Cost of sales include raw materials, salaries and related expenses for direct and indirect manufacturing personnel and manufacturing overhead.

Selling and administrative expenses consist primarily of salaries and related expenses for personnel, sales commissions, travel expenses, marketing programs, professional services, management information systems, human resources and other corporate expenses.

Gross research and development expenses consist primarily of salaries and related expenses for engineers and other technical personnel as well as fees paid to third-party consultants. We are eligible to receive research and development (R&D) tax credits and government grants. Related R&D tax credits and government grants are recorded as a reduction of gross R&D expenses.

Results of Operations

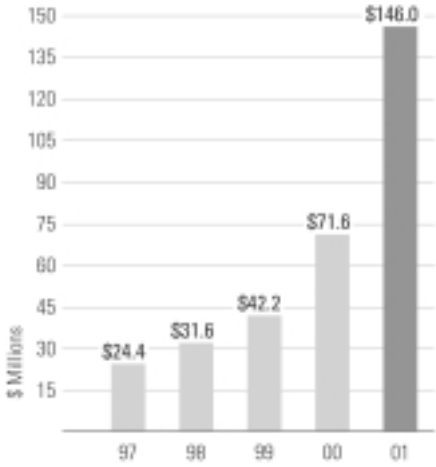
The following table sets forth certain Canadian GAAP consolidated statements of earnings data in thousands of US dollars, except per share data, and as a percentage of sales for the years indicated:

Years Ended August 31,	1999	2000	2001	1999	2000	2001
Sales	$ 42,166	$ 71,639	$ 146,013	100.0 %	100.0 %	100.0 %
Cost of sales	14,998	24,712	54,946	35.6	34.5	37.6
Gross margin	27,168	46,927	91,067	64.4	65.5	62.4
Operating expenses						
Selling and administrative	13,279	24,304	46,236	31.5	33.9	31.7
Net research and development	4,315	6,402	13,601	10.2	8.9	9.3
Amortization of property, plant and equipment	857	1,451	3,559	2.0	2.0	2.4
Amortization of intangible assets	41	47	9,876	0.1	0.1	6.8
Non-recurring expenses	-	-	3,288	-	-	2.3
Earnings from operations	8,676	14,723	14,507	20.6	20.6	9.9
Interest income, net	136	1,480	6,098	0.3	2.1	4.2
Foreign exchange gain (loss)	(506)	(684)	3,327	(1.2)	(1.0)	2.3
Earnings before income taxes and amortization of goodwill	8,306	15,519	23,932	19.7	21.7	16.4
Income taxes	2,492	5,298	8,150	5.9	7.4	5.6
Earnings before amortization of goodwill	5,814	10,221	15,782	13.8	14.3	10.8
Amortization of goodwill	-	297	31,076	-	0.4	21.3
Net earnings (loss) for the year	$ 5,814	$ 9,924	$ (15,294)	13.8 %	13.9 %	(10.5)%
Basic and diluted net earnings (loss) per share	$ 0.14	$ 0.25	$ (0.29)			
Research and development data:						
Gross research and development	$ 6,390	$ 9,374	$ 17,601	15.2 %	13.1 %	12.1 %
Net research and development	$ 4,315	$ 6,402	$ 13,601	10.2 %	8.9 %	9.3 %
Other data (unaudited):						
Adjusted net earnings*	$ 5,843	$ 10,252	$ 24,463	13.9 %	14.3 %	16.8 %
Basic and diluted adjusted net earnings per share*	$ 0.14	$ 0.26	$ 0.46			

* Net earnings excluding amortization of goodwill and the after-tax effect of amortization of intangible assets and non-recurring expenses. This information may not be comparable to similarly titled measures reported by other companies because it is non-GAAP information.

Sales

Sales totalled $146.0 million, $71.6 million and $42.2 million in fiscal 2001, 2000 and 1999, respectively. Sales increased 104% in fiscal 2001 compared to 2000 due to increased demand for our Industrial and Scientific products as well as our Portable and Monitoring products, market acceptance of several products launched in 2001 and the impact of the Burleigh Instruments and EXFO Photonic Solutions acquisitions completed during the year. In addition, the increase in sales of our Industrial and Scientific products significantly affected our top line because these products have a higher average selling price than Portable and Monitoring products.



Altogether, Industrial and Scientific products accounted for almost 50% of our sales in fiscal 2001 compared to just over 30% in 2000. In fiscal 2002, we expect our Portable and Monitoring products to regain a larger share of our total sales due to continued carrier spending and the impact of the Avantas acquisition in the second half of the year. Although telecommunication carriers have lowered their capital expenditures for network deployment, they are upgrading networks by adding DWDM channels and increasing data transmission rates. As a result, they still need to purchase test and measurement equipment to ensure network reliability. The Avantas acquisition will initially benefit the Portable and Monitoring Division, but it should eventually increase sales in the Industrial and Scientific Division.

Accepted orders increased 53% to $132.1 million in fiscal 2001 from $86.2 million for 2000. Our book-to-bill ratio, however, decreased 25% to 0.90 in fiscal 2001 compared to 1.20 in 2000. The decrease in our book-to-bill ratio reflects the downturn in the telecommunications industry, which began impacting our booking in the third quarter of 2001.

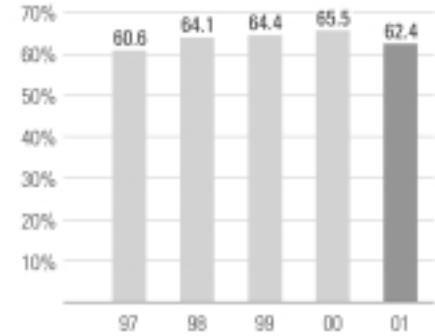
In fiscal 2000, sales increased 70% compared to 1999. Growth in sales was mainly due to increased demand for our Industrial and Scientific products as well as a general sales increase in our other products.

North American sales accounted for 58.3%, 61.6% and 56.3% of global sales in fiscal 2001, 2000 and 1999, respectively. International sales represented 41.7%, 38.4% and 43.7% of global sales in fiscal 2001, 2000 and 1999, respectively. The increase in international sales in fiscal 2001 compared to 2000 mainly reflects our sustained efforts to develop the Asian market. We almost tripled our sales in this region and added service centers in Beijing and Singapore to better serve our customers. The jump in North American sales in fiscal 2000 compared to 1999 was the result of our ability to exploit a robust economy in that region during that period.

We sell our products to a broad range of customers including telecommunication carriers, optical component and system manufacturers as well as research and development laboratories. No customer accounted for more than 6.4%, 5.8% and 6.8% of sales in fiscal 2001, 2000 and 1999, respectively.

Gross Margin

Gross margin amounted to 62.4%, 65.5% and 64.4% of sales for fiscal 2001, 2000 and 1999, respectively. Despite the increase in sales of Industrial and Scientific products, which tend to be slightly higher-margin products, gross margin decreased in fiscal 2001 compared to 2000 due to a number of reasons. First of all, we significantly increased our manufacturing capacity as well as hired and trained related manufacturing employees to face current and future demand for our products. Secondly, we re-engineered our manufacturing processes to be more cost-effective and to better mitigate the impact of potential pricing pressure in the future. Thirdly, we acquired EXFO Photonic Solutions, which operates in a market that has relatively lower-margin products. Finally, the slowdown in the telecommunications industry, which affected us mostly in the last quarter of fiscal 2001, prevented us from a better absorption of our fixed costs.



The improvement in gross margin in fiscal 2000 compared to 1999 reflects the increase in government grants earned in 2000, increased sales of higher-margin products and our cost-reduction manufacturing programs.

Gross margin can be negatively affected by competitive pricing pressure, increases in component costs and obsolescence costs, shifts in product mix, reductions in government grants, under-absorption of manufacturing fixed costs and increases in product offerings by other suppliers in the fiber-optic test, measurement and automation industry.

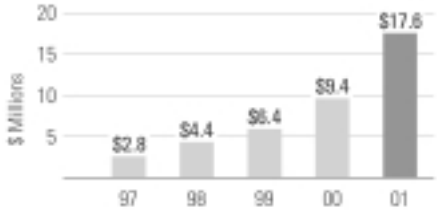
Selling and Administrative

Selling and administrative expenses reached $46.2 million, $24.3 million and $13.3 million for fiscal 2001, 2000 and 1999, respectively. As a percentage of sales, selling and administrative expenses amounted to 31.7%, 33.9% and 31.5% for fiscal 2001, 2000 and 1999, respectively. The dollar increase for fiscal 2001 compared to 2000 is directly related to higher commissions resulting from increased sales activity, increased promotional and marketing expenses, expenses to consolidate our sales force in Asia, expenses related to running a public company and the impact of the Burleigh Instruments and EXFO Photonic Solutions acquisitions. The percentage decrease is mainly due to a better absorption of these expenses because sales are increasing at a faster rate than selling and administrative expenses.

The increase in selling and administrative expenses in fiscal 2000 compared to 1999 reflects increased personnel expenses for sales and marketing staff, increased expenses related to customer support, increased sales commissions related to higher sales, increased promotional and marketing expenses as well as the expenses related to running a public company since June 2000.

Considering current market conditions, efforts will be undertaken to maintain our selling and administrative expenses at an acceptable level without impeding our efforts to strategically position our company, improve our sales, marketing and customer service teams, integrate our acquired companies and satisfy our customers.

Research and Development



Gross R&D expenses totalled $17.6 million, $9.4 million and $6.4 million for fiscal 2001, 2000 and 1999, respectively. As a percentage of sales, gross R&D expenses were 12.1%, 13.1% and 15.2% for fiscal 2001, 2000 and 1999, respectively. The increase in gross R&D dollars in fiscal 2001 compared to 2000 reflects our commitment to innovation by hiring additional R&D personnel as well as by the acquisitions of Burleigh Instruments and EXFO Photonic Solutions. Taking into account these acquisitions, we added 95 employees to our R&D departments in fiscal 2001, supporting our continued focus on innovative product development. Our sustained efforts in R&D allowed us to launch more than 20 new products in 2001. Altogether, 46% of our sales in fiscal 2001 originated from products that have been on the market for two years or less. This figure confirms our dedication to innovation and our anticipation of customers' needs and expectations.

The decrease, as percentage of sales, in fiscal 2001 compared to 2000 is mainly due to the fact that sales increased at a faster rate than R&D expenses during this period.

The increase in R&D dollars in fiscal 2000 compared to 1999 reflects the hiring of additional personnel to develop new products and enhance current ones. During fiscal 2000, we added 45 employees to our R&D Department.

Tax credits and grants from federal, provincial and state governments for R&D activities were $4.0 million, $3.0 million and $2.1 million for fiscal 2001, 2000 and 1999, respectively. The increase in tax credits and grants in fiscal 2001 compared to 2000 is directly related to the hiring of additional R&D personnel as well as the impact of the EXFO Photonic Solutions acquisition. The increase in tax credits and grants in fiscal 2000 compared to 1999 is the result of hiring additional R&D personnel.

Tax credits and grants, as a percentage of gross R&D expenses, were 22.7%, 31.7% and 32.5% for fiscal 2001, 2000 and 1999, respectively. The decrease in fiscal 2001 compared to 2000 is related to a reduction in the effective tax credit rate and grants on R&D carried out in Canada. It should be noted that R&D carried out by US-based Burleigh Instruments is not eligible for tax credits. As a result, the gross R&D percentage was further reduced in fiscal 2001.

In terms of net R&D expenses, they amounted to 9.3%, 8.9% and 10.2% of sales for fiscal 2001, 2000 and 1999, respectively. We expect to continue investing heavily in R&D in the upcoming year, reflecting our focus on innovation and our desire to exceed our customers' needs and expectations.

Amortization of Intangible Assets

In conjunction with the acquisitions of Burleigh Instruments and EXFO Photonic Solutions, we recorded $54.7 million in intangible assets primarily consisting of core technology. These intangible assets, which are amortized over periods from five months to five years, resulted in an amortization expense of $9.9 million in fiscal 2001.

Non-Recurring Expenses

In June 2001, we implemented a structured plan to reduce costs and increase efficiency in order to align our cost structure to market conditions and be better positioned amidst a challenging environment.

Under this plan, we incurred non-recurring expenses of $3.3 million, including $0.8 million in severance expenses for the 245 employees who were terminated and $2.5 million in unused facilities and assets. No such expenses were incurred in fiscal 2000 and 1999.

This plan should enable us to reduce our operating expenses by approximately $8 million in fiscal 2002.

Interest Income, Net

Interest income amounted to $6.1 million, $1.5 million and $0.1 million for fiscal 2001, 2000 and 1999, respectively. The increase in our interest income results solely from short-term investments of the remaining net proceeds of our Initial Public Offering on June 29, 2000. The increase in interest income is somewhat offset by interest expenses and bank charges related to borrowings under our lines of credit. Our interest income will decrease in fiscal 2002 because we used short-term investments to pay for cash considerations in recent acquisitions and because interest rates may continue to drop.

Foreign Exchange Gain (Loss)

Foreign exchange gain amounted to $3.3 million in fiscal 2001 compared to foreign exchange losses of $0.7 million in 2000 and $0.5 million in 1999.

The foreign exchange gain in fiscal 2001 can be mostly attributed to the disposal of short-term investments denominated in US dollars and to the foreign exchange impact on operating activities of Canadian entities denominated in currencies other than the Canadian dollar. Foreign exchange losses incurred in fiscal 2000 and 1999 are solely due to the foreign exchange impact on operating activities of Canadian entities denominated in currencies other than the Canadian dollar.

Income Taxes

Our effective income tax rates were 34.1%, 34.1% and 30.0% for fiscal 2001, 2000 and 1999, respectively. Our effective income tax rate was flat in fiscal 2001 compared to 2000. The increase from fiscal 1999 to 2000 can be attributed to a decrease in our manufacturing and processing deduction.

Amortization of Goodwill

In conjunction with the acquisitions of Burleigh Instruments and EXFO Photonic Solutions, we recorded $248.5 million in goodwill. Goodwill, which is amortized over five years, resulted in an amortization expense of $31.1 million in fiscal 2001.

Net Earnings (Loss)

Net loss amounted to $15.3 million in fiscal 2001 compared to net earnings of $9.9 million in 2000 and $5.8 million in 1999. In terms of per share amounts, we recorded a net loss of $0.29 in fiscal 2001 compared to net earnings of $0.25 in 2000 and $0.14 in 1999.

Adjusted Net Earnings

As a measure to assess financial performance, we use adjusted net earnings and adjusted net earnings per share. Adjusted net earnings represent net earnings excluding amortization of goodwill and the after-tax effect of amortization of intangible assets and non-recurring expenses.

Adjusted net earnings amounted to $24.5 million, $10.3 million and $5.8 million in fiscal 2001, 2000 and 1999, respectively. In terms of adjusted net earnings per share, it reached $0.46, $0.26 and $0.14 in fiscal 2001, 2000 and 1999, respectively.

Liquidity and Capital Resources

Prior to our Initial Public Offering, we had financed operations and met our capital expenditure requirements mainly through cash flows from operations, research and development tax credits and government grants. On June 29, 2000, we closed our Initial Public Offering of 8,050,000 subordinate voting shares at a price of US$26.00 per share in the United States and Cdn$38.55 per share in Canada. Total proceeds, including the over-allotment option exercised by the underwriters, were approximately US$209 million.

Cash Position and Short-Term Investments

As at August 31, 2001, cash and cash equivalents as well as short-term investments consisted of $74.6 million. Our working capital was at $130.3 million. The announced acquisition of Avantas Networks Corporation will be partially financed with $8.0 million of cash on hand.

Operating Activities

Cash flows provided by operating activities were $3.1 million in fiscal 2001 compared to cash flows used of $4.0 million in 2000 and cash flows provided of $3.7 million in 1999. Cash flows provided by operating activities in fiscal 2001 were primarily due to net earnings after items not affecting cash and cash equivalents of $24.5 million. This figure was mainly offset by an increase of $20.3 million in inventories required to ensure minimal manufacturing and delivery lead times.

Cash flows used in operating activities in fiscal 2000 were primarily due to net earnings after items not affecting cash and cash equivalents of $10.9 million. This figure was mainly offset by an increase of $10.5 million in accounts receivable, resulting from higher volumes of sales and $10.7 million in inventories that were required to ensure minimal manufacturing and delivery lead times.

The major items not affecting cash and cash equivalents consisted of net amortization expenses of $43.9 million for fiscal 2001 and $1.0 million for 2000.

Financing Activities

Cash flows used in financing activities were $4.6 million in fiscal 2001 compared to cash flows provided of $172.9 million in 2000 and cash flows used of $3.3 million in 1999. Cash flows used in financing activities in fiscal 2001 were mainly due to the repayment of bank advances and long-term debt of $5.4 million. Considering these repayments, we have available credit facilities as at August 31, 2001 that provide for advances of up to $11.4 million under lines of credit. These lines of credit bear interest at prime rate.

Cash flows provided by financing activities in fiscal 2000 were the result of the net proceeds of our Initial Public Offering of $192.9 million less the dividends paid of $17.6 million. Cash flows used in financing activities in fiscal 1999 were due to the payment of $3.2 million in dividends that were declared that year. We do not foresee payments of additional dividends during the next three fiscal years.

Investing Activities

Cash flows provided by investing activities were $9.2 million in fiscal 2001 compared to cash flows used of $169.0 million in 2000 and $1.2 million in 1999.

In fiscal 2001, we disposed of $93.4 million in short-term investments to finance the $15.9 million purchase of property, plant and equipment as well as to pay the cash consideration of $68.3 million for the Burleigh Instruments and EXFO Photonic Solutions acquisitions. Despite these investments, the disposal of short-term investments generated net cash flows of $9.2 million in fiscal 2001.

The purchases of $159.8 million in short-term investments from the net proceeds of our Initial Public Offering and of $7.2 million in property, plant and equipment explain the use of cash flows for investing activities in fiscal 2000. In fiscal 1999, the purchase of $1.2 million in property, plant and equipment explain the use of cash flows in investing activities. As at August 31, 2001, property, plant and equipment amounted to $27.1 million, while intangible assets and goodwill related to the acquisitions of Burleigh Instruments and EXFO Photonic Solutions totalled $264.2 million, net of related accumulated amortization.

Outlook

We believe that our existing cash balances and short-term investments, together with cash flows from operations and available credit facilities, will be sufficient to meet our expected liquidity and capital requirements for the upcoming year, taking into account the cash consideration to be paid for the previously announced acquisition of Avantas Networks. However, possible investments in or acquisitions of complementary businesses, products or technologies may require additional financing prior to such time. There can be no assurance that additional debt or equity financing will be available when required or, if available, it can be secured on terms satisfactory to us.

New Accounting Standards

On August 1, 2001, the Canadian Institute of Chartered Accountants issued section 1581 "Business Combinations," which supersedes section 1580, and issued section 3062 "Goodwill and Other Intangible Assets." Section 1581 requires business combinations initiated after June 30, 2001 or business combinations accounted for by the purchase method with a date of acquisition after June 30, 2001, to be accounted for using the purchase method of accounting. This section also broadens criteria for recording intangible assets separately from goodwill. Upon the adoption of section 3062, recorded goodwill and intangible assets will be evaluated against these new criteria and may result in certain intangible assets being reclassified into goodwill or, alternatively, amounts initially recorded as goodwill being separately identified and recognized apart from goodwill as intangible assets. Section 3062 requires the use of a non-amortization approach to account for purchased goodwill and indefinite-lived intangibles. Under the non-amortization approach, goodwill and indefinite-lived intangibles will not be amortized, but instead they will be reviewed for impairment and written down and charged to earnings only in the periods in which the recorded value of goodwill and indefinite-lived intangibles exceed their fair value. This section will be adopted on September 1, 2002.

The impact of adopting section 3062 will allow us to use the non-amortization approach for goodwill and will reduce annual goodwill amortization by approximately $50 million. Moreover, we will implement a new goodwill impairment methodology and any potential initial impairment losses on goodwill determined by this methodology will be charged to deficit. Any subsequent impairment losses on goodwill will be charged to earnings in the period in which it is incurred.

Under US GAAP, any potential initial impairment losses on goodwill determined by this methodology will be charged to earnings.

For more details on new US accounting standards, see note 19 to our consolidated financial statements.

Risks and Uncertainties

Over the past few years, we have been successful in maintaining a strong rate of growth by effectively managing our activities, by focusing on the research and development of new and innovative products, by penetrating international markets, by seeking and closing important strategic acquisitions and, finally, by attracting and retaining highly skilled employees. However, we operate in a highly competitive field that is in constant evolution and, as a result, we encounter various risks and uncertainties that must be given appropriate consideration in our strategic management policies.

The main risks and uncertainties related to the fiber-optic test, measurement and automation industry involve the quick development of new products that have short lifecycles and require extensive research and development; the difficulty of attracting and retaining highly skilled employees as well as offering them effective training programs; and the ability to quickly adapt our cost structure to changing market conditions in order to maintain or increase our growth.

In addition, given our strategic goals for growth and competitive positioning in our industry, we are expanding into international markets. This exposes us to certain risks and uncertainties related to changes in local laws and regulations, multiple technological standards, protective legislation and pricing pressure.

Furthermore, while the important strategic acquisitions we have made are essential to our long-term growth, they also expose us to certain risks and uncertainties related to the rapid and effective integration of these companies as well as their products, technologies and personnel.

We are also exposed to currency risks as a result of the export of our products manufactured in Canada, substantially all of which are denominated in US dollars. These risks are partially hedged by the operating expenses of certain international subsidiaries, the purchase of raw materials in US dollars and forward exchange contracts. (See note 18 to our consolidated financial statements).

Also, an economic slowdown in our industry could result in some of our customers experiencing difficulties and, consequently, this could have a negative effect on our results. However, the sectorial and geographic diversity of our customer base provides us with a reasonable level of protection in this area. Finally, other financial instruments which potentially subject us to credit risks consist principally of cash and cash equivalents, short-term investments and forward exchange contracts. Our short-term investments consist of debt instruments issued by high-credit quality financial institutions and corporations and units of a low-risk mutual fund. Our cash and cash equivalents and forward exchange contracts are held with or issued by high-credit quality financial institutions; therefore, we consider the risk of non-performance on these instruments to be remote.

To obtain more information about our risks and uncertainties, please refer to the disclosure documents published with securities commissions.

Forward-Looking Statements

This annual report contains forward-looking statements that involve risks and uncertainties. These statements relate to our future plans, objectives, expectations and intentions. We have identified these statements by the use of words such as "may," "will," "expect," "anticipate," "intend," "plan," "estimate," "believe," "continue" or other similar expressions. These forward-looking statements reflect our current expectations and assumptions as to future events that may not prove to be accurate. Our actual results are subject to a number of risks and uncertainties and could differ materially from those discussed in these statements. Factors that could contribute to these differences include, but are not limited to, those discussed in our Annual Information Form filed with the US Securities and Exchange Commission and the Canadian Securities Commissions. In light of the many risks and uncertainties surrounding our business and operations, you should keep in mind that we cannot guarantee that the forward-looking statements described in this annual report will transpire. We undertake no obligation and do not intend to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as may be required under applicable law.