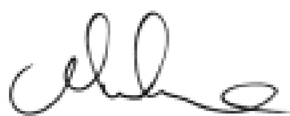
Management's Report

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 generally accepted accounting principles in Canada 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 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 composed 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.



Germain Lamonde
Chairman, President and CEO

Pierre Plamondon, CA
Vice-President, Finance and Chief Financial Officer

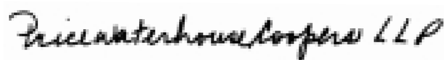
Auditors' Report

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, 2001 and 2002 and the consolidated statements of earnings, retained earnings (deficit) and contributed surplus and cash flows for each of the years in the three-year period ended August 31, 2002. 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 and United States 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, 2001 and 2002 and the results of its operations and its cash flows for each of the years in the three-year period ended August 31, 2002, in accordance with Canadian generally accepted accounting principles.



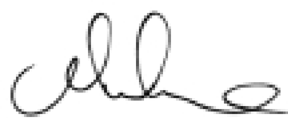
Chartered Accountants
Quebec, Quebec, Canada
September 23, 2002

Consolidated Balance Sheets

(in thousands of US dollars)

The accompanying notes are an integral part of these consolidated financial statements.

As at August 31,	2001	2002
Assets		
Current assets		
Cash and cash equivalents	$ 7,729	$ 9,128
Short-term investments (notes 8 and 18)	66,861	40,553
Accounts receivable (notes 8 and 18)		
Trade	24,531	9,881
Other	3,660	3,267
Income taxes receivable (note 8)	-	13,473
Inventories (notes 4, 5 and 8)	44,345	23,822
Prepaid expenses	1,265	1,280
Future income taxes (note 15)	1,423	1,272
	149,814	102,676
Income taxes receivable (note 8)	-	6,234
Property, plant and equipment (notes 6 and 8)	27,140	26,246
Intangible assets and goodwill (notes 4, 7 and 8)	264,242	34,040
Future income taxes (note 15)	1,381	8,730
	$ 442,577	$ 177,926
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 9)	$ 16,180	$ 10,699
Income taxes payable	2,623	-
Deferred revenue	616	503
Current portion of long-term debt	106	100
	19,525	11,302
Deferred grants (note 14)	1,002	654
Long-term debt (note 10)	664	564
Future income taxes (note 15)	6,581	-
	27,772	12,520
Commitments (note 11)		
Contingencies (note 12)		
Shareholders' equity		
Share capital (note 13)	429,995	489,611
Contributed surplus	1,457	1,487
Cumulative translation adjustment	(8,333)	(8,854)
Deficit	(8,314)	(316,838)
	414,805	165,406
	$ 442,577	$ 177,926



On behalf of the Board:

Germain Lamonde
Chairman, President and CEO

André Tremblay
Chairman, Audit Committee

Consolidated Statements of Earnings

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

The accompanying notes are an integral part of these consolidated financial statements.

Years Ended August 31,	2000	2001	2002
Sales (note 16)	$ 71,639	$ 146,013	**$ 68,330**
Cost of sales*	24,712	54,946	**50,801**
Gross margin	46,927	91,067	**17,529**
Operating expenses			
Selling and administrative	24,304	46,236	**35,446**
Net research and development (note 14)	6,402	13,601	**12,782**
Amortization of property, plant and equipment	1,451	3,559	**5,932**
Amortization of intangible assets	47	9,876	**11,615**
Write-down of intangible assets (note 4)	-	-	**23,657**
Restructuring and other charges (note 4)	-	3,288	**2,880**
Total operating expenses	32,204	76,560	**92,312**
Earnings (loss) from operations	14,723	14,507	**(74,783)**
Interest income, net	1,480	6,098	**1,456**
Foreign exchange gain (loss)	(684)	3,327	**(458)**
Earnings (loss) before income taxes and amortization and write-down of goodwill (note 15)	15,519	23,932	**(73,785)**
Income taxes (note 15)	5,298	8,150	**(25,451)**
Earnings (loss) before amortization and write-down of goodwill	10,221	15,782	**(48,334)**
Amortization of goodwill	297	31,076	**38,021**
Write-down of goodwill (note 4)	-	-	**222,169**
Net earnings (loss) for the year	$ 9,924	$ (15,294)	**$ (308,524)**
Basic and diluted earnings (loss) per share			
Earnings (loss) before amortization and write-down of goodwill	$ 0.26	$ 0.30	**$ (0.80)**
Net earnings (loss)	$ 0.25	$ (0.29)	**$ (5.09)**
Basic weighted average number of shares outstanding (000's)	39,951	53,014	**60,666**
Diluted weighted average number of shares outstanding (000's) (note 17)	40,086	53,495	**60,966**

* Including inventory write-offs of nil, nil and $18,463 for the years ended August 31, 2000, 2001 and 2002, respectively (see note 4).

Consolidated Statements of Retained Earnings (Deficit) and Contributed Surplus

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

The accompanying notes are an integral part of these consolidated financial statements.

Retained Earnings (Deficit)

Years Ended August 31,	2000	2001	**2002**
Balance – Beginning of year	$ 14,592	$ 6,980	**$ (8,314)**
Add			
Net earnings (loss) for the year	9,924	(15,294)	**(308,524)**
	24,516	(8,314)	**(316,838)**
Deduct			
Dividends			
Class A shares	17,216	-	**-**
Class F shares	320	-	**-**
	17,536	-	**-**
Balance – End of year	$ 6,980	$ (8,314)	**$ (316,838)**
Dividends per share			
Class A shares	$ 0.45	$ -	**$ -**
Class F shares	$ 0.45	$ -	**$ -**

Contributed Surplus

Years Ended August 31,	2000	2001	**2002**
Balance – Beginning of year	$ -	$ -	**$ 1457**
Add			
Premium on resale of share capital	-	1,457	**30**
Balance – End of year	$ -	$ 1,457	**$ 1,487**

Consolidated Statements of Cash Flows

(in thousands of US dollars)

The accompanying notes are an integral part of these consolidated financial statements.

Years Ended August 31,	2000	2001	2002
Cash flows from operating activities			
Net earnings (loss) for the year	$ 9,924	$ (15,294)	**$ (308,524)**
Add (deduct) items not affecting cash and cash equivalents			
Discount on short-term investments	(807)	191	**271**
Inventory write-offs	-	-	**18,463**
Amortization	1,795	44,511	**55,568**
Write-down of goodwill and intangible assets	-	-	**245,826**
Foreign exchange gains on disposal of short-term investments	-	(3,437)	**(74)**
Restructuring and other charges	-	1,083	**741**
Future income taxes	(33)	(1,779)	**(13,397)**
Change in non-cash operating working capital items			
Accounts receivable	(10,476)	447	**15,406**
Income taxes	2,149	2,237	**(19,736)**
Inventories	(10,732)	(20,308)	**4,332**
Prepaid expenses	(519)	(67)	**356**
Accounts payable and accrued liabilities	3,917	(3,736)	**(7,470)**
Deferred revenue	215	100	**(106)**
Deferred grants	567	(57)	**(335)**
	(4,000)	3,891	**(8,679)**
Cash flows from financing activities			
Bank advances	(357)	(2,046)	**-**
Repayment of mandatorily redeemable preferred shares	-	(354)	**-**
Repayment of loan from a company under common control	(1,349)	-	**-**
Repayment of long-term debt	(812)	(3,355)	**(106)**
Issuance of share capital	209,690	-	**-**
Redemption of share capital	-	(33)	**(6)**
Resale of share capital	-	1,490	**36**
Share issue expenses	(16,743)	(331)	**(14)**
Dividends paid	(17,587)	-	**-**
	172,842	(4,629)	**(90)**
Cash flows from investing activities			
Additions to short-term investments	(519,645)	(772,808)	**(506,228)**
Proceeds from disposal of short-term investments	359,886	865,373	**531,733**
Additions to property, plant and equipment and intangible assets	(7,180)	(15,911)	**(5,245)**
Business combinations (note 3)	(2,108)	(68,255)	**(9,756)**
	(169,047)	8,399	**10,504**
Change in cash and cash equivalents	(205)	7,661	**1,735**
Effect of foreign exchange rate changes on cash and cash equivalents	511	(661)	**(336)**
Cash and cash equivalents – Beginning of year	423	729	**7,729**
Cash and cash equivalents – End of year	$ 729	$ 7,729	**$ 9,128**
Supplementary information			
Interest paid	$ 480	$ 377	**$ 269**
Income taxes paid	$ 3,761	$ 8,171	**$ 4,172**

Notes to Consolidated Financial Statements

(tabular amounts in thousands of US 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, monitoring and automation solutions for the global telecommunications industry. These solutions measure the physical-, optical- and protocol-layers of optical fiber and related hardware and help automate manufacturing processes. The company derives substantially all of its revenue from customers located in the United States, Canada, Europe and Asia. The company's customers consist primarily of telecommunications carriers, network service providers, optical component and system manufacturers, as well as research and development laboratories.

2 · Summary of significant accounting policies

Basis of presentation

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada. These principles conform, in all material respects, with accounting principles generally accepted in the United States, except for the differences and additional disclosures provided in note 19. 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 revenues and expenses during the reporting years. Actual results could differ from those estimates.

Consolidation

These consolidated financial statements include the accounts of the company and its domestic and international subsidiaries. Intercompany accounts and transactions have been eliminated.

Reporting currency

The functional currency of the company is the Canadian dollar. However, the company has adopted the US dollar as its reporting currency. The financial statements are translated into the reporting currency 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 revenues and expenses are translated at the monthly average exchange rates. All gains and losses resulting from the translation of the financial statements into the reporting currency are included in the cumulative translation adjustment in shareholders' equity.

In the event that management decides to declare dividends, such dividends would be declared in Canadian dollars.

Foreign currency translation

Foreign currency transactions

Transactions denominated in currencies other than the functional currency are translated into the functional currency as follows: monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date and revenues and expenses are translated at the exchange rate in effect on the date of the transaction. Non-monetary assets and liabilities are translated at historical rates. Gains and losses arising from such translation are reflected in the statements of earnings.

Foreign subsidiaries

The financial statements of integrated foreign operations are remeasured into the functional currency using the temporal method. Under this method, monetary assets and liabilities are remeasured at the exchange rate in effect at the balance sheet date. Non-monetary assets and liabilities are remeasured at historical rates. Revenues and expenses are remeasured at the monthly average exchange rates. Gains and losses resulting from remeasurement are reflected in the statements of earnings.

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.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks and 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 is determined using the first-in, first-out method. The cost of finished goods is determined using the average cost method.

Property, plant and equipment and amortization

Property, plant and equipment are recorded at cost less related government grants and research and development tax credits. Amortization is provided on a straight-line basis over their estimated useful lives as follows:

	Term
Buildings	15 and 25 years
Equipment	2 to 10 years
Leasehold improvements	Remaining lease term

The carrying value of property, plant and equipment is evaluated for impairment whenever significant events or circumstances occur which may indicate an impairment in value, based upon a comparison of the carrying value to the net recoverable amount.

Intangible assets, goodwill and amortization

Intangible assets include the cost of acquired in-process research and development, core technology, workforce and trademark, net of accumulated amortization. Core technology represents the existing technology acquired in business combinations that has reached technological feasibility while acquired in-process research and development represents the existing technology that has not reached technological feasibility and has no future alternative use. Intangible assets are amortized on a straight-line basis over their estimated useful lives ranging from five to ten months for in-process research and development, five years for core technology, one year for workforce and two years for trademark.

Goodwill represents the excess of the purchase price of acquired businesses over the estimated fair value of net identifiable assets acquired. Goodwill related to business combinations with a date of acquisition prior to July 1, 2001, is amortized on a straight-line basis over the estimated useful life of five years until August 31, 2002. Goodwill related to business combinations with a date of acquisition after June 30, 2001, is not amortized but is reviewed for impairment.

Intangible assets and goodwill are reviewed for impairment when events or circumstances indicate that costs may not be recoverable. Impairment exists when the carrying value of the asset is greater than the pre-tax undiscounted future cash flows expected to be provided by the asset. The amount of impairment loss, if any, is the excess of the carrying value over the estimated pre-tax undiscounted future cash flows. Intangible assets and goodwill are written down for any permanent impairment in value of the unamortized portion.

Revenue recognition

For products in which software is incidental, the company recognizes revenue when persuasive evidence of an arrangement exists, the product has been delivered, the price is fixed and determinable and collection of the resulting receivable is reasonably assured. In addition, provisions are made for estimated returns, warranties and support obligations.

For products in which software is not incidental, revenues are separated into two categories: product and customer support revenues, based upon vendor-specific objective evidence of fair value. Product revenues for these sales are recognized as described above. Customer support revenues are deferred and recognized ratably over the years of the support arrangement. Except when provided within one year of delivery, costs of providing this support are insignificant and accrued at the time of delivery and no software upgrades are provided.

For all sales, the company uses a binding purchase order as evidence that a sales arrangement exists.

Delivery generally occurs when the product is shipped to a common carrier.

At the time of the transaction, the company assesses whether the price associated with its revenue transactions is fixed and determinable and whether or not collection is reasonably assured. The company assesses whether the price is fixed and determinable based on the payment terms associated with the transaction. The company assesses collection based on a number of factors, including past transaction history with the customer and the creditworthiness of the customer. Generally, collateral or other security is not requested from customers.

Most sales arrangements do not generally include acceptance clauses. However, if a sales arrangement includes an acceptance provision, acceptance occurs upon the earliest of receipt of a written customer acceptance or expiration of the acceptance period. For these sales arrangements, the sale is recognized when acceptance occurs.

Advertising costs

Advertising costs are expensed as incurred.

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 assets. 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.

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, net of related tax credits and government grants. Development expenses which meet generally accepted criteria for deferral are capitalized, net of related tax credits and government grants, and amortized against earnings over the estimated period of benefit.

As at August 31, 2002, the company had not deferred any development costs.

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 for the years 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.

Earnings (loss) per share

Basic earnings (loss) and dividends per share are determined using the weighted average number of common shares outstanding during the year.

Diluted earnings per share are determined using the weighted average number of common shares outstanding during the year, plus the effects of dilutive potential common shares outstanding during the year. This method requires that diluted earnings per share be calculated, using the treasury stock method, as if all dilutive potential common shares had been exercised at the later of the beginning of the year or the date of issuance, as the case may be, and that the funds obtained thereby be used to purchase common shares of the company at the average fair value of the common shares during the year.

Stock-based compensation plans

The company maintains stock-based compensation plans, which are described in note 13. Under accounting principles generally accepted in Canada, no compensation cost is recognized when stock, stock options or stock awards are issued to plan participants. Any consideration received from plan participants upon the purchase of stock or the exercise of stock options or stock awards is credited to share capital. The costs related to the stock appreciation rights are accrued and charged to earnings.

New accounting standards

In November 2001, The Canadian Institute of Chartered Accountants (CICA) revised section 1650, "Foreign Currency Translation", which is effective for fiscal years beginning on or after January 1, 2002. The revised standard, which the company will adopt retroactively on September 1, 2002, no longer permits the deferral and amortization of unrealized exchange gains and losses that arise on the translation of long-term foreign currency denominated monetary assets and liabilities. Under the new rules, such gains and losses must be reported in earnings as they arise. Adopting this revised standard will not have a significant impact on the company's financial statements since the company currently has no such long-term monetary items.

In November 2001, the CICA issued Accounting Guideline No. 13, "Hedging Relationships", which shall be applied to hedging relationships in effect in fiscal years beginning on or after July 1, 2003. This new accounting guideline, which the company will adopt prospectively on September 1, 2003, establishes basic criteria that must be met before hedge accounting can be used. It also describes the types of exposures that can be hedged and the types of instruments that qualify as hedges, sets detailed designation and documentation requirements and requires formal effectiveness testing. The company has not yet assessed the impact of the adoption of this new guideline.

In November 2001, the CICA issued section 3870, "Stock-Based Compensation and Other Stock-Based Payments", which is effective for fiscal years beginning on or after January 1, 2002. The new section applies to awards granted on or after the date of adoption, and requires that stock-based payments to non-employees and direct awards of stock to employees be accounted for using a fair value-based method. The new section also encourages, but does not require, the use of a fair value-based method to account for stock-based compensation costs arising from awards to employees. The new section requires pro forma disclosures with respect to net earnings and net earnings per share if a fair value-based method of accounting is not adopted for awards granted to employees. The company will adopt this new standard prospectively on September 1, 2002. The company will not account for the stock-based compensation costs arising from awards to employees. However, it will provide the required pro forma disclosures with respect to net earnings and net earnings per share. Consequently, the adoption of this new standard will not have a significant impact on the company's financial results.

In August 2001, the CICA issued section 1581 "Business Combinations" and 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 those 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 transitional provisions of section 3062, the company did not amortize the goodwill resulting from the acquisition of EXFO Protocol Inc., for which the acquisition date was November 2, 2001.

The company adopted section 3062 prospectively from September 1, 2002. Upon the adoption of this new section, goodwill recorded prior to July 1, 2001, is no longer subject to amortization. Also, under the transitional provisions of the section, the company performed an initial impairment test to identify goodwill impairment using a fair value-based method. Under the new section, a goodwill impairment exists when the carrying value of a reporting unit exceeds its fair value. For the purposes of the impairment test, the company allocated its existing goodwill to its reporting units and completed an evaluation of the fair value of such reporting units. Based on the comparison of the fair value of the reporting units to their carrying value, goodwill of the reporting units was not considered impaired.

Goodwill will also be tested for impairment on an annual basis or more frequently if events or circumstances occur that more likely than not reduce the fair value of a reporting unit below its carrying value. Any impairment loss arising from this test will be charged to earnings in the period in which it is incurred.

3 · Business combinations

The company made a number of business combinations in 2000, 2001 and 2002. The fair value allocated to intangible assets acquired was based upon independent valuations performed in conjunction with the business combinations. Also, acquired goodwill is not deductible for income tax purposes.

Business combination during 2002

Avantas Networks Corporation (renamed EXFO Protocol Inc.)

On November 2, 2001, the company acquired a 100% interest in EXFO Protocol Inc. ("EXFO Protocol"), a Canadian company specializing in fiber-optic protocol testing, in exchange for a total consideration valued at $94,952,000 or $69,381,000 net of $25,571,000 of cash and cash equivalents acquired. The total consideration includes acquisition-related costs of $1,272,000.

The consideration paid consisted of $9,756,000 in cash, net of cash and cash equivalents acquired of $25,571,000 and the issuance of 4,374,573 subordinate voting shares valued at $59,625,000. The fair value of the subordinate voting shares issued was determined based on the market price of the shares beginning three days before and ending three days after the terms of the acquisition were agreed upon and announced, being August 20, 2001.

This acquisition has been accounted for using the purchase method and, consequently, the results of operations of EXFO Protocol have been included in the consolidated statement of earnings of the company since November 2, 2001, being the date of acquisition.

The purchase price, including acquisition-related costs, has been allocated based on the estimated fair value of net assets at the date of acquisition as follows:

Assets acquired	
Current assets	$ 6,040
Property, plant and equipment	2,003
In-process research and development	1,400
Core technology	5,050
Future income tax assets	476
Current liabilities assumed	(3,575)
Net identifiable assets acquired	11,394
Goodwill (note 4)	57,987
Purchase price	69,381
Less: Subordinate voting shares issued	59,625
Cash paid, net of cash and cash equivalents acquired	$ 9,756

Business combinations during 2001

Burleigh Instruments, Inc. (renamed EXFO Burleigh Products Group Inc.)

On December 20, 2000, the company acquired a 100% interest in EXFO Burleigh Products Group Inc. ("EXFO Burleigh"), a U.S. company which manufactures precision scientific instruments used in basic and applied research, engineering and production test applications in a variety of fields, in exchange for a total consideration valued at $189,270,000, including acquisition-related costs of $2,461,000.

The consideration paid consisted of $42,461,000 in cash and the issuance of 6,488,816 subordinate voting shares valued at $146,809,000.

Furthermore, as part of this acquisition, the company established a restricted stock award plan for employees of EXFO Burleigh (note 13). This plan provides that in the event of an employee's departure, shares to be issued to this employee under the plan will be issued to EXFO Burleigh's former shareholders. In such circumstances, this issuance of shares will be recorded as additional goodwill.

EFOS Inc. (renamed EXFO Photonic Solutions Inc.)

On March 15, 2001, the company acquired a 100% interest in EXFO Photonic Solutions Inc. ("EXFO Photonic Solutions"), a Canadian company specializing in precision light-based adhesive spot-curing technologies as well as curing process control for the global optical component manufacturing market. This acquisition was settled for a total consideration valued at $110,146,000, including acquisition-related costs of $194,000. The consideration paid consisted of $25,194,000 in cash and the issuance of 3,700,000 subordinate voting shares valued at $84,952,000.

These two acquisitions have been accounted for using the purchase method and, consequently, the net earnings of EXFO Burleigh and EXFO Photonic Solutions have been included in the consolidated statement of earnings of the company from the date of acquisition of these subsidiaries, being December 20, 2000, for EXFO Burleigh and March 15, 2001, for EXFO Photonic Solutions.

The fair value of subordinate voting shares issued as part of these business combinations was determined based on the market price of the shares beginning three days before and ending three days after the dates of acquisition of the subsidiaries.

The purchase price, including acquisition-related costs, has been allocated based on the estimated fair value of net assets at the dates of acquisition as follows:

	EXFO Burleigh	EXFO Photonic Solutions
Assets acquired		
Current assets	$ 7,092	$ 9,195
Property, plant and equipment	4,457	1,054
In-process research and development	1,800	972
Core technology (note 4)	24,000	25,324
Work force	1,250	907
Trademark	-	421
Liabilities assumed	(9,068)	(7,169)
Future income tax liabilities	(8,342)	(983)
Net identifiable assets acquired	21,189	29,721
Goodwill (note 4)	168,081	80,425
Purchase price	189,270	110,146
Less: Subordinate voting shares issued	146,809	84,952
Cash paid, net of cash and cash equivalents acquired	$ 42,461	$ 25,194

Vanguard Technical Solutions, Inc.

On March 16, 2001, the company, through one of its subsidiaries, Burleigh Automation Inc., acquired substantially all the assets of Vanguard Technical Solutions, Inc., a U.S. company specializing in the design and manufacturing of ultra-precision assembly equipment for sensitive process and critical assembly challenges on the production floor. This acquisition, which was settled for a total cash consideration of $600,000 allocated to property and equipment, has been accounted for using the purchase method.

Business combinations during 2000

Nortech Fibronic Inc.

On February 4, 2000, the company acquired a 100% interest in Nortech Fibronic Inc. ("Nortech"), a Canadian company specializing in fiber-optic testing and temperature sensing, in exchange for total consideration valued at $2,799,000. The consideration paid consisted of $2,108,000 in cash, the issuance of 800,000 Class G shares, which were mandatorily redeemable, for cash or subordinate voting shares at the option of the company, for an amount of $553,000, and a non-interest-bearing debenture in the amount of $138,000, repaid in 2001.

This acquisition has been accounted for using the purchase method. The estimated fair value of assets and liabilities acquired amounted to $2,488,000 and $2,231,000, respectively, resulting in goodwill of $2,542,000 related to the telecommunications core business.

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

The mandatorily redeemable preferred shares were settled in 2001 for $354,000, resulting in a purchase price adjustment of $189,000, which has been applied against goodwill.

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. 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 years have been restated as if the companies had always been combined.

4 · Special charges

Write-down of goodwill and intangible assets

In May 2002, as part of its review of financial results, the company performed an assessment of the carrying value of goodwill and intangible assets recorded in conjunction with the acquisitions of EXFO Burleigh, EXFO Photonic Solutions and EXFO Protocol. The assessment was performed because of the severe and continued downturn in the telecommunications industry, the persisting unfavorable market conditions affecting the subsidiaries' industries and the decline in technology valuations. The growth prospects for those subsidiaries were significantly lower than previously expected and less than those of historical periods and the decline in market conditions affecting the subsidiaries is significant and other than temporary. As a result, the company concluded that the carrying value of goodwill and certain acquired intangible assets was impaired and it recorded a charge of $222,169,000 to write down a significant portion of goodwill and a pre-tax charge of $23,657,000 to write down a significant portion of acquired core technology. Of the total impairment loss of $245,826,000, $125,017,000 relates to EXFO Burleigh, $71,508,000 relates to EXFO Photonic Solutions and $49,301,000 relates to EXFO Protocol.

The impairment loss was calculated as the excess of the carrying value of the assets over the pre-tax undiscounted future cash flows. The pre-tax undiscounted future cash flows were estimated at the subsidiaries' level since the company had distinct cash flows for each of them and because they are not fully integrated into the company's activities. The cash flow periods used ranged from three to five years, using annual growth rates between 15% and 30%.

The assumptions supporting the estimated undiscounted future cash flows, including the annual growth rates, reflect management's best estimates.

Restructuring and other charges and inventory write-offs

During 2001, the company implemented a structured plan to reduce costs and increase efficiency. Under that plan, the company recorded charges of $3,288,000, including $844,000 in severance expenses for the 245 employees who were terminated, $1,476,000 for unused assets and $968,000 for future payments on exited leased facilities. These charges have been included in the restructuring and other charges in the statement of earnings for the year ended August 31, 2001. As at August 31, 2002, the accrued liabilities related to this restructuring plan amounted to $483,000 and consisted of future payments on exited leased facilities.

During 2002, the company incurred additional charges of $21,343,000 to further reduce its costs. Under additional structured plans, the company recorded $2,012,000 in severance expenses for the additional 350 employees who were terminated and $868,000 for the write-off of property, plant and equipment. These charges are included in the restructuring and other charges in the statement of earnings for the year ended August 31, 2002. Also, the company recorded $18,463,000 in inventory write-offs for excess and obsolete inventories, which are included in the cost of sales in the statement of earnings for the year ended August 31, 2002. As at August 31, 2002, the accrued liabilities related to the severance expenses incurred in 2002 amounted to $299,000.

5 · Inventories

As at August 31,	2001	**2002**
Raw materials	$ 29,891	**$ 13,507**
Work in progress	3,507	**1,382**
Finished goods	10,947	**8,933**
	$ 44,345	**$ 23,822**

6 · Property, plant and equipment

As at August 31,	2001		2002	
	Cost	Accumulated amortization	**Cost**	**Accumulated amortization**
Land	$ 2,735	$ -	**$ 2,124**	**$ -**
Buildings	9,077	326	**8,043**	**695**
Equipment	23,906	9,286	**29,177**	**14,662**
Leasehold improvements	2,390	1,356	**4,121**	**1,862**
	38,108	$ 10,968	**43,465**	**$ 17,219**
Less:				
Accumulated amortization	10,968		**17,219**	
	$ 27,140		**$ 26,246**	

7 · Intangible assets and goodwill

As at August 31,	2001	2002
In-process research and development, net of accumulated amortization of $4,195 ($2,769 in 2001)	$ -	**$ -**
Core technology, net of accumulated amortization of $14,815 ($5,678 in 2001)	43,805	**16,270**
Work force, net of accumulated amortization of $2,148 ($1,281 in 2001)	874	**-**
Other assets, net of accumulated amortization of $305 ($246 in 2001)	391	**194**
	45,070	**16,464**
Goodwill, net of accumulated amortization of $69,449 ($31,325 in 2001)	219,172	**17,576**
	$ 264,242	**$ 34,040**

In 2002, the company recorded charges of $23,657,000 and $222,169,000 to write down intangible assets and goodwill, respectively (note 4).

8 · Credit facilities

The company has available credit facilities under a line of credit, which provide for advances of up to Cdn$10,000,000 (US$6,415,000). These facilities which are renewable annually, bear interest at prime rate (prime rate in 2001). Short-term investments, accounts receivable, inventories and all tangible and intangible assets of the company have been pledged as collateral against these facilities. As at August 31, 2001 and 2002, these credit facilities were unused.

9 · Accounts payable and accrued liabilities

As at August 31,	2001	2002
Trade	$ 7,732	**$ 4,738**
Salaries and social benefits	3,917	**2,638**
Commissions	1,307	**283**
Tax on capital	463	**856**
Warranty	901	**849**
Restructuring charges (note 4)	1,230	**782**
Other	630	**553**
	$ 16,180	**$ 10,699**

10 · Long-term debt

As at August 31,		2001		2002
Loans collateralized by equipment, bearing interest at 9.6%, repayable in monthly installments of $13,000 including principal and interest, maturing in 2008	$	754	$	**664**
Unsecured non-interest-bearing loan, repaid during the year		16		**-**
		770		**664**
Less: Current portion		106		**100**
	$	664	$	**564**

As at August 31, 2002, minimum principal repayments required in each of the next five years are $100,000 in 2003, $110,000 in 2004, $122,000 in 2005, $136,000 in 2006 and $146,000 in 2007.

11 · Commitments

The company has entered into operating leases for certain of its premises and equipment, which expire at various dates through May 2011. Minimum rentals payable under these operating leases amount to $6,800,000 as at August 31, 2002.

For the years ended August 31, 2000, 2001 and 2002, rental expense amounted to $579,000, $1,580,000 and $1,936,000, respectively, of which $163,000, $238,000 and $234,000, respectively, were paid to a company owned by the President of the company.

12 · Contingencies

On November 27, 2001, a class action suit was filed in the United States District Court for the Southern District of New York against the company, four of the underwriters of its Initial Public Offering and some of its executive officers pursuant to the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and sections 11, 12 and 16 of the Securities Act of 1933. This class action alleges that the company's registration statement and prospectus filed with the Securities and Exchange Commission on June 29, 2000, contained material misrepresentations and/or omissions resulting from (i) the underwriters allegedly soliciting and receiving additional, excessive and undisclosed commissions from certain investors in exchange for which they allocated material portions of the shares issued in connection with the company's Initial Public Offering; and (ii) the underwriters allegedly entering into agreements with customers whereby shares issued in connection with the company's Initial Public Offering would be allocated to those customers in exchange for which customers agreed to purchase additional amounts of shares in the after market at pre-determined prices.

On April 19, 2002, the plaintiffs filed an amended complaint containing master allegations against all of the underwriters in all of the 310 cases included in this class action and, also filed an amended complaint containing allegations specific to four of the company's underwriters, the company and two of its executive officers. In addition to the allegations mentioned above, the amended complaint alleges that the underwriters (i) used their analysts to manipulate the stock market; and (ii) implemented schemes that allowed issuer insiders to sell their shares rapidly after an Initial Public Offering and benefit from high market prices. As concerns the company and its two executive officers in particular, the amended complaint alleges that (i) the company's registration statement was materially false and misleading because it failed to disclose the additional commissions and compensation to be received by underwriters; (ii) the two named executive officers learned of or recklessly disregarded the alleged misconduct of the underwriters; (iii) the two named executive officers had motive and opportunity to engage in alleged wrongful conduct due to personal holdings of the company's stock and the fact that an alleged artificially inflated stock price could be used as currency for acquisitions; and (iv) the two named executive officers, by virtue of their positions with the company, controlled the company and the contents of the registration statement and had the ability to prevent its issuance or cause it to be corrected. The plaintiffs in this suit seek an unspecified amount for damages suffered.

In July 2002, the issuers filed a motion to dismiss the plaintiffs' amended complaint.

Management believes that the company and its executive officers have fully complied with all applicable securities laws and that the claims against it and its officers are without merit. The company has referred this matter to its insurers and is vigorously defending its position in this litigation. However, at this time, it is not possible to predict the outcome of this case, nor determine the amount of possible losses. Accordingly, no provision for this case has been made in the consolidated financial statements as of August 31, 2002.

As at August 31, 2002, the company has outstanding letters of guarantee of Cdn$741,000 (US$475,000), which expire at various dates through 2011.

As at August 31, 2002, the company has guaranteed the repayment of third-party loans totaling Cdn$214,000 (US$137,000) detained by certain employees with respect to the purchase of Class F shares under the stock purchase plan (note 13).

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 June 29, 2000, the company filed articles of amendment 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 canceled.

The following tables summarize the share capital activity since August 31, 1999:

	Class A shares		Class F shares		
	Number	Amount	Number	Amount	Total amount
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, 2001 and 2002	-	$ -	-	$ -	**$ -**

	Multiple voting shares		Subordinate voting shares		
	Number	Amount	Number	Amount	Total amount
Balance as at August 31, 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**
Business combinations (note 3)	-	-	10,188,816	231,761	**231,761**
Conversion of multiple voting shares into subordinate voting shares	(100,000)	-	100,000	-	**-**
Redemption	-	-	(43,999)	(33)	**(33)**
Resale	-	-	43,999	33	**33**
Share issue expenses, net of related income taxes of $106,000	-	-	-	(225)	**(225)**
Balance as at August 31, 2001	37,900,000	1	19,046,080	429,994	**429,995**
Business combination (note 3)	-	-	4,374,573	59,625	**59,625**
Exercise of stock awards	-	-	144,532	-	**-**
Redemption	-	-	(7,022)	(6)	**(6)**
Resale	-	-	7,022	6	**6**
Share issue expenses, net of related income taxes of $5,000	-	-	-	(9)	**(9)**
Balance as at August 31, 2002	37,900,000	$ 1	23,565,185	$ 489,610	**$ 489,611**

Stock purchase plan

The company's stock purchase plan terminated at the time of the Initial Public Offering, being June 29, 2000. 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 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 from the date of acquisition. Prior to its Initial Public Offering, the company issued 707,264 Class F shares in exchange for a weighted average cash consideration of Cdn$0.98 (US$0.67) per share.

Stock option plan

In May 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 cannot exceed 4,470,961 shares. The maximum number of subordinate voting shares that may be granted to any individual cannot exceed 5% of the number of outstanding subordinate voting shares. The exercise price is the market price of the common shares on the date of grant. Options granted under the plan generally expire ten years from the date of grant. Options granted under the plan generally vest over a four-year period, with 25% vesting on an annual basis commencing on the first anniversary of the date of grant. Up to October 10, 2000, the number of options, which ultimately would become exercisable in any given year, and in aggregate, was dependent on the degree to which the company's financial performance objectives were met. Nevertheless, on October 10, 2000, the Board of Directors of the company amended the vesting terms for options granted pursuant to the option plan to remove the financial performance criterion. Accordingly, options granted vest over the four-year period. The Board of Directors may accelerate the vesting of any or all outstanding options upon the occurrence of a change of control.

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

Years Ended August 31,		2000		2001		**2002**
	Number	Weighted average exercise price	Number	Weighted average exercise price	**Number**	**Weighted average exercise price**
Outstanding – Beginning of year	-	$ -	609,734	$ 26	**2,414,231**	**$ 28**
Granted	609,734	26	2,153,352	29	**1,039,805**	**10**
Forfeited	-	-	(348,855)	(29)	**(856,462)**	**(25)**
Outstanding – End of year	609,734	$ 26	2,414,231	$ 28	**2,597,574**	**$ 22**
Exercisable – End of year	-	$ -	127,561	$ 26	**512,161**	**$ 28**

The following table summarizes information about stock options as at August 31, 2002:

	Options outstanding as at August 31, 2002		Options exercisable as at August 31, 2002	
Exercise price	Number	Weighted average remaining contractual life	Number	Weighted average remaining contractual life
$2.59	5,550	3.8 years	-	-
$5.65	53,479	3.5 years	-	-
$9.13 to $12.69	849,746	3.2 years	-	-
$19.19 to $27.80	1,325,170	2.3 years	421,253	2.2 years
$34.07 to $45.94	303,079	2.1 years	75,770	2.1 years
$56.75	60,550	2.0 years	15,138	2.0 years
	2,597,574	2.6 years	512,161	2.1 years

Restricted stock award plan

On December 20, 2000, the company established a restricted stock award plan for employees of EXFO Burleigh. Each stock award entitles employees to receive one subordinate voting share at a purchase price of nil. Stock awards granted under the plan vest over a four-year period, with 25% vesting on an annual basis commencing on the first anniversary of the date of grant. According to the plan, upon the involuntary termination of a member of the defined management team, all outstanding restricted stock awards granted to such employees automatically vest. The plan will expire on December 20, 2004.

The following table summarizes the restricted stock award activity since December 2000:

Years Ended August 31,	2001	**2002**
Outstanding – Beginning of year	-	**359,781**
Granted	359,781	**-**
Exercised	-	**(144,532)**
Outstanding – End of year	359,781	**215,249**
Exercisable – End of year	-	**-**

As of August 31, 2002, the weighted average remaining contractual life of the outstanding restricted stock awards was 2.3 years.

Stock appreciation rights plan

On August 4, 2001, the company established a stock appreciation rights plan for certain of its employees. Under that plan, eligible employees are entitled to receive a cash amount equivalent to the difference between the market price of the common shares on the date of exercise and the exercise price determined on the date of grant. Stock appreciation rights granted under the plan generally expire ten years from the date of grant. Stock appreciation rights generally vest over a four-year period, with 25% vesting on an annual basis commencing on the first anniversary of the date of grant.

Considering the market price of the common shares of US$2.13 as at August 31, 2002, no compensation expense has been recorded in 2002 under that plan.

The following table summarizes the stock appreciation rights activity since August 2001:

Years Ended August 31,	2001		**2002**	
	Number	Weighted average exercise price	**Number**	**Weighted average exercise price**
Outstanding – Beginning of year	-	$ -	**22,400**	**$ 30**
Granted	22,400	30	**1,000**	**12**
Forfeited	-	-	**(13,400)**	**(31)**
Outstanding – End of year	22,400	$ 30	**10,000**	**$ 26**
Exercisable – End of year	-	$ -	**2,250**	**$ 27**

The following table summarizes information about stock appreciation rights as at August 31, 2002:

	Stock appreciation rights outstanding as at August 31, 2002		Stock appreciation rights exercisable as at August 31, 2002	
Exercise price	Number	Weighted average remaining contractual life	Number	Weighted average remaining contractual life
$12.22	1,000	3.3 years	-	-
$19.19 to $22.25	6,500	2.3 years	1,625	2.3 years
$45.94	2,500	2.1 years	625	2.1 years
	10,000	2.3 years	2,250	2.2 years

14 · Other disclosures

Net research and development expenses

Net research and development expenses comprise the following:

Years Ended August 31,		2000		2001		**2002**
Gross research and development expenses	$	9,374	$	17,601	**$**	**17,005**
Research and development tax credits		(2,436)		(3,369)		**(3,890)**
Government grants		(536)		(631)		**(333)**
	$	6,402	$	13,601	**$**	**12,782**

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 Cdn$600,000 (US$385,000) toward 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 Cdn$2,220,000 (US$1,424,000) 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 maintains 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, 2002, the company recognized a total of Cdn$2,820,000 (US$1,809,000) under this program, of which Cdn$1,801,000 (US$1,155,000) have been credited to earnings with the balance of Cdn$1,019,000 (US$654,000) having been included in deferred grants in the balance sheet.

Furthermore, in 1999, the company entered into another agreement with the Minister. Pursuant to this agreement, the Minister agreed to provide grants 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 the new employees continue to participate in the specific training program for a period of at least ten consecutive months. Should this condition not be met by the company, the Minister may enforce various recourse, 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 Cdn$2,965,000 (US$1,902,000) under this program, which has been credited to earnings.

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 eligible for a refundable tax credit granted by the Province of Quebec government. This credit is earned on the increase of production and marketing salaries incurred in the Quebec City area at a rate of 40%. Since 2000, the company has recognized a total of Cdn$3,911,000 (US$2,509,000) under this program, which has been credited to earnings.

The reduction in the company's work force described in note 4 had no effect on amounts already recognized in the statements of earnings under these programs.

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

Interest income for the years ended August 31, 2000, 2001 and 2002, is net of related government grants of $196,000, $15,000 and nil, respectively.

Cost of sales for the years ended August 31, 2000, 2001 and 2002, is net of government grants of $915,000, $1,742,000 and $546,000, respectively.

Selling and administrative expenses for the years ended August 31, 2000, 2001 and 2002, are net of government grants of $386,000, $260,000 and $213,000, respectively.

Research and development expenses for the years ended August 31, 2000, 2001 and 2002, are net of government grants of $536,000, $631,000 and $333,000, respectively.

Defined contribution plans

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

Deferred profit-sharing plan

The company maintains a plan for certain eligible Canadian resident employees, under which the company may elect 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. Since June 2002, the company has suspended its contributions to the plan as part of its cost-reduction efforts. Contributions to this plan during the years ended August 31, 2000, 2001 and 2002, amounted to Cdn$202,000 (US$137,000), Cdn$407,000 (US$266,000) and Cdn$136,000 (US$88,000), respectively.

401K plan

The company maintains a 401K plan for eligible U.S. resident employees. Under this 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, 2000, 2001 and 2002, the company recorded contributions totaling $23,000, $285,000 and $317,000, respectively.

15 · Income taxes

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

Years Ended August 31,	2000	2001	**2002**
Income taxes at combined Canadian federal and provincial statutory tax rate (38% in 2000, 37% in 2001 and 36% in 2002)	$ 5,897	$ 8,855	**$ (26,563)**
Increase (decrease) due to:			
Manufacturing and processing deduction	(645)	(1,201)	**525**
Non-taxable income	-	(144)	**(143)**
Non-deductible expenses	57	274	**334**
Higher rate on interest income	133	480	**-**
Lower rate on foreign exchange gain	-	(283)	**-**
Difference between combined Canadian federal and provincial statutory tax rate and foreign subsidiaries statutory tax rates	-	60	**(1,101)**
Reduction of Canadian federal statutory tax rate	-	-	**168**
Effect of consolidation of subsidiaries	-	(276)	**1,325**
Tax deductions	-	(136)	**(518)**
Other	(144)	159	**522**
Change in valuation allowance	-	362	**-**
	$ 5,298	$ 8,150	**$ (25,451)**
The provision for income taxes consist of the following:			
Current			
Canadian	$ 5,227	$ 8,416	**$ (10,816)**
United States	61	1,305	**(1,232)**
Other	43	208	**(6)**
	5,331	9,929	**(12,054)**
Future			
Canadian	(16)	940	**(4,475)**
United States	(17)	(2,719)	**(8,694)**
Other	-	-	**(228)**
	(33)	(1,779)	**(13,397)**
	$ 5,298	$ 8,150	**$ (25,451)**
Details of the company's income taxes:			
Earnings (loss) before income taxes and amortization and write-down of goodwill			
Canadian	$ 15,317	$ 28,202	**$ (47,431)**
United States	115	(5,356)	**(28,228)**
Other	87	1,086	**1,874**
	$ 15,519	$ 23,932	**$ (73,785)**

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

As at August 31,	2001	2002
Future income tax assets		
Property, plant and equipment and intangible assets	$ 107	**$ 3,725**
Provisions and accruals	1,208	**1,339**
Government grants	247	**206**
Deferred revenue	198	**-**
Share issue expenses	3,128	**1,069**
Restructuring charges	930	**715**
Research and development expenses	86	**1,178**
Losses carried forward	272	**6,904**
Other	39	**7**
	6,215	**15,143**
Valuation allowance	(362)	**(359)**
	$ 5,853	**$ 14,784**
Future income tax liabilities		
Property, plant and equipment and intangible assets	$ (8,640)	**$ (4,566)**
Research and development tax credits	(680)	**(150)**
Provisions and accruals	-	**(66)**
Government grants	(310)	**-**
	(9,630)	**(4,782)**
Future income tax assets (liabilities), net	$ (3,777)	**$ 10,002**

As at August 31, 2002, a company subsidiary has accumulated losses for income tax purposes of approximately $896,000 and research and development expenses of approximately $955,000 at the provincial level for which a valuation allowance of $359,000 has been established. These losses can be carried forward against the subsidiary's future years' taxable income until 2008. These accumulated research and development expenses can be carried forward indefinitely against the subsidiary's future years' provincial taxable income.

16 · Segment information

Management has organized the company under one operating segment, being the development, manufacturing and marketing of fiber-optic test, measurement, monitoring and automation solutions. This operating segment is composed of Portable and Monitoring products and Industrial and Scientific products.

Product sales are detailed as follows:

Years Ended August 31,	2000	2001	2002
Portable and Monitoring products	$ 49,075	$ 69,399	**$ 38,887**
Industrial and Scientific products	22,564	76,614	**29,443**
	$ 71,639	$ 146,013	**$ 68,330**

Sales to external customers by geographic region are detailed as follows:

Years Ended August 31,	2000	2001	2002
United States	$ 36,139	$ 72,604	**$ 35,129**
Canada	8,006	12,531	**3,971**
Europe	14,503	30,568	**9,539**
Asia	6,486	19,059	**12,971**
South America	2,221	5,838	**2,581**
Other	4,284	5,413	**4,139**
	$ 71,639	$ 146,013	**$ 68,330**

Sales have been allocated to geographic regions based on the country of residence of the related customers. During 2002, the company derived 10.2% of its sales ($6,965,000) from one customer. The three most significant customers represented 15.4% of sales for that same year. During 2000 and 2001, there were no customers from which 10% or more of total sales were derived.

Long-lived assets by geographic region are detailed as follows:

As at August 31,	2001	2002
United States	$ 171,450	$ 16,141
Canada	119,932	44,145
	$ 291,382	$ 60,286

Long-lived assets consist of property, plant and equipment, intangible assets and goodwill.

17 · Earnings (loss) per share

The following table summarizes the reconciliation of the basic weighted average number of shares outstanding and the diluted weighted average number of shares outstanding used in the diluted earnings per share calculations:

Years Ended August 31,	2000	2001	2002
Basic weighted average number of shares outstanding (000's)	39,951	53,014	60,666
Conversion of preferred shares Series I	26	-	-
Stock options	109	231	31
Restricted stock awards	-	250	269
Diluted weighted average number of shares outstanding (000's)	40,086	53,495	60,966
Stock options excluded from the calculation of diluted earnings per share because the exercise price was greater than the average market price of the common shares (000's)	-	953	2,734

The diluted loss per share for the years ended August 31, 2001 and 2002, was the same as the basic loss per share since the dilutive effect of stock options and restricted stock awards was not included in the calculation; otherwise, the effect would be anti-dilutive. Accordingly, diluted loss per share for those years was calculated using the basic weighted average number of shares outstanding.

18 · Financial instruments

Short-term investments

Short-term investments consist of the following:

As at August 31,	2001	2002
Commercial paper denominated in Canadian dollars, bearing interest at annual rates of 4.35% to 4.60% in 2001 and 2.61% to 2.93% in 2002, maturing on different dates between September 2001 and November 2001 in 2001 and September 2002 and November 2002 in 2002	$ 52,000	$ 40,553
Mutual fund denominated in Canadian dollars	14,861	-
	$ 66,861	$ 40,553

Fair value

Cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities 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 $66,861,000 and $40,553,000 as at August 31, 2001 and 2002, 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 corporations. 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 geographic 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 ongoing credit reviews of all its customers and establishes an allowance for doubtful accounts receivable when accounts are determined to be uncollectible. Allowance for doubtful accounts amounted to $893,000 and $520,000 as at August 31, 2001 and 2002, respectively.

Interest rate risk

As at August 31, 2002, 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
Accounts payable and accrued liabilities	Non-interest bearing
Long-term debt	As described in note 10

Forward exchange contracts

The company is exposed to currency risks as a result of its export sales of products manufactured in Canada, substantially all of which are denominated in US dollars. These risks are partially hedged by forward exchange contracts and certain operating expenses. As at August 31, 2001 and 2002, the company held contracts to sell US dollars at various forward rates, which are summarized as follows:

	Contractual amounts	Weighted average contractual forward rates
As at August 31, 2001		
September 2001 to August 2002	$ 15,200	1.4969
September 2002 to February 2003	1,800	1.5184
As at August 31, 2002		
September 2002 to August 2003	$ 6,400	1.5464
September 2003 to June 2004	2,200	1.5679

As at August 31, 2001 and 2002, these contracts generated deferred unrealized losses of US$533,000 and US$39,000, respectively, which have not been reflected in the statements of earnings.

19 · 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 significant disclosures required under U.S. GAAP have also been provided in the accompanying financial statements and notes. The following summarizes the significant differences between Canadian and U.S. GAAP and other required disclosures under U.S. GAAP not already provided in the accompanying financial statements.

Reconciliation of net earnings (loss) to conform with U.S. GAAP

The following summary sets out the significant differences between the company's reported net earnings (loss) and net earnings (loss) per share under Canadian GAAP and as compared to U.S. GAAP:

Years Ended August 31,		2000	2001	**2002**
Net earnings (loss) for the year in accordance with Canadian GAAP		$ 9,924	$ (15,294)	**$ (308,524)**
Non-cash stock-based compensation costs related to stock option plan	a)	(1,464)	(954)	**49**
Non-cash stock-based compensation costs related to stock purchase plan	a)	(538)	(477)	**(661)**
Non-cash stock-based compensation costs related to restricted stock award plan	a)	-	(3,481)	**(3,038)**
Unrealized gains on forward exchange contracts	c)	-	97	**444**
Future income taxes on forward exchange contracts	c)	-	20	**(212)**
Future income taxes on acquired in-process research and development	d)	-	(936)	**(444)**
Amortization of intangible assets	e)	-	-	**239**
Future income taxes on amortization of intangible assets	e)	-	-	**(80)**
Amortization of goodwill	d), e)	-	(8,453)	**(9,263)**
Write-down of goodwill and intangible assets	e)	-	-	**(62,557)**
Future income taxes on write-down of intangible assets	e)	-	-	**(1,154)**
Net earnings (loss) for the year in accordance with U.S. GAAP		7,922	(29,478)	**(385,201)**
Other comprehensive income (loss)				
Foreign currency translation adjustments	b)	1,555	(9,888)	**(521)**
Unrealized holding gains on available-for-sale securities, net of related future income taxes	f)	37	-	**-**
Reclassification of holding gains on available-for-sale securities included in net earnings (loss), net of related future income taxes	f)	(36)	(37)	**-**
Comprehensive income (loss)		$ 9,478	$ (39,403)	**$ (385,722)**
Basic and diluted net earnings (loss) per share in accordance with U.S. GAAP	g)	$ 0.20	$ (0.56)	**$ (6.35)**

Shareholders' equity

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

Share capital

As at August 31,		2000	2001	**2002**
Share capital in accordance with Canadian GAAP		$ 198,459	$ 429,995	**$ 489,611**
Stock-based compensation costs related to stock purchase plan	a), h)			
Current year		2,647	(150)	**(64)**
Cumulative effect of prior years		45	2,692	**2,542**
Reclassification from other capital upon exercise of restricted stock awards		-	-	**3,270**
Shares issued upon business combinations	d)	-	65,584	**65,584**
Share capital in accordance with U.S. GAAP		$ 201,151	$ 498,121	**$ 560,943**

Deferred stock-based compensation costs

As at August 31,		2000	2001	**2002**
Deferred stock-based compensation costs in accordance with Canadian GAAP		$ -	$ -	**$ -**
Stock-based compensation costs related to stock-based compensation plans	a), h)			
Current year		(21,396)	(8,145)	**-**
Cumulative effect of prior years		(35)	(19,429)	**(7,968)**
Amortization for the year		2,002	4,912	**4,698**
Reduction of stock-based compensation costs		-	14,694	**403**
Deferred stock-based compensation costs in accordance with U.S. GAAP		$ (19,429)	$ (7,968)	**$ (2,867)**

Other capital

As at August 31,		2000	2001	**2002**
Other capital in accordance with Canadian GAAP		$ -	$ -	**$ -**
Stock-based compensation costs related to stock-based compensation plans	a), h)			
Current year		18,749	8,145	**-**
Cumulative effect of prior years		-	18,749	**12,350**
Reduction of stock-based compensation costs		-	(14,544)	**(1,387)**
Reclassification to share capital upon exercise of restricted stock awards		-	-	**(3,270)**
Other capital in accordance with U.S. GAAP		$ 18,749	$ 12,350	**$ 7,693**

Retained earnings (deficit)

As at August 31,		2000	2001	**2002**
Retained earnings (deficit) in accordance with Canadian GAAP		$ 6,980	$ (8,314)	**$ (316,838)**
Stock-based compensation costs related to stock-based compensation plans	a)			
Current year		(2,002)	(4,912)	**(3,650)**
Cumulative effect of prior years		(10)	(2,012)	**(6,924)**
Unrealized gains on forward exchange contracts, net of related future income taxes	c)			
Current year		-	117	**232**
Cumulative effect of prior years		-	-	**117**
Future income taxes on acquired in-process research and development	d)			
Current year		-	(936)	**(444)**
Cumulative effect of prior years		-	-	**(936)**
Write-down of goodwill and intangible assets	e)			
Current year		-	-	**(62,557)**
Future income taxes on write-down of intangible assets	e)			
Current year		-	-	**(1,154)**
Amortization of intangible assets	e)			
Current year		-	-	**239**
Future income taxes on amortization of intangible assets	e)			
Current year		-	-	**(80)**
Amortization of goodwill	d), e)			
Current year		-	(8,453)	**(9,263)**
Cumulative effect of prior years		-	-	**(8,453)**
Change in reporting currency	b)			
Cumulative effect of prior years		1,016	1,016	**1,016**
Retained earnings (deficit) in accordance with U.S. GAAP		$ 5,984	$ (23,494)	**$ (408,695)**

Accumulated other comprehensive income (loss)

As at August 31,		2000	2001	**2002**
Foreign currency translation adjustments	b)			
Balance – Beginning of year		$ (1,016)	$ 539	**$ (9,349)**
Change during the year		1,555	(9,888)	**(521)**
Balance – End of year		539	(9,349)	**(9,870)**
Unrealized holding gains on available-for-sale securities, net of future income taxes	f)			
Balance – Beginning of year		36	37	-
Unrealized gains arising during the year, net of related future income taxes		37	-	-
Reclassification adjustment for amounts included in net earnings (loss), net of related future income taxes		(36)	(37)	-
Balance – End of year		37	-	-
Accumulated other comprehensive income (loss)		$ 576	$ (9,349)	**$ (9,870)**

Balance sheets

The following table summarizes the significant differences in balance sheet items between Canadian GAAP and U.S. GAAP:

		As at August 31, 2001		**As at August 31, 2002**	
		As reported	U.S. GAAP	**As reported**	**U.S. GAAP**
Intangible assets	e)				
Cost		$ 55,044	$ 55,044	**$ 37,927**	**$ 30,301**
Accumulated amortization		(9,974)	(9,974)	**(21,463)**	**(17,030)**
		$ 45,070	$ 45,070	**$ 16,464**	**$ 13,271**
Goodwill	d), e)				
Cost		$ 250,497	$ 315,547	**$ 87,025**	**$ 92,747**
Accumulated amortization		(31,325)	(39,762)	**(69,449)**	**(87,251)**
		$ 219,172	$ 275,785	**$ 17,576**	**$ 5,496**
Shareholders' equity					
Share capital	a), d), h)	$ 429,995	$ 498,121	**$ 489,611**	**$ 560,943**
Contributed surplus		1,457	1,457	**1,487**	**1,487**
Cumulative translation adjustment	b)	(8,333)	-	**(8,854)**	-
Deferred stock-based compensation costs	a), h)	-	(7,968)	-	**(2,867)**
Other capital	a)	-	12,350	-	**7,693**
Deficit	a), b), c), d), e)	(8,314)	(23,494)	**(316,838)**	**(408,695)**
Accumulated other comprehensive loss	b), f)	-	(9,349)	-	**(9,870)**
		$ 414,805	$ 471,117	**$ 165,406**	**$ 148,691**

Statements of cash flows

For the years ended August 31, 2000, 2001 and 2002, there are no significant differences between the statements of cash flows under Canadian GAAP as compared to U.S. GAAP.

Reconciliation items

a) 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. This plan terminated at the time of the Initial Public Offering on June 29, 2000.

Stock option plan

In accordance with APB 25, the company's stock option plan was considered to be a variable plan until October 10, 2000. As a result of the amendment to the stock option plan described in note 13, the performance criterion was removed and the number of shares to be issued under the plan was fixed and the company recorded, in 2001, a net reduction of the compensation cost and deferred compensation cost previously recognized of $467,000 and $14,544,000, respectively. Compensation cost under this plan is measured as the difference between the fair value of the underlying stock at the date of grant and the exercise price of the option. Compensation cost is amortized to expense over the estimated vesting period up to a maximum of four years.

Restricted stock award plan

Under APB 25, compensation cost related to the restricted stock award plan is measured as the difference between the fair value of the underlying stock at the date of grant and the exercise price, which is nil. Compensation cost is amortized to expense over the estimated vesting period up to a maximum of four years, being the acquisition period.

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

b) Change in reporting currency

On September 1, 1999, the company adopted the US 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 statement of earnings for the year ended August 31, 1999, was translated into US dollars using an exchange rate of US$1.00 = Cdn$1.4958. Under U.S. GAAP, revenues and expenses would be translated at exchange rates prevailing at the respective transaction dates. Average exchange rate for the year ended August 31, 1999, was US$1.00 = Cdn$1.5068. The exchange rate as at August 31, 1999, was US$1.00 = Cdn$1.4958.

As a result, a permanent difference of $1,016,000 was created on September 1, 1999, affecting the cumulative translation adjustment and the retained earnings under both Canadian GAAP and U.S. GAAP.

c) Forward exchange contracts

On September 1, 2000, the company prospectively adopted Statement of Financial Accounting Standard No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133) and its amendments (SFAS 138), which require all derivatives to be carried on the balance sheet at fair value. The forward exchange contracts used by the company have not qualified for hedging accounting treatment during the years ended August 31, 2001 and 2002; accordingly, changes in the fair value of the derivatives have been charged to earnings during these years.

Under Canadian GAAP, the company's forward exchange contracts held for the purpose of hedging anticipated sales qualified for hedge accounting and any unrealized gains or losses were deferred and recognized in the statement of earnings upon settlement of the related transactions.

d) Business combinations

Under Canadian GAAP, until June 30, 2001, the value of shares issued upon a business combination was determined based on the market price of the shares over a reasonable period of time before and after the date of acquisition while under U.S. GAAP, the value of shares was determined based on the market price of the shares over a reasonable period of time before and after the companies have reached an agreement on the purchase price, the significant terms of the agreement are known and the proposed transaction is announced.

Consequently, the measurement dates of the acquisitions of EXFO Burleigh and EXFO Photonic Solutions for U.S. GAAP purposes occurred on December 14, 2000 and on March 6, 2001, respectively, the dates on which all significant terms of the agreements were known. The average market price of the shares a few days before and after those dates was $31.09 and $25.84, respectively. Considering the number of shares issued upon those acquisitions, the total consideration for U.S. GAAP purposes amounts to $244,198,000 ($189,270,000 under Canadian GAAP) for EXFO Burleigh and $120,802,000 ($110,146,000 under Canadian GAAP) for EXFO Photonic Solutions, thus increasing share capital and goodwill under U.S. GAAP.

However, since July 1, 2001, the shares issued upon a business combination are valued under Canadian GAAP using the same method as used under U.S. GAAP.

Furthermore, under U.S. GAAP, in-process research and development acquired in a business combination is written off at the time of acquisition and no future income taxes are recognized on this asset in the purchase price allocation process. Under Canadian GAAP, in-process research and development acquired in a business combination is capitalized and amortized over its estimated useful life. Future income taxes are recognized on the acquisition date on that asset in the purchase price allocation process. As at August 31, 2001 and 2002, in-process research and development recorded under Canadian GAAP was fully amortized.

e) Write-down of goodwill and intangible assets

Under U.S. GAAP, when assets being tested for recoverability were acquired in business combinations accounted for by the purchase method, the goodwill that arose in that transaction shall be included as part of the assets grouping in determining recoverability. The intangible assets tested for recoverability in 2002 were acquired in business combinations accounted for using the purchase method and, consequently, the company allocated goodwill to those assets on a pro rata basis using the relative fair values of the long-lived assets and identifiable intangible assets acquired as determined at the date of acquisition. The carrying value of goodwill identified with the impaired intangible assets was written down before any reduction was made to the impaired intangible assets. Intangible assets were then written down to their fair value.

The fair value of intangible assets was determined based on discounted future cash flows. The cash flows periods used were ten and eleven years, using annual growth rates ranging between 10% and 30% and discount rates ranging between 15% and 18%. The assumptions supporting discounted cash flows, including the cash flow periods, the annual growth rates and the discount rates, reflect management’s best estimates. The discount rates were based upon the company’s weighted average cost of capital as adjusted for the risks associated with operations.

The unallocated portion of goodwill was tested for recoverability at the subsidiaries’ level based on the related pre-tax undiscounted future cash flows using the same assumptions and methodology as used for Canadian GAAP purposes.

Under U.S. GAAP, the company recorded a charge of $281,278,000 to write down a significant portion of goodwill and a pre-tax charge of $27,105,000 to write down a significant portion of acquired core technology. Of the total charge of $308,383,000, $170,079,000 relates to EXFO Burleigh, $83,637,000 relates to EXFO Photonic Solutions and $54,667,000 relates to EXFO Protocol.

Under Canadian GAAP, no allocation of goodwill is required and each asset is tested for recoverability separately based on its pre-tax undiscounted cash flows over its expected period of use.

Also, under Canadian GAAP, the impairment loss for intangible assets is measured as the difference between the carrying value and the pre-tax undiscounted future cash flows.

Finally, under U.S. GAAP, the carrying value of goodwill reviewed for impairment was $46,380,000 higher than the carrying value of the same goodwill tested under Canadian GAAP because the measurement dates used to account for the business combinations were different between Canadian GAAP and U.S. GAAP as explained in item d).

f) 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 (loss) 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.

g) Earnings (loss) per share

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

h) Share capital

Under Canadian GAAP, restricted shares reacquired from employees under the stock purchase plan are treated as arm’s length repurchases of shares whereas under U.S. GAAP, the reacquisition of shares would be accounted for as a forfeiture by the employee, resulting in any difference between the amount originally credited to share capital and the remaining deferred compensation cost being credited to compensation expense in the current period. The subsequent resale of the shares would be treated as an issuance of shares for the proceeds received.

i) New accounting standards

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS 141 “Business Combinations” and SFAS 142 “Goodwill and Other Intangible Assets”. SFAS 141 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. SFAS 141 also broadens criteria for recording intangible assets separately from goodwill. Upon the adoption of SFAS 142, recorded goodwill and intangible assets will be evaluated against those 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. SFAS 142 requires the use of a non-amortization approach to account for purchased goodwill and indefinite-lived intangibles.

Under transitional provisions of SFAS 142, the company did not amortize the goodwill resulting from the acquisition of EXFO Protocol Inc., for which the acquisition date was November 2, 2001.

The company adopted SFAS 142 prospectively on September 1, 2002. Upon the adoption of this new section, goodwill recorded prior to July 1, 2001, is no longer subject to amortization. Also, under the transitional provisions of the SFAS 142, the company performed an initial impairment test to identify goodwill impairment using a fair value-based method. Under SFAS 142, a goodwill impairment exists when the carrying value of a reporting unit exceeds its fair value. For the purposes of the impairment test, the company allocated its existing goodwill to its reporting units and completed an evaluation of the fair value of such reporting units. Based on the comparison of the fair value of the reporting units to their carrying value, goodwill of the reporting units was not considered impaired.

Goodwill will also be tested for impairment on an annual basis or more frequently if events or circumstances occur that more likely than not reduce the fair value of a reporting unit below its carrying value. Any impairment loss arising from this test will be charged to earnings in the period in which it is incurred.

In June 2001, the FASB issued SFAS 143 "Accounting for Asset Retirement Obligation", which is effective for fiscal years beginning on or after June 15, 2002. This standard requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The company will adopt this new standard prospectively on September 1, 2002, and its adoption will not have a significant impact on the company's financial statements.

In October 2001, the FASB issued SFAS 144 "Accounting for Impairment or Disposal of Long-Lived Assets", which supersedes SFAS 121 and the provisions of APB 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" with regard to reporting the effects of a disposal of a segment of a business. SFAS 144 retains many of the provisions of SFAS 121, but significantly changes the criteria that would have to be met to classify an asset as held for disposal such that long-lived assets to be disposed of other than by sale are considered held and used until disposed of. In addition, SFAS 144 retains the basic provisions of APB 30 for presentation of discontinued operations in the statement of earnings but broadens that presentation to a component of an entity. This new standard is effective for fiscal years beginning on or after December 15, 2001. The company will adopt this new standard prospectively on September 1, 2002, and its adoption will not have a significant impact on the company's financial statements.

In April 2002, the FASB issued SFAS 145 "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections". This new standard is effective for fiscal years beginning on or after May 15, 2002, or for transactions occurring after May 15, 2002, related to SFAS 13, paragraph 8 and 9 (c). This statement rescinds SFAS 4 "Reporting Gains and Losses from Extinguishment of Debt" and an amendment of that Statement, SFAS 64 "Extinguishments of Debt Made to Satisfy Sinking-Funds Requirements". This Statement also rescinds SFAS 44 "Accounting for Intangible Assets of Motor Carriers". This Statement amends SFAS 13 "Accounting for Leases" to eliminate an inconsistency between the required accounting for sale-leaseback transactions. This Statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The company will adopt this new standard prospectively on September 1, 2002, and its adoption will not have a significant impact on the company's financial statements.

In June 2002, the FASB issued SFAS 146 "Accounting for Costs Associated with Exit or Disposal Activities". This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF No. 94-3, "Liability Recognition of Certain Employee Termination Benefits and Other Costs to Exit an Activity". This Statement improves financial reporting by requiring that a liability for a cost associated with an exit or disposal activity be recognized and measured initially at fair value only when the liability is incurred. This Statement specifies that a liability for a cost associated with an exit or disposal activity is incurred when the definition of a liability in SFAS 6 is met. This Statement is effective for exit or disposal activities that are initiated after December 31, 2002. The company will adopt this new standard prospectively on January 1, 2003, and has not yet assessed the impact of its adoption.

Unaudited pro forma information on business combinations

Under U.S. GAAP, pro forma information must be provided as though the business combinations had occurred at the beginning of the reported periods.

The following unaudited pro forma information reflects the results of operations as if the 2002 acquisition had been completed on September 1, 2001 and 2000; the 2001 acquisitions had been completed on September 1, 2000.

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.

Years Ended August 31,	2001	**2002**
	(unaudited)	
Sales	$ 166,083	**$ 683,371**
Net loss	$ (63,203)	**$ (385,870)**
Basic and diluted net loss per share	$ (1.03)	**$ (6.29)**

Accounting for stock-based compensation

Under U.S. GAAP, the company has elected to measure compensation costs related to grants of stock options and stock awards 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 (loss), basic and diluted net earnings (loss) per share as if the fair value-based method of accounting had been applied.

The fair value of options or awards granted was estimated using the Black-Scholes options pricing model with the following weighted average assumptions:

Years Ended August 31,	2000	2001	**2002**
Risk-free interest rate	6.04%	5.36%	**4.50%**
Expected volatility	75%	75%	**80%**
Dividend yield	Nil	Nil	**Nil**
Weighted average expected life	32 months	33 months	**40 months**

The Black-Scholes options valuation model was developed for use in estimating the fair value of traded options and awards which have no vesting restrictions, and are fully transferable. In addition, option and award valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the company's employee stock options and stock awards have characteristics significantly different from those of traded options and awards, 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 and stock awards.

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

Years Ended August 31,	2000	2001	**2002**
Pro forma net earnings (loss) for the year	$ 8,939	$ (39,109)	**$ (390,831)**
Pro forma basic and diluted net earnings (loss) per share	$ 0.22	$ (0.74)	**$ (6.44)**

The following table summarizes the stock-based compensation costs for options outstanding based on the fair value-based method:

Years Ended August 31,	2000	2001	**2002**
Exercise price			
$2.59	$ -	$ -	**$ 1**
$5.65	-	-	**54**
$9.13 to $12.69	-	-	**2,631**
$19.19 to $27.80	447	6,636	**1,815**
$34.07 to $45.94	-	2,902	**1,076**
$56.75	-	1,047	**4**
	$ 447	$ 10,585	**$ 5,581**

These options will generate aggregate stock-based compensation costs of $26,589,000 over their vesting periods. As at August 31, 2002, the deferred stock-based compensation costs amount to $9,976,000 and will be charged to expense over the next four years. For the years ended August 31, 2000, 2001 and 2002, the weighted average fair value of options amounted to $15.07, $14.64 and $9.19, respectively.

As of August 31, 2002, none of the vested options has been exercised. As of August 31, 2002, the market price of the company's common shares was $2.13.

20 · Subsequent events

On September 3, 2002, EXFO acquired a building from a company owned by the President of the company for a cash consideration of $930,000. This transaction was measured at the exchange amount since it was not in the normal course of operations, the change in ownership interest in the building was substantive and the exchange amount was supported by independent evidence.

On September 5, 2002, the company entered into an agreement to acquire substantially all the assets of *gnubi communications*, *L.P.*, a U.S. company which supplies multi-channel telecom and datacom testing solutions for optical transport equipment manufacturers and research and development laboratories. This acquisition is expected to be settled for a total consideration ranging between $4,300,000 and $7,200,000. The consideration paid will consist of $1,800,000 in cash, $2,500,000 by the issuance of subordinate voting shares and a cash contingent consideration based on sales volume for 2003. This acquisition will be accounted for using the purchase method. This acquisition is expected to be closed in the first quarter of 2003.