

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

The following discussion and analysis of the consolidated financial condition and results of operations of EXFO Electro-Optical Engineering Inc. (EXFO) for the fiscal years ended August 31, 2002, 2001 and 2000 should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report. Our consolidated financial statements are reported in US dollars and have been prepared in accordance with generally accepted accounting principles in Canada, or Canadian GAAP. To the extent applicable to our consolidated financial statements included elsewhere in this annual report, these principles conform in all material respects with generally accepted accounting principles in the United States, or U.S. GAAP, except as described in Note 19 to our consolidated financial statements.

## Corporate Highlights

### EXFO Launches 25 Products in 2002

EXFO announced in September 2002 that it had launched 25 new products in fiscal 2002. Key product launches included the FTB-8000 SONET/SDH Analyzer for deployments of 10 Gb/s optical networks; the FTB-8500 Packet Blazer™ to ensure Gigabit Ethernet performance in high-speed optical networking; the FTB-5800 Chromatic Dispersion Analyzer for high-speed, dense wavelength-division multiplexing (DWDM); the next-generation IQS-500 Intelligent Test System and related test modules for automated testing and manufacturing applications; and the ProAlign™ 5000 Component Assembly Workstation for the automated assembly of array-type devices.

### EXFO Carries Out Restructuring Actions and Reviews Assets for Impairment

As a result of the telecommunications downturn that affected several markets, EXFO carried out a series of restructuring measures in fiscal 2002 to accelerate its return to profitability. Several proactive actions were taken to lower the company's cost structure, including workforce reductions and inventory write-offs. Overall for fiscal 2002, EXFO reduced its workforce by 350 people and wrote off \$18.5 million in excess and obsolete inventories.

EXFO also performed in May 2002 an assessment of the carrying value of goodwill and intangible assets recorded in conjunction with the three strategic acquisitions made during the last two years. Considering the ongoing unfavorable market conditions, the company recorded a charge of \$222.2 million to write down a significant portion of goodwill and a pre-tax charge of \$23.7 million to write down a significant portion of acquired intangible assets.

### EXFO Implements New ERP System

In December 2001, a new enterprise resource planning (ERP) system was implemented at EXFO's headquarters in Quebec City, QC. This ERP system will enable the company to improve the efficiency of its operations and should provide customers with better and more prompt service.

### EXFO Completes Acquisition of Avantas Networks

EXFO announced in November 2001 that it had completed its previously announced acquisition of Avantas Networks Corporation (renamed EXFO Protocol Inc.) for a total consideration of \$95.0 million, or \$69.4 million net of \$25.6 million of cash and cash equivalents acquired. This acquisition was accounted for using the purchase method and has resulted in goodwill of \$58.0 million, which is not amortized under new accounting rules. In May 2002, as part of the assessment of the carrying value of goodwill recorded in business combinations, EXFO Protocol's goodwill was written down to its fair value, resulting in an impairment loss of \$49.3 million. EXFO Protocol is a supplier of leading-edge fiber-optic testing and optical-network-performance management equipment supporting a wide range of protocols and data transmission rates.

### Subsequent Event

Subsequent to the year-end, EXFO announced it had acquired substantially all the assets of *gnubi communications, L.P.*, including its technology, expertise, customer base and inventories, in a stock-and-cash deal that ranged between \$4.3 million and \$7.2 million. Consideration paid consisted of \$2.5 million in EXFO stock, \$1.8 million in cash and a cash earn-out based upon sales volume up to a maximum of \$2.9 million. *gnubi*, a privately held company in Dallas, Texas, is a leading supplier of multi-channel telecom and datacom testing solutions with an established customer base of Tier 1 optical transport equipment manufacturers and R&D labs.

## Industry Overview

### Optical Networking Market

The past decade has witnessed growth in the volume of data traffic largely due to the popularity of the Internet and related bandwidth-intensive applications. According to the Computer Industry Almanac, the number of Internet users around the world is expected to increase from 530 million in 2001 to 1.12 billion in 2005. In addition, users are continuously seeking applications that require a great deal of bandwidth such as virtual private networking (VPN), storage area networking (SAN) and rich media streaming over the Internet.

The increase in Internet users and in bandwidth-intensive applications created a need for high-capacity communications networks. To meet this increasing demand for bandwidth, many telecommunications carriers designed and installed new networks based on optical fiber, deployed additional fiber within their existing networks or used advances in optical technology such as dense wavelength-division multiplexing. DWDM involves combining beams of light of slightly different wavelengths through a single fiber, with each wavelength carrying its own stream of information. DWDM gained wide market acceptance because it incorporates technologies that greatly reduce the cost of optical transmission over long distances and because it provides network flexibility in access and metropolitan areas.

Following a period of significant growth, the telecommunications industry is enduring a market correction. Network service providers (NSPs) have lowered their capital spending to improve short-term financials and reduce debt-loads which, in turn, have initiated an industry-wide consolidation period. Despite these challenging market conditions, new bandwidth-hungry applications are pushing telecom and datacom demand deeper into metropolitan, access and enterprise networks. As a result, NSPs are continuously upgrading their existing networks with higher transmission rates, newer protocols and additional channels to meet the latest bandwidth and application requirements. The system and component manufacturing markets, meanwhile, have been sharply affected by the reduction in capital spending of NSPs. During the past 18 months, NSPs have repeatedly downsized their capital spending budgets for deploying new networks, which has resulted in a slowdown among system and component vendors.

### Optical Test, Measurement and Automation Equipment Market

The fiber-optic test, measurement and automation market has not been immune to the challenging conditions in the optical networking sector. However, vendors with extensive product portfolios, which include all-in-one protocol-, optical- and physical-layer test solutions, marketed their products to NSPs, who needed to upgrade their networks to higher transmission rates, add DWDM channels or maintain their existing networks. Likewise, test, measurement and automation vendors, whose products increase efficiency and reduce costs on the production floor, still attracted the attention of system and optical component manufacturers, who kept investing in their R&D programs to stay ahead of the competition.

Fiber-optic test, measurement and automation equipment is essential for research and development, manufacturing, installation and maintenance as well as network monitoring. When light travels along optical fiber and through the optical components and systems that link optical fibers together, it is subject to unwanted effects such as reflection, attenuation, noise and various types of dispersion, all of which degrade signal quality and reduce transmission performance. Fiber-optic test and measurement equipment is critical for measuring these effects and helping NSPs and manufacturers of optical components, sub-systems and optical networking systems ensure performance and reliability.

Fiber-optic test and measurement equipment like a bit-error-rate tester is also used to ensure data integrity. Data sent along an optical network must respect transmission protocols, such as ATM, SONET, SDH, Ethernet and Gigabit Ethernet, and fall within accepted data transmission rates from 64 Kb/s to 10 Gb/s. Otherwise, the information sent from a transmitter will be incomprehensible to the receiver.

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

## Company Overview

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

One of our strongest competitive advantages is our modular platform design. EXFO introduced modular test platforms more than six years ago, and remains the uncontested leader with all-in-one test sets that provide greater value for customers seeking enhanced productivity. Our PC-based platforms, which are supported by an extensive suite of plug-and-play test modules, are widely accepted among Tier 1 carriers and system manufacturers with an established base of more than 10,000 units on the market today.

During the last two years, we strengthened our competitive positioning with a string of acquisitions. In fiscal 2001, we completed two key acquisitions to bolster growth in our Industrial and Scientific Division. We acquired Burleigh Instruments, Inc. (renamed EXFO Burleigh Products Group Inc.) for its wavelength measurement instruments and nanopositioning alignment systems. We also added EFOS Inc. (renamed EXFO Photonic Solutions Inc.) for its precision light-based, adhesive spot-curing technology.

In fiscal 2002, we expanded into protocol-layer testing with the closing of the Avantas Networks Corporation acquisition (renamed EXFO Protocol Inc.), a supplier of leading-edge, fiber-optic testing and optical-network-performance management equipment. This acquisition was highly strategic because it enabled us to combine protocol-, optical- and physical-layer testing inside a single platform—the FTB-400 Universal Test System—to help our customers increase revenues and reduce operational costs in a fast-changing market.

Subsequent to the year-end, we also announced that we had purchased substantially all the assets of *gnubi communications, L.P.*, a leading supplier of multi-channel telecom and datacom testing solutions. *gnubi's* protocol-layer test equipment for optical transport equipment manufacturers fully complements EXFO Protocol's offering that is targeted at the network service provider market. As a result, these latest acquisitions enabled us to double our addressable market, while offering a complete test solution for the entire life cycle of an optical network: R&D, manufacturing, installation and maintenance, as well as network monitoring.

## Sales

We sell our products to more than 2000 customers in 70 countries around the world through our direct sales force and, indirectly, through distribution channels. North America accounted for 57% of our sales in fiscal 2002 compared to 43% for the rest of the world. With regard to sales distribution, it was a 57-43% split in favor of our Portable and Monitoring products in 2002. In terms of customer breakdown, we had one 10%-customer in 2002 with our top three customers representing 15.4% of sales for the year.

## Cost of Sales

Cost of sales includes raw materials, salaries and related expenses for direct and indirect manufacturing personnel and manufacturing overhead. We expense cost of sales as the related revenue is recognized. Excess, obsolete or scrapped materials are included in cost of sales.

## Operating Expenses

We classify our operating expenses into three general categories: selling and administrative expenses, research and development expenses and amortization expenses.

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

Gross research and development expenses consist primarily of salaries and related expenses for engineers and other technical personnel, material component costs as well as fees paid to third-party consultants. We expense our research and development costs as they are incurred. We are eligible to receive research and development tax credits and government grants on research and development carried out in Canada. Related research and development tax credits and government grants are recorded as a reduction of gross research and development expenses.

Operating expenses related to our restructuring plans have been recorded as a separate component of operating expenses. These expenses consist primarily of severance expenses, costs to exit leased facilities, a write-off of property, plant and equipment, as well as a write-down of intangible assets.

## Critical Accounting Policies and Estimates

Management's discussion and analysis of financial conditions and results of operations is based on our consolidated financial statements included elsewhere in this annual report. They have been prepared in accordance with Canadian GAAP. The preparation of financial statements in accordance with GAAP 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 periods. On an ongoing basis, we evaluate these estimates and assumptions, including those related to revenue recognition, allowance for doubtful accounts, allowance for excess and obsolete inventories, research and development tax credits and government grants, impairment of intangible assets and goodwill, future income taxes, warranty obligations, restructuring charges, contingencies and other obligations. We base our estimates on historical experience and on other factors that we believe to be reasonable under the circumstances, the result of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

The following summarizes our critical accounting policies and those that require the most significant judgment and estimates in the preparation of our consolidated financial statements.

*Revenue recognition.* For products in which software is incidental, we recognize 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, we use 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, we assess whether the price associated with our revenue transactions is fixed and determinable and whether or not collection is reasonably assured. We assess whether the price is fixed and determinable based on the payment terms associated with the transaction. We assess collection based on a number of factors, including past transaction history 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 receipt of a written customer acceptance or expiration of the acceptance period. For these sales arrangements, the sale is recognized when acceptance occurs.

*Allowance for doubtful accounts.* We estimate collectibility of accounts receivable on an ongoing basis by periodically reviewing balances outstanding over a certain period of time. We determine our allowance for doubtful accounts receivable based on our historical accounts receivable collection experience and on the information that we have about the status of our accounts receivable balances. If the financial conditions of our customers deteriorate, resulting in an impairment of their ability to make required payments, additional allowance may be required, which could adversely affect our future results.

*Allowance for excess and obsolete inventories.* We state our inventories at the lower of cost and net realizable value and provide reserves for excess and obsolete inventories. We determine our reserves for excess and obsolete inventories considering our quantities on hand and our expected needs for these inventories to support future sales of our products. It is possible that additional inventory reserves may occur if future sales are less than our forecasts, which could adversely affect our future results.

*Research and development tax credits and government grants.* We record research and development tax credits and government grants based on our interpretation of tax laws and grant programs, especially regarding related eligible projects and expenses, and when there is a reasonable assurance that we have complied and will continue to comply with all conditions and laws. Also, our judgment and estimates are based on historical experience. It is possible, however, that the tax authorities have a different interpretation of laws and application of conditions related to the programs or that we will not comply with all conditions related to grants in the future, which could adversely affect our future results.

*Impairment of goodwill and intangible assets.* We assess impairment of goodwill and intangible assets 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 value of the unamortized portion. In fiscal 2002, we incurred significant impairment losses on goodwill and intangible assets recorded in conjunction with our three strategic acquisitions made during the last two years.

On September 1, 2002, upon the adoption of section 3062 of the Canadian Institute of Chartered Accountants Handbook (CICA), we performed an initial impairment test of goodwill based on a fair value method. Based on that initial test, goodwill was not considered impaired. Moving forward, this test will be performed on an annual basis or more frequently if events or circumstances occur that more likely than not trigger an impairment.

*Future income tax assets.* We account 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. In assessing the recoverability of our future income tax assets, we consider whether it is more likely than not that some or all of the future income tax assets will not be realized. The ultimate realization of certain future income tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences will become deductible. If we obtain information that causes our forecast of future taxable income to change or if actual future taxable income differs from our forecast, we may have to revise the carrying value of our future income tax assets, which would affect our net earnings in the period in which the change was made. We review the recoverability of our future income tax assets on a quarterly basis.

## Results of Operations

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

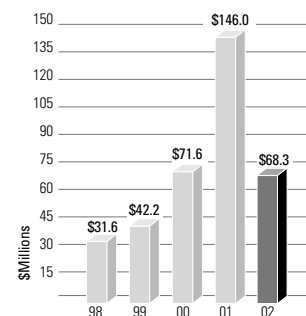
| Years Ended August 31,  | 2000      | 2001        | 2002         | 2000   | 2001    | 2002     |
|---|-----------|-------------|--------------|--------|---------|----------|
| Sales   | \$ 71,639 | \$ 146,013  | \$ 68,330    | 100.0% | 100.0%  | 100.0%   |
| Cost of sales   | 24,712    | 54,946      | 50,801       | 34.5   | 37.6    | 74.3     |
| Gross margin*   | 46,927    | 91,067      | 17,529       | 65.5   | 62.4    | 25.7     |
| Operating expenses  |           |             |              |        |         |          |
| Selling and administrative  | 24,304    | 46,236      | 35,446       | 33.9   | 31.7    | 51.9     |
| Net research and development  | 6,402     | 13,601      | 12,782       | 8.9    | 9.3     | 18.7     |
| Amortization of property, plant and equipment                                   | 1,451     | 3,559       | 5,932        | 2.0    | 2.4     | 8.7      |
| Amortization of intangible assets   | 47        | 9,876       | 11,615       | 0.1    | 6.8     | 17.0     |
| Write-down of intangible assets   | —         | —           | 23,657       | —      | —       | 34.6     |
| Restructuring and other charges   | —         | 3,288       | 2,880        | —      | 2.3     | 4.2      |
| Total operating expenses  | 32,204    | 76,560      | 92,312       | 44.9   | 52.5    | 135.1    |
| Earnings (loss) from operations   | 14,723    | 14,507      | (74,783)     | 20.6   | 9.9     | (109.4)  |
| Interest income, net  | 1,480     | 6,098       | 1,456        | 2.1    | 4.2     | 2.1      |
| Foreign exchange gain (loss)  | (684)     | 3,327       | (458)        | (1.0)  | 2.3     | (0.7)    |
| Earnings (loss) before income taxes and amortization and write-down of goodwill | 15,519    | 23,932      | (73,785)     | 21.7   | 16.4    | (108.0)  |
| Income taxes  | 5,298     | 8,150       | (25,451)     | 7.4    | 5.6     | (37.2)   |
| Earnings (loss) before amortization and write-down of goodwill                  | 10,221    | 15,782      | (48,334)     | 14.3   | 10.8    | (70.8)   |
| Amortization of goodwill  | 297       | 31,076      | 38,021       | 0.4    | 21.3    | 55.6     |
| Write-down of goodwill  | —         | —           | 222,169      | —      | —       | 325.1    |
| Net earnings (loss) for the year  | \$ 9,924  | \$ (15,294) | \$ (308,524) | 13.9%  | (10.5)% | (451.5)% |
| Basic and diluted net earnings (loss) per share                                 | \$ 0.25   | \$ (0.29)   | \$ (5.09)    |        |         |          |
| Research and development data:  |           |             |              |        |         |          |
| Gross research and development  | \$ 9,374  | \$ 17,601   | \$ 17,005    | 13.1%  | 12.1%   | 24.9%    |
| Net research and development  | \$ 6,402  | \$ 13,601   | \$ 12,782    | 8.9%   | 9.3%    | 18.7%    |
| <b>Other data (unaudited):**</b>  |           |             |              |        |         |          |
| Pro forma net earnings (loss)   | \$ 10,252 | \$ 24,500   | \$ (11,248)  | 14.3%  | 16.8%   | (16.5)%  |
| Basic and diluted pro forma net earnings (loss) per share                       | \$ 0.26   | \$ 0.46     | \$ (0.19)    |        |         |          |

\* Including inventory write-offs of nil, nil and \$18,463 for the years ended August 31, 2000, 2001 and 2002, respectively. Excluding inventory write-offs of \$18,463 for the year ended August 31, 2002, gross margin would have reached 52.7% for that year. This latter information is unaudited and is a non-GAAP measure.

\*\* Net earnings (loss) excluding amortization and write-down of goodwill and the after-tax effect of amortization and write-down of intangible assets, restructuring and other charges, as well as inventory write-offs. This information may not be comparable to similarly titled measures reported by other companies because it is non-GAAP information. Please refer to page 19 of this annual report for a detailed quantitative reconciliation.

## Sales

Sales totaled \$68.3 million, \$146.0 million and \$71.6 million in fiscal 2002, 2001 and 2000, respectively. Sales decreased 53% in fiscal 2002 compared to 2001 due to a reduced demand for our products and pricing pressure attributable to the severe downturn in the telecommunications industry. The fiber-optic telecommunications industry has not rebounded as quickly as many industry experts forecasted. Established telecommunications carriers have decreased their capital expenditures to improve short-term financials and reduce debt loads, while a number of others have filed for bankruptcy. Lower spending levels have produced a trickle-down effect throughout the fiber-optic industry, including in research and development, manufacturing, installation and maintenance, as well as network monitoring companies. Test, measurement, monitoring and automation equipment vendors, in turn, have been negatively affected due to the dramatic reduction in the deployment of optical networks. Consequently, both our Portable and Monitoring products and our Industrial and Scientific products suffered from this lack of demand and pricing pressure. Our Industrial and Scientific products, however, were more severely affected by the downturn. With regard to sales distribution, it was a 57%-43% split in favor of our Portable and Monitoring products in fiscal 2002 compared to 52%-48% in favor of our Industrial and Scientific products in 2001.



Net accepted orders decreased 56% to \$58.3 million in fiscal 2002 from \$132.1 million in 2001. Our book-to-bill ratio decreased to 0.85 in fiscal 2002 compared to 0.90 in 2001. However, our book-to-bill ratio, which began decreasing in the third quarter of 2001, has been steadily increasing since the second quarter of 2002. Our book-to-bill ratio for the last quarter of fiscal 2002 was 1.03.

Sales increased 104% in fiscal 2001 compared to 2000 due to increased demand for our Industrial and Scientific products as well as our Portable and Monitoring products, market acceptance of several products launched in 2001 and the impact of the EXFO Burleigh Products Group ("EXFO Burleigh") and EXFO Photonic Solutions acquisitions completed during the year. In addition, the increase in sales of our Industrial and Scientific products significantly increased our top line because these products have a higher average selling price than Portable and Monitoring products. Altogether, our Industrial and Scientific products accounted for 52% of sales in fiscal 2001 compared to 31% in 2000.

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

North American sales accounted for 57%, 58% and 62% of global sales in fiscal 2002, 2001 and 2000, respectively. International sales represented 43%, 42% and 38% of global sales in fiscal 2002, 2001 and 2000, respectively. Despite the relative stability in our international sales between fiscal 2002 and 2001 as a percentage of total sales, sales to the Asian market reached 19% of global sales in fiscal 2002 compared to 13% in 2001 as a result of our sustained efforts to develop this market. On the other hand, sales to the European market decreased to 14% of global sales in fiscal 2002 compared to 21% of sales in 2001, mainly because this market has been the most affected by the downturn in the telecommunications industry.

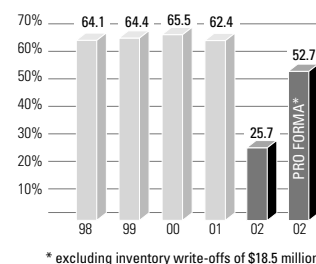
The increase in international sales in fiscal 2001 compared to 2000 mainly reflects our sustained efforts to develop the Asian market. We almost tripled our sales in this region and added service centers in Beijing and Singapore to better serve our customers.

We sell our products to a broad range of customers including telecommunications carriers, network service providers, optical component and system manufacturers, as well as research and development laboratories. No customer accounted for more than 10.2%, 6.4% and 5.8% of sales in fiscal 2002, 2001 and 2000, respectively. In fiscal 2002, our three most significant customers represented 15.4% of sales.

## Gross Margin

Gross margin amounted to 25.7%, 62.4% and 65.5% of sales for fiscal 2002, 2001 and 2000, respectively.

In fiscal 2002, we recorded inventory write-offs of \$18.5 million for obsolete and excess inventories. These special charges were recorded due to weaker demand for our products and our expected needs for the upcoming 24 months at the time of the write-offs. Excluding these special charges, our gross margin would have reached 52.7% of sales. Even excluding these special charges, our gross margin decreased 9.7% in fiscal 2002 from 62.4% in 2001, mainly because of the significant decrease in our sales in 2002. Weaker demand for our products and pricing pressure prevented us from a better absorption of our fixed manufacturing costs. Our manufacturing capacity in Quebec City, QC and Victor, NY almost doubled in fiscal 2001, while sales decreased significantly in 2002.



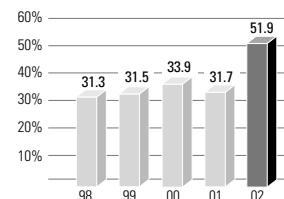
\* excluding inventory write-offs of \$18.5 million

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

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

## Selling and Administrative

Selling and administrative expenses reached \$35.4 million, \$46.2 million and \$24.3 million for fiscal 2002, 2001 and 2000, respectively. As a percentage of sales, selling and administrative expenses amounted to 51.9%, 31.7% and 33.9% for fiscal 2002, 2001 and 2000, respectively. The dollar decrease in fiscal 2002 compared to 2001 is directly related to lower expenses resulting from our restructuring plans implemented since June 2001 and lower commission expenses since our sales decreased significantly in fiscal 2002. However, this decrease was offset in part by the impact of the acquisition of EXFO Protocol in November 2001. On the other hand, the significant drop in sales in fiscal 2002 caused the selling and administrative expenses percentage to increase since these expenses tend to be fixed and because sales decreased at a faster rate than selling and administrative expenses.

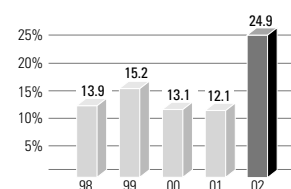


The dollar increase in fiscal 2001 compared to 2000 is directly related to higher commissions resulting from increased sales activity, increased promotional and marketing expenses, expenses to consolidate our sales force in Asia, expenses related to running a public company and the impact of the EXFO Burleigh and EXFO Photonic Solutions acquisitions. The percentage decrease is mainly due to a better absorption of these expenses because sales increased at a faster rate than selling and administrative expenses.

Considering the challenging market conditions, we will continue to maintain our selling and administrative expenses at an acceptable level without impeding our efforts to strategically position our company, improve our sales, as well as provide quality service to customers and integrate our acquired companies.

## Research and Development

Gross research and development expenses totaled \$17.0 million, \$17.6 million and \$9.4 million for fiscal 2002, 2001 and 2000, respectively. As a percentage of sales, gross research and development expenses amounted to 24.9%, 12.1% and 13.1% for fiscal 2002, 2001 and 2000, respectively.



The slight decrease in gross research and development dollars in fiscal 2002 compared to 2001 is mainly due to the mix and timing of research and development projects and the effect of our restructuring plans implemented in 2002; these factors were partially offset by the impact of the acquisition of EXFO Protocol. The percentage increase reflects our strong focus on innovation despite the significant decrease in sales.

We firmly believe that innovation and new product introductions are the key to gaining market share in this current economic environment and ensuring the long-term growth and profitability of the company. In fiscal 2002, 48% of sales originated from products that have been on the market for two years or less. This is a slight improvement compared to 46% of our sales in fiscal 2001. In fiscal 2002, we released 25 new products compared to 20 in 2001. These figures confirm our dedication to innovation and our anticipation of customer needs and expectations.

The increase in gross research and development dollars in fiscal 2001 compared to 2000 reflects the hiring of additional research and development personnel, as well as the acquisitions of EXFO Burleigh and EXFO Photonic Solutions. The decrease, as a percentage of sales, in fiscal 2001 compared to 2000 is mainly due to the fact that sales increased at a faster rate than research and development expenses during that period.

Tax credits and grants from federal, provincial and state governments for research and development activities were \$4.2 million, \$4.0 million and \$3.0 million for fiscal 2002, 2001 and 2000, respectively. Our tax credits and grants remained relatively flat between fiscal 2002 and 2001 since our gross research and development expenses were relatively unchanged year-over-year. The increase in our tax credits and grants in fiscal 2001 compared to 2000 is directly related to the hiring of additional research and development personnel as well as the impact of the EXFO Photonic Solutions acquisition.

Tax credits and grants, as a percentage of gross research and development expenses, were 24.8%, 22.7% and 31.7% for fiscal 2002, 2001 and 2000, respectively. Tax credits and grants, as a percentage of gross research and development expenses, increased slightly between 2001 and 2002 since more research and development activities were carried out in Canada, where such activities are entitled to research and development tax credits, following the acquisition of EXFO Protocol. The decrease in fiscal 2001 compared to 2000 is related to a reduction in the effective tax credit rate and grants on research and development carried out in Canada. It should be noted that research and development carried out by US-based EXFO Burleigh is not eligible for tax credits. As a result, tax credits and grants, as a percentage of gross research and development expenses, were further reduced in fiscal 2001.

In terms of net research and development expenses, they amounted to 18.7%, 9.3% and 8.9% of sales for fiscal 2002, 2001 and 2000, respectively. Although we intend to reduce our research and development expenses as a percentage of sales, we expect to continue investing heavily in research and development in the upcoming year, reflecting our focus on innovation, our desire to gain market share and our goal to exceed customer needs and expectations.

## Amortization of Intangible Assets

In conjunction with the acquisitions of EXFO Burleigh, EXFO Photonic Solutions and EXFO Protocol during the last two years, we recorded \$61.1 million in intangible assets, primarily consisting of core technology. These intangible assets, which are amortized over periods from five months to five years from the date of acquisitions, resulted in amortization expenses of \$11.6 million and \$9.9 million in fiscal 2002 and 2001, respectively.

Intangible assets related to these acquisitions have been reviewed for impairment as described below and this resulted in a pre-tax write-down charge of \$23.7 million in the third quarter of 2002. Considering this write-down, the amortization of intangible assets will decrease by approximately \$6.5 million in the upcoming fiscal year.

## Write-Down of Goodwill and Intangible Assets

In May 2002, as part of our review of financial results, we 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 our subsidiaries' industries and the decline in technology valuations. The growth prospects for our subsidiaries were significantly lower than previously expected and less than those of historical periods. In addition, the decline in market conditions affecting the subsidiaries is significant and other than temporary. As a result, we concluded that the carrying value of goodwill and certain acquired intangible assets was impaired and we recorded a charge of \$222.2 million to write down a significant portion of goodwill and a pre-tax charge of \$23.7 million to write down a significant portion of acquired core technology. Of the total impairment loss of \$245.8 million, \$125.0 million relates to EXFO Burleigh, \$71.5 million relates to EXFO Photonic Solutions and \$49.3 million 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 we had distinct cash flows for each of them and because they are not fully integrated into our 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 our best estimates.

On September 1, 2002, upon the adoption of section 3062 of the CICA and under its transitional provisions, we performed an initial impairment test to identify potential goodwill impairment using a fair value-based method. Under the new section, a goodwill impairment loss exists when the carrying value of a reporting unit exceeds its fair value. For the purposes of the impairment test, we allocated our existing goodwill to our reporting units and completed an evaluation of the fair value of such reporting units. Based upon the comparison of the fair value of the reporting units to their carrying value, goodwill of the reporting units was not considered impaired.

For a more complete description of this new accounting standard, please refer to the "New Accounting Standards" section further in this document.

## Restructuring and Other Charges

In fiscal 2001, we implemented a structured plan to reduce our costs and increase our efficiency. Under that plan, we recorded charges of \$3.3 million, including \$0.8 million in severance expenses for the 245 employees who were terminated, \$1.5 million for unused assets and \$1.0 million for future payments on exited leased facilities.

In fiscal 2002, we incurred additional charges of \$2.9 million to further reduce our costs. Under additional structured plans, we recorded \$2.0 million in severance expenses for the additional 350 employees who were terminated and \$0.9 million for the write-off of property, plant and equipment.

Our cost-cutting measures represent our best efforts to respond to the difficult market conditions. However, these efforts may be inappropriate or insufficient. Our actions in this regard may not be successful in achieving the cost reductions or other benefits expected, may be insufficient to align our cost structure to market conditions, or may be more costly or extensive than anticipated.

## Interest Income, Net

Net interest income amounted to \$1.5 million, \$6.1 million and \$1.5 million for fiscal 2002, 2001 and 2000, respectively. The decrease in our net interest income in fiscal 2002 compared to 2001 is directly related to the use of short-term investments to finance our strategic acquisitions, our operating activities and the purchases of property, plant and equipment, as well as a general decrease in interest rates.

The increase in our net interest income in fiscal 2001 compared to 2000 results solely from short-term investments of the remaining net proceeds of our Initial Public Offering on June 29, 2000.

We expect our net interest income to decrease in the upcoming fiscal year because of the aforementioned reasons.

## Foreign Exchange Gain (Loss)

Foreign exchange loss amounted to \$0.5 million in fiscal 2002 compared to a foreign exchange gain of \$3.3 million in fiscal 2001 and a foreign exchange loss of \$0.7 million in 2000.

The foreign exchange loss in fiscal 2002 is the result of the translation of operating activities denominated in currencies other than the Canadian dollar.

The foreign exchange gain in fiscal 2001 can be mostly attributed to the disposal of short-term investments denominated in US dollars and the translation of operating activities denominated in currencies other than the Canadian dollar.

We manage our exposure to currency risk with forward exchange contracts and operating activities of Canadian entities denominated in currencies other than the Canadian dollar.

## Income Taxes

Our effective income tax recovery rate was 34.5% in fiscal 2002 compared to income tax rates of 34.1% for both fiscal 2001 and 2000.

As at August 31, 2002, future income tax assets were \$10.0 million and mainly relate to tax losses, provisions and accruals as well as research and development expenses, as described in note 15 to our consolidated financial statements. Our current forecasts demonstrate that most of the future income tax assets should be recovered over the next three fiscal years. However, if we obtain information that causes our forecast of future taxable income to change or if actual future taxable income differs from our forecast, we may have to revise the carrying value of our future income tax assets, which would affect our net earnings in the period in which the change was made. We review the recoverability of our future income tax assets on a quarterly basis.

Research and development expenses and most of the provisions and accruals can be carried forward indefinitely against future years' taxable income. The Canadian tax losses, which represent \$3.5 million in future income tax assets, expire over the next seven years while U.S. tax losses, which represent \$3.4 million in future income tax assets, expire in 20 years.

## Amortization of Goodwill

In conjunction with the acquisitions of EXFO Burleigh and EXFO Photonic Solutions, we recorded \$248.5 million in goodwill, which is amortized over five years. These acquisitions resulted in amortization expenses of \$38.0 million and \$31.1 million for fiscal 2002 and 2001, respectively. The acquisition of EXFO Protocol has been accounted for using new accounting standards contained in sections 1581 and 3062 of the CICA and, consequently, goodwill resulting from this acquisition was not amortized.

Goodwill related to these acquisitions has been reviewed for impairment, as described above, and this resulted in a write-down charge of \$222.2 million in the third quarter of 2002. Starting on September 1, 2002, goodwill will no longer be amortized under new accounting standards.

## Net Earnings (Loss)

Net loss amounted to \$308.5 million and \$15.3 million in fiscal 2002 and 2001, respectively, compared to net earnings of \$9.9 million in 2000. In terms of per share amounts, we recorded a net loss of \$5.09 and \$0.29 in fiscal 2002 and 2001, respectively, compared to net earnings of \$0.25 in 2000.

## Pro Forma Net Earnings (Loss)

As a measure to assess financial performance, we use pro forma net earnings (loss) and pro forma net earnings (loss) per share. Pro forma net earnings (loss) represent net earnings (loss) excluding amortization and write-down of goodwill and the after-tax effect of amortization and write-down of intangible assets, restructuring and other charges as well as inventory write-offs.

Pro forma net loss amounted to \$11.2 million in fiscal 2002 compared to pro forma net earnings of \$24.5 million and \$10.3 million in fiscal 2001 and 2000, respectively. In terms of pro forma per share amounts, we recorded a loss of \$0.19 in fiscal 2002 compared to net earnings of \$0.46 and \$0.26 in fiscal 2001 and 2000, respectively.

Pro forma net earnings (loss) is reconciled as follows:

| Years Ended August 31,   | 2000             | 2001             | 2002               |
|--|------------------|------------------|--------------------|
|  | (unaudited)      | (unaudited)      | (unaudited)        |
| Net earnings (loss) in accordance with GAAP                            | \$ 9,924         | \$ (15,294)      | \$ (308,524)       |
| Pro forma adjustments:   |                  |                  |                    |
| Amortization of goodwill   | 297              | 31,076           | 38,021             |
| Write-down of goodwill   | —                | —                | 222,169            |
| Amortization of intangible assets                                      | 47               | 9,876            | 11,615             |
| Tax effect of amortization of intangible assets                        | (16)             | (3,363)          | (4,007)            |
| Write-down of intangible assets  | —                | —                | 23,657             |
| Tax effect of write-down of intangible assets                          | —                | —                | (8,160)            |
| Restructuring and other charges and inventory write-offs               | —                | 3,288            | 21,343             |
| Tax effect of restructuring and other charges and inventory write-offs | —                | (1,083)          | (7,362)            |
| <b>Pro forma net earnings (loss)</b>                                   | <b>\$ 10,252</b> | <b>\$ 24,500</b> | <b>\$ (11,248)</b> |
| Net earnings (loss) per share  | \$ 0.25          | \$ (0.29)        | \$ (5.09)          |
| Basic and diluted pro forma net earnings (loss) per share              | \$ 0.26          | \$ 0.46          | \$ (0.19)          |

We provide pro forma financial information to help the investor better understand our operating results. This information is not in accordance with, or an alternative to, generally accepted accounting principles and may not be comparable to similarly titled measures reported by other companies.

## Liquidity and Capital Resources

We finance our operations and major investments and meet our capital expenditure requirements mainly through the use of cash and cash equivalents, short-term investments and the issuance of subordinate voting shares.

## Cash Position and Short-Term Investments

As at August 31, 2002, cash and cash equivalents as well as short-term investments consisted of \$49.7 million. Our working capital was at \$91.4 million. Our cash and cash equivalents and short-term investments decreased by \$24.9 million in fiscal 2002, including \$8.7 million for financing of operating activities as well as cash payments of \$9.8 million and \$5.2 million, respectively, for the acquisition of EXFO Protocol and the purchases of property, plant and equipment.

The acquisition of substantially all the assets of *gnubi communications, L.P.* will be partially financed with \$1.8 million of cash on hand. In fiscal 2003, however, we expect to recover \$13.5 million in income taxes mainly due to the carry-back of current tax losses and tax credits on our research and development activities. As at August 31, 2002, total commitments under operating leases and long-term debt for fiscal 2003 amounted to \$1.4 million.

## Operating Activities

Cash flows used by operating activities were \$8.7 million in fiscal 2002 compared to cash flows provided of \$3.9 million in fiscal 2001 and cash flows used of \$4.0 million in 2000. Cash flows used by operating activities in fiscal 2002 were primarily due to the net loss after items not affecting cash and cash equivalents of \$1.1 million combined with the increase of income taxes receivable of \$19.7 million and the decrease in accounts payable and accrued liabilities of \$7.5 million. These figures were partially offset by the result of the net decrease in accounts receivable and inventories of \$19.7 million. The increase in our income taxes receivable is related to income tax recovery following the carry-back to previous years' taxable income of our consolidated tax loss, while the decrease in our accounts payable and accrued liabilities is due to the reduction in our purchases following the slowdown in our industry. The decrease in our accounts receivable is due to the reduction in our sales level and the improvement in our days of sales outstanding (DSOs), while the decrease in our inventories is due to our efforts to maintain them at the lowest acceptable level considering the decrease in sales.

Cash flows provided by operating activities in fiscal 2001 were primarily due to net earnings after items not affecting cash and cash equivalents of \$25.3 million. This figure was mainly offset by the increase of \$20.3 million in inventories required to ensure minimal manufacturing and delivery lead times.

In fiscal 2002, the major items not affecting cash and cash equivalents consisted of inventory write-offs of \$18.5 million, write-down of goodwill and intangible assets of \$245.8 million, amortization expenses of \$55.6 million and future income tax recovery of \$13.4 million. In fiscal 2001, the major items not affecting cash and cash equivalents consisted of amortization expenses of \$44.5 million and realized foreign exchange gains on disposal of short-term investments of \$3.4 million.

## Financing Activities

Cash flows used by financing activities were \$90,000 and \$4.6 million in fiscal 2002 and 2001, respectively, compared to cash flows provided of \$172.8 million in 2000. Cash flows used by financing activities in fiscal 2002 were due to the repayment of our long-term debt. Cash flows used in financing activities in fiscal 2001 were mainly due to the repayment of our bank advances and our long-term debt of \$5.4 million.

As at August 31, 2002, we had credit facilities that provide for advances of up to Cdn\$10 million (US\$6.4 million) under a line of credit. This line of credit bears interest at prime rate.

## Investing Activities

Cash flows provided by investing activities were \$10.5 million and \$8.4 million in fiscal 2002 and 2001, respectively, compared to cash flows used of \$169.0 million in 2000.

In fiscal 2002, we disposed of \$25.5 million in short-term investments to finance our operating activities of \$8.7 million as well as the respective cash payments of \$9.8 million and \$5.2 million for the acquisition of EXFO Protocol and the purchases of property, plant and equipment.

In fiscal 2001, we disposed of \$92.6 million in short-term investments to finance the cash payments of \$68.3 million and \$15.9 million for the acquisitions of EXFO Burleigh and EXFO Photonic Solutions and the purchases of property, plant and equipment, respectively. Despite these investments and purchases, the disposal of short-term investments generated net cash flows of \$8.4 million in fiscal 2001.

## Outlook

As described above, we incurred an operating loss of \$74.8 million in fiscal 2002 and operating activities used \$8.7 million in cash flows. There can be no assurance as to whether and when we will return to profitability or that our sales will return to prior levels. However, we believe that our cash balances and short-term investments, combined with available credit facilities, will be sufficient to meet our expected liquidity and capital requirements for at least the next 12 months. On the other hand, possible additional operating losses and/or possible investments in or acquisitions of complementary businesses, products or technologies may require additional financing prior to such time. There can be no assurance that additional debt or equity financing will be available when required or, if available, it can be secured on satisfactory terms.

## Stock Option Plan

The aggregate number of subordinate voting shares covered by options granted under the stock option plan was 2,597,574 as at August 31, 2002. The weighted average exercise price of those stock options was \$22 compared to the market price of \$2.13 per share as at August 31, 2002. The maximum number of subordinate voting shares issuable under the plan cannot exceed 4,470,961 shares. The following table summarizes information about stock options granted to the members of the Board of Directors and to Management and Corporate Officers of the company and its subsidiaries as at August 31, 2002:

|   | Number  | % of issued and outstanding | Weighted average exercise price |
|---|---------|-----------------------------|---------------------------------|
| Chairman of the Board, President and CEO (one individual) | 100,482 | 3.87%                       | \$ 14.06                        |
| Board of Directors (four individuals)                     | 80,838  | 3.11%                       | \$ 10.95                        |
| Management and Corporate Officers (ten individuals)       | 429,155 | 16.52%                      | \$ 21.82                        |
|   | 610,475 | 23.50%                      | \$ 19.10                        |

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. As described in the "New Accounting Standards" section below, we will adopt this new standard prospectively on September 1, 2002, and as permitted by the CICA, we will not account for the stock-based compensation costs arising from awards to employees, but we will comply with the required pro forma disclosures with respect to net earnings and net earnings per share.

Like many other companies, we do not believe that the use of the Black-Scholes option valuation model provides a reliable single measure of the fair value of our employees' stock options and stock awards. For example, using of the Black-Scholes model as required under U.S. GAAP, our 2,597,574 outstanding options with an average exercise price of \$22 would have generated aggregate stock-based compensation costs of \$26,589,000. None of the options issued by EXFO have been exercised because the market price of the company's common shares as at August 31, 2002, is well below the exercise price.

Please refer to note 19 to our consolidated financial statements for further explanation of stock-based compensation costs.

## New Accounting Standards

In November 2001, the CICA revised section 1650, "Foreign Currency Translation", which is effective for fiscal years beginning on or after January 1, 2002. The revised standard, which we 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 our financial statements since we currently have 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 we 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. We have 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. We will adopt this new standard prospectively on September 1, 2002. We will not account for the stock-based compensation costs arising from awards to employees. However, we 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 our 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 transitional provisions of section 3062, we did not amortize the goodwill resulting from the acquisition of EXFO Protocol, for which the acquisition date was November 2, 2001.

We adopted section 3062 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 section, we 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, we allocated our existing goodwill to our 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.

For details on new U.S. accounting standards, please refer to note 19 to our consolidated financial statements.

## Risks and Uncertainties

Over the past few years, we have been able to manage our activities, focus on research and development of new and innovative products, penetrate international markets and close important strategic acquisitions. However, we operate in a highly competitive field that is in constant evolution and, as a result, we encounter various risks and uncertainties that must be given appropriate consideration in our strategic management policies.

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

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

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

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

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

For a more complete understanding of risk factors that may affect us, please refer to the risk factors set forth in our disclosure documents published with securities commissions.

## Quarterly Summary Financial Information (unaudited)

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

|  | 1st quarter | 2nd quarter | 3rd quarter  | 4th quarter | Years ended<br>August 31, |
|--|-------------|-------------|--------------|-------------|---------------------------|
| <b>2002</b>  |             |             |              |             |                           |
| Sales  | \$ 20,138   | \$ 14,601   | \$ 16,348    | \$ 17,243   | \$ 68,330                 |
| Cost of sales  | \$ 12,532   | \$ 12,885   | \$ 17,080    | \$ 8,304    | \$ 50,801                 |
| Gross margin (loss)                                    | \$ 7,606    | \$ 1,716    | \$ (732)     | \$ 8,939    | \$ 17,529                 |
| Loss from operations                                   | \$ (10,893) | \$ (16,612) | \$ (43,396)  | \$ (3,882)  | \$ (74,783)               |
| Net loss   | \$ (19,055) | \$ (22,675) | \$ (263,826) | \$ (2,968)  | \$ (308,524)              |
| Pro forma net loss*                                    | \$ (1,937)  | \$ (4,099)  | \$ (3,930)   | \$ (1,183)  | \$ (11,248)               |
| Basic and diluted net loss per share*                  | \$ (0.33)   | \$ (0.37)   | \$ (4.29)    | \$ (0.05)   | \$ (5.09)                 |
| Basic and diluted pro forma net<br>loss per share*     | \$ (0.03)   | \$ (0.07)   | \$ (0.06)    | \$ (0.02)   | \$ (0.19)                 |
| <b>2001</b>  |             |             |              |             |                           |
| Sales  | \$ 28,519   | \$ 36,293   | \$ 45,781    | \$ 35,420   | \$ 146,013                |
| Cost of sales  | \$ 10,308   | \$ 12,787   | \$ 17,418    | \$ 14,433   | \$ 54,946                 |
| Gross margin   | \$ 18,211   | \$ 23,506   | \$ 28,363    | \$ 20,987   | \$ 91,067                 |
| Earnings (loss) from operations                        | \$ 6,791    | \$ 6,912    | \$ 4,335     | \$ (3,531)  | \$ 14,507                 |
| Net earnings (loss)                                    | \$ 7,505    | \$ 24       | \$ (8,630)   | \$ (14,193) | \$ (15,294)               |
| Pro forma net earnings*                                | \$ 7,638    | \$ 7,511    | \$ 6,204     | \$ 3,219    | \$ 24,500                 |
| Basic and diluted net earnings<br>(loss) per share*    | \$ 0.16     | \$ -        | \$ (0.15)    | \$ (0.25)   | \$ (0.29)                 |
| Basic and diluted pro forma net<br>earnings per share* | \$ 0.16     | \$ 0.14     | \$ 0.11      | \$ 0.06     | \$ 0.46                   |
| <b>2000</b>  |             |             |              |             |                           |
| Sales  | \$ 11,688   | \$ 17,423   | \$ 19,411    | \$ 23,117   | \$ 71,639                 |
| Cost of sales  | \$ 3,733    | \$ 5,876    | \$ 7,347     | \$ 7,756    | \$ 24,712                 |
| Gross margin   | \$ 7,955    | \$ 11,547   | \$ 12,064    | \$ 15,361   | \$ 46,927                 |
| Earnings from operations                               | \$ 2,092    | \$ 3,640    | \$ 3,847     | \$ 5,144    | \$ 14,723                 |
| Net earnings   | \$ 1,300    | \$ 2,412    | \$ 2,748     | \$ 3,464    | \$ 9,924                  |
| Pro forma net earnings*                                | \$ 1,306    | \$ 2,461    | \$ 2,885     | \$ 3,599    | \$ 10,252                 |
| Basic and diluted net earnings per share*              | \$ 0.03     | \$ 0.06     | \$ 0.07      | \$ 0.08     | \$ 0.25                   |
| Basic and diluted pro forma net<br>earnings per share* | \$ 0.03     | \$ 0.06     | \$ 0.07      | \$ 0.08     | \$ 0.26                   |

\* Pro forma net earnings (loss) and per share data are calculated independently for each of the quarters presented. Therefore, the sum of this quarterly information may not equal the corresponding annual information. Pro forma net earnings (loss) represent net earnings (loss) excluding amortization and write-down of goodwill and the after-tax effect of amortization and write-down of intangible assets, restructuring and other charges as well as inventory write-offs. This information may not be comparable to similarly titled measures reported by other companies because it is non-GAAP information.