

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

This discussion and analysis contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995, and we intend that such forward-looking statements be subject to the safe harbors created thereby. Forward-looking statements are statements other than historical information or statements of current condition. Words such as may, will, expect, believe, anticipate, intend, could, estimate, continue, or the negative or comparable terminology are intended to identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events and circumstances are considered forward-looking statements. They are not guarantees of future performance and involve risks and uncertainties. Actual results may differ materially from those in forward-looking statements due to various factors including consolidation in the global telecommunications test, measurement and monitoring industry; capital spending levels in the telecommunications, life sciences and high-precision assembly sectors; concentration of sales; fluctuating exchange rates and our ability to execute in these uncertain conditions; the effects of the additional actions we have taken in response to such economic uncertainty (including our ability to quickly adapt cost structures with anticipated levels of business, ability to manage inventory levels with market demand); market acceptance of our new products and other upcoming products; limited visibility with regards to customer orders and the timing of such orders; our ability to successfully integrate our acquired and to-be-acquired businesses; our ability to successfully expand international operations; the retention of key technical and management personnel; and future economic, competitive, financial and market conditions, including any slow-down or recession in the global economy. Assumptions relating to the foregoing involve judgments and risks, all of which are difficult or impossible to predict and many of which are beyond our control. Other risk factors that may affect our future performance and operations are detailed in our Annual Report, on Form 20-F, and our other filings with the U.S. Securities and Exchange Commission and the Canadian securities commissions. We believe that the expectations reflected in the forward-looking statements are reasonable based on information currently available to us, but we cannot assure you that the expectations will prove to have been correct. Accordingly, you should not place undue reliance on these forward-looking statements. These statements speak only as of the date of this document. Unless required by law or applicable regulations, we undertake no obligation to revise or update any of them to reflect events or circumstances that occur after the date of this document.

The following discussion and analysis of financial condition and results of operations is dated January 8, 2009.

All dollar amounts are expressed in US dollars, except as otherwise noted.

INDUSTRY OVERVIEW

The fundamental drivers for increased bandwidth and convergence towards IP-based networks in the global telecommunications industry remain solid for the moment. However, it is still unknown what impact the current recession will have on global telecom investment levels, particularly in the United States and Western Europe. The growth in bandwidth demand, the intense competition between telecom operators (telcos) and cable companies (cablecos), as well as the various benefits of new converged IP networks (attracting new applications and revenues while reducing cost of operation) are reasons several operators may continue investing in broadband deployments and IP convergence.

Global Internet bandwidth demand is fuelled by a wide range of applications like video streaming, Web gaming, etc. TeleGeography Research estimated that global Internet bandwidth increased at a compound annual growth rate (CAGR) of 54% from 2004 to 2008. This trend will likely remain strong in the years to come with upcoming deployments of Internet protocol television (IPTV), high-definition Internet protocol television (HD-IPTV) and increased online video streaming, since these applications, among others, will consume a colossal amount of additional bandwidth. As a result, telcos and cablecos will likely maintain significant investments in their access networks in order to provide differentiated, revenue-generating services to attract and retain consumers, who are increasingly relying on broadband network services for their work, entertainment and everyday activities.

As the volume of IP traffic, number of applications and quantity of consumers are increasing, so is the need for a 24/7, real-time service assurance solution that monitors IP traffic at the application level, from the access to the core network, as this is the best method for wireline and wireless operators to minimize the cost to operate their networks and provide a superior customer experience.

As well, it is now clear from a telco perspective, that fiber-to-the-home (FTTH) is becoming the access network architecture of choice for network operators. It allows them to meet heightened bandwidth requirements and future-proof their access networks, as residential bandwidth requirements are growing from the 1 to 5 Mbit/s (megabits per second) of the past to the 30 to 100 Mbit/s required in the long-term to assure multiple HD-IPTV channels, online gaming, high-speed content-rich Internet, VoIP (voice-over-Internet protocol) telephony and a myriad of other IP-based applications. Some projects, however, might be delayed based on the ability to fund such projects. Hybrid architectures, combining copper and fiber (fiber-to-the-curb, or FTTC, and fiber-to-the-node, or FTTN), will also keep expanding in the short term, since they are less-expensive methods to increase bandwidth and can be mass-deployed faster.

These investment decisions are applicable not only to green-field deployments and high-rise buildings, but also to larger-scale rollouts as long-term operating costs are less than FTTC and FTTN. It is noteworthy to mention that the cost of deploying FTTH has largely fallen over the last four years as volume increased and deployment tools, like those we offer, are making the task increasingly simple and efficient. We are only at the early stages of fiber deployments in access networks, both in the Americas and around the world. It is also worth noting that Western Europe and even China have become increasingly committed to deploying FTTH networks, given their high population density.

As bandwidth growth in access networks continues to increase, it has begun placing a strain on metro rings and core networks. It is also driving the need for higher-speed technologies; for example, 43 Gbit/s (gigabits per second) SONET/SDH is now seeing early deployments and becoming mainstream, while the upcoming 100 Gbit/s Ethernet is in the early stage of field trials by a selected few operators. The deployment of these solutions is expected to be significantly more economical, especially if trenches need to be dug in order to deploy new fiber in metro or long-distance routes.

As telecommunication networks are being transformed to provide IP-based voice, video and data capabilities, legacy SONET/SDH standards, which were first established in the mid-1980s and implemented until 2005, do not have the payload flexibility to seamlessly and efficiently mix and transport video with voice and data. These networks will not be capable to efficiently carry these emerging IP-based services as they are designed for public switched telephone network (PSTN), point-to-point voice transmission only. As a result, with new SONET/SDH standards, which are part of what the industry is calling *next-gen networks*, telco operators are increasingly turning to next-generation, IP-based networks to allow for more flexible and efficient transport of applications and services, and to offer customers higher-margin triple-play services—and even quadruple-play services—as wireline and wireless technologies become increasingly interconnected. Finally, as subscribers of these new services reach a critical mass, telcos are relying on service assurance solutions to ensure that the quality of service (QoS) and quality of experience (QoE) demanded by users are optimal in the post-deployment phase.

These market dynamics positively affected telecom test and monitoring suppliers in the first quarter of fiscal 2009. However, deteriorating macro-economic conditions in the United States and Western Europe could instigate a slowdown in capital spending among customers that would necessarily reduce demand for our test and monitoring solutions.

COMPANY OVERVIEW

We reported sales of \$46.4 million in the first quarter of fiscal 2009, which represented an increase of 13.1% year-over-year. We also reported record-high net accepted orders of \$52.3 million in the first quarter of fiscal 2009 for a book-to-bill ratio of 1.13. Total sales for the first quarter of fiscal 2009 included \$4.5 million from newly acquired Brix Networks Inc. and Navtel Communications Inc. Excluding the impact of these two acquisitions, we would have posted year-over-year organic sales growth of 2.1% in the first quarter of fiscal 2009.

Looking at the bottom line, we generated GAAP net earnings of \$5.3 million, or \$0.08 per diluted share, in the first quarter of fiscal 2009, compared to a net loss of \$93,000, or \$0.00 per share, for the same period last year. Net earnings for the first quarter of fiscal 2009 were positively and significantly affected by the weaker value of the Canadian dollar compared to the US dollar. During the first quarter of fiscal 2009, we reported a foreign exchange gain of \$4.6 million, compared to a foreign exchange loss of \$616,000 for the same period last year. Net earnings per diluted share in the first quarter of 2009 included charges of \$0.02 for stock-based compensation costs and the after-tax amortization expense for intangible assets. EBITDA (earnings before interest, income taxes, depreciation and amortization) reached \$9.1 million, or 19.7% of sales in the first quarter of fiscal 2009, compared to \$1.4 million, or 3.4% of sales for the same period last year (see further in this document for a complete reconciliation of EBITDA to GAAP net earnings/loss).

During the first quarter of fiscal 2009, we faced a substantial and sudden decrease in the value of the Canadian dollar versus the US dollar, which had a two-fold positive impact on our financial results. Firstly, the average value of the Canadian dollar decreased 13.9% in the first quarter of fiscal 2009, compared to the same period last year. Given that most of our sales are denominated in US dollars but a significant portion of our expenses are denominated in Canadian dollars, our financial results were positively affected as these expenses (denominated in Canadian dollars) were reduced when translated in US dollars for reporting purposes. Secondly, we recorded an exchange gain of \$4.6 million, which represents the effect of the 14.1% decrease (compared to August 31, 2008) in the value of the Canadian dollar versus the US dollar on our balance sheet items denominated in foreign currencies. In comparison, for the same period last year, we reported a foreign exchange loss of \$616,000. During that period, the average value of the Canadian dollar increased 13.8% compared to the US dollar year-over-year and the period-end value of the Canadian dollar increased 5.6% compared to August 31, 2007.

On November 6, 2008, we announced that our Board of Directors had authorized a renewal of our share repurchase program, by way of a normal course issuer bid on the open market, of up to 10% of our public float (as defined by the Toronto Stock Exchange), or 2.7 million subordinate voting shares, at the prevailing market price. We expect to use cash, short-term investments or future cash flows from operations to fund the repurchase of shares. The period of the normal course issuer bid started on November 10, 2008, and will end on November 9, 2009, or on an earlier date if we repurchase the maximum number of shares permitted under the bid. The program does not require that we repurchase any specific number of shares, and it may be modified, suspended or terminated at any time and without prior notice. All shares repurchased under the bid will be cancelled.

On November 10, 2008, we announced that our Board of Directors had authorized a substantial issuer bid (the "Offer") to purchase for cancellation up to 8.8 million subordinate voting shares for an aggregate purchase price not to exceed CA\$30 million. The Offer is being made by way of a "modified Dutch Auction" pursuant to which shareholders may tender all or a portion of their shares (i) at a price not less than CA\$3.40 per share and not more than CA\$3.90 per share, in increments of CA\$0.05 per share, or (ii) without specifying a purchase price, in which case their shares will be purchased at the purchase price determined in accordance with the Offer. The Offer expired on December 16, 2008, and, on December 18, 2008, we purchased for cancellation 7.7 million subordinated voting shares for an aggregate purchase price of CA\$30 million, excluding related fees. We used cash and short-term investments to fund the repurchase of shares.

Upon the approval of the Offer, we suspended the normal course issuer bid referred to above, until 20 business days following the expiration of the Offer.

During the first quarter of fiscal 2009, we launched five new products, including a new software release for the Transport Blazer product line that delivers unprecedented insight into 40 Gbit/s network behavior; new software releases for the InterWatch platform and Packet Blazer product line to support the migration of voice and video applications to the IPv6 (Internet Protocol, version 6) addressing scheme; and expanded Ethernet test capabilities on the Power Blazer product line through multistream, quality of service (QoS) support. Sales from products that have been on the market two years or less represented 33.1% of total sales in the first quarter of fiscal 2009.

OUR STRATEGY, KEY PERFORMANCE INDICATORS AND CAPABILITY TO DELIVER RESULTS

For a complete description of our strategy and the related key performance indicators, as well as our capability to deliver results in fiscal 2009, please refer to the corresponding sections in our most recent Annual Report, filed with the securities commissions.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

For a complete description of our critical accounting policies and estimates, please refer to the corresponding section in our most recent Annual Report, filed with the securities commissions. The following details the changes in critical accounting policies that were adopted in fiscal 2009 and those to be adopted after 2009.

Adopted in fiscal 2009

In December 2006, the Canadian Institute of Chartered Accountants (CICA) issued three new sections, which provide a complete set of disclosure and presentation requirements for financial instruments: Section 3862, “Financial Instruments – Disclosures”; Section 3863, “Financial Instruments – Presentation”; and Section 1535, “Capital Disclosures”.

Section 3862 replaces the disclosure portion of Section 3861, “Financial Instruments – Disclosure and Presentation”. The new standard places increased emphasis on disclosures regarding risks associated with both recognized and unrecognized financial instruments and how these risks are managed. It is also intended to remove any duplicate disclosures and simplify the disclosures about concentrations of risk, credit risk, liquidity risk and price risk previously found in Section 3861.

Section 3863 carries forward the presentation requirements from Section 3861, unchanged.

Section 1535 applies to all entities, regardless of whether they have financial instruments and are subject to external capital requirements. The new section requires disclosure of information about an entity’s objectives, policies and processes for managing capital, as well as quantitative data about capital and whether the entity has complied with any capital requirements.

We adopted these new standards on September 1, 2008 and provided the required disclosure in our interim consolidated financial statements.

In June 2007, the CICA issued Section 3031, “Inventories”. This standard requires the measurement of inventories at the lower of cost and net realizable value and includes guidance on the determination of cost, including allocation of overheads and other costs to inventory. The standard also requires the consistent use of either first-in, first-out (FIFO) or weighted average cost formula to measure the cost of inventories and requires the reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories. The new standard applies to fiscal years beginning on or after January 1, 2008. We adopted this new standard on September 1, 2008, and its adoption had no effect on our consolidated financial statements.

In June 2007, the CICA amended Section 1400, “General Standards of Financial Statement Presentation” to include new requirements regarding an entity’s ability to continue as a going concern. These amendments apply to fiscal years beginning on or after January 1, 2008. We adopted these amendments on September 1, 2008, and their adoption had no effect on our consolidated financial statements.

To be adopted after fiscal 2009

In February 2008, the CICA issued Section 3064, “Goodwill and intangible assets”, which supersedes Section 3062, “Goodwill and other intangible assets” and Section 3450, “Research and development costs”. Various changes have been made to other sections of the CICA Handbook for consistency purposes. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill remain unchanged from the standards included in Section 3062. This new section applies to fiscal years beginning on or after October 1, 2008. We will adopt this new standard on September 1, 2009, and have not yet determined the effects its adoption will have on our consolidated financial statements.

RESULTS OF OPERATIONS

The following discussion and analysis of our consolidated financial condition and results of operations for the three months ended November 30, 2007 and 2008, should be read in conjunction with our interim consolidated financial statements and the related notes thereto. Our interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP) and significant differences in measurement and disclosure from United States generally accepted accounting principles (U.S. GAAP) are set out in note 13 to our interim consolidated financial statements. Our measurement currency is the Canadian dollar, although we report our financial statements in US dollars. The following table sets forth interim consolidated statements of earnings data in thousands of US dollars, except per share data, and as a percentage of sales for the periods indicated:

	Three months ended November 30,		Three months ended November 30,	
	2008	2007	2008	2007
	(unaudited)		(unaudited)	
Consolidated statements of earnings data:				
Sales	\$ 46,363	\$ 40,985	100.0%	100.0%
Cost of sales ⁽¹⁾	17,480	18,144	37.7	44.3
Gross margin	28,883	22,841	62.3	55.7
Operating expenses				
Selling and administrative	17,091	14,817	36.9	36.2
Net research and development	7,221	6,012	15.6	14.7
Amortization of property, plant and equipment	1,159	976	2.5	2.3
Amortization of intangible assets	1,319	734	2.8	1.8
Total operating expenses	26,790	22,539	57.8	55.0
Earnings from operations	2,093	302	4.5	0.7
Interest income	466	1,483	1.0	3.7
Foreign exchange gain (loss)	4,568	(616)	9.9	(1.5)
Earnings before income taxes	7,127	1,169	15.4	2.9
Income taxes				
Current	(61)	1,181	(0.1)	2.9
Future	1,901	81	4.1	0.2
	1,840	1,262	4.0	3.1
Net earnings (loss) for the period	\$ 5,287	\$ (93)	11.4%	(0.2)%
Basic and diluted net earnings (loss) per share	\$ 0.08	\$ (0.00)		
Segment information:				
Sales:				
Telecom Division	\$ 41,159	\$ 35,365	88.8%	86.3%
Life Sciences and Industrial Division	5,204	5,620	11.2	13.7
	\$ 46,363	\$ 40,985	100.0%	100.0%
Earnings from operations:				
Telecom Division	\$ 1,355	\$ 21	2.9%	0.1%
Life Sciences and Industrial Division	738	281	1.6	0.6
	\$ 2,093	\$ 302	4.5%	0.7%
Research and development data:				
Gross research and development	\$ 8,612	\$ 7,486	18.6%	18.3%
Net research and development	\$ 7,221	\$ 6,012	15.6%	14.7%

(1) The cost of sales is exclusive of amortization, shown separately.

SALES

For the three months ended November 30, 2008, our global sales increased 13.1% to \$46.4 million from \$41.0 million for the same period last year, with an 89%-11% split in favor of our Telecom Division (86%-14% for the same period last year).

Telecom Division

For the three months ended November 30, 2008, our Telecom Division sales increased 16.4% to \$41.2 million from \$35.4 million for the same period last year.

In the first quarter of fiscal 2009, we posted year-over-year sales growth mainly due to the market acceptance as well as market share gain of our next-generation IP test solutions, and due to the inclusion of the sales of newly acquired Brix Networks and Navtel Communications' products. In fact, sales of Brix Network and Navtel Communications amounted to \$4.5 million together for the quarter. Excluding these sales, our telecom sales would have increased 3.6% organically year-over-year. During the first quarter of fiscal 2009, we posted record-high sales and bookings of protocol test solutions and, unsurprisingly, our protocol test solutions represented our fastest-growing product line. Also, they represented more than 30% of our telecom sales in the first quarter of fiscal 2009, compared to more than 10% for the same period last year.

On the other hand, sales of optical test solutions slightly decreased during the first quarter of fiscal 2009, compared to the same period last year. This mainly results from lower sales in the Americas including Verizon's Fiber Optic Service (FIOS). Global sales to this top customer represented 4.0% (\$1.6 million) of our telecom sales in the first quarter of fiscal 2009, compared to 13.1% (\$4.6 million) for the same period last year. Excluding sales to this customer, our telecom sales would have increased 28.6% in the first quarter of fiscal 2009, compared to the same period last year. This shows that we have successfully diversified our customer base year-over-year. It should be noted that this customer was not our top customer during the first quarter of fiscal 2009 (second largest).

Finally, in the first quarter of fiscal 2009, foreign exchange losses on our forward exchange contracts, which are included in our telecom sales, amounted to \$211,000 compared to foreign exchange gains of \$1.3 million for the same period last year. In the first quarter of fiscal 2009, the average value of the Canadian dollar versus the US dollar decreased 13.9% compared to the same period last year.

Sales of our copper-access test solutions were slightly up in the first quarter of fiscal 2009, compared to the same period last year. During fiscal 2008, we launched the AXS-200 SharpTESTER, a new added-value product that integrates Consultronics (copper-access) core knowledge and intellectual property; the AXS-200 SharpTESTER platform also houses a new test module, the AXS-200/630 Triple-Play Test Set, which differentiates our access network offering from that of other vendors. These new, innovative products have yet to contribute to our sales for this market segment.

Life Sciences and Industrial Division

For the three months ended November 30, 2008, our Life Sciences and Industrial Division sales decreased 7.4% to \$5.2 million from \$5.6 million for the same period last year.

A significant portion of sales of that division are conducted through original equipment manufacturer (OEM) agreements. Consequently, we are dependent, to some extent, on the buying pattern of our customers. Moreover, a significant part of our product offering is related to manufacturing applications of consumer goods, which have been more susceptible to the state of the global economy.

Net bookings

Overall, for the two divisions, net accepted orders increased 19.7% year-over-year to a record-high \$52.3 million in the first quarter of fiscal 2009 from \$43.7 million for the same period last year, for a book-to-bill ratio of 1.13.

This increase of bookings year-over-year is due to significant order acceleration in our Protocol test segment, lead by a major order amounting up to \$4 million that was announced in the first quarter of fiscal 2009 when a Tier-1 wireless operator in North America has selected our converged service assurance solution to provide real-time monitoring of the quality of voice-over-IP (VoIP) and IP multimedia subsystem (IMS) services over its converged network.

Geographic distribution

In the first quarter of fiscal 2009, sales to the Americas, Europe, Middle-East and Africa (EMEA) and Asia-Pacific (APAC) accounted for 56%, 27% and 17% of global sales, respectively, compared to 58%, 24% and 18%, respectively for the same period last year.

In the first quarter of fiscal 2009, we reported year-over-year sales increases (in dollars) in every geographic area. In fact, sales to the Americas, EMEA and APAC increased (in dollars) 11.1%, 24.9% and 3.6%, respectively, which resulted in a slightly larger percentage of sales coming from international markets.

In the Americas, the increase in sales in the first quarter of fiscal 2009, compared to the same period last year, comes from every region; we posted a sales growth of 43.3%, 6.3% and 8.9% in Canada, United States and Latin America, respectively. In the United States, despite the decrease in sales to our top customer year-over-year, we were able to increase our sales in this region partially thanks to the contribution of Brix Networks and Navtel Communications whose sales were traditionally in that region. As mentioned above, during the first quarter of fiscal 2008, we benefited from aggressive FTTH rollouts from our top customer, and sales to this customer represented 11.3% (\$4.6 million) of our global sales in the first quarter of fiscal 2008, compared to 3.5% (\$1.6 million) for the same period this year. We believe that we did not lose market share with this particular customer in the first quarter of fiscal 2009. We believe we have expanded market share as we successfully got additional product-line approvals to partially offset the decline in optical business and came out to a significant growth in booking at that account during the last quarter. Excluding sales to this customer, sales to the United States would have increased 31.3% in dollars year-over-year; this shows that, overall, we have diversified our customer base and product mix year-over-year in this region. Finally, sales to Latin America fluctuate depending on the timing and scope of our customers' projects.

The increase in sales in the EMEA market, in dollars, in the first quarter of fiscal 2009, compared to the same period last year, is a result of our continued strategy from the last few years to aggressively develop this market in the past several years, to consistently invest in sales resources, and to develop stronger support and service operations in this region. In addition, many Tier-1 carriers in EMEA are migrating their traditional circuit-switched core networks to higher-speed, dense wavelength-division multiplexing (DWDM) and next-generation packet-based architectures, which is creating a market demand for our protocol test solutions as well as our DWDM, ROADM and fiber characterization test kits. Furthermore, we are leveraging our FTTx leadership gained in the United States to provide consultancy with many of the early adopters in this field in EMEA.

In the APAC market, we are seeing the continued return on investment of some specific optical, protocol as well as life sciences and industrial products developed and targeted for this important market. This increasingly competitive range, coupled with our steadily expanding market presence, is responsible for the higher sales in this region in the first quarter of fiscal 2009, compared to the same period last year.

Through our two divisions, we sell our products to a broad range of customers, including network service providers, network equipment manufacturers, wireless operators, cable TV operators, optical system and component manufacturers, as well as customers in the life sciences and high-precision assembly sectors. In the first quarter of fiscal 2009, no customer accounted for more than 10% of our global sales, and our top three customers accounted for 10.4% of our global sales. In the corresponding period last year our top customer accounted for 11.3% (\$4.6 million) of our global sales, and our top three customers accounted for 16.5% of our global sales.

GROSS MARGIN

Gross margin reached 62.3% of sales for the three months ended November 30, 2008, compared to 55.7% for the same period last year.

In the first quarter of fiscal 2009, gross margin reached its highest level since the second quarter of fiscal 2001. The increase in our gross margin in the first quarter of fiscal 2009, compared to the same period last year, can be explained by the following factors.

First, the impact of the fluctuations in the value of the Canadian dollar compared to the US dollar was twofold in the first quarter of fiscal 2009. Indeed, over the last several quarters, our procurement costs decreased as the Canadian dollar strengthened compared to the US dollar and as a significant portion of our raw material purchases is denominated in US dollars. This allowed us to improve our gross margin continually over the last quarters, as our raw material costs of parts purchased in US dollar are measured in Canadian dollar in our financial statements. In addition, the sudden decrease in the value of the Canadian dollar versus the US dollar resulted in a lower cost of goods sold expressed in US dollars in the statements of earnings. However, the increase of our procurement cost of raw materials purchased in US dollars, as a result of the sudden and recent decrease in the value of the Canadian dollar compared to the US dollar, will be seen in the next quarters, as these raw materials will be included in the cost of goods sold of products manufactured with these parts.

Secondly, in the first quarter of fiscal 2009, our gross margin was positively affected by the significant increase in sales of our protocol test solutions year-over-year, including those of Brix Networks and Navtel Communications, as these products have better margins than our other test solutions. Sales of protocol test solutions reached their highest level in the first quarter of fiscal 2009.

In addition, the significant increase in global sales year-over-year resulted in an increase in manufacturing activities, allowing us to better absorb our fixed manufacturing costs.

Finally, the operation of our manufacturing facility in China resulted in a larger portion of our sales coming from products manufactured in China; those products have a lower cost of goods than those manufactured in our facilities in Canada, thus resulting in an improvement in gross margin year-over-year.

Considering the expected sales growth in fiscal 2009, the expected increase in sales of protocol products and the full contribution of Brix Networks and Navtel Communications (which tend to generate higher margins), the cost-effective design of our products, our manufacturing activities in China and our tight control on operating costs, we expect our gross margin to improve in the future. However, our gross margin may fluctuate quarter-over-quarter as our sales may fluctuate. Furthermore, our gross margin can be negatively affected by increased competitive pricing pressure, customer concentration and/or consolidation, increased obsolescence costs, shifts in customer and product mix, under-absorption of fixed manufacturing costs, challenges encountered in the operation of our manufacturing facility in China and increases in product offerings by other suppliers in our industry. Finally, any increase in the strength of the Canadian dollar, compared to the US dollar, would have a negative impact on our gross margin in fiscal 2009 and beyond.

SELLING AND ADMINISTRATIVE

For the three months ended November 30, 2008, selling and administrative expenses were \$17.1 million, or 36.9% of sales, compared to \$14.8 million, or 36.2% of sales for the same period last year.

Brix Networks and Navtel Communications, which were acquired in the third quarter of fiscal 2008, contributed for the whole period to our selling and administrative expenses in the first quarter of fiscal 2009, which caused these expenses to increase compared to the same period last year. In addition, selling expenses for Brix Networks and Navtel Communications tend to be higher in percentage of sales than the rest of the business, as their sales cycle is much longer and complex than our other product lines.

In addition, during the first quarter of fiscal 2009, we continued intensifying our sales and marketing activities to develop our markets and leverage our significant research and development investments; this resulted in higher sales and marketing expenditures (including additional employees and expenses to support the launch of several new products and to increase brand name recognition), compared to the corresponding period last year.

However, during the first quarter of fiscal 2009, the substantial and sudden decrease in the average value of the Canadian dollar compared to the US dollar had a significant positive impact on our selling and administrative expenses, since a significant portion of these expenses are denominated in Canadian dollars and since these expenses increased year-over-year as our sales grew.

Also, during the first quarter of fiscal 2008, we discontinued certain product lines, which led to the lay-off of some of our sales and marketing personnel, resulting in severance expenses during that period.

For fiscal 2009, considering the expected increase in sales and the significant impact of the acquisitions of Brix Networks and Navtel Communications on our selling and administrative expenses—whose selling expenses tend to be higher, as their products deliver better margins compared to the rest of our product lines—we expect our selling and administrative expenses to increase in dollars and range between 32% and 34%. In particular, in fiscal 2009, we expect our commission expenses to increase as sales volume increases. Furthermore, considering our goal of becoming the leading player in the telecom test, measurement and monitoring space, we plan to continue intensifying our sales and marketing efforts, both domestic and international, which will also cause our expenses to rise. Finally, any increase in the strength of the Canadian dollar would also cause our selling and administrative expenses to increase, as a significant portion of these expenses are incurred in Canadian dollars.

RESEARCH AND DEVELOPMENT

Gross research and development expenses

For the three months ended November 30, 2008, gross research and development expenses totalled \$8.6 million, or 18.6% of sales, compared to \$7.5 million, or 18.3% of sales for the same period last year.

Brix Networks and Navtel Communications, which were acquired in the third quarter of fiscal 2008, contributed for the whole period to our gross research and development expenses in the first quarter of fiscal 2009, which caused these expenses to increase compared to the same period last year. In addition, Brix Networks and Navtel Communications tend to incur a higher percentage of sales for research and development expenses compared to our other product lines as their products are more software-intensive, although they deliver higher margins than most of our other product lines.

In addition, we intensified our research and development activities, namely in our software development center in Pune, India, which resulted in increased gross research and development expenses in the first quarter of fiscal 2009, compared to the same period last year.

However, during the first quarter of fiscal 2009, the significant and rapid decrease in the average value of the Canadian dollar compared to the US dollar also had a substantial positive effect on our gross research and development expenses as an important portion of these expenses are denominated in Canadian dollars and also because these expenses increased year-over-year.

Also, in the first quarter of fiscal 2008, we closed down our R&D operations in Budapest, Hungary, and certain R&D projects, which resulted in severance expenses during that period.

Tax credits

For the three months ended November 30, 2008, tax credits from the Canadian federal and provincial governments for research and development activities were \$1.4 million, or 16.2% of gross research and development expenses, compared to \$1.5 million, or 19.7% of gross research and development expenses for the same period last year.

All our research and development tax credits are denominated in Canadian dollars. The significant and sudden decrease in the value of the Canadian dollar compared to the US dollar during the first quarter of fiscal 2009 had a negative impact on these tax credits expressed in US dollars.

However, that decrease in tax credits was offset in part by increased research and development activities in Canada where we are eligible to tax credits.

The decrease in research and development tax credits as a percentage of gross research and development expenses is mainly due to the fact that the portion of gross research and development incurred in Canada, where we are entitled to tax credits, was lower than last year following the establishment of our new software development center in India as well as the acquisition of Brix Networks, which is located in the United States. Our research and development activities conducted outside Canada do not entitle us to tax credits.

For fiscal 2009, we expect that our net research and development expenses will increase in dollars, and range between 14% and 16% of sales, given our focus on innovation, the addition of Brix Networks and Navtel Communications, whose products are software-intensive, the addition of software features in our products, our desire to gain market share and our goal to exceed customer expectations. Also, we are increasingly taking advantage of talent pools around the world with the establishment of a research and development center focused on software development in Pune, India. Finally, any increase in the strength of the Canadian dollar in the upcoming quarters would cause our net research and development expenses to increase, as a significant portion of these are incurred in Canadian dollars.

AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT

For the three months ended November 30, 2008, amortization of property, plant and equipment was \$1.2 million, compared to \$976,000 for the same period last year.

The recent startup of our own manufacturing and research and development facilities in China and India, the upgrade of our IT systems, and the impact of the acquisition of Brix Networks and Navtel Communications in the third quarter of fiscal 2008 resulted in an increase in our amortization expenses in the first quarter of fiscal 2009, compared to the same period last year. However, the significant decrease in the average value of the Canadian dollar versus the US dollar in the first quarter of fiscal 2009, compared to the same period last year, limited the increase in our amortization expenses year-over-year as a significant portion of these expenses are denominated in Canadian dollars.

AMORTIZATION OF INTANGIBLE ASSETS

In conjunction with the business combinations we completed over the past several years, we recorded intangible assets, primarily consisting of core technology. These intangible assets resulted in amortization expense of \$1.3 million during the first quarter of fiscal 2009, compared to \$734,000 for the same period last year.

The increase in amortization expenses in the first quarter of fiscal 2009, compared to the same period last year, is mainly due to the acquisition of Brix Networks core technology in the third quarter of 2008.

INTEREST INCOME

Our interest income mainly resulted from our short-term investments, less interests and bank charges. For the three months ended November 30, 2008, interest income amounted to \$466,000, compared to \$1.5 million for the same period last year.

The decrease in interest income in the first quarter of fiscal 2009, compared to the same period last year, is mainly due to the decrease of our cash and short-term investments following the cash payment of \$41.0 million for the acquisitions of Brix Networks and Navtel Communications in the third quarter of fiscal 2008, the redemption of share capital for \$8.5 million over the last 12 months, in accordance with our share buy-back program as well as the general reduction in interest rates year-over-year. In addition, the significant decrease in the average value of the Canadian dollar, compared to the US dollar year-over-year, contributed to the decrease in our interest income in the first quarter of fiscal 2009, compared to the same period last year, as it is denominated in Canadian dollars.

FOREIGN EXCHANGE GAIN (LOSS)

Foreign exchange gains and losses are mainly the result of the translation of operating activities denominated in currencies other than the Canadian dollar.

For the three months ended November 30, 2008, the foreign exchange gain amounted to \$4.6 million compared to a foreign exchange loss of \$616,000 for the same period last year.

During the first quarter of fiscal 2009, the value of the Canadian dollar significantly and rapidly decreased versus the US dollar compared to the previous quarter, which resulted in a foreign exchange gain in the first quarter of fiscal 2009. In fact, the period-end value of the Canadian dollar decreased 14.1% to CA\$1.2372 = US\$1.00 in the first quarter of fiscal 2009, compared to CA\$1.0626 = US\$1.00 at the end of the previous quarter. This represents the largest quarterly change in the value of the Canadian dollar compared to the US dollar in the history of the company. We also have to consider that the volume of operations denominated in foreign currency increased year-over-year, further increasing the exchange gain compared to the same period last year.

On the other hand, during the first quarter of fiscal 2008, the value of the Canadian dollar significantly and rapidly increased versus the US dollar compared to the previous quarter, which resulted in a significant foreign exchange loss in the first quarter of fiscal 2008. In fact, the period-end value of the Canadian dollar increased 5.6% to CA\$1.0008 = US\$1.00 in the first quarter of fiscal 2008, compared to CA\$1.0564 = US\$1.00 at the end of the previous quarter.

It should be noted that foreign exchange rate fluctuations also flow through the P&L line items as a significant portion of our operating items are denominated in Canadian dollars, and we report our results in US dollars. Consequently, the significant decrease in the average value of the Canadian dollar in the first quarter of fiscal 2009, compared to the same period last year, resulted in a significant and positive impact on our financial results. This was amplified by the fact that our operating activities incurred in Canadian dollars increased year-over-year. In fact, the average value of the Canadian dollar in the first quarter of fiscal 2009 was CA\$1.1501 = US\$1.00 versus CA\$0.9901 = US\$1.00 for the same period last year, representing a decrease of 13.9% in the average value of the Canadian dollar year-over-year.

We manage our exposure to currency risks with forward exchange contracts. In addition, some of our Canadian entities' operating activities are denominated in US dollars or other currencies, which further hedges these risks. However, any increase in the value of the Canadian dollar, compared to the US dollar, would have a negative impact on our operating results.

INCOME TAXES

For the three months ended November 30, 2008, our income tax expense totaled \$1.8 million compared to \$1.3 million for the same period last year.

For the three months ended November 30, 2008, we reported income tax expenses of \$1.8 million on earnings before income taxes of \$7.1 million, for an effective income tax rate of 25.8%. Our combined Canadian and provincial statutory tax rate is 31%. This situation mainly results from the fact that a significant portion of our foreign exchange gain is created by the translation of financial statements of our foreign integrated subsidiaries, and is therefore non-taxable. On the other hand, we continue to maintain a valuation allowance for some of our subsidiaries at loss and we have some non-deductible expenses, such as stock-based compensation costs. Otherwise, the actual tax rate would have been closer to the statutory tax rate.

For the three months ended November 30, 2007, we reported income tax expenses of \$1.3 million on earnings before income taxes of \$1.2 million, for an effective income tax rate of 108%. This unusual situation mainly resulted from the fact that some expenses were non-deductible for tax purposes (mainly stock-based compensation expenses and foreign exchange losses created by the translation of financial statements of our foreign integrated subsidiaries) and the fact that we continue to maintain a valuation allowance for some of our subsidiaries at loss. In addition, we recorded income tax expenses for minimum taxes payable in certain tax jurisdictions, which taxes are not related to pre-tax earnings. Otherwise, the actual tax rate would have been closer to the statutory tax rate.

Please refer to note 10 to our interim consolidated financial statements for details on income taxes and a full reconciliation of the income tax provision.

LIQUIDITY AND CAPITAL RESOURCES

Cash requirements and capital resources

As at November 30, 2008, cash and short-term investments totalled \$71.4 million, while our working capital was at \$124.8 million. Our cash and short-term investments decreased \$16.2 million in the first quarter of fiscal 2009, compared to the previous quarter, mainly due to the significant decrease in the value of the Canadian dollar compared to the US dollar. Indeed, we recorded an unrealized foreign exchange loss on our cash and short-term investments of \$11.6 million. This unrealized foreign exchange loss resulted from the translation, in US dollars, of our Canadian-dollar-denominated cash and short-term investments and was included in the accumulated other comprehensive income in the balance sheet. In addition, we paid \$1.5 million and \$447,000 for the purchases of capital assets and the redemption of share capital, respectively. Finally, operating activities used cash flows of \$2.7 million.

Our short-term investments consist of commercial paper issued by 13 (ten as at August 31, 2008) high-credit quality corporations and trusts; therefore, we consider the risk of non-performance of these financial instruments to be limited. None of these debt instruments are expected to be affected by a liquidity risk, and none of them represent asset-backed commercial paper. For the purposes of managing our cash position, we have established a cash management policy, which we follow and monitor on a regular basis. These short-term investments will be used for working capital and other general corporate purposes, including other potential acquisitions and our share repurchase programs.

We believe that our cash balances and short-term investments will be sufficient to meet our liquidity and capital requirements for the foreseeable future, including the cash contingent consideration payable for the acquisition of Brix Networks, the cash payment of CA\$30 million (US\$25.1 million) required in December 2008 under our substantial issuer bid, and the effect of our normal course issuer bid. In addition to these assets, we have unused available lines of credit totaling \$9.5 million for working capital and other general corporate purposes and unused lines of credit of \$10.2 million for foreign currency exposure related to forward exchange contracts. However, possible operating losses and/or possible investments in or acquisitions of complementary businesses, products or technologies may require additional financing. There can be no assurance that additional debt or equity financing will be available when required or, if available, that it can be secured on satisfactory terms.

Sources and uses of cash

We finance our operations and meet our capital expenditure requirements mainly through cash flows from operating activities, the use of our cash and short-term investments as well as the issuance of subordinate voting shares.

Operating activities

Cash flows used by operating activities were \$2.7 million for the three months ended November 30, 2008, compared to \$2.4 million for the same period last year.

Cash flows used by operating activities in the first quarter of fiscal 2009 were mainly attributable to the net earnings after items not affecting cash of \$7.3 million, offset by the negative net change in non-cash operating items of \$10.0 million mainly due to the negative effect on cash of the increase of \$7.3 million in our accounts receivable (due to timing of sales, as sales mainly occurred at the end of the quarter), the increase of \$696,000 in our income taxes and tax credits recoverable (mainly tax credits earned during the quarter and not yet recovered), the increase of \$542,000 in our prepaid expenses (fees paid for the substantial issuer bid), and the decrease of \$1.1 million in our accounts payable and accrued liabilities, mainly due to timing of purchases and payments.

Cash flows used by operating activities in the first quarter of fiscal 2008 were mainly attributable to the net earnings after items not affecting cash of \$3.3 million, offset by the negative net change in non-cash operating items of \$5.7 million mainly due to the negative effect on cash of the increase of \$458,000 in our income taxes and tax credits recoverable (mainly tax credits earned during the quarter and not yet recovered), the increase of \$612,000 in our prepaid expenses, and the decrease of \$5.7 million in our accounts payable and accrued liabilities, mainly due to timing of purchases and payments. The decrease of \$1.2 million in our accounts receivable (timing and sequential decrease of sales) offset in part these negative effects on cash.

Investing activities

Cash flows provided by investing activities were \$3.0 million for the three months ended November 30, 2008, compared to \$1.5 million for the same period last year. In the first quarter of fiscal 2009, we disposed (net of acquisitions) of \$4.5 million worth of short-term investments but paid \$1.5 million for the purchase of capital assets. For the corresponding period last year, we disposed (net of acquisitions) \$3.1 million worth of short-term investments and paid \$1.6 million for the purchase of capital assets.

Financing activities

Cash flows used by financing activities were \$421,000 for the three months ended November 30, 2008, compared to cash flows provided by financing activities of \$525,000 for the same period last year. During the first quarter of fiscal 2009, we paid \$447,000 for the redemption of share capital under our normal course issuer bid program and received \$26,000 from the exercise of stock options. For the corresponding period last year, cash flows provided by financing activities were due to changes in bank loan of \$699,000, offset by the cash payment of \$174,000 for the redemption of share capital under our normal course issuer bid program.

FORWARD EXCHANGE CONTRACTS

We utilize forward exchange contracts to manage our foreign currency exposure. Our policy is not to utilize those derivative financial instruments for trading or speculative purposes.

Our forward exchange contracts, which are used to hedge anticipated US-dollar-denominated sales, qualify for hedge accounting; therefore, foreign exchange translation gains and losses on these contracts are recognized as an adjustment of the revenues when the corresponding sales are recorded.

As at November 30, 2008, we held forward exchange contracts to sell US dollars at various forward rates, which are summarized as follows:

Expiry dates	Contractual amounts	Weighted average contractual forward rates
December 2008 to August 2009	\$ 28,300,000	1.0616
September 2009 to August 2010	24,200,000	1.0760
September 2010 to August 2011	14,600,000	1.1221
September 2011	1,000,000	1.1278
Total	\$ 68,100,000	1.0807

The fair value of forward exchange contracts, which represents the amount that the company would receive or pay to settle the contracts based on the forward exchange rate at period end, amounted to net gains of \$62,000 as at August 31, 2008 and net losses of \$8.0 million as at November 30, 2008, following the significant decrease in the value of the Canadian dollar compared to the US dollar during the quarter.

CONTINGENCY

On November 27, 2001, a class-action suit was filed in the United States District Court for the Southern District of New York against EXFO, four of the underwriters of our Initial Public Offering and some of our 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 EXFO'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 EXFO's Initial Public Offering; and (ii) the underwriters allegedly entering into agreements with customers whereby shares issued in connection with EXFO'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 predetermined prices.

On April 19, 2002, the plaintiffs filed an amended complaint containing master allegations against all of the defendants in all of the 310 cases included in this class action and also filed an amended complaint containing allegations specific to four of EXFO's underwriters, EXFO and two of our 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 EXFO and our two executive officers in particular, the amended complaint alleges that (i) EXFO'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 EXFO'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 EXFO, controlled it 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 and a decision was rendered on February 19, 2003. Only one of the claims against EXFO was dismissed. On October 8, 2002, the claims against its officers were dismissed pursuant to the terms of Reservation of Rights and Tolling Agreements entered into with the plaintiffs.

In June 2004, an agreement of partial settlement was submitted to the court for preliminary approval. The proposed partial settlement was between the plaintiffs, the issuer defendants in the consolidated actions, the issuer officers and directors named as defendants, and the issuers' insurance companies. The court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005, the court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The court also appointed the notice administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members by January 15, 2006. The settlement fairness hearing occurred on April 24, 2006, and the court reserved decision at that time.

While the partial settlement was pending approval, the plaintiffs continued to litigate against the underwriter defendants. The district court directed that the litigation proceed within a number of "focus cases" rather than in all of the 310 cases that have been consolidated. EXFO's case is not one of these focus cases. On October 13, 2004, the district court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the district court's class certification decision.

On April 6, 2007, the Second Circuit denied the plaintiffs' petition for rehearing of that decision and, on May 18, 2007, the Second Circuit denied the plaintiffs' petition for rehearing *en banc*. In light of the Second Circuit's opinion, liaison counsel for all issuer defendants, including EXFO, informed the court that this settlement could not be approved, because the defined settlement class, like the litigation class, could not be certified. On June 25, 2007, the district court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and, on September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the district court denied the motions to dismiss, except as to Section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside of the previously certified class period. Briefing on the class certification motion was completed in May 2008. That motion was withdrawn without prejudice on October 10, 2008.

Due to the inherent uncertainties of litigation, the final outcome of the case is uncertain and it is not possible to determine the amount of any possible losses. We will continue to defend our position in this litigation that the claims against EXFO, and our officers, are without merit. Accordingly, no provision for this case has been made in the interim consolidated financial statements as at November 30, 2008.

SHARE CAPITAL AND STOCK-BASED COMPENSATION PLANS

Share capital

As at January 8, 2009, EXFO had 36,643,000 multiple voting shares outstanding, entitling to ten votes each and 22,930,178 subordinate voting shares outstanding. The multiple voting shares and the subordinate voting shares are unlimited as to number and without par value. On December 18, 2008, we redeemed 7.7 million subordinated voting shares for a total consideration of CA\$30 million, plus related fees, based on our substantial issuer bid program.

Long-Term Incentive Plan and Deferred Share Unit Plan

The aggregate number of subordinate voting shares covered by stock options, restricted share units (RSUs) and deferred share units (DSUs) granted under the Long-Term Incentive Plan and the Deferred Share Unit Plan was 3,112,200 as at November 30, 2008. The maximum number of subordinate voting shares issuable under these two plans cannot exceed 6,306,153 shares. The following tables summarize information about stock options, RSUs and DSUs granted to the members of the Board of Directors and to Management and Corporate Officers of the company and its subsidiaries as at November 30, 2008:

Stock Options	Number	% of issued and outstanding	Weighted average exercise price
Chairman of the Board, President and CEO (one individual)	179,642	10%	\$9.05
Board of Directors (four individuals)	148,807	8%	\$6.19
Management and Corporate Officers (eight individuals)	212,139	12%	\$14.49
	540,588	30%	\$10.40
		% of issued and outstanding	
Restricted Share Units (RSUs)	Number		
Chairman of the Board, President and CEO (one individual)	150,714	12%	
Management and Corporate Officers (eleven individuals)	525,084	43%	
	675,798	56%	

Deferred Share Units (DSUs)	<u>Number</u>	<u>% of issued and outstanding</u>
Board of Directors (five individuals)	<u>90,517</u>	<u>100%</u>

OFF-BALANCE SHEET ARRANGEMENTS

As at November 30, 2008, our off-balance sheet arrangements consisted of letters of guarantee. As at November 30, 2008, our letters of guarantee amounted to \$5.4 million; these letters of guarantee expire at various dates through fiscal 2011. From this amount, we had \$1.1 million worth of letters of guarantee for our own selling and purchase requirements, which were reserved from one of our lines of credit. The remainder in the amount of \$4.3 million was used to secure our line of credit in Chinese currency. This line of credit was unused as at November 30, 2008. This \$4.3 million letter of guarantee is secured by short-term investments.

VARIABLE INTEREST ENTITY

As of November 30, 2008, we did not have interests in any variable interest entities.

RISKS AND UNCERTAINTIES

Over the past several years, we have managed our business in a difficult environment; focused on research and development programs for new and innovative products aimed at expected growth pockets in our sector; continued the development of our domestic and international markets; and made strategic acquisitions. However, we operate in a highly competitive sector 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.

We are exposed to currency risks due to the export of our Canadian-manufactured products, the large majority of which are denominated in US dollars. These risks are partially hedged by operating expenses denominated in US dollars and forward exchange contracts. The increased strength of the Canadian dollar, compared to the US dollar, over the last few years, has caused our operating expenses to increase significantly. Any further increase in the value of the Canadian dollar in the coming months would negatively affect our results of operations.

In addition, risks and uncertainties related to the telecommunications test, measurement and monitoring industry involve the rapid development of new products that may have short life cycles and require extensive research and development; the difficulty of adequately predicting market size and trends; the difficulty of retaining highly skilled employees; and the ability to quickly adapt our cost structure to changing market conditions in order to achieve profitability.

Furthermore, given our strategic goals for growth and competitive positioning in our industry, we are continuously expanding into international markets, including our manufacturing facilities in China and our software development center in India. This exposes us to certain risks and uncertainties, namely changes in local laws and regulations, multiple technological standards, protective legislation, pricing pressure, cultural differences and the management of operations in China and India.

Also, while strategic acquisitions, like those we have made in the past, those closed in fiscal 2008 and possibly others in the future, 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 businesses as well as their products, technologies and personnel. Finally, integration requires the dedication of management resources, which may detract their attention from our day-to-day business and operations.

Our business is subject to the effects of general economic conditions in North America and throughout the world and, more particularly, market conditions in the telecommunications industry. In the past, our operating results were adversely affected by reduced telecom capital spending in North America, Europe and Asia and by general unfavorable economic conditions. In particular, sales to network service providers in North America were significantly and adversely affected by a downturn in 2001 in the telecommunications industry. With a recession or slowdown in key geographic regions or markets, we may experience a material adverse impact on our business, operating results and financial condition.

The economic environment of 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, short-term investments and forward exchange contracts. Our short-term investments consist of debt instruments issued by high-credit quality corporations and trusts. Our cash 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 limited.

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 at www.EXFO.com or www.sedar.com in Canada or www.sec.gov/edgar.shtml in the U.S.

Non-GAAP financial measure

We provide a non-GAAP financial measure (EBITDA*) as supplemental information regarding our operational performance. We use EBITDA for the purposes of evaluating our historical and prospective financial performance, as well as our performance relative to our competitors. This measure also helps us to plan and forecast future periods as well as to make operational and strategic decisions. We believe that providing this information to our investors, in addition to the GAAP measures, allows them to see the company's results through the eyes of management, and to better understand our historical and future financial performance.

The presentation of this additional information is not prepared in accordance with GAAP. Therefore, the information may not necessarily be comparable to that of other companies and should be considered as a supplement to, not a substitute for, the corresponding measures calculated in accordance with GAAP.

The following table summarizes the reconciliation of EBITDA to GAAP net earnings (loss):

	Three months ended November 30,	
	2008	2007
GAAP net earnings (loss) for the period	\$ 5,287	\$ (93)
Add (deduct):		
Amortization of property, plant and equipment	1,159	976
Amortization of intangible assets	1,319	734
Interest income	(466)	(1,483)
Income taxes	1,840	1,262
EBITDA for the period	<u>\$ 9,139</u>	<u>\$ 1,396</u>
EBITDA in percentage of sales	<u>19.7 %</u>	<u>3.4 %</u>

* EBITDA is defined as net earnings (loss) before interest, income taxes, amortization of property, plant and equipment and amortization of intangible assets.