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 service assurance 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 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 March 27, 2009.

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

INDUSTRY OVERVIEW

The fundamental drivers for increased bandwidth and converged, IP networks in the global telecommunications industry remain the same, but they are now combined with more constraints for capital expenditures and a more pressing need to reduce operating expenses, as operators are typically seeing a reduction in the number of wireline connections, as some consumers are transferring to wireless only. In addition, as the global economic turbulence continues, it has negatively affected a number of network operators and network equipment manufacturers (NEMs), especially in the United States and Western Europe. In fact, several of these players have announced significant reductions in capital expenditures and staffing levels for calendar year 2009 in anticipation of lower revenue streams.

Despite this challenging macro-economic environment, it should be noted that telecom market dynamics in 2009 are completely different from those permeating the industry downturn in 2001. First of all, there is currently a myriad of bandwidth-intensive applications generating a strong growth in bandwidth demand both in wireless and wireline networks. As an example, monthly traffic is now at the exabyte level (1 exabyte equals 1 quintillion bytes) in 2009, while in 2001, there were few applications outside of regular e-mail delivery. Secondly, the ongoing demand for bandwidth has placed an obvious strain on access, metro rings and long-haul routes, whereas in 2001, there was an overabundance of bandwidth capacity in the optical backbone networks. Finally, most network operators are in a better financial position today than in 2001, when many of them were financially overextended, with some declaring outright bankruptcy.

Notwithstanding these market discrepancies, the intense competition between telecom network operators and cable companies and the benefits of converged IP networks (new services attracting higher-margin revenues while reducing operating costs) are further reasons operators will likely continue investing in broadband deployments and IP convergence.

According to Cisco's Visual Networking Index, global IP traffic will nearly double every two years (compound annual growth rate of 46%) from 2007-2012, reaching just under 44 exabytes per month in 2012. Global bandwidth demand is driven by a wide range of applications including peer-to-peer file sharing, Internet gaming as well as various forms of IP video. For example, YouTube consumed more bandwidth in 2008 than traffic crossing the entire US network backbone in 2000, according to Cisco. Social Networking applications like Facebook and others are also huge drivers for the increasing bandwidth needed in modern networks.

This trend will likely remain strong for 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 consume colossal amounts of bandwidth. As a result, telecom operators and cable companies will likely maintain significant investments in their access networks in order to remain competitive and provide differentiated, revenue-generating services so as 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 that fiber-to-the-home (FTTH) is becoming the access network architecture of choice for network operators. This architecture 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. 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 being developed aggressively despite the difficult economic environment, The early stages of 100 Gbit/s Ethernet field trials should start later this calendar year, conducted by a select few operators. In the long run, 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, did not have the payload flexibility to seamlessly and efficiently mix and transport video with voice and data. These networks will not be capable of efficiently carrying these emerging IP-based services as they are designed for public switched telephone network (PSTN), point-to-point voice transmission only. As a result, new-generation OTN standards have been defined and are at the very foundation 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 affected telecom test and service assurance suppliers in the second quarter of fiscal 2009. On the other hand, the global recession mainly afflicting customers in the United States and Western Europe could potentially delay network investments and necessarily reduce demand for our test and service assurance solutions.

COMPANY OVERVIEW

We reported sales of $46.4 million in the second quarter of fiscal 2009, which represented an increase of 7.1% year-over-year. We also reported net accepted orders of $47.3 million in the second quarter of fiscal 2009 for a book-to-bill ratio of 1.02. Total sales for the second quarter of fiscal 2009 included $9.2 million from newly acquired Brix Networks Inc. and Navtel Communications Inc.

Looking at the bottom line, we generated GAAP net earnings of $2.7 million, or $0.04 per diluted share, in the second quarter of fiscal 2009, compared to $4.0 million, or $0.06 per share, for the same period last year. Net earnings for the second quarter of fiscal 2009 were positively and significantly affected by the weaker value of the Canadian dollar, compared to the US dollar. During the second quarter of fiscal 2009, we reported a foreign exchange gain of $1.1 million, compared to a foreign exchange loss of $232,000 for the same period last year. Net earnings in the second quarter of 2009 included charges of $1.4 million for stock-based compensation costs and the after-tax amortization expense for intangible assets. EBITDA (earnings before interest, income taxes, depreciation and amortization) reached $6.0 million, or 12.9% of sales in the second quarter of fiscal 2009, compared to $5.1 million, or 11.8% of sales for the same period last year (see further in this document for a complete reconciliation of EBITDA to GAAP net earnings).

During the first half of fiscal 2009, we recorded a significant foreign exchange gain of $5.7 million, which mostly comes from the first quarter of 2009, when we recorded a foreign exchange gain of $4.6 million. Indeed, 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; this had a two-fold positive impact on our financial results. First, in the first quarter of fiscal 2009, the $4.6 million foreign exchange gain represented the effect of the 14.1% decrease (compared to August 31, 2008) in the period-end value of the Canadian dollar versus the US dollar on our balance sheet items. During the second quarter of 2009, we witnessed more stability in the period-end value of the Canadian dollar, compared to the previous quarter (decrease of 2.6%), which resulted in a foreign exchange gain of $1.1 million. Secondly, the average value of the Canadian dollar decreased 13.9% in the first quarter of fiscal 2009, and 18.4% in the second quarter of fiscal 2009 compared to the corresponding periods 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 (measured in Canadian dollars) were reduced when translated in US dollars for reporting purposes. In comparison, we reported a foreign exchange loss of $232,000 and $848,000 for the second quarter and the first half of fiscal 2008. During these periods, the value of the Canadian dollar increased 2.1% and 7.8%, respectively, compared to the US, which resulted in foreign exchange losses during these periods.

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 subordinate voting shares for an aggregate purchase price not to exceed CA$30 million. On December 18, 2008, pursuant to the Offer, we purchased for cancellation 7,7 million subordinate voting shares for the aggregate purchase price of CA$30 million (US$24.9 million), plus related fees of $576,000. We used cash and short-term investments to fund the purchase of shares.

During the second quarter of fiscal 2009, EXFO closed the acquisition of Swedish-based PicoSolve Inc., a supplier of ultra-high-speed optical sampling oscilloscopes for 40G and 100G R&D, manufacturing and deployment applications.

During the second quarter of 2009, we launched seven new products, namely a ground-breaking distributed PMD analyzer that allows network operators to quantify the level of potentially debilitating PMD on each fiber section of a network instead of an entire link. As a result, network operators can cost-effectively upgrade their networks to 40 Gbit/s or even 100 Gbit/s by identifying and repairing only the affected sections of their networks, rather than overhauling their entire systems. Other notable product launches included a new software suite for packet-over-optical transport network (OTN) test applications in next-generation, IP networks; a new software suite for end-to-end testing of Internet Protocol Multimedia Subsystem (IMS) networks; and a new passive optical network (PON) power meter for fiber-to-the-home (FTTH) test applications. Following the quarter-end, we released three additional products including a portable, multilayer platform (FTB-500) designed for high-end test applications in the field and central office. Sales from products that have been on the market two years or less represented 41% of total sales in the second quarter of 2009 and 37% after six months.

Following the quarter-end, we were named recipient of the Growth Strategy Leadership Award by Frost & Sullivan for the fifth consecutive time. The award is presented to the company whose growth strategy generates the largest market-share gains in the global fiber-optic test equipment (FOTE) market during the previous research period. According to Frost & Sullivan, a leading global growth consulting firm, we captured first place overall in the FOTE market with a market share of 18.0% in 2008, up from third place in 2006 with a market share of 12.7%. (Frost & Sullivan did not grant an award in 2008 for market-share gains in 2007). Frost & Sullivan estimated the FOTE market to be $567.4 million in 2008, including $247.9 million for the portable installation and maintenance (I&M) test market. Based on Frost & Sullivan's market data, we improved our leadership position in the portable I&M test market from 25.5% in 2006 to 33.3% in 2008.

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.

In January 2009, the CICA issued Section 1582, “Business Combinations”, which replaces Section 1581, “Business Combinations”. This new section establishes the standards for the accounting of business combinations and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This standard applies prospectively to business combinations with acquisition dates on or after January 1, 2011; earlier adoption is permitted.

In January 2009, the CICA issued Section 1601, “Consolidated Financial Statements”, which replaces Section 1600, “Consolidated Financial Statements”, and establishes the standards for preparing consolidated financial statements. This new section applies to fiscal years beginning on or after January 1, 2011; earlier adoption is permitted. We are currently evaluating the impact, if any, that adopting this standard will have on our consolidated financial statements.

In January 2009, the CICA issued Section 1602, “Non-controlling Interests”, which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. This new section applies to fiscal years beginning on or after January 1, 2011; earlier adoption is permitted as of the beginning of a fiscal year.

Should we decide to early adopt one of these three new sections, we must adopt all three on the same date.

RESULTS OF OPERATIONS

The following discussion and analysis of our consolidated financial condition and results of operations for the periods ended February 29, 2008 and February 28, 2009, 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 February 28, 2009	**Three months ended February 29, 2008**	**Six months ended February 28, 2009**	**Six months ended February 29, 2008**
	(unaudited)		**(unaudited)**	
Sales	**$ 46,372**	$ 43,281	**$ 92,735**	$ 84,266
Cost of sales [(1)]	**18,353**	18,060	**35,833**	36,204
Gross margin	**28,019**	25,221	**56,902**	48,062
Operating expenses				
Selling and administrative	**15,800**	13,683	**32,891**	28,500
Net research and development	**7,325**	6,185	**14,546**	12,197
Amortization of property, plant and equipment	**1,049**	998	**2,208**	1,974
Amortization of intangible assets	**1,246**	720	**2,565**	1,454
Total operating expenses	**25,420**	21,586	**52,210**	44,125
Earnings from operations	**2,599**	3,635	**4,692**	3,937
Interest income	**175**	1,616	**641**	3,099
Foreign exchange gain (loss)	**1,090**	(232)	**5,658**	(848)
Earnings before income taxes	**3,864**	5,019	**10,991**	6,188
Income taxes [(2)]	**1,209**	995	**3,049**	2,257
Net earnings for the period	**$ 2,655**	$ 4,024	**$ 7,942**	$ 3,931
Basic and diluted net earnings per share	**$ 0.04**	$ 0.06	**$ 0.12**	$ 0.06
Segmented information:				
Sales:				
Telecom Division	**$ 41,367**	$ 37,435	**$ 82,526**	$ 72,800
Life Sciences and Industrial Division	**5,005**	5,846	**10,209**	11,466
	$ 46,372	$ 43,281	**$ 92,735**	$ 84,266
Earnings from operations:				
Telecom Division	**$ 2,117**	$ 2,817	**$ 3,472**	$ 2,838
Life Sciences and Industrial Division	**482**	818	**1,220**	1,099
	$ 2,599	$ 3,635	**$ 4,692**	$ 3,937
Research and development data:				
Gross research and development	**$ 8,791**	$ 7,575	**$ 17,403**	$ 15,061
Net research and development	**$ 7,325**	$ 6,185	**$ 14,546**	$ 12,197

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

(2) Include a one-time income tax expense of $1.5 million as a result of changes in Canadian federal enacted tax rates and an income tax recovery of $2.7 million as a result of changes of our tax strategy, for the three and the six months ended February 29, 2008.

	Three months ended February 28, 2009	Three months ended February 29, 2008	Six months ended February 28, 2009	Six months ended February 29, 2008
	(unaudited)		(unaudited)	
Sales	**100.0 %**	100.0 %	**100.0 %**	100.0 %
Cost of sales [(1)]	**39.6**	41.7	**38.6**	43.0
Gross margin	**60.4**	58.3	**61.4**	57.0
Operating expenses				
Selling and administrative	**34.1**	31.6	**35.5**	33.8
Net research and development	**15.8**	14.3	**15.7**	14.5
Amortization of property, plant and equipment	**2.2**	2.3	**2.4**	2.3
Amortization of intangible assets	**2.7**	1.7	**2.7**	1.7
Total operating expenses	**54.8**	49.9	**56.3**	52.3
Earnings from operations	**5.6**	8.4	**5.1**	4.7
Interest income	**0.4**	3.7	**0.7**	3.6
Foreign exchange gain (loss)	**2.3**	(0.5)	**6.1**	(1.0)
Earnings before income taxes	**8.3**	11.6	**11.9**	7.3
Income taxes [(2)]	**2.6**	2.3	**3.3**	2.6
Net earnings for the period	**5.7 %**	9.3 %	**8.6 %**	4.7 %
Segmented information:				
Sales:				
Telecom Division	**89.2 %**	86.5 %	**89.0 %**	86.4
Life Sciences and Industrial Division	**10.8**	13.5	**11.0**	13.6
	100.0 %	100.0 %	**100.0 %**	100.0 %
Earnings from operations:				
Telecom Division	**4.6 %**	6.5 %	**3.7 %**	3.4 %
Life Sciences and Industrial Division	**1.0**	1.9	**1.4**	1.3
	5.6 %	8.4 %	**5.1 %**	4.7 %
Research and development data:				
Gross research and development	**19.0 %**	17.5 %	**18.8 %**	17.9 %
Net research and development	**15.8 %**	14.3 %	**15.7 %**	14.5 %

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

(2) Include a one-time income tax expense of $1.5 million as a result of changes in Canadian federal enacted tax rates and an income tax recovery of $2.7 million as a result of changes of our tax strategy, for the three and the six months ended February 29, 2008.

SALES

For the three months ended February 28, 2009, our global sales increased 7.1% to $46.4 million from $43.3 million for the same period last year, with an 89%-11% split in favor of our Telecom Division.

For the six months ended February 28, 2009, our global sales increased 10.1% to $92.7 million from $84.3 million for the same period last year, with an 89%-11% split in favor of our Telecom Division.

Telecom Division

For the three months ended February 28, 2009, sales of our Telecom Division increased 10.5% to $41.4 million from $37.4 million for the same period last year.

For the six months ended February 28, 2009, sales of our Telecom Division increased 13.4% to $82.5 million from $72.8 million for the same period last year.

In the second quarter and the first half 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 $9.2 million and $13.8 million together for the second quarter and the first half of 2009, respectively. Sales of Brix Networks recognized in the second quarter of fiscal 2009 included a significant order shipped to a Tier-1 wireless North American operator; this order was for our converged service assurance solution, which provides real-time monitoring of the quality of voice-over-IP (VoIP) and IP multimedia subsystem (IMS) services over converged networks. Excluding sales of Brix Networks and Navtel Communications, our telecom sales would have decreased 14.1% and 5.5% organically year-over-year during these two periods, reflecting the impact of the global economic recession so far in fiscal 2009. During the second quarter of fiscal 2009, we posted record-high sales of protocol test solutions and, unsurprisingly, our protocol test solutions (which include Brix Network and Navtel Communications' sales) represented our fastest-growing product line. Also, they represented more than 40% of our telecom sales in the second quarter of fiscal 2009, for the first time in our history, which compares to more than 20% for the same period last year.

On the other hand, sales of optical test solutions and copper-access decreased during the second quarter and the first half of fiscal 2009, compared to the same periods last year. This mainly results from lower sales in the Americas, due to the global economic recession and its repercussions on our customers.

In addition, in the second quarter and the first half of fiscal 2009, foreign exchange losses on our forward exchange contracts, which are included in our telecom sales, amounted to $1.3 million and $1.5 million, respectively, compared to foreign exchange gains of $1.2 million and $2.5 million, respectively, for the same periods last year, significantly reducing our sales year-over-year. In fact, if we exclude the impact of the foreign exchange gains or losses on our foreign exchange contracts recorded in our sales, telecom sales would have increased 17.6% and 19.6% year-over-year in the second quarter and the first half of fiscal 2009, respectively, compared to the same periods last year. In the second quarter and first half of fiscal 2009, the average value of the Canadian dollar versus the US dollar decreased 18.4% and 16.2%, respectively, compared to the corresponding periods last year, which resulted in significant foreign exchange losses on our forward exchange contracts in fiscal 2009.

During the second quarter of fiscal 2009, our top customer represented 22.7% ($9.4 million) of our telecom sales, compared to 6.5% ($2.4 million) for the same period last year. They represented 13.4% ($11.0 million) of our telecom sales in the first half of fiscal 2009, compared to 9.7% ($7.0 million) for the same period last year. Excluding sales to this customer, our telecom sales would have decreased 8.7% in the second quarter of fiscal 2009 but increased 8.7% in the first half of fiscal 2009, compared to the corresponding periods last year. This shows that after six months into fiscal 2009, we were able to diversify our customer base.

Life Sciences and Industrial Division

For the three months ended February 28, 2009, sales of our Life Sciences and Industrial Division decreased $841,000, or 14.4% year-over-year at $5.0 million, compared to $5.8 million for the same period last year.

For the six months ended February 28, 2009, sales of our Life Sciences and Industrial Division decreased $1.3 million, or 11.0% year-over-year to $10.2 million, from $11.5 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 affected by the current state of the global economy.

Net bookings

Overall, for the two divisions, net accepted orders increased 6.3% year-over-year to $47.3 million in the second quarter of fiscal 2009 from $44.5 million for the same period last year, for a book-to-bill ratio of 1.02.

This increase in bookings year-over-year is due to significant order acceleration in our Protocol test segment, which includes newly acquired Brix Networks and Navtel Communications' product lines. However, the strong performance of our Protocol test segment in terms of bookings in the second quarter of fiscal 2009, compared to the same period last year, was offset in part by the impact of the current worldwide recession on our optical and copper-access business.

Geographic distribution

For the three months ended February 28, 2009, sales to the Americas, Europe, Middle East and Africa (EMEA) and Asia-Pacific (APAC) accounted for 60%, 25% and 15% of global sales, respectively. For the corresponding period last year, sales to the Americas, EMEA and APAC accounted for 51%, 34% and 15% of global sales, respectively. For the six months ended February 28, 2009, sales to the Americas, EMEA and APAC accounted for 58%, 26% and 16% of global sales, respectively. For the corresponding period last year, sales to the Americas, EMEA and APAC accounted for 54%, 29% and 16% of global sales, respectively.

In the second quarter of fiscal 2009, we reported year-over-year sales increases (in dollars) in the Americas and APAC. In fact, sales to these regions increased (in dollars) 25.7% and 5.1%, respectively. Sales to EMEA decreased (in dollars) 20.1% year-over-year. During the first half of fiscal 2009, we reported year-over-year sales increases (in dollars) in Americas and APAC. In fact sales to these regions increased (in dollars) 18.2% and 4.3%, respectively. Sales to EMEA decreased (in dollars) 1.8% year-over-year.

In the Americas, the increase in sales in the second quarter and the first half of fiscal 2009, compared to the same period last year, comes from Canada and the United States. In fact, we posted year-over-year sales growth of 69.6% and 24.2% in Canada and the United States, respectively during the second quarter of fiscal 2009 and 57.8% and 14.8%, respectively during the first half of fiscal 2009. The significant increase in sales in Canada in the second quarter and the first half of fiscal 2009, compared to the same periods last year, mainly comes from our optical and protocol test solutions, especially with Tier-1 NSPs. In the United States, the growth in sales in the second quarter and the first half of fiscal 2009, compared to the same periods last year, is mainly due to the contribution of newly acquired Brix Networks and Navtel Communications, as a large order from a Tier-1 North American wireless operator for Brix Networks solutions was recognized in the sales for the second quarter of fiscal 2009. The contribution of Brix Networks and Navtel Communications in the second quarter and the first half of fiscal 2009 mitigated the effect of the recession on our sales in the United States, mainly those of our optical and copper-access test solutions. Finally, sales to Latin America decreased (in dollars) 24.6% and 6.8% year-over-year in the second quarter and the first half of fiscal 2009, respectively, as sales to this region depend on the timing and scope of our customers' projects.

The decrease in sales in the EMEA market, in dollars, in the second quarter and the first half of fiscal 2009, compared to the same periods last year, is due to the impact of the global recession as we are seeing some caution from many of our customers with their new fiscal year budgets (calendar 2009) While we see this as a delay and a change in spending patterns, we expect that investments in next-generation access and transport networks will not be affected in the long term and we are positioning ourselves to capitalize on that, with recent additions to our product portfolio and sales strategy. In fact, 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. Also, as a portion of these orders in this region are denominated in Euros or British Pounds, the weakness of the US dollar against these currencies in the second quarter and for the first half of fiscal 2009, also had a negative impact on our sales expressed in US dollars for this region, which contributed to the decrease in sales compared to the corresponding periods last year.

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 second quarter and the first half of fiscal 2009, compared to the same periods 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 second quarter of fiscal 2009, our top customer accounted for 20.3% ($9.4 million) of our global sales, and our top three customers accounted for 29.2% of our global sales. In the corresponding period last year, no customer accounted for more than 10% of our global sales, and our top three customers accounted for 14.6% of our global sales. For the six months ended February 28, 2009, our top customer accounted for 11.9% ($11.0 million) of our global sales, and our top three customers accounted for 18.8% of our global sales. For the corresponding period last year, no customer accounted for more than 10% of our global sales, and our top three customers accounted for 14.8% of our global sales. In the second quarter and the first half of fiscal 2009,   our top customer placed a significant order to purchase a converged service assurance solution. Excluding this major sale, this customer would have represented less than 10% of our global sales for both periods.

GROSS MARGIN

Gross margin increased to 60.4% of sales for the three months ended February 28, 2009, from 58.3% for the same period last year.

Gross margin increased to 61.4% of sales for the six months ended February 28, 2009, compared to 57.0% for the same period last year.

The increase in our gross margin in the second quarter and the first half of fiscal 2009, compared to the same periods 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 two-fold in the second quarter and the first half of fiscal 2009. In fact, 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 are denominated in US dollars. This allowed us to improve our gross margin continually over the last few quarters, as our raw material costs of parts purchased in US dollar are measured in Canadian dollars in our financial statements. In addition, the sudden decrease in the value of the Canadian dollar, versus the US dollar, since the beginning of fiscal 2009 resulted in a lower cost of goods sold expressed in US dollars in the statements of earnings. However, the increase in the procurement costs of our 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, have begun to materialize and will continue to materialize over time, in line with the inventory turnover rate, as these raw materials are included in the cost of goods sold of products manufactured with these parts.

Secondly, in the second quarter and the first half 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 newly acquired 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 second quarter of fiscal 2009.

In addition, 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.

Also, the shift in the geographic distribution of our sales resulted in more sales to the Americas compared to Europe, Middle-East and Africa (EMEA) as well as Asia-Pacific (APAC) in the second quarter and the first half of fiscal 2009, versus the corresponding periods last year. This resulted in an improvement of the gross margin year-over-year since sales to the Americas tend to generate better margins than those in the EMEA and APAC regions.

Finally, foreign exchange losses on our forward exchange contracts, which are included in our telecom sales, had a negative impact on our margin in the second quarter and in the first half of fiscal 2009, while this impact was positive in the corresponding periods last 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 the effects of the actual worldwide recession, 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 February 28, 2009, selling and administrative expenses were $15.8 million, or 34.1% of sales, compared to $13.7 million, or 31.6% of sales for the same period last year.

For the six months ended February 28, 2009, selling and administrative expenses were $32.9 million, or 35.5% of sales, compared to $28.5 million, or 33.8% 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 periods to our selling and administrative expenses in the second quarter and the first half of fiscal 2009, which caused these expenses to increase compared to the same periods last year. In addition, selling expenses for Brix Networks and Navtel Communications tend to be higher in percentage of sales than the rest of our business, as their sales cycle is much longer and complex than our other product lines.

In addition, during the second quarter and the first half of fiscal 2009, we maintained 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 periods last year.

However, during the second quarter and the first half 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 is 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 the first half of fiscal 2008.

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 maintain our sales and marketing efforts, both domestic and international. 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 February 28, 2009, gross research and development expenses totalled $8.8 million, or 19.0% of sales, compared to $7.6 million, or 17.5% of sales for the same period last year.

For the six months ended February 28, 2009, gross research and development expenses totalled $17.4 million, or 18.8% of sales, compared to $15.1 million, or 17.9% of sales for the same period last year.

Brix Networks and Navtel Communications, which were acquired in the third quarter of fiscal 2008, contributed to our gross research and development expenses during the entire second quarter and the first half of fiscal 2009, which caused these expenses to increase, compared to the same periods 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 by hiring additional employees, namely in our software development center in Pune, India, which resulted in increased gross research and development expenses in the second quarter and the first half of fiscal 2009, compared to the same periods last year.

However, during the second quarter and the first half 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 the first half of fiscal 2009.

Tax credits

For the three months ended February 28, 2009, tax credits from the Canadian federal and provincial governments for research and development activities were $1.5 million, or 16.7% of gross research and development expenses, compared to $1.4 million, or 18.3% of gross research and development expenses for the same period last year.

For the six months ended February 28, 2009, these tax credits were $2.9 million, or 16.4% of gross research and development expenses, compared to $2.9 million, or 19.0% 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 second quarter and the first half 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 for tax credits.

The decrease in research and development tax credits as a percentage of gross research and development expenses for the second quarter and the first half of fiscal 2009, compared to the corresponding periods last year, 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 February 28, 2009, amortization of property, plant and equipment was $1.0 million, compared to $998,000 for the same period last year. For the six months ended February 28, 2009, amortization expenses amounted to $2.2 million, compared to $2.0 million 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 second quarter and the first half of fiscal 2009, compared to the corresponding periods last year. However, the significant decrease in the average value of the Canadian dollar versus the US dollar in the second quarter and the first half of fiscal 2009, compared to the same periods 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

For the three months ended February 28, 2009, amortization of intangible assets was $1.2 million, compared to $720,000 for the same period last year. For the six months ended February 28, 2009, amortization of intangible assets was $2.6 million compared to $1.5 million for the same period last year.

The increase in amortization expenses in the second quarter and the first half of fiscal 2009, compared to the same periods 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 February 28, 2009, interest income amounted to $175,000, compared to $1.6 million for the same period last year. For the six months ended February 28, 2009, interest income amounted to $641,000, compared to $3.1 million for the same period last year.

The decrease in interest income in the second quarter and the first half of fiscal 2009, compared to the corresponding periods last year, is mainly due to the decrease in 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 amounting to $34.0 million over the last 12 months, in accordance with our share buy-back programs 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 second quarter and the first half 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 February 28, 2009, the foreign exchange gain amounted to $1.1 million, compared to a foreign exchange loss of $232,000 for the same period last year.

For the six months ended February 28, 2009, the foreign exchange gain amounted to $5.7 million compared to a foreign exchange loss of $848,000 for the same period last year.

During the second quarter of fiscal 2009, the value of the Canadian dollar decreased versus the US dollar compared to the previous quarter, which resulted in a foreign exchange gain of $1.1 million during that period. In fact, the period-end value of the Canadian dollar decreased 2.6% to CA$1.2707 = US$1.00 in the second quarter of fiscal 2009 compared to CA$1.2372 = US$1.00 at the end of the previous quarter. We also have to consider that the volume of operations denominated in foreign currency (including balance sheet items) increased year-over-year further increasing the foreign exchange gain, compared to the same period last year.

During the first half of fiscal 2009, the value of the Canadian dollar significantly and rapidly decreased versus the US dollar, compared to August 31, 2008, which resulted in a foreign exchange gain of $5.7 million in the first half of fiscal 2009. In fact, the period-end value of the Canadian dollar decreased 16.4% to CA$1.2707 = US$1.00 in the first half of fiscal 2009, compared to CA$1.0626 = US$1.00 at the end of fiscal 2008. We also have to consider that the volume of operations denominated in foreign currency (including balance sheet items) increased year-over-year, further increasing the exchange gain compared to the same period last year.

During the second quarter of fiscal 2008, the value of the Canadian dollar increased quarter-over-quarter, compared to the US dollar, which resulted in a foreign exchange loss of $232,000 during that period. In fact, the period-end value of the Canadian dollar increased 2.1% versus the US dollar in the second quarter of fiscal 2008, compared to the previous quarter.

During the first half of fiscal 2008, the value of the Canadian dollar increased significantly, compared to the US dollar, which resulted in a significant foreign exchange loss of $848,000 during that period. In fact, the period-end value of the Canadian dollar for the first half of fiscal 2008 increased 7.8% versus the US dollar, compared to August 31, 2007.

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 decrease in the average value of the Canadian dollar in the second quarter and the first half of fiscal 2009, compared to the same periods last year, resulted in a significant and positive impact on our financial results for these periods. 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 second quarter of fiscal 2009 was CA$1.2334 = US$1.00 versus CA$1.0066 = US$1.00 for the same period last year, representing a decrease of 18.4% in the average value of the Canadian dollar year-over-year. For the first half of fiscal 2009, the average value of the Canadian dollar was CA$1.1918 = US$1.00 versus CA$0.9984 = US$1.00 for the same period last year, representing a decrease of 16.2% 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 February 28, 2009, our income tax expense was $1.2 million, compared to $995,000 for the same period last year.

For the six months ended February 28, 2009, our income tax expense was $3.0 million compared to $2.3 million for the same period last year.

For the three months ended February 28, 2009, we reported income tax expenses of $1.2 million on earnings before income taxes of $3.9 million, for an effective income tax rate of 31.3%. For the six months ended February 28, 2009, we reported income tax expenses of $3.0 million on earnings before income taxes of $11.0 million, for an effective income tax rate of 27.7%. Our combined Canadian and provincial statutory tax rate is 31%. 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 all periods.

For the three months ended February 29, 2008, we reported an income tax expense of $995,000 on earnings before income taxes of $5.0 million, for an effective income tax rate of 19.8%. For the six months ended February 29, 2008, we reported an income tax expense of $2.3 million on earnings before income taxes of $6.2 million, for an effective income tax rate of 36.5%. The distortion between the income tax expense and pre-tax income for these periods can be explained by the following factors. First, on December 14, 2007, reductions to the Canadian federal statutory tax rate, previously announced by the Canadian federal Government, were enacted. Therefore, our Canadian federal future income tax assets decreased by $1.5 million and generate a one-time future income tax expense for the same amount during the second quarter and the first half of fiscal 2008. However, during the second quarter of fiscal 2008, based on these new enacted tax rates, we reviewed our tax strategy for the future use of our Canadian federal operating losses, tax deductions, timing differences and R&D tax credits to minimize income taxes payable on future years' taxable income, by amending our prior year's income tax returns to create a net operating loss to be carried back to prior years, which released previously used research and development tax credits. This resulted in an increase in our tax-related assets of $2.7 million and a one-time income tax recovery for the same amount during the second quarter and the first half of fiscal 2008. These two offsetting elements represented a net income tax recovery of $1.2 million in the statements of earnings for the three- and six-month periods ended February 29, 2008. Also, during these periods, 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 some revenues were non-taxable (namely certain R&D tax credits). In addition, we continued to maintain a valuation allowance for some of our subsidiaries at loss, and we utilize previously unrecognized future income tax assets. Finally, we recorded income tax expenses for minimum taxes payable in certain tax jurisdictions, where taxes are not related to pre-tax earnings. Otherwise, actual tax rate would have been closer to the statutory tax rate for both periods.

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 February 28, 2009, our cash and short-term investments totalled $58.1 million, while our working capital was at $97.7 million. Our cash and short-term investments decreased $13.2 million in the second quarter of fiscal 2009, compared to the previous quarter, mainly due to the cash payments of $25.6 million for the redemption of share capital under our substantial issuer bid program and $2.9 million for the purchase of capital assets. In addition, our cash position decreased quarter-over-quarter due to the 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 $1.0 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. On the other hand, operating activities generated cash flows of $16.3 million during the second quarter of fiscal 2009.

Our short-term investments consist of commercial paper issued by 14 (13 as at November 30, 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, payments of contingent considerations and our share repurchase program.

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 considerations payable for the acquisition of Brix Networks and capital assets as well as the effect of our normal course issuer bid. In addition to these assets, we have unused available lines of credit totaling $11.2 million for working capital and other general corporate purposes and unused lines of credit of $15.0 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 provided by operating activities were $16.3 million for the three months ended February 28, 2009, compared to $9.4 million for the same period last year.

Cash flows provided by operating activities in the second quarter of fiscal 2009 were mainly attributable to the net earnings after items not affecting cash of $8.8 million, and to the net change in non-cash operating items of $7.5 million mainly due to the effect on cash of the $4.5 million decrease in our accounts receivable (due to timing of sales), the $352,000 decrease in our income taxes and tax credits recoverable (tax credits received during the quarter less tax credits earned during the quarter and not yet recovered), the $308,000 decrease in our prepaid expenses (fees initially paid for the substantial issuer bid), the $488,000 decrease in our inventories and the $1.8 million increase in our accounts payable and accrued liabilities, mainly due to timing of purchases and payments.

Cash flows provided by operating activities in the first half of fiscal 2009 were mainly attributable to the net earnings after items not affecting cash of $16.1 million, offset by the negative net change in non-cash operating items of $2.5 million mainly due to the negative effect on cash of the $2.8 million increase in our accounts receivable (due to timing of sales), the $344,000 increase in our income taxes and tax credits recoverable (mainly tax credits earned during the period and not yet recovered), the $234,000 increase in our prepaid expenses. However, the increase in our accounts payable and accrued liabilities generated cash flows of $762,000, mainly due to timing of purchases and payments.

Cash flows provided by operating activities were $9.4 million for the three months ended February 29, 2008. Cash flows provided by operating activities in the second quarter of fiscal 2008 were mainly attributable to the net earnings after items not affecting cash of $15.8 million offset in part by the negative net change in non-cash operating items of $6.4 million. The negative net change in non-cash operating items was mainly due to the negative effect on cash of the increase of $9.2 million of our income tax and tax credits recoverable as well as the $985,000 increase in our accounts receivable. The increase in our income taxes and tax credits is mainly due to the increase in our tax credits recoverable following the change in our tax strategy explained elsewhere in this document. This increase was for the most part offset by the positive effect on cash of the decrease of our future income tax assets, which also resulted from the change in the tax strategy. The increase in our accounts receivable is due to the increase in sales during the quarter. These negative effects on cash were offset by the positive effect on cash of the $794,000 decrease in our inventories and the $2.7 million increase in our accounts payable and accrued liabilities. The decrease in our inventories resulted from increased sales activities during the quarter. The increase in our accounts payable and accrued liabilities resulted from the timing of certain purchases and payments as well as increased activities during the quarter.

Cash flows provided by operating activities were $7.2 million for the six months ended February 29, 2008. Cash flows provided by operating activities in the first half of fiscal 2008 were mainly attributable to the net earnings after items not affecting cash of $19.3 million, offset in part by the negative net change in non-cash operating items of $12.1 million; this negative net change in non-cash operating items was mainly due to the negative effect on cash of the $9.6 million increase in our income tax and tax credits recoverable, as well as the $3.0 million decrease in our accounts payable and accrued liabilities. The increase in our income taxes and tax credits recoverable comes from the increase in our tax credits as explained above. The decrease in our accounts payable and accrued liabilities is due to timing of purchases and payments during the period. These negative effects on cash flows were offset in part by the positive effect on cash of the $707,000 decrease in our inventories, which resulted from increased sales activities during the period.

Investing activities

Cash flows provided by investing activities were $13.2 million for the three months ended February 28, 2009, compared to cash flows used by investing activities of $5.7 million for the same period last year. In the second quarter of fiscal 2009, we disposed (net of acquisitions) of $16.1 million worth of short-term investments but paid $2.9 million for the purchase of capital assets. For the corresponding period last year, we acquired (net of disposal and maturity) $3.6 million worth of short-term investments and paid $2.1 million for the purchase of capital assets.

Cash flows provided by investing activities were $16.2 million for the six months ended February 28, 2009, compared to cash flows used by investing activities of $4.2 million for the same period last year. In the first half of fiscal 2009, we disposed (net of acquisitions) of $20.6 million worth of short-term investments but paid $4.5 million for the purchase of capital assets. For the corresponding period last year, we acquired (net of disposal and maturity) $480,000 worth of short-term investments and paid $3.7 million for the purchase of capital assets.

Financing activities

Cash flows used by financing activities were $25.6 million for the three months ended February 28, 2009, compared to cash flows of $10,000 provided by financing activities for the same period last year. During the second quarter of fiscal 2009, we paid $25.6 million for the redemption of share capital under our share repurchase programs. However, we received $5,000 from the exercise of stock options.

Cash flows used by financing activities were $26.0 million for the six months ended February 28, 2009, compared to cash flows provided by financing activities of $535,000 for the same period last year. During the first half of fiscal 2009, we paid $26.1 million for the redemption of share capital under our share repurchase programs. However, we received $31,000 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. 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 February 28, 2009, 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
March 2009 to August 2009	$ 18,800,000	1.0567
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	$ 58,600,000	1.0822

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 $8.5 million as at February 29, 2009, following the significant decrease in the value of the Canadian dollar, compared to the US dollar, during the first six months of fiscal 2009.

CONTINGENCIES

Class action

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 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. On February 25, 2009, liaison counsel for the plaintiffs informed the district court that a settlement has been agreed to in principle, subject to formal approval by the parties, and preliminary and final approval by the court.

Due to the inherent uncertainties of litigation, the final outcome of the case including the approval of the settlement described above 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 February 28, 2009.

Contingent consideration

Following the purchase of assets during the three months ended February 28, 2009, we had a contingent cash consideration of up to $1,000,000, payable based upon the achievement of a booking volume in the next 24 months following the purchase.

SHARE CAPITAL AND STOCK-BASED COMPENSATION PLANS

Share capital

As at March 27, 2009, EXFO had 36,643,000 multiple voting shares outstanding, entitling to ten votes each and 22,969,344 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 (US$24.9 million), plus related fees of $576,000, in accordance with 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 3,203,521 as at February 28, 2009. 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 our Board of Directors and to our Management and Corporate Officers as at February 28, 2009:

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	9%	$6.19
Management and Corporate Officers (eight individuals)	212,139	12%	$14.49
	540,588	**31%**	$**10.40**

Restricted Share Units	Number	% of issued and outstanding
Chairman of the Board, President and CEO (one individual)	140,459	10%
Management and Corporate Officers (eleven individuals)	481,554	36%
	622,013	**46%**

Deferred Share Units	Number	% of issued and outstanding
Board of Directors (five individuals)	**98,926**	**100%**

OFF-BALANCE SHEET ARRANGEMENTS

As at February 28, 2009, our off-balance sheet arrangements consisted of letters of guarantee. As at February 28, 2009, 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 $1.2 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 $4.2 million was used to secure our line of credit in Chinese currency. This line of credit was unused as at February 28, 2009. This $4.2 million letter of guarantee is secured by short-term investments.

VARIABLE INTEREST ENTITY

As of February 28, 2009, 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, 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 the recession in key geographic regions or markets, we may experience a material adverse impact on our business, operating results and financial condition.

Also, 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.

The current 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:

	Three months ended February 28, 2009	Six months ended February 28, 2009	Three months ended February 29, 2008	Six months ended February 29, 2008
GAAP net earnings for the period	$ 2,655	$ 7,942	$ 4,024	$ 3,931
Add (deduct):				
Amortization of property, plant and equipment	1,049	2,208	998	1,974
Amortization of intangible assets	1,246	2,565	720	1,454
Interest income	(175)	(641)	(1,616)	(3,099)
Income taxes	1,209	3,049	995	2,257
EBITDA for the period	$ 5,984	$ 15,123	$ 5,121	$ 6,517
EDITDA in percentage of sales	12.9%	16.3%	11.8 %	7.7 %

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