

## **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 the effect of the actual worldwide recession on the telecom market for our customers and suppliers; fluctuating exchange rates and our ability to execute in these uncertain conditions; 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; 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 condition. 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 June 30, 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 intact, but they are being constrained by an economic recession that is forcing network operators and network equipment manufacturers to reduce their capital and operating expenses. 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 during the industry downturn of 2001. First of all, there is currently a myriad of bandwidth-intensive applications generating strong growth in bandwidth demand, both in wireless and wireline networks. For example, monthly traffic is 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 a strain on access, metro rings and long-haul routes, whereas in 2001 there was an overabundance of bandwidth capacity in optical backbone networks, which drove bandwidth pricings down very significantly. Finally, most network operators have healthy balance sheets today, while in 2001 many of them were financially overextended with some declaring outright bankruptcy.

Notwithstanding this current market downturn, 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 to attract and retain consumers, who are increasingly relying on broadband network services for their work, entertainment and everyday activities.

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, social networking, 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.

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 are not capable of efficiently carrying emerging IP-based services since they were designed for public switched telephone network (PSTN), point-to-point voice transmission only. As a result, new OTN standards have been defined to transport IP applications over Ethernet and are at the very foundation of what the industry is calling next-generation networks. Network operators are increasingly turning to such 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, network operators 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.

As well, it is now clear that fiber-to-the-home (FTTH) is becoming the access network architecture of choice for network operators wishing to provide a great user experience in combined video, data and voice offering. 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, may 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 more quickly.

FTTH 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 few years as volume increased and test tools, like those we offer, are rendering deployments increasingly simple and efficient. Also, while deploying FTTH is more capital intensive, it provides the benefits of very high bandwidth capabilities and significantly lower cost of operation and superior reliability. We are only at the early stages of fiber deployments in access networks, both in North America 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. FTTH is now also finding a new opportunity in multi-dwelling units (MDUs) as a low cost alternative to bring very large bandwidth at minimal cost/apartment.

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 being deployed and becoming mainstream, while upcoming 100 Gbit/s Ethernet is being developed despite the difficult economic environment. A few network operators are even expected to begin 100 Gbit/s Ethernet field-trials later this calendar year. In the long run, the deployment of these solutions is expected to be a significantly more economical way to add capacity in saturated network portions, especially if trenches need to be dug in order to deploy new fiber in metro and long-distance routes.

These market dynamics affected telecom test and service assurance suppliers in the third quarter of fiscal 2009. On the other hand, the economic 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 \$43.6 million in the third quarter of fiscal 2009, which represented a decrease of 10.2% year-over-year. This decrease in sales mainly results from the global economic recession as well as from currency fluctuations since the beginning of the fiscal year. However, total sales for the third quarter of fiscal 2009 included \$7.3 million from Brix Networks Inc. and Navtel Communications Inc, compared to \$2.2 million for the same period last year, which mitigated in part the decrease in sales year-over-year. These two acquisitions were closed approximately one month and two months into the third quarter of fiscal 2008, respectively. After nine months into fiscal 2009, sales increased 2.7% year-over-year to \$136.4 million, from \$132.8 million for the same period last year. Total sales for the first nine months of fiscal 2009 included \$21.0 million from Brix Networks Inc. and Navtel Communications Inc, compared to \$2.2 million for the same period last year. Excluding the positive impacts of our two recent acquisitions, our organic sales would have decreased 21.6% and 11.7% during the third quarter and the first nine months of fiscal 2009, respectively, reflecting the impact of the global economic recession and the negative effects of the currency fluctuations on our sales during these periods, compared to the same periods last year.

We also reported net accepted orders of \$40.2 million in the third quarter of fiscal 2009 for a book-to-bill ratio of 0.92. Net bookings for the third quarter of fiscal 2009 were also affected by the global economic recession.

Looking at the bottom line, we generated a GAAP net loss of \$23.3 million, or \$0.39 per share, in the third quarter of fiscal 2009, compared to net earnings of \$11.2 million, or \$0.16 per diluted share, for the same period last year. Net loss for the third quarter of fiscal 2009 included a non-cash impairment of goodwill in the amount of \$21.7 million. GAAP net loss was also negatively and significantly affected by the rapid strengthening of value of the Canadian dollar, compared to the US dollar in the third quarter of 2009. Indeed, during the third quarter of fiscal 2009, we reported a significant foreign exchange loss of \$4.7 million, compared to a small foreign exchange loss of \$59,000 for the same period last year. In fact, this \$ 4.7 million foreign exchange loss off-set the \$4.6 million foreign exchange gain reported in the first quarter of fiscal 2009, when the value of the Canadian dollar sharply decreased compared to the US dollar during that period. Net earnings for the third quarter of fiscal 2008 included \$5.3 million for the recognition of previously unrecognized future income tax assets in the United States and an extraordinary gain of \$3.0 million related to the negative goodwill on the Navtel acquisition. Net loss in the third quarter of 2009 included charges of \$1.5 million for stock-based compensation costs and the after-tax amortization expense for intangible assets. EBITDA (net earnings (loss) before interest, income taxes, amortization of property, plant and equipment, amortization of intangible assets, impairment of goodwill and extraordinary gain) were negative at \$2.0 million, or 4.6% of sales in the third quarter of fiscal 2009, compared to \$6.5 million (positive), or 13.3% of sales for the same period last year. EBITDA were \$13.1 million, or 9.6% of sales for the nine months ended May 31, 2009, compared to \$13.0 million, or 9.8% of sales for the same period last year (see further in this document for a complete reconciliation of EBITDA to GAAP net earnings (loss)).

The foreign exchange loss recorded in the third quarter of fiscal 2009 mainly represented the effect of the 16.4% increase (compared to February 28, 2009) in the period-end value of the Canadian dollar versus the US dollar on our balance sheet items. During the corresponding period last year, we witnessed more stability in the period-end value of the Canadian dollar, compared to the previous quarter (decrease of 1.4%), which resulted in a smaller foreign exchange loss of \$59,000. However, the average value of the Canadian dollar decreased 17.3% in the third quarter of fiscal 2009, compared to the corresponding period last year. Given that most of our sales are denominated in US dollars but a significant portion of our expenses is denominated in Canadian dollars, our financial results were positively affected as these expenses (measured in Canadian dollars) increased when translated in US dollars for reporting purposes.

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, we closed the acquisition of Sweden-based PicoSolve Inc., a supplier of ultra-high-speed optical sampling oscilloscopes for 40G and 100G R&D, manufacturing and deployment applications.

In the third quarter of fiscal 2009, we performed our annual impairment test for goodwill for all reporting units. Recoverability of goodwill is determined at the reporting unit level, using a two-step approach. First, the carrying value of the reporting units is compared to their fair value. If the carrying value of a reporting unit exceeds its fair value, the second step is performed to determine the amount of the impairment loss. Following the significant decrease in our stock price following the pre-announcement of our third quarter results on June 1, 2009, we came to the conclusion that the carrying value of one of our reporting unit exceeded its fair value. Due to the extensive work involved in performing the second step of the goodwill impairment test, we had not completed our analysis at the time our interim consolidated financial statements were due. However, we recorded an impairment charge of \$21.7 million in the third quarter of fiscal 2009, based on our best estimate to bring the goodwill of this reporting unit to its fair value. We expect to complete step two of the impairment test in the fourth quarter of 2009 and any adjustment to the amount of impairment recorded in the third quarter, will be recorded prospectively during that period. This reporting unit reports to the Telecom Division.

We launched 11 new products in the third quarter of fiscal 2009 and 23 since the beginning of the year. Key product launches in the third quarter included a portable test solution for characterizing 40 Gbit/s and 100 Gbit/s Ethernet networks; 1 Gbit/s and 10 Gbit/s test heads for carrier Ethernet and mobile backhaul testing applications; IPv6 testing capabilities across the company's transport and datacom product portfolio; a portable, multi-layer platform for high-end test applications in the field and central office; and an optical time domain reflectometer (OTDR) optimized for fiber-to-the-home (FTTH) applications and live fiber troubleshooting. Sales from products that have been on the market two years or less accounted for 40.6% of total sales in the third quarter of 2009 and 38.3% since the beginning of fiscal 2009.

During the third quarter of fiscal 2009, 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.

In June 2009, we laid-off a certain number of employees across the organization as part of a restructuring plan to cope with current difficult market conditions. This will result in a one-time restructuring charge of \$1.3 million that will be recorded in the fourth quarter of fiscal 2009 and is expected to deliver about \$6 million in annual savings.

## **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 May 31, 2008 and 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 14 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 May 31, 2009 (unaudited)	Three months ended May 31, 2008 (unaudited)	Nine months ended May 31, 2009 (unaudited)	Nine months ended May 31, 2008 (unaudited)
Sales	\$ 43,636	\$ 48,581	\$ 136,371	\$ 132,847
Cost of sales <sup>(1)</sup>	<u>16,441</u>	<u>19,004</u>	<u>52,274</u>	<u>55,208</u>
Gross margin	<u>27,195</u>	<u>29,577</u>	<u>84,097</u>	<u>77,639</u>
Operating expenses				
Selling and administrative	16,732	15,660	49,623	44,160
Net research and development	7,781	7,373	22,327	19,570
Amortization of property, plant and equipment	1,166	1,071	3,374	3,045
Amortization of intangible assets	1,355	1,015	3,920	2,469
Impairment of goodwill	<u>21,713</u>	<u>–</u>	<u>21,713</u>	<u>–</u>
Total operating expenses	<u>48,747</u>	<u>25,119</u>	<u>100,957</u>	<u>69,244</u>
Earnings (loss) from operations	<u>(21,552)</u>	4,458	<u>(16,860)</u>	8,395
Interest income	42	964	683	4,063
Foreign exchange gain (loss)	<u>(4,687)</u>	<u>(59)</u>	<u>971</u>	<u>(907)</u>
Earnings (loss) before income taxes and extraordinary gain	<u>(26,197)</u>	5,363	<u>(15,206)</u>	11,551
Income taxes				
Current	(88)	112	148	(7,080)
Future	<u>(2,763)</u>	<u>2,432</u>	<u>50</u>	<u>11,881</u>
Recognition of previously unrecognized future income tax assets	<u>–</u>	<u>(5,324)</u>	<u>–</u>	<u>(5,324)</u>
Earnings (loss) before extraordinary gain	<u>(23,346)</u>	8,143	<u>(15,404)</u>	12,074
Extraordinary gain	<u>–</u>	<u>3,036</u>	<u>–</u>	<u>3,036</u>
Net earnings (loss) for the period	<u>\$ (23,346)</u>	<u>\$ 11,179</u>	<u>\$ (15,404)</u>	<u>\$ 15,110</u>
Basic earnings (loss) before extraordinary gain per share	\$ (0.39)	\$ 0.12	\$ (0.25)	\$ 0.18
Diluted earnings (loss) before extraordinary gain per share	\$ (0.39)	\$ 0.12	\$ (0.25)	\$ 0.17
Basic and diluted net earnings (loss) per share	\$ (0.39)	\$ 0.16	\$ (0.25)	\$ 0.22
Segmented information:				
Sales:				
Telecom Division	\$ 39,047	\$ 42,843	\$ 121,573	\$ 115,643
Life Sciences and Industrial Division	<u>4,589</u>	<u>5,738</u>	<u>14,798</u>	<u>17,204</u>
	<u>\$ 43,636</u>	<u>\$ 48,581</u>	<u>\$ 136,371</u>	<u>\$ 132,847</u>
Earnings (loss) from operations:				
Telecom Division	\$ (21,990)	\$ 3,819	\$ (18,518)	\$ 6,657
Life Sciences and Industrial Division	<u>438</u>	<u>639</u>	<u>1,658</u>	<u>1,738</u>
	<u>\$ (21,552)</u>	<u>\$ 4,458</u>	<u>\$ (16,860)</u>	<u>\$ 8,395</u>
Research and development data:				
Gross research and development	\$ 9,347	\$ 8,843	\$ 26,750	\$ 23,904
Net research and development	\$ 7,781	\$ 7,373	\$ 22,327	\$ 19,570

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

	Three months ended <u>May 31, 2009</u>	Three months ended <u>May 31, 2008</u>	Nine months ended <u>May 31, 2009</u>	Nine months ended <u>May 31, 2008</u>
	(unaudited)		(unaudited)	
Sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of sales <sup>(1)</sup>	37.7	39.1	38.3	41.6
Gross margin	62.3	60.9	61.7	58.4
Operating expenses				
Selling and administrative	38.3	32.2	36.4	33.2
Net research and development	17.8	15.2	16.4	14.7
Amortization of property, plant and equipment	2.7	2.2	2.5	2.3
Amortization of intangible assets	3.1	2.1	2.9	1.9
Impairment of goodwill	49.8	-	15.9	-
Total operating expenses	111.7	51.7	74.1	52.1
Earnings (loss) from operations	(49.4)	9.2	(12.4)	6.3
Interest income	0.1	1.9	0.5	3.1
Foreign exchange gain (loss)	(10.7)	(0.1)	0.7	(0.7)
Earnings (loss) before income taxes and extraordinary gain	(60.0)	11.0	(11.2)	8.7
Income taxes				
Current	(0.2)	0.2	0.1	(5.3)
Future	(6.3)	5.0	0.0	8.9
Recognition of previously unrecognized future income tax assets	-	(11.0)	-	(4.0)
	(6.5)	(5.8)	0.1	(0.4)
Earnings (loss) before extraordinary gain	(53.5)	16.8	(11.3)	9.1
Extraordinary gain	-	6.2	-	2.3
Net earnings (loss) for the period	(53.5) %	23.0 %	(11.3) %	11.4 %
Segmented information:				
Sales:				
Telecom Division	89.5 %	88.2 %	89.1 %	87.0 %
Life Sciences and Industrial Division	10.5	11.8	10.9	13.0
	100.0 %	100.0 %	100.0 %	100.0 %
Earnings (loss) from operations:				
Telecom Division	(50.4) %	7.9 %	(13.6) %	5.0 %
Life Sciences and Industrial Division	1.0	1.3	1.2	1.3
	(49.4) %	9.2 %	(12.4) %	6.3 %
Research and development data:				
Gross research and development	21.4 %	18.2 %	19.6 %	18.0 %
Net research and development	17.8 %	15.2 %	16.4 %	14.7 %

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

## SALES

For the three months ended May 31, 2009, our global sales decreased 10.2% to \$43.6 million from \$48.6 million for the same period last year, with a 90%-10% split in favor of our Telecom Division.

For the nine months ended May 31, 2009, our global sales increased 2.7% to \$136.4 million from \$132.8 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 May 31, 2009, sales of our Telecom Division decreased 8.9% to \$39.0 million from \$42.8 million for the same period last year.

The following table summarizes information about sales of our Telecom Division for the three months ended May 31, 2008 and 2009, in thousands of US dollars:

	<b>Three months ended May 31, 2009</b>	<b>Three months ended May 31, 2008</b>	<b>Change in \$</b>	<b>Change in %</b>
	<b>(unaudited)</b>			
Telecom Division sales	\$ 39,047	\$ 42,843	\$ (3,796)	(8.9) %
(Gains) losses on forward exchange contracts	1,425	(1,020)	2,445	239.7
Telecom Division sales, excluding gains/losses on forward exchange contracts	40,472	41,823	(1,351)	(3.2)
Impact of recent acquisitions	(7,266)	(2,167)	(5,099)	(235.3)
Organic sales	<u>\$ 33,206</u>	<u>\$ 39,656</u>	<u>\$ (6,450)</u>	<u>(16.3) %</u>

For the nine months ended May 31, 2009, sales of our Telecom Division increased 5.1% to \$121.6 million from \$115.6 million for the same period last year.

The following table summarizes information about sales of our telecom Division for the nine months ended May 31, 2008 and 2009, in thousands of US dollars:

	<b>Nine months ended May 31, 2009</b>	<b>Nine months ended May 31, 2008</b>	<b>Change in \$</b>	<b>Change in %</b>
	<b>(unaudited)</b>			
Telecom Division sales	\$ 121,573	\$ 115,643	\$ 5,930	5.1 %
(Gains) losses on forward exchange contracts	2,959	(3,507)	6,466	184.4
Telecom Division sales, excluding gains/losses on forward exchange contracts	124,532	112,136	12,396	11.1
Impact of recent acquisitions	(20,980)	(2,167)	(18,813)	(868.2)
Organic sales	<u>\$ 103,552</u>	<u>\$ 109,969</u>	<u>\$ (6,417)</u>	<u>(5.8) %</u>

In the third quarter of fiscal 2009, we reported year-over-year decrease in sales mainly due to the impact of the worldwide economic recession that affected most of our product lines during that period. In addition, as a portion of our sales are denominated in Canadian dollars, euros or British pounds, the strength of the US dollar against these currencies in the third quarter of fiscal 2009 compared to the third quarter of 2008, also had a negative impact on our sales expressed in US dollars, which contributed to the decrease in sales compared to the corresponding period last year. This was amplified by foreign exchange losses on our forward exchange contracts, which are recorded in sales. In fact, in the third quarter of fiscal 2009, foreign exchange losses on our forward exchange contracts amounted to \$1.4 million and accordingly reduced our sales, compared to foreign exchange gains of \$1.0 million for the same period last year, which increased our sales; this represents a decrease in sales of \$2.4 million year-over-year.

However, the decrease in sales in the third quarter of fiscal 2009 compared to the same period last year was offset in part by 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 \$7.3 million in the third quarter of 2009, compared to \$2.2 million for the same period last year. Excluding sales of Brix Networks and Navtel Communications and the impact of the foreign exchange gains or losses on our forward exchange contracts, our telecom sales would have decreased 16.3% organically year-over-year during this period, reflecting the impact of the global economic recession and the decrease of the Canadian dollar, euro and British pound compared to the US dollar.

During the first nine months of fiscal 2009, we reported year-over-year sales increase of 5.1% due to the contribution of newly acquired Brix Networks and Navtel Communications. In fact, sales of Brix Network and Navtel Communications amounted to \$21.0 million for the first nine months of 2009, compared to \$2.2 million for the same period last year. Our year over year growth would have reached 11.1% if we exclude the impact of the foreign exchange gains and losses on our forward exchange contracts that are recorded in our sales. In the first nine months of fiscal 2009, foreign exchange losses on our forward exchange contracts amounted to \$3.0 million, compared to foreign exchange gains of \$3.5 million for the same period last year, which represents a decrease in sales of \$6.5 million year-over-year. Excluding sales of Brix Networks and Navtel Communications and the impact of the foreign exchange gains and losses on our forward exchange contracts, our telecom sales would have decreased 5.8% organically year-over-year during this period, reflecting the impact of the global economic recession and the impact of a weaker Canadian dollar, euro and British pound compared to the US dollar year-over-year. In fact, and as mentioned above, the decrease in the value of these currencies versus the US dollar year-over-year had a significant negative impact on our sales, as a portion of these are denominated in Canadian dollars, euros and British pounds and we report our results in US dollars.

During the third quarter of fiscal 2009, our top customer represented 12.1% (\$4.7 million) of our telecom sales, compared to 10.2% (\$4.4 million) for the same period last year. It represented 13.0% (\$15.8 million) of our telecom sales in the first nine months of fiscal 2009, compared to 9.9% (\$11.4 million) for the same period last year.

### ***Life Sciences and Industrial Division***

For the three months ended May 31, 2009, sales of our Life Sciences and Industrial Division decreased \$1.1 million, or 20.0% year-over-year to \$4.6 million, compared to \$5.7 million for the same period last year.

For the nine months ended May 31, 2009, sales of our Life Sciences and Industrial Division decreased \$2.4 million, or 14.0% year-over-year to \$14.8 million, from \$17.2 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. Finally, the decrease in the value of the Canadian dollar, the euro and the British pound versus the US dollar year-over-year had a negative impact on sales of this division since a portion of these are denominated in currencies other than the US dollars and we report our results in US dollar.

### ***Net bookings***

Overall, for the two divisions, net accepted orders decreased 20.7% year-over-year to \$40.2 million in the third quarter of fiscal 2009, from \$50.7 million for the same period last year, for a book-to-bill ratio of 0.92.

This decrease in bookings year-over-year is due to the global economic recession that negatively impacted our orders in the third quarter of fiscal 2009. However, the positive contribution of newly acquired Brix Networks product lines offset in part the effect of the recession in our bookings.

### ***Geographic distribution***

For the three months ended May 31, 2009, sales to the Americas, Europe, Middle East and Africa (EMEA) and Asia-Pacific (APAC) accounted for 57%, 29% and 14% of global sales, respectively. For the corresponding period last year, sales to the Americas, EMEA and APAC accounted for 60%, 28% and 12% of global sales, respectively. For the nine months ended May 31, 2009, sales to the Americas, EMEA and APAC accounted for 58%, 27% and 15% of global sales, respectively. For the corresponding period last year, sales to the Americas, EMEA and APAC accounted for 56%, 29% and 15% of global sales, respectively.

In the third quarter of fiscal 2009, we reported year-over-year sales decreases (in dollars) in the Americas and EMEA. In fact, sales to these regions decreased (in dollars) 15.6% and 5.3%, respectively. Sales to APAC increased (in dollars) 5.5% year-over-year. During the first nine months of fiscal 2009, we reported year-over-year sales increases (in dollars) in the Americas and APAC. Sales to these regions increased (in dollars) 5.0% and 4.6%, respectively. Sales to EMEA decreased (in dollars) 3.1% year-over-year.

In the Americas, the decrease in sales in the third quarter, compared to the same period last year, comes from the United States where we posted a year-over-year decrease in sales of 24.2%. The current global economic recession forced NSPs and NEMs to reduce their capital and operating expenses and several customers have announced significant reductions in capital expenditures and staffing levels for calendar year 2009 in anticipation of lower revenue streams; this directly affected our sales in the United States during the third quarter of fiscal 2009, compared to the same period last year. Also, in the third quarter of fiscal 2009, we recorded significant foreign exchange losses on our forward exchange contracts, which are included in our sales to the Americas for the most part, compared to forward exchange gains for the same period last year. The decrease in sales to the United States in the third quarter of fiscal 2009 was offset in part by a general increase of 29.5% of sales made in Canada, despite the negative impact of a weaker Canadian dollar versus the US dollar year-over-year on our Canadian-dollar-denominated sales. Finally, the contribution of Brix Networks and Navtel Communications in the third quarter also mitigated the effect of the recession on our sales in the United States, as most of their sales are made in the United States and Canada.

For the nine months ended May 31, 2009, the increase in sales in the Americas compared to the same period last year comes from Canada, where we posted sales growth of our optical and protocol test solutions, especially with Tier-1 NSPs, despite the negative impact of a weaker Canadian dollar versus the US dollar year-over-year on our Canadian-dollar-denominated sales. This increase in sales was offset in part by lower sales in the United States, mainly due to the foreign exchange losses on our forward exchange contracts. However, excluding the negative foreign exchange impact of our forward exchange contracts, sales to the United States, which include sales from our recent acquisitions, would have increased for the first nine months of fiscal 2009, compared to the same period last year. Finally, the contribution of Brix Networks and Navtel Communications in the first nine months of 2009 also mitigated the effect of the recession on our sales in the United States.

The decrease in sales in the EMEA market, in dollars, in the third quarter and the first nine months of fiscal 2009, compared to the same periods last year, is due to the impact of the global recession as we are witnessing caution from many of our customers with their 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 strength of the US dollar against these currencies in the third quarter and the first nine months of fiscal 2009, 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 APAC, 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 third quarter and the first nine months 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 third quarter of fiscal 2009, our top customer accounted for 10.8% (\$4.7 million) of our global sales, and our top three customers accounted for 22.2% 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 14.9% of our global sales. For the nine months ended May 31, 2009, our top customer accounted for 11.6% (\$15.8 million) of our global sales, and our top three customers accounted for 18.9% 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 14.5% of our global sales.

## **GROSS MARGIN**

Gross margin increased to 62.3% of sales for the three months ended May 31, 2009, from 60.9% for the same period last year.

Gross margin increased to 61.7% of sales for the nine months ended May 31, 2009, compared to 58.4% for the same period last year.

The increase in our gross margin in the third quarter and the first nine months of fiscal 2009, compared to the same periods last year, can be explained by the following factors.

First, in the third quarter and the first nine months 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.

Second, during the third quarter and the first nine months of fiscal 2009, the value of the Canadian dollar significantly fluctuated compared to the US dollar, which impacted our gross margin for these periods, compared to the same periods last year. In fact, since the beginning of fiscal 2009, the value of the Canadian dollar significantly decreased compared to the US dollar; this resulted in lower cost of goods sold expressed in US dollars in the statements of earnings, thus increasing our gross margin year-over-year. However, the increase in the procurement costs of our raw materials purchased in US dollars, as a result of the recent and significant 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.

In addition, the operation of our manufacturing facilities 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.

However, foreign exchange losses on our forward exchange contracts, which are included in our sales, had a negative impact on our gross margin in the third quarter and in the first nine months of fiscal 2009, while this impact was positive (foreign exchange gains) in the corresponding periods last year, thus reducing our gross margin year-over-year.

Considering the expected increase in sales of protocol products, including the full contribution of Brix Networks and Navtel Communications in fiscal 2009 (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 continue 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 for the remaining of 2009 and beyond.

## **SELLING AND ADMINISTRATIVE**

For the three months ended May 31, 2009, selling and administrative expenses were \$16.7 million, or 38.3% of sales, compared to \$15.7 million, or 32.2% of sales for the same period last year.

For the nine months ended May 31, 2009, selling and administrative expenses were \$49.6 million, or 36.4% of sales, compared to \$44.2 million, or 33.2% of sales for the same period last year.

Navtel Communications and Brix Networks, which were acquired one month and two months into the third quarter of fiscal 2008, respectively, contributed for the whole periods to our selling and administrative expenses in the third quarter and the first nine months 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 third quarter and the first nine months 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.

Finally, during the third quarter of fiscal 2009, we had large orders sold directly to international customers for which we had to pay commissions to distributors, which increased our selling expenses year-over-year.

However, during the third quarter and the first nine months of fiscal 2009, the substantial and sudden decrease in the average value of the Canadian dollar, compared to the US dollar year-over-year, 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.

Also, during the first quarter of fiscal 2008, we discontinued certain product lines, which led to the layoff of some of our sales and marketing personnel, resulting in severance expenses during the first nine months of fiscal 2008.

For fiscal 2009, considering the impact of the worldwide recession on our sales level, the recent major increase in the value of the Canadian dollar 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 37% and 39%. As these percentages are higher than anticipated and in answer to the worldwide recession and the increase strength of the Canadian dollar, we will adjust our selling and administrative cost structure to account for the current economic environment, while preserving as much as possible our sales and marketing efforts, both domestic and international considering our goal of becoming the leading player in the telecom test, measurement and monitoring space. 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 May 31, 2009, gross research and development expenses totalled \$9.3 million, or 21.4% of sales, compared to \$8.8 million, or 18.2% of sales for the same period last year.

For the nine months ended May 31, 2009, gross research and development expenses totalled \$26.8 million, or 19.6% of sales, compared to \$23.9 million, or 18.0% of sales for the same period last year.

Navtel Communications and Brix Networks, which were acquired one month and two months into the third quarter of fiscal 2008, respectively, contributed to our gross research and development expenses during the entire periods in the third quarter and the first nine months of fiscal 2009; this caused these expenses to increase both in dollars and in percentage, compared to the same periods last year. Indeed, 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 third quarter and the first nine months of fiscal 2009, compared to the same periods last year.

However, during the third quarter and the first nine months of fiscal 2009, the significant and rapid decrease in the average value of the Canadian dollar, compared to the US dollar, had a substantial positive effect on our gross research and development expenses, as a significant portion of these expenses is 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 nine months of fiscal 2008.

### ***Tax credits***

For the three months ended May 31, 2009, tax credits from the Canadian federal and provincial governments for research and development activities were \$1.6 million, or 16.8% of gross research and development expenses, compared to \$1.5 million, or 16.6% of gross research and development expenses for the same period last year.

For the nine months ended May 31, 2009, these tax credits were \$4.4 million, or 16.5% of gross research and development expenses, compared to \$4.3 million, or 18.1% 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 decrease in the average value of the Canadian dollar, compared to the US dollar, during the third quarter and the first nine months of fiscal 2009, compared to the same periods last year, had a negative impact on these tax credits once 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 first nine months of fiscal 2009, compared to the corresponding period 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 16% and 18% of sales, given the impact of the worldwide recession on our sales level, the recent major increase in the value of the Canadian dollar, 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 May 31, 2009, amortization of property, plant and equipment was \$1.2 million, compared to \$1.1 million for the same period last year. For the nine months ended May 31, 2009, amortization expenses amounted to \$3.4 million, compared to \$3.0 million for the same period last year.

The increased activities 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 third quarter and the first nine months 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 third quarter and the first nine months 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 is denominated in Canadian dollars.

#### **AMORTIZATION OF INTANGIBLE ASSETS**

For the three months ended May 31, 2009, amortization of intangible assets was \$1.4 million, compared to \$1.0 million for the same period last year. For the nine months ended May 31, 2009, amortization of intangible assets was \$3.9 million compared to \$2.5 million for the same period last year.

The increase in amortization expenses in the third quarter and the first nine months 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.

#### **IMPAIRMENT OF GOODWILL**

In the third quarter of fiscal 2009, we performed our annual impairment test for goodwill for all reporting units. Recoverability of goodwill is determined at the reporting unit level, using a two-step approach. First, the carrying value of the reporting units is compared to their fair value. If the carrying value of a reporting unit exceeds its fair value, the second step is performed to determine the amount of the impairment loss. Following the significant decrease in our stock price following the pre-announcement of our third quarter results on June 1, we came to the conclusion that the carrying value of one of our reporting unit exceeded its fair value. Due to the extensive work involved in performing the second step of the goodwill impairment test, we had not completed our analysis at the time our interim consolidated financial statements were due. However, we recorded an impairment charge of \$21.7 million in the third quarter of fiscal 2009, based on our best estimate to bring the goodwill of this reporting unit to its fair value. We expect to complete step two of the impairment test in the fourth quarter of 2009 and any adjustment to the amount of impairment recorded in the third quarter will be recorded prospectively during that period. This reporting unit reports to the Telecom Division.

## **INTEREST INCOME**

Our interest income mainly resulted from our short-term investments, less interests and bank charges. For the three months ended May 31, 2009, interest income amounted to \$42,000, compared to \$964,000 for the same period last year. For the nine months ended May 31, 2009, interest income amounted to \$683,000, compared to \$4.1 million for the same period last year.

The decrease in interest income in the third quarter and the first nine months 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 \$30.8 million over the last 12 months, in accordance with our share buy-back programs as well as the significant 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 third quarter and the first nine months of fiscal 2009, compared to the same periods 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 May 31, 2009, the foreign exchange loss amounted to \$4.7 million, compared to \$59,000 for the same period last year.

For the nine months ended May 31, 2009, the foreign exchange gain amounted to \$971,000, compared to a foreign exchange loss of \$907,000 for the same period last year.

During the third quarter of fiscal 2009, the value of the Canadian dollar significantly increased versus the US dollar compared to the previous quarter, which resulted in a significant foreign exchange loss of \$4.7 million during that period. In fact, the period-end value of the Canadian dollar increased 16.4% to CA\$1.0917 = US\$1.00 in the third quarter of fiscal 2009 compared to CA\$1.2707 = US\$1.00 at the end of the previous quarter.

During the first nine months of fiscal 2009, we witnessed huge volatility in the value of the Canadian dollar as it fluctuated compared to the US dollar, which overall resulted in a foreign exchange gain of \$971,000. In fact, the period-end value of the Canadian dollar significantly decreased 14.1% in the first quarter of fiscal 2009 compared to the US dollar, which generated a foreign exchange gain of \$4.6 million, but increased 16.4 % in the third quarter of 2009 compared to the previous quarter. Overall for the period, the period-end value of the Canadian dollar decreased 2.7% to CA\$1.0917 = US\$1.00, compared to CA\$1.0626 = US\$1.00 at the end of fiscal 2008.

During the third quarter of fiscal 2008, the value of the Canadian dollar was relatively stable (close to par) compared to the US dollar. This resulted in a small foreign exchange loss of \$59,000 during that period. In fact the period-end value of the Canadian dollar slightly increased 1.4% in the third quarter of fiscal 2008, compared to the previous quarter.

During the first nine months of fiscal 2008, the value of the Canadian dollar significantly increased compared to the US dollar, which resulted in a significant foreign exchange loss of \$907,000 during that period. In fact, the period-end value of the Canadian dollar for the first nine months of fiscal 2008 increased 6.3%, 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 third quarter and the first nine months 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 third quarter of fiscal 2009 was CA\$1.2153 = US\$1.00 versus CA\$1.0047 = US\$1.00 for the same period last year, representing a decrease of 17.3% in the average value of the Canadian dollar year-over-year. For the first nine months of fiscal 2009, the average value of the Canadian dollar was CA\$1.1996 = US\$1.00 versus CA\$1.0005 = US\$1.00 for the same period last year, representing a decrease of 16.6% 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 in upcoming quarters would have a negative impact on our operating results.

## INCOME TAXES

For the three months ended May 31, 2009, we recorded an income tax recovery of \$2.9 million, compared to \$2.8 million for the same period last year.

For the nine months ended May 31, 2009, we recorded an income tax expense of \$198,000, compared to an income tax recovery of \$523,000 for the same period last year.

For the three months ended May 31, 2009, we reported an income tax recovery of \$2.9 million on a loss before income taxes of \$26.2 million, for an effective income tax rate of 10.9%. For the nine months ended May 31, 2009, we reported income tax expenses of \$198,000 on a loss before income taxes of \$15.2 million, for an effective income tax rate of 1.3%. Our combined Canadian and provincial statutory tax rate is 31%. First, a portion of the impairment of goodwill is not deductible for tax purposes. In addition, a significant portion of our foreign exchange gain (loss) is created by the translation of financial statements of our foreign integrated subsidiaries, and is therefore non-taxable or non-deductible. 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 May 31, 2008, we reported an income tax recovery of \$2.8 million on earnings before income taxes and extraordinary gain of \$5.4 million, for an effective income tax rate of 51.8%. During the third quarter of fiscal 2008, considering the expected positive impact of the acquisitions of Brix Networks and Navtel Communications on future years' taxable income of our US subsidiaries (federal level), and because reported taxable income of these subsidiaries was higher than expected, we concluded that it was more likely than not that all future income taxes of our consolidated US group would be recovered. Consequently, we reversed the valuation allowance previously recorded against future income tax assets in the amount of \$7.6 million. The portions of the valuation allowance that was reversed during the quarter, and that was attributable to the impact of the acquisitions of Brix Networks and Navtel Communications, in the amount of \$1.6 million and \$652,000, respectively, were included in the purchase price allocation of the related acquired businesses. The remaining of the reversal, in the amount of \$5.3 million, has been recorded in the income taxes in the statements of earnings for the three and the nine months ended May 31, 2008. Excluding this unusual tax recovery, we would have reported an income tax expense of \$2.5 million on earnings before income taxes and extraordinary gain of \$5.4 million, for an effective income tax rate of 47.4%. In fact, during the third quarter of fiscal 2008, 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 utilized previously unrecognized future income tax assets, mainly in the United States. Finally, we recorded income tax expenses for minimum taxes payable in certain tax jurisdictions, whose taxes are not related to pre-tax earnings. Otherwise, actual tax rate would have been closer to the statutory tax rate.

For the nine months ended May 31, 2008, we reported an income tax recovery of \$523,000 on earnings before income taxes and extraordinary gain of \$11.6 million, for an effective income tax rate of 4.5%. The distortion between income taxes and earnings before income taxes and extraordinary gain for that period can be explained by the following factors. First and as previously mentioned, during the third quarter of fiscal 2008, we reversed the valuation allowance previously recorded in our US subsidiaries (US federal level), which resulted in an unusual income tax recovery of \$5.3 million during the first nine months of fiscal 2008. In addition, 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 first nine months 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 will release previously used research and development tax credits. This resulted in an increase of our tax-related assets of \$2.7 million and a one-time income tax recovery for the same amount during the first nine months of fiscal 2008. Excluding these three unusual tax items, we would have reported an income tax expense of \$6.0 million on earnings before income taxes and extraordinary gain of \$11.6 million, for an effective income tax rate of 51.9%. In fact, during the first nine months of fiscal 2008, 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, whose 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 11 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 May 31, 2009, our cash and short-term investments totalled \$64.5 million, while our working capital was at \$116.6 million. Our cash and short-term investments increased \$6.4 million in the third quarter of fiscal 2009. During that period, we recorded an unrealized foreign exchange gain of \$8.4 million on our cash and short-term investments. This unrealized foreign exchange gain 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, operating activities generated cash flows of \$1.8 million during the third quarter of fiscal 2009. On the other hand, we made cash payments of \$1.5 million for the purchase of capital assets and \$2.4 million for the payment of a contingent consideration upon a business combination.

Our short-term investments consist of commercial paper issued by 9 (14 as at February 28, 2009) 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, the payment of a contingent consideration 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 consideration payable for 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 \$13.5 million for working capital and other general corporate purposes and unused lines of credit of \$16.3 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 \$1.8 million for the three months ended May 31, 2009, compared to \$1.4 million for the same period last year. Cash flows provided by operating activities were \$15.5 million for the nine months ended May 31, 2009, compared to \$8.6 million for the same period last year.

Cash flows provided by operating activities in the third quarter of fiscal 2009 were mainly attributable to the net earnings after items not affecting cash of \$1.1 million, and to the positive net change in non-cash operating items of \$774,000, mainly due to the positive effect on cash of the \$3.5 million decrease in our accounts receivable (due to timing of sales) and the \$568,000 decrease in our inventories; this was mostly offset by the negative effect on cash of the \$1.8 million increase in our income taxes and tax credits recoverable (tax credits earned during the quarter and not yet recovered) and the \$1.3 million decrease in our accounts payable and accrued liabilities, mainly due to timing of purchases and payments.

Cash flows provided by operating activities in the first nine months of fiscal 2009 were mainly attributable to the net earnings after items not affecting cash of \$17.2 million, offset by the negative net change in non-cash operating items of \$1.7 million mainly due to the negative effect on cash of the \$2.2 million increase in our income taxes and tax credits recoverable (tax credits earned during the period and not yet recovered), the \$338,000 increase in our prepaid expenses and the \$539,000 decrease in our accounts payable and accrued liabilities, mainly due to timing of purchases and payments; this was offset in part by the positive effect on cash of the \$639,000 million decrease in our accounts receivable (due to timing of sales) and the \$689,000 decrease in our inventories.

Cash flows provided by operating activities in the third quarter of fiscal 2008 were mainly attributable to the net earnings after items not affecting cash of \$7.4 million, offset in part by the negative net change in non-cash operating items of \$6.0 million. The negative net change in non-cash operating items was mainly due to the negative effect on cash of the increase of \$1.8 million of our income tax and tax credits recoverable as well as the increase of \$3.6 million of our inventories. The increase in our income taxes and tax credits is mainly due to the increase of our tax credits recoverable that were earned during the quarter but not yet recovered. The increase in our inventories resulted from an expected increase in sales activities for the next quarter.

Cash flows provided by operating activities in the first nine months of fiscal 2008 were mainly attributable to the net earnings after items not affecting cash of \$26.7 million, offset in part by the negative net change in non-cash operating items of \$18.0 million; this negative net change in non-cash operating items was mainly due to the negative effect on cash of the \$11.4 million increase in our income taxes and tax credits recoverable, the \$2.9 million increase in our inventories as well as the \$3.1 million decrease in our accounts payable and accrued liabilities. The increase in our income taxes and tax credits recoverable is mainly due to the increase of 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 income taxes and tax credits recoverable is also due to tax credits earned during the period but not yet recovered. The increase in our inventories resulted from expected increased sales activities for the next quarter. The decrease in our accounts payable and accrued liabilities is due to the timing of certain purchases and payments.

### *Investing activities*

Cash flows used by investing activities were \$420,000 for the three months ended May 31, 2009, compared to cash flows provided by investing activities of \$323,000 for the same period last year. In the third quarter of fiscal 2009, we disposed (net of acquisitions) of \$3.5 million worth of short-term investments but paid \$1.5 million for the purchase of capital assets and \$2.4 million for a contingent consideration on a business combination. For the corresponding period last year, we disposed (net of acquisitions) of \$42.6 million worth of short-term investments to pay for the cash consideration of \$40.9 million for the two business combinations closed during the quarter. On the other hand, we paid \$1.4 million for the purchase of capital assets.

Cash flows provided by investing activities were \$15.8 million for the nine months ended May 31, 2009, compared to cash flows used by investing activities of \$3.8 million for the same period last year. In the first nine months of fiscal 2009, we disposed (net of acquisitions) of \$24.1 million worth of short-term investments but paid \$6.0 million for the purchase of capital assets and \$2.4 million for a contingent consideration on a business combination. For the corresponding period last year, we disposed (net of acquisitions) of \$42.2 million worth of short-term investments to pay \$40.9 million for the cash consideration of the two business combinations closed during that period. On the other hand, we paid \$5.1 million for the purchase of capital assets.

### *Financing activities*

Cash flows provided by financing activities were \$10,000 for the three months ended May 31, 2009, compared to cash flows used by financing activities of \$2.4 million for the same period last year. During the third quarter of fiscal 2009, we received \$10,000 from the exercise of stock options. For the corresponding period last year, we redeemed share capital for a cash consideration of \$3.2 million. However, our bank loan increased \$786,000 during that period.

Cash flows used by financing activities were \$26.0 million for the nine months ended May 31, 2009, compared to \$1.8 million for the same period last year. During the first nine months of fiscal 2009, we paid \$26.1 million for the redemption of share capital under our share repurchase programs. For the corresponding period last year, we redeemed share capital for \$3.4 million. However, our bank loan increased \$1.5 million.

## **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 May 31, 2009, we held forward exchange contracts to sell US dollars at various forward rates, which are summarized as follows:

<u>Expiry dates</u>	<u>Contractual amounts</u>	<u>Weighted average contractual forward rates</u>
June 2009 to August 2009	\$ 9,100,000	1.0651
September 2009 to August 2010	27,600,000	1.1016
September 2010 to August 2011	14,600,000	1.1221
September 2011	1,000,000	1.1278
Total	<u>\$ 52,300,000</u>	<u>1.1015</u>

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 and \$566,000 as at August 31, 2008 and May 31, 2009, respectively.

## 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 April 2, 2009, a stipulation and agreement of settlement between the plaintiffs, issuer defendants and underwriter defendants was submitted to the Court for preliminary approval. The Court granted the plaintiffs' motion for preliminary approval and preliminarily certified the settlement classes on June 10, 2009. The settlement fairness hearing has been scheduled for September 10, 2009. Following the hearing, if the Court determines that the settlement is fair to the class members, the settlement will be approved and the case against EXFO and our individual defendants will be dismissed with prejudice.

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 May 31, 2009.

#### ***Contingent consideration***

Following the purchase of assets during the nine months ended May 31, 2009, we had a contingent cash consideration of up to \$1,000,000, payable based upon the achievement of a certain booking volume in the next 24 months following the purchase.

## **SHARE CAPITAL AND STOCK-BASED COMPENSATION PLANS**

### ***Share capital***

As at June 30, 2009, EXFO had 36,643,000 multiple voting shares outstanding, entitling to ten votes each, and 22,978,402 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 subordinate 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 3,203,703 as at May 31, 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 May 31, 2009:

<b>Stock Options</b>	<b>Number</b>	<b>% of issued and outstanding</b>	<b>Weighted average exercise price</b>
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
	<b>540,588</b>	<b>31%</b>	<b>\$10.40</b>

  

<b>Restricted Share Units</b>	<b>Number</b>	<b>% of issued and outstanding</b>
Chairman of the Board, President and CEO (one individual)	140,459	10%
Management and Corporate Officers (eleven individuals)	481,554	35%
	<b>622,013</b>	<b>45%</b>

  

<b>Deferred Share Units</b>	<b>Number</b>	<b>% of issued and outstanding</b>
Board of Directors (five individuals)	<b>105,213</b>	<b>100%</b>

#### **OFF-BALANCE SHEET ARRANGEMENTS**

As at May 31, 2009, our off-balance sheet arrangements consisted of letters of guarantee. As at May 31, 2009, our letters of guarantee amounted to \$6.1 million; these letters of guarantee expire at various dates through fiscal 2011. From this amount, we had \$1.3 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 \$4.8 million was used to secure our line of credit in Chinese currency. This line of credit was unused as at May 31, 2009.

#### **VARIABLE INTEREST ENTITY**

As of May 31, 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](http://www.EXFO.com) or [www.sedar.com](http://www.sedar.com) in Canada or at [www.sec.gov/edgar.shtml](http://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), in thousands of US dollars:

	<b>Three months ended May 31, 2009</b>	<b>Nine months ended May 31, 2009</b>	<b>Three months ended May 31, 2008</b>	<b>Nine months ended May 31, 2008</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>	<b>(unaudited)</b>	<b>(unaudited)</b>
GAAP net earnings (loss) for the period	\$ (23,346)	\$ (15,404)	\$ 11,179	\$ 15,110
Add (deduct):				
Amortization of property, plant and equipment	1,166	3,374	1,071	3,045
Amortization of intangible assets	1,355	3,920	1,015	2,469
Interest income	(42)	(683)	(964)	(4,063)
Income taxes	(2,851)	198	(2,780)	(523)
Impairment of goodwill	21,713	21,713	-	-
Extraordinary gain	-	-	(3,036)	(3,036)
EBITDA for the period	<u>\$ (2,005)</u>	<u>\$ 13,118</u>	<u>\$ 6,485</u>	<u>\$ 13,002</u>
EDITDA in percentage of sales	<u>(4.6)%</u>	<u>9.6%</u>	<u>13.3%</u>	<u>9.8%</u>

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