

## 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, expect, believe, plan, anticipate, intend, could, estimate, continue, or similar expressions or the negative of such expressions are intended to identify forward-looking statements. In addition, any statement that refers 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, but not limited to, macroeconomic uncertainty as well as capital spending and network deployment levels in the telecommunications industry (including our ability to quickly adapt cost structures with anticipated levels of business and our ability to manage inventory levels with market demand); future economic, competitive, financial and market conditions; consolidation in the global telecommunications test and service assurance industry and increased competition among vendors; limited visibility with regards to customer orders and the timing of such orders; fluctuating exchange rates; concentration of sales; timely release and market acceptance of our new products and other upcoming products; our ability to successfully expand international operations; our ability to successfully integrate businesses that we acquire; and the retention of key technical and management personnel. 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 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 November 1, 2013.

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

### COMPANY OVERVIEW

We are a leading provider of next-generation test and service assurance solutions for network operators and equipment manufacturers in the global telecommunications industry. We offer core-to-edge solutions that enable customers to increase network capacity and optimize reliability on their wireline and wireless IP (Internet protocol) networks. As such, we target high-growth market opportunities related to increasing bandwidth and improving quality of experience on network infrastructures : 4G/LTE (long-term evolution), wireless backhaul, small cells and distributed antenna systems (DAS), 100G network upgrades and fiber-to-the-home (FTTH)/fiber-to-the-curb (FTTC)/fiber-to-the-node (FTTN) deployments.

Our success has been largely predicated on our core expertise in developing test equipment for wireline networks. These solutions are available as handheld test instruments, portable platforms with related modules, and as rack-mounted chassis with related modules. Our PC-centric, open-ended platforms, combined with cloud-based software applications, can be transformed into a fully connected test environment called the FTB Ecosystem. Leveraging platform connectivity, customers can keep track of their entire test fleet, manage software updates and schedule calibration procedures. All test data within the FTB Ecosystem can be stored in a central database and used as a point of reference against future measurements. Consequently, this enhanced test environment enables customers to increase productivity and reduce operating expenses.

Over the years, we expanded our product portfolio into service assurance for next-generation IP networks and into test equipment for 2G, 3G and 4G/LTE wireless networks. Our service assurance solution, called the Brix System, is a probe-based hardware and software solution that delivers end-to-end, quality of service and quality of experience visibility as well as real-time IP service monitoring and verification of next-generation IP networks. Built around a distributed architecture, the Brix System enables the successful launch and ongoing profitable operation of IP-based voice, video and data applications and services.

Our 2G, 3G and 4G/LTE test portfolio mainly consists of network simulators and protocol analyzers. Our network simulators simulate real-world, large-scale network traffic and end-user behavior in a laboratory environment in order to predict network behavior, uncover faults and optimize networks before wireless networks and services are deployed. Our protocol analyzers analyze mobile network elements in order to validate functionality according to wireless technology specifications, whether these elements interoperate with each other effectively when combined to form a network, and how well the live network performs.

The competitive advantages of our products include a high degree of innovation, modularity (especially wireline products) and ease of use. Ultimately, our products enable network equipment manufacturers and operators to design, deploy, troubleshoot and monitor wireline and wireless networks and, in the process, help them reduce the cost of operating their networks.

We have a staff of approximately 1600 people in 25 countries, supporting more than 2000 telecom customers in approximately 100 countries around the world. We operate three main manufacturing sites, which are located in Quebec City, Canada, in Shenzhen, China and in Oulu, Finland. We also have five main research and development expertise centers in Boston, Toronto, Montreal, Quebec City and Oulu, supplemented by a software development center in India.

We launched 15 new products in fiscal 2013, including two in the fourth quarter. Key new product introductions in 2013 included among others the TravelHawk Pro, a 4G/LTE network troubleshooting tool that has been selected by three of the world's top five LTE operators; the FTB-88100NGE Power Blazer, the first portable, multiservice test solution supporting transmission rates from 100M to 100G; and the BV-100 service assurance probe that enables network operators to validate service-level agreements and end-user quality of experience at customer premises and cell sites.

We reported sales of \$242.2 million in fiscal 2013, which represents a decrease of 3.1% year-over-year from \$250.0 million in 2012.

We reported net earnings of \$1.3 million, or \$0.02 per diluted share, in fiscal 2013, compared to a net loss of \$3.6 million, or \$0.06 per share, in 2012. Net earnings in fiscal 2013 included \$6.4 million in after-tax amortization of intangible assets, \$1.8 million in stock-based compensation costs, \$0.1 million in after-tax restructuring charges and a foreign exchange gain of \$4.1 million. Net loss for fiscal 2012 included \$7.8 million in after-tax amortization of intangible assets, \$1.9 million in stock-based compensation costs, \$1.9 million in after-tax restructuring charges, a gain of \$0.3 million for the changes in the fair value of the cash contingent consideration and a foreign exchange loss of \$0.7 million.

Adjusted EBITDA (net earnings (loss) before interest, income taxes, depreciation and amortization, restructuring charges, changes in the fair value of the cash contingent consideration, stock-based compensation costs and foreign exchange gain or loss) amounted to \$17.3 million, or 7.2% of sales, in fiscal 2013, compared to \$18.4 million, or 7.3% of sales, in 2012. See further in this document for a complete reconciliation of adjusted EBITDA and IFRS net earnings (loss).

On November 7, 2012, we announced that our Board of Directors approved the renewal of our share repurchase program, by way of a normal course issuer bid on the open market of up to 10% of the issued and outstanding subordinate voting shares, representing 2,072,721 subordinate voting shares at the prevailing market price. The normal course issuer bid started start on November 12, 2012, and will end on November 11, 2013.

## **Sales**

We sell our products to a diversified customer base in approximately 100 countries through our direct sales force and channel partners, such as sales representatives and distributors. Most of our sales are denominated in US dollars and euros.

In fiscal 2011, 2012 and 2013, no customer accounted for more than 10% of our sales, with our top customer representing 7.2%, 4.4% and 6.1% of our sales respectively.

We believe that we have a vast array of products, a diversified customer base, and a good spread across geographical areas, which provides us with reasonable protection against the concentration of sales and credit risk.

## **Cost of Sales**

The cost of sales includes raw materials, salaries and related expenses for direct and indirect manufacturing personnel, as well as overhead costs. Excess, obsolete and scrapped materials are also included in the cost of sales. However, the cost of sales is presented exclusive of depreciation and amortization, which are shown separately in the statements of earnings.

## **Operating Expenses**

We classify our operating expenses into three main categories: selling and administrative expenses, research and development expenses, as well as depreciation and amortization expenses.

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

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

## RESULTS OF OPERATIONS

(in thousands of US dollars, except per share data, and as a percentage of sales for the years indicated)

<b>Consolidated statements of earnings data:</b>						
	<b>2013</b>	2012	2011	<b>2013</b>	2012	2011
Sales.....	\$ <b>242,150</b>	\$ 249,966	\$ 269,743	<b>100.0 %</b>	100.0 %	100.0 %
Cost of sales <sup>(1)</sup> .....	<b>92,469</b>	91,792	100,296	<b>38.2</b>	36.7	37.2
Selling and administrative .....	<b>88,756</b>	94,139	87,062	<b>36.6</b>	37.7	32.3
Net research and development .....	<b>45,444</b>	49,854	47,927	<b>18.8</b>	19.9	17.7
Depreciation of property, plant and equipment .....	<b>6,028</b>	6,169	6,655	<b>2.5</b>	2.5	2.5
Amortization of intangible assets .....	<b>6,643</b>	7,819	9,183	<b>2.7</b>	3.1	3.4
Changes in the fair value of cash contingent consideration .....	–	(311)	(2,685)	–	(0.1)	(1.0)
Interest and other income .....	<b>(113)</b>	(131)	(511)	–	(0.1)	(0.2)
Foreign exchange (gain) loss .....	<b>(4,082)</b>	657	3,808	<b>(1.7)</b>	0.3	1.4
Earnings (loss) before income taxes .....	<b>7,005</b>	(22)	18,008	<b>2.9</b>	–	6.7
Income taxes.....	<b>5,664</b>	3,571	8,814	<b>2.3</b>	1.4	3.3
Net earnings (loss) from continuing operations.....	<b>1,341</b>	(3,593)	9,194	<b>0.6 %</b>	(1.4)%	3.4 %
Net earnings from discontinued operations.....	–	–	12,926			
<b>Net earnings (loss) for the year.....</b>	<b>\$ 1,341</b>	<b>\$ (3,593)</b>	<b>\$ 22,120</b>			
Basic and diluted net earnings (loss) from						
continuing operations per share .....	\$ <b>0.02</b>	\$ (0.06)	\$ 0.15			
Basic net earnings (loss) per share.....	\$ <b>0.02</b>	\$ (0.06)	\$ 0.37			
Diluted net earnings (loss) per share .....	\$ <b>0.02</b>	\$ (0.06)	\$ 0.36			
Other selected information:						
Gross margin <sup>(2)</sup> .....	\$ <b>149,681</b>	\$ 158,174	\$ 169,447	<b>61.8 %</b>	63.3 %	62.8 %
Research and development data:						
Gross research and development .....	\$ <b>54,334</b>	\$ 59,282	\$ 57,226	<b>22.4 %</b>	23.7 %	21.2 %
Net research and development .....	\$ <b>45,444</b>	\$ 49,854	\$ 47,927	<b>18.8 %</b>	19.9 %	17.7 %
Restructuring charges included in:						
Cost of sales .....	\$ –	\$ 264	\$ –	– %	0.1 %	– %
Selling and administrative expenses .....	\$ –	\$ 1,181	\$ –	– %	0.5 %	– %
Net research and development expenses.....	\$ <b>89</b>	\$ 884	\$ –	– %	0.4 %	– %
Adjusted EBITDA <sup>(2)</sup> .....	\$ <b>17,338</b>	\$ 18,372	\$ 36,581	<b>7.2 %</b>	7.3 %	13.5 %
<b>Consolidated balance sheets data:</b>						
Total assets .....	\$ <b>281,538</b>	\$ 306,683	\$ 322,355			

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

(2) Refer to page 22 for non-IFRS measures.

## **RESULTS FROM CONTINUING OPERATIONS (formerly the Telecom Division)**

### **Sales and bookings**

#### ***Fiscal 2013 vs. 2012***

In fiscal 2013, our sales decreased 3.1% to \$242.2 million, compared to \$250.0 million in 2012, and our bookings decreased 4.6% year-over-year to \$233.5 million from \$244.8 million in 2012, for a book-to-bill ratio of 0.96 in 2013.

Market conditions in the telecommunications industry remain difficult due an uncertain macro-economic environment, marked by challenging end-markets in several European countries, uneven network operator spending in the Asia-Pacific region while investments in the Americas have been more robust. In addition, operators are attempting to monetize their investments in next-generation fixed and mobile networks as data revenue growth is not keeping pace with the required level of expenditures. Consequently, network operators are reassessing their business models and spending levels in efforts to improve profitability.

In addition, in fiscal 2013, we faced increased competition and pricing pressure compared to 2012, which reduced our sales and bookings year-over-year.

Furthermore, in fiscal 2013, calendar year-end budget spending from network operators was even more limited than the previous year, which reduced our sales and bookings for that year, compared to 2012. The magnitude of customers' calendar year-end budget spending may fluctuate year-over-year.

Finally, in fiscal 2013, we recorded in our sales foreign exchange gains of \$380,000 on our forward exchange contracts, compared to \$1.1 million in 2012, which contributed to decrease our sales 0.3% year-over-year.

However, in the second half of fiscal 2013, we witnessed some improvements in the United States as we delivered year-over-year sales growth in this area in 2013 based in part on 4G/LTE and 100G deployments.

In fiscal 2013, we also shipped large orders of our MaxTester 635 Copper, DSL and Multiplay Test Set to two tier-1 operators. We did not recognize such large orders in fiscal 2012.

#### ***Fiscal 2012 vs. 2011***

In fiscal 2012, our sales decreased 7.3% to a \$250.0 million, compared to \$269.7 million in 2011.

In fiscal 2012, market conditions were difficult as explained in the section above. In addition, Europe turned out to be more impacted than we expected, the anticipated pick-up of spending in the Americas did not materialize, especially with tier-1 operators, while China was sluggish. This resulted in lower sales in fiscal 2012, compared to 2011.

In addition, network operators grappled with issues of monetizing their investments in next-generation fixed and mobile networks as data revenue growth did not keep pace with the required level of expenditures. Consequently, network operators reassessed their business models and spending levels in efforts to improve profitability, as they increasingly scrutinized their capital expenditures and even delayed some purchasing decisions.

Also, in fiscal 2012, as a result of the above-mentioned factors, we did not benefit from the same level of calendar year-end budget spending from some of our customers compared to 2011.

Furthermore, in fiscal 2011, we received a follow-on order worth over \$6 million from a tier-1 European operator for our AXS-200/635 triple-play tester. We did not recognize such large single order in fiscal 2012.

Also, in fiscal 2012, the increase in the average value of the US dollar compared to the euro had a negative impact of approximately \$2 million on our sales compared to 2011 as we report our results in US dollars; this represented a decrease of 0.7% of sales year-over-year.

Finally, in fiscal 2012, we recorded in our sales foreign exchange gains of \$1.1 million on our forward exchange contracts, compared to \$2.8 million in 2011, which contributed to decrease our sales 0.6% year-over-year.

### ***Geographic distribution***

In fiscal 2013, sales to the Americas, Europe, Middle-East and Africa (EMEA) and Asia-Pacific (APAC) accounted for 53%, 28% and 19% of sales respectively, compared to 52%, 29% and 19% respectively in 2012 and 51%, 32% and 17% respectively in 2011.

### **GROSS MARGIN (non-IFRS measure – refer to page 22 of this document)**

Gross margin amounted to 61.8%, 63.3% and 62.8% of sales in fiscal 2013, 2012 and 2011 respectively.

### ***Fiscal 2013 vs. 2012***

The decrease in our gross margin in fiscal 2013, compared to 2012, can be explained by the following factors.

In fiscal 2013, our gross margin was unfavorably affected by our product mix. Namely, in fiscal 2013, we shipped large orders of our copper-access test solutions; this product line typically delivers lower margins than our other test solutions.

In addition, increased pricing pressure in fiscal 2013, compared to 2012 had a negative impact on our gross margin year-over-year.

Furthermore, a lower sales volume in fiscal 2013 compared to 2012 (3.1%) resulted in a lower absorption of our fixed manufacturing costs, which resulted in a lower gross margin year-over-year.

Also, in fiscal 2012, our warranty expenses were lower compared to 2013; this resulted in a positive impact on our gross margin in fiscal 2012.

In addition, in fiscal 2013, due to the decrease in the value of the Canadian dollar versus the US dollar, we reported a lower gain on our forward exchange contracts in our sales compared to 2012, which negatively affected our gross margin year-over-year.

Finally, the decrease in the value of the Canadian dollar, compared to the US dollar over the last few months, had a negative impact on our gross margin in fiscal 2013 compared to 2012; in fact, our procurement costs increased as the Canadian dollar decreased compared to the US dollar, since a significant portion of our raw material purchases are denominated in US dollars and our raw material costs of parts purchased in US dollars are measured in Canadian dollars in our financial statements.

However, in fiscal 2013, a larger portion of our sales came from products manufactured in our facilities in China compared to 2012, thus offsetting in part the year-over-year decrease in our gross margin; those products have a lower cost of goods than those manufactured in our facilities in Canada and Finland.

Also, in fiscal 2012, we recorded \$264,000 in restructuring charges in the cost of sales (nil in 2013), which negatively impacted our gross margin for that year.

#### ***Fiscal 2012 vs. 2011***

The increase in our gross margin in fiscal 2012, compared to 2011, can be explained by the following factors.

First, in fiscal 2012, our gross margin was favorably affected by our product mix. In addition, in fiscal 2011, we reported larger orders for copper-access solutions, which typically deliver lower margins than our test solutions, and we granted larger volume discounts on a significant part of these sales.

Furthermore, in fiscal 2012, our warranty expenses were lower compared to 2011; this resulted in a positive impact on our gross margin year-over-year.

In addition, in fiscal 2012, a larger portion of our sales came from products manufactured in our facilities in China compared to 2011, thus resulting in an improvement in our gross margin year-over-year.

On the other hand, a lower sales volume in fiscal 2012 compared to 2011 (7.3%) resulted in a lower absorption of our fixed manufacturing costs, which prevented us from further improving our gross margin year-over-year.

In addition, in fiscal 2012, we faced increased pricing pressure compared to 2011, which negatively affected our gross margin year-over-year.

Also, in fiscal 2012, we recorded \$264,000 in restructuring charges in the cost of sales, which negatively impacted our gross margin year-over-year.

Furthermore, in fiscal 2012, due to the decrease in the value of the Canadian dollar versus the US dollar, we reported a lower gain on our forward exchange contracts in our sales compared to 2011, which negatively affected our gross margin year-over-year.

Finally, the decrease in the value of the Canadian dollar, compared to the US dollar had a negative impact on our gross margin in fiscal 2012 compared to 2011.

#### ***Outlook for fiscal 2014***

Considering the expected sales growth, the expected increase in sales of protocol products as well as software-intensive products and services, the cost-effective design of our products, and our tight control on costs, we expect our gross margin to improve in the future. However, our gross margin may fluctuate quarter-over-quarter due to the mix of our products and as our sales may fluctuate. Furthermore, our gross margin can be negatively affected by increased competitive pricing pressure, customer concentration and/or consolidation, increased obsolescence and warranty costs, shifts in customer mix, under-absorption of fixed manufacturing costs, increases in product offerings by other suppliers in our industry, as well as unfavorable exchange rates.

#### **SELLING AND ADMINISTRATIVE EXPENSES**

Selling and administrative expenses amounted to \$88.8 million, \$94.1 million and \$87.1 million for fiscal 2013, 2012 and 2011 respectively. As a percentage of sales, selling and administrative expenses amounted to 36.6%, 37.7% and 32.3% for fiscal 2013, 2012 and 2011 respectively.

### ***Fiscal 2013 vs. 2012***

In fiscal 2013, our selling and administrative expenses, especially salaries and benefits as well as travel expenses, decreased year-over-year due to tight controls on expenses and the impact of our 2012 restructuring plan.

In addition, in fiscal 2012, we recorded \$1.2 million, or 0.5% of sales (nil in 2013), in restructuring charges in our selling and administrative expenses for the employees laid off as part of our 2012 restructuring plan.

Finally, in fiscal 2013, commission expenses to our sales channels were lower compared to 2012, due to a lower sales volume year-over-year.

### ***Fiscal 2012 vs. 2011***

In fiscal 2012, we intensified our sales and marketing efforts, including additional employees, both domestically and internationally, and we incurred bad debt expenses compared to bad debt recovery in 2011; in addition, despite a lower sales volume year-over-year (7.3%), our commission expenses to our sales channels were almost flat compared to 2011 due to the shift in product and territory mix; this caused our expenses to increase as a percentage of sales year-over-year.

In addition, in fiscal 2012, we recorded \$1.2 million, or 0.5% of sales, in restructuring charges in our selling and administrative expenses for the employees laid off as part of our 2012 restructuring plan.

However, the increase in the average value of the US dollar in fiscal 2012 compared to the Canadian dollar and the euro year-over-year had a positive impact on our selling and administrative expenses, as a portion of these expenses are incurred in Canadian dollars and euros and we report our results in US dollars.

### ***Outlook for fiscal 2014***

For fiscal 2014, we expect our selling and administrative expenses to decrease as percentage of sales and range between 33% and 35%. However, any increase in the strength of the Canadian dollar and the euro versus the US dollar in the upcoming quarters would cause our selling and administrative expenses to increase, as a portion of these expenses are incurred in these currencies and we report our results in US dollars.

## **RESEARCH AND DEVELOPMENT EXPENSES**

### ***Gross research and development expenses***

Gross research and development expenses totaled \$54.3 million, \$59.3 million and \$57.2 million for fiscal 2013, 2012 and 2011 respectively. As a percentage of sales, gross research and development expenses amounted to 22.4%, 23.7% and 21.2% for fiscal 2013, 2012 and 2011 respectively, while net research and development expenses accounted for 18.8%, 19.9% and 17.7% of sales for these respective years.

### ***Fiscal 2013 vs. 2012***

In fiscal 2013, our gross research and development expenses decreased year-over-year, especially salaries and benefits, due to tight controls on expenses and to the impact of our 2012 restructuring plan.

In addition, in fiscal 2012, we recorded \$884,000, or 0.4% of sales, in restructuring charges in our gross research and development expenses for the employees laid off as part of our 2012 restructuring plan, compared to \$89,000 in 2013.

Furthermore, in fiscal 2013, a shift in the mix and timing of research and development projects resulted in decreased gross research and development expenses compared to 2012, mainly from consultants, subcontracting and material expenses.

Finally, in fiscal 2013, the year-over-year increase in the average value of the US dollar compared to the Indian rupee had a positive impact on our gross research and development expenses, as a portion of these expenses are incurred in Indian rupees and we report our results in US dollars.

#### ***Fiscal 2012 vs. 2011***

In fiscal 2012, we intensified our research and development activities, including additional employees, which resulted in increased gross research and development expenses compared to 2011. In addition, in fiscal 2012, the mix and calendar of research and development projects resulted in increased gross research and development expenses compared to 2011.

In addition, in fiscal 2012, we recorded \$884,000, or 0.4% of sales, in restructuring charges in our gross research and development expenses for the employees laid off as part of our 2012 restructuring plan.

However, the increase in the average value of the US dollar in fiscal 2012 compared to the Canadian dollar, the euro and the Indian rupee year-over-year had a positive impact on our gross research and development expenses, as most of these expenses are incurred in these currencies and we report our results in US dollars.

#### ***Tax credits and grants***

We are entitled to tax credits from the Canadian federal and provincial governments for eligible research and development activities conducted in Canada. We are also eligible for grants by a Finnish technology organization on certain research and development projects conducted in Finland.

Tax credits and grants for research and development activities were \$8.9 million, \$9.4 million and \$9.3 million for fiscal 2013, 2012 and 2011 respectively. As a percentage of gross research and development expenses, tax credits reached 16.4%, 15.9% and 16.2% for fiscal 2013, 2012 and 2011 respectively.

#### ***Fiscal 2013 vs. 2012***

The decrease in tax credits and grants in fiscal 2013 compared to 2012 results from the decrease in gross research and development expenses year-over-year as we were entitled to the same tax credit and grant programs year-over-year.

#### ***Outlook for fiscal 2014***

For fiscal 2014, we expect our net research and development expenses to slightly decrease as a percentage of sales and range between 17% and 19%. However, any increase in the strength of the Canadian dollar, the euro and the Indian rupee versus the US dollar in the upcoming quarters would cause our net research and development expenses to increase, as most of these expenses are incurred in these currencies and we report our results in US dollars.

### **DEPRECIATION OF PROPERTY, PLANT AND EQUIPMENT**

In fiscal 2013, depreciation of property, plant and equipment amounted to \$6.0 million, compared to \$6.2 million and \$6.7 million in 2012 and 2011 respectively.

### ***Fiscal 2012 vs. 2011***

The decrease in depreciation expense in fiscal 2012, compared to 2011, was due to the fact that some assets became fully depreciated as well as the increase in the average value of the US dollar versus the Canadian dollar, the euro and the Indian rupee year-over-year, as most of our depreciation expense is incurred in these currencies and we report our results in US dollars.

### **AMORTIZATION OF INTANGIBLE ASSETS**

In conjunction with the business combinations we completed over the past several years, we recorded intangible assets, primarily consisting of core technology, customer relationships and brand names. In addition, intangible assets include software. These intangible assets resulted in amortization expenses of \$6.6 million, \$7.8 million and \$9.2 million for fiscal 2013, 2012 and 2011 respectively.

### ***Fiscal 2013 vs. 2012***

The decrease in amortization expenses in fiscal 2013 compared to 2012 comes from the fact that core technology related to the acquisition of Brix Networks Inc. (acquired in fiscal 2008) became fully amortized during fiscal 2013.

### ***Fiscal 2012 vs. 2011***

The decrease in amortization expenses in fiscal 2012, compared to 2011, comes from the fact that core technologies related to the acquisition of Consultronics Limited (acquired in fiscal 2006) became fully amortized during fiscal 2011. In addition, the increase in the average value of the US dollar compared to the Canadian dollar and the euro had, to some extent, a positive impact on our amortization expenses, as most of these expenses are incurred in these currencies and we report our results in US dollars.

### ***Outlook for fiscal 2014***

We expect amortization of intangible assets to decrease in fiscal 2014 compared to 2013 due to the fact that core technology related to the acquisition of Brix Networks Inc. became fully amortized during fiscal 2013.

### **CHANGES IN THE FAIR VALUE OF THE CASH CONTINGENT CONSIDERATION**

In fiscal 2012, changes in the fair value of the cash contingent consideration amounted to \$311,000, compared to \$2.7 million in 2011.

In connection with the acquisition of NetHawk Oyj in 2010, we had a cash contingent consideration of up to €8.7 million based on a sales volume of certain NetHawk products over a three-year period ended on December 2012. We recorded the cash contingent consideration payable at fair value in each balance sheet date based on actual and forecasted sales over the period of the contingent consideration. Changes in the fair value of the cash contingent consideration payable were recorded in the consolidated statements of earnings.

### ***Fiscal 2012***

As at August 31, 2012, the fair value of the cash contingent consideration payable was estimated to nil based on actual and forecasted sales of certain NetHawk products over the period of the contingent consideration; the resulting change in the fair value during the year ended August 31, 2012, in the amount of \$311,000 (€235,000), was recorded in the consolidated statements of earnings for that year.

### ***Fiscal 2011***

As at August 31, 2011, the fair value of the cash contingent consideration payable was estimated to \$338,000 (€235,000), which resulted in a change in the fair value of \$2.7 million, recorded in the statement of earnings in fiscal 2011.

### **FOREIGN EXCHANGE GAIN (LOSS)**

Foreign exchange gains and losses are mainly the result of the translation of operating activities denominated in currencies other than our functional currency, which is the Canadian dollar. A portion of our foreign exchange gains or losses results from the translation of cash balances and deferred income taxes denominated in US dollars. We manage our exposure to currency risks in part with forward exchange contracts. In addition, some of our entities' operating activities are denominated in US dollars, euros or other currencies, which further hedges these risks. However, we remain exposed to currency risks; namely, any increase in the value of the Canadian dollar, compared to the US dollar, would have a negative impact on our operating results.

We reported a foreign exchange gain of \$4.1 million in fiscal 2013, compared to a foreign exchange loss of \$657,000 and \$3.8 million in 2012 and 2011 respectively.

### ***Fiscal 2013***

In fiscal 2013, the period-end value of the Canadian dollar significantly decreased versus the US dollar and the euro, compared to the previous year end, which resulted in a foreign exchange gain of \$4.1 million during the year. The period-end value of the Canadian dollar decreased 6.3% compared to the US dollar to CA\$1.0530 = US\$1.00 in fiscal 2013, compared to CA\$0.9863 = US\$1.00 at the end of the previous year, and decreased 12.0% compared to the euro to CA\$1.3936 = €1.00 in fiscal 2013, compared to CA\$1.2438 = €1.00 at the end of the previous year. In fiscal 2013, the average value of the Canadian dollar compared to the US dollar was CA\$1.0107 = US\$1.00.

### ***Fiscal 2012***

In fiscal 2012, we witnessed some volatility in the value of the Canadian dollar as it fluctuated compared to the US dollar, which overall resulted in a foreign exchange loss of \$657,000. The period-end value of the Canadian dollar slightly decreased 0.9% to CA\$0.9863 = US\$1.00 in fiscal 2012, compared to CA\$0.9784 = US\$1.00 in 2011, while the average value of the Canadian dollar compared to the US dollar was CA\$1.0094 = US\$1.00 in 2012.

### ***Fiscal 2011***

In fiscal 2011, the period-end value of the Canadian dollar significantly increased versus the US dollar, compared to the previous year end, which resulted in a significant foreign exchange loss of \$3.8 million during the year. The period-end value of the Canadian dollar increased 9.0% versus the US dollar to CA\$0.9784 = US\$1.00 in fiscal 2011, compared to CA\$1.0665 = US\$1.00 in 2010. In fiscal 2011, the average value of the Canadian dollar compared to the US dollar was CA\$0.9894 = US\$1.00.

Foreign exchange rate fluctuations also flow through the P&L line items as a significant portion of cost of sales and our operating items are denominated in Canadian dollars, euros and Indian rupees, and we report our results in US dollars.

### ***Fiscal 2013 vs. 2012***

In fiscal 2013, the increase of the average US dollar compared to the Canadian dollar and Indian rupee year-over-year had a positive impact on our financial results. The average value of the US dollar in fiscal 2013 increased 1.3% and 7.3% respectively, compared to the Canadian dollar and the Indian rupee.

### ***Fiscal 2012 vs. 2011***

In fiscal 2012, the increase in the average value of the US dollar, compared to the Canadian dollar, the euro and the Indian rupee year-over-year, resulted in a positive impact on our financial results. The average value of the US dollar in fiscal 2012 increased 2.0%, 6.2% and 12.3% respectively, compared to the Canadian dollar, the euro and the Indian rupee.

## **INCOME TAXES**

We recorded income tax expenses of \$5.7 million, \$3.6 million and \$8.8 million in fiscal 2013, 2012 and 2011 respectively.

### ***Fiscal 2013***

In fiscal 2013, we reported income tax expenses of \$5.7 million on earnings before income taxes of \$7.0 million. This situation mainly resulted from the fact that we did not recognize deferred income tax assets for some of our subsidiaries at loss and we had some non-deductible expenses, such as stock-based compensation costs. However, a significant portion of our foreign exchange gain was created by the translation of financial statements of our foreign subsidiaries, and was therefore non-taxable. Otherwise, the effective tax rate would have been closer to the combined Canadian and provincial statutory tax rate of 27% in fiscal 2013.

### ***Fiscal 2012***

In fiscal 2012, we reported income tax expenses of \$3.6 million on a loss before income taxes of \$22,000. This situation mainly resulted from the fact that we did not recognize deferred income tax assets for some of our subsidiaries at loss and we had some non-deductible expenses, such as stock-based compensation costs. However, in fiscal 2012, we recognized previously unrecognized deferred income tax assets of one of our subsidiaries, which resulted in a one-time income tax recovery of \$557,000. Otherwise, the effective tax rate would have been closer to the combined Canadian and provincial statutory tax rate of 27% in fiscal 2012.

### ***Fiscal 2011***

In fiscal 2011, we reported an income tax expense of \$8.8 million on earnings before income taxes of \$18.0 million. This situation mainly resulted from the fact that a significant portion of our foreign exchange loss was created by the translation of financial statements of our foreign subsidiaries, and was therefore non-deductible. In addition, we did not recognize deferred income tax assets for some of our subsidiaries at loss and we had some non-deductible expenses, such as stock-based compensation costs. However, the changes in the fair value of the cash consideration, which resulted in a gain of \$2.7 million, were non-taxable. Otherwise, the effective tax rate would have been closer to the statutory tax rate of 29% in fiscal 2011.

Please refer to note 21 to our consolidated financial statements for a full reconciliation of our income tax provision.

## **RESULTS OF DISCONTINUED OPERATIONS (formerly the Life Sciences and Industrial Division)**

On October 1, 2010, we completed the sale of our Life Sciences and Industrial Division and that Division contributed one month to our results of the first quarter of fiscal 2011. Results from operations for that Division for the first quarter of fiscal 2011 were included in net earnings from discontinued operations along with the gain on the sale of the Division.

### **SALES**

In fiscal 2011, sales of the discontinued operations (one-month contribution) amounted to \$2.0 million.

### **NET EARNINGS**

In fiscal 2011, we reported net earnings from discontinued operations of \$12.9 million, which included a gain on disposal of discontinued operations of \$13.2 million and \$264,000 in stock-based compensation costs.

### **LIQUIDITY AND CAPITAL RESOURCES**

#### ***Cash requirements and capital resources***

As at August 31, 2013, cash and short-term investments totaled \$50.3 million, while our working capital was at \$110.5 million. Our cash and short-term investments decreased \$16.9 million in fiscal 2013, compared to 2012. First, in fiscal 2013, we made cash payments of \$8.0 million for the purchase of capital assets, \$3.1 million for the redemption of share capital under our share repurchase program and \$589,000 for the repayment of our long-term debt. In addition, in fiscal 2013, operating activities used \$2.0 million in cash. Finally, we recorded an unrealized foreign exchange loss of \$3.2 million on our cash and short-term investments. This unrealized foreign exchange loss resulted from the translation, in US dollars, of our Canadian-dollar-denominated cash and short-term investments and was included in the accumulated other comprehensive income in the balance sheet.

Our short-term investments consist of a commercial paper issued by a high-credit quality corporation; therefore, we consider the risk of non-performance of this financial instrument to be limited. This debt instrument is not expected to be affected by a significant liquidity risk. For the purpose of managing our cash position, we have established a cash management policy, which we follow and monitor on a regular basis. Our cash and short-term investments will be used for working capital and other general corporate purposes, potential acquisitions as well as our share repurchase program. As at August 31, 2013, cash balances included an amount of \$30.4 million that bears interest at an annual rate of 1.5%.

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 effect of our normal course issuer bid. In addition to these assets, we have unused available lines of credit totaling \$15.6 million for working capital and other general corporate purposes and unused lines of credit of \$21.9 million for foreign currency exposure related to forward exchange contracts. However, possible operating losses, additional restructuring costs 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.

As at August 31, 2013, our commitments under operating leases amount to \$3.8 million in 2014, \$3.0 million in 2015, \$1.7 million in 2016, \$0.6 million in 2017 and \$0.7 million in 2018 and after, for total commitments of \$9.8 million.

### ***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 (including discontinued operations)***

Cash flows used by operating activities were \$2.0 million in fiscal 2013, compared to cash flows provided of \$25.3 million and \$23.3 million in 2012 and 2011 respectively.

#### ***Fiscal 2013 vs. 2012***

Cash flows used by operating activities in fiscal 2013 were attributable to the net earnings after items not affecting cash of \$16.4 million more than offset by the negative net change in non-cash operating items of \$18.4 million; this was mainly due to the negative effect on cash of the increase of \$14.8 million in our accounts receivable due to the timing of sales during the year, the negative effect on cash of the increase of \$4.2 million in our income tax and tax credits recoverable due to tax credits earned during the year not yet recovered as well as the negative effect on cash of the decrease of \$2.6 million in our accounts payable, accrued liabilities, provisions and other liabilities due to timing of purchases and payments during the year. These negative effects on cash were offset in part by the positive effect on cash of the decrease of \$2.9 million in our inventories due to the decrease in sales year-over-year and an improved inventory turn during the year.

#### ***Fiscal 2012 vs. 2011***

Cash flows provided by operating activities in fiscal 2012 were mainly attributable to the net earnings after items not affecting cash of \$12.0 million and the positive net change in non-cash operating items of \$13.3 million; this was mainly due to the positive effect on cash of the decrease of \$8.0 million in our accounts receivable, due to the decrease in sales year-over-year and the timing of sales within the year, the decrease of \$10.9 million in our inventories due the decrease in sales year-over-year and an improved inventory turn, as well as the increase of \$538,000 in our accounts payable, accrued liabilities, provisions and other liabilities due to timing of purchases and payments during the year. These positive effects on cash were offset in part by the negative effect of the increase of \$5.6 million in our income taxes and tax credits recoverable due to tax credits earned during the period not yet recovered and the increase of \$589,000 in our prepaid expenses due to the timing of payments during the year.

#### ***Investing activities (including discontinued operations)***

Cash flows used by investing activities amounted to \$5.0 million in fiscal 2013, compared to cash flows provided of \$13.1 million in 2012 and cash flows used of \$25.3 million in 2011.

#### ***Fiscal 2013***

In fiscal 2013, we paid \$8.0 million for the purchase of capital assets but we disposed (net of acquisitions) of \$3.0 million worth of short-term investments.

#### ***Fiscal 2012***

In fiscal 2012, we disposed (net of acquisitions) of \$36.9 million worth of short-term investments, but we paid \$23.8 million for the purchase of capital assets, mainly for our building in Montreal, Canada.

### **Fiscal 2011**

In fiscal 2011, we acquired (net of disposal) \$34.7 million worth of short-term investments and we paid \$12.2 million for the purchase of capital assets and \$1.0 million in relation to the acquisition of NetHawk. However, we received \$22.1 million from the disposal of discontinued operations and \$568,000 from the sale of non-core capital assets.

#### *Financing activities (including discontinued operations)*

Cash flows used by financing activities amounted to \$3.6 million in fiscal 2013, compared to \$3.3 million in 2012 and cash flows provided of \$1.6 million in 2011.

### **Fiscal 2013**

In fiscal 2013, we redeemed share capital for a cash consideration of \$3.1 million and repaid \$589,000 of our long-term debt. However, we received \$87,000 from the exercise of stock options.

### **Fiscal 2012**

In fiscal 2012, we reimbursed our bank loan of \$782,000, we made a repayment of \$577,000 of our long-term debt, and we redeemed share capital for a cash consideration of \$2.2 million. However, we received \$310,000 from the exercise of stock options.

### **Fiscal 2011**

In fiscal 2011, our bank loan increased \$772,000 and we received \$1.5 million from the exercise of stock options, but we repaid \$619,000 on our long-term debt.

## **FORWARD EXCHANGE CONTRACTS**

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

Our forward exchange contracts, which are used to hedge anticipated US-dollar-denominated sales, qualify for hedge accounting; therefore, realized 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 August 31, 2013, 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>
September 2013 to August 2014	\$ 22,200,000	1.0280
September 2014 to August 2015	15,000,000	1.0529
September 2015 to August 2016	5,000,000	1.0716
Total	<u>\$ 42,200,000</u>	<u>1.0420</u>

The carrying amount of forward exchange contracts is equal to fair value, which is based on the amount at which they could be settled based on estimated current market rates. The fair value of forward exchange contracts amounted to net gains of \$2.3 million and \$932,000 as at August 31, 2011 and 2012 respectively, and net losses of \$808,000 as at August 31, 2013. The year-end exchange rate was CA\$1.0530 = US\$1.00 as at August 31, 2013.

## SHARE CAPITAL

### *Share capital*

As at November 1, 2013, EXFO had 31,643,000 multiple voting shares outstanding, entitling to 10 votes each and 28,727,373 subordinate voting shares outstanding. The multiple voting shares and the subordinate voting shares are unlimited as to number and without par value.

## OFF-BALANCE SHEET ARRANGEMENTS

As at August 31, 2013, our off-balance sheet arrangements consisted of letters of guarantee amounting to \$667,000 for our own selling and purchasing requirements, which were reserved from our lines of credit; these letters of guarantee expire at various dates through fiscal 2017.

## SPECIAL PURPOSE ENTITIES

As at August 31, 2013, we did not have interests in any special purpose entities.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and the disclosures of contingent assets and liabilities at the date of the financial statements. On an ongoing basis, we evaluate these estimates and assumptions, including those related to the fair value of financial instruments, the allowance for doubtful accounts receivable, the amount of tax credits recoverable, the provision for excess and obsolete inventories, the estimated useful lives of capital assets, the valuation of long-lived assets, the impairment of goodwill, the recoverable amount of deferred income tax assets, the amount of certain accrued liabilities, provisions and deferred revenue as well as stock-based compensation costs. We base our estimates and assumptions on historical experience and on other factors that we believe to be reasonable under the circumstances.

### *Critical judgments in applying accounting policies*

#### *(a) Determination of functional currency*

We operate in multiple countries and generate revenue and incur expenses in several currencies, namely the Canadian dollar, the US dollar, the euro, the British Pound, the Indian rupee and the CNY (Chinese currency). The determination of the functional currency of EXFO and its subsidiaries may require significant judgment. In determining the functional currency of EXFO and its subsidiaries, we take into account primary, secondary and tertiary indicators. When indicators are mixed and the functional currency is not obvious, we use our judgment to determine the functional currency.

For the years ended August 31, 2011 and 2012, we had one foreign operation (NetHawk) having the euro as its functional currency. For the year ended August 31, 2013, following changes in the organizational structure affecting this subsidiary and centralization of certain of its activities into those of our parent company and based on the analysis of relevant indicators, we have determined that the functional currency of this subsidiary is now the Canadian dollar. In accordance with IAS 21, *"The Effects of Changes in Foreign Exchange Rates"*, this change has been accounted for prospectively from the date of the change.

*(b) Determination of cash generating units and allocation of goodwill*

For the purpose of impairment testing, goodwill must be allocated to each cash-generating unit (CGU) or group of CGUs that are expected to benefit from the synergies of the business combination. Initial allocation and possible reallocation of goodwill to a CGU or a group of CGUs requires judgment.

During the year ended August 31, 2013, following changes in the organizational structure affecting the NetHawk CGU and centralization of certain of its activities into those of our parent company, we applied judgment in reallocating the goodwill associated with the NetHawk CGU to our parent company's operations. The reallocation of goodwill did not trigger impairment.

***Critical estimated and assumptions***

*(a) Inventories*

We state our inventories at the lower of cost, determined on an average cost basis and net realizable value, and we provide reserves for excess and obsolete inventories. We determine our reserves for excess and obsolete inventories based on the quantities on hand at the reporting dates compared to foreseeable needs over the next 12 months, taking into account changes in demand, technology or market. It is possible that additional inventory reserves may occur if future sales are less than our forecasts or if there is a significant shift in product mix compared to our forecasts, which could adversely affect our future results.

*(b) Income taxes*

We are subject to income tax laws and regulations in several jurisdictions. Under these laws and regulations, uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. We maintain provisions for uncertain tax positions that we believe appropriately reflect our risk based on our interpretation of laws and regulations. In addition, we make reasonable estimates and assumptions to determine the amount of deferred tax assets that can be recognized in our consolidated financial statements, based upon the likely timing and level of anticipated future taxable income together with tax planning strategies. The ultimate realization of our deferred income tax assets is dependent upon the generation of sufficient future taxable income during the periods in which those assets are expected to be realized.

As at August 31, 2013, we had deferred income tax assets in the balance sheet in the amount of \$10.8 million mainly in the United States. In order to realize these deferred income tax assets, we need to generate \$27 million in pre-tax earnings at the United States level. In order to generate \$27 million in pre-tax earnings at the United State level over the estimated recovery period of seven years, we need to generate a pre-tax earnings compound annual growth rate (CAGR) of 9%, which we believe is probable.

*(c) Tax credits recoverable*

Tax credits are recorded provided that there is reasonable assurance that we have complied and will comply with all the conditions related to the tax credits and that the tax credits will be received. The ultimate recovery of our non-refundable-long-term tax credits is dependent upon the generation of sufficient future taxable income during the tax credits carry-forward periods. We have made reasonable estimates and assumptions to determine the amount of non-refundable-long-term tax credits that can be recognized in our consolidated financial statements, based upon the likely timing and level of anticipated future taxable income together with tax planning strategies.

As at August 31, 2013, our non-refundable research and development tax credits recognized in the balance sheet amounted to \$42.4 million. In order to recover these non-refundable research and development tax credits, we need to generate approximately \$275 million (CA\$290 million) in pre-tax earnings at the Canadian federal level and approximately \$11 million at the Canadian provincial level. In order to generate \$275 million in pre-tax earnings at the Canadian Federal level over the estimated recovery period of 16 years, we need to generate a pre-tax earnings CAGR of 5%, which we believe is probable. Our non-refundable research and development tax credits can be carried forward over a twenty-year period.

*(d) Impairment of non-financial assets*

Impairment exists when the carrying value of an asset or group of assets (cash generating unit (CGU)) exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The fair value less costs to sell calculation is based on available data from binding sales transactions in an arm's length transaction, available data from observable active market prices less incremental costs for disposing of the asset, the company's stock price, or data from recent transactions of similar assets, within the same industry, when available. When such information is not available, or to supplement this information, we use discounted cash flows. The establishment of discounted cash flows requires the use of estimates, including our expectations of future revenue growth, operating costs and profit margins as well as discount rates for each CGU.

*i) Growth rates*

The assumptions used are based on historical growth, our internal budget, expectations of future revenue growth as well as industry and market trends. We projected revenues, operating margins and cash flows for periods of five years, and we applied a perpetual growth rate thereafter.

*ii) Discount rate*

We used a discount rate to calculate the present value of estimated future cash flows, which represents our weighted average cost of capital (WACC), plus a premium to take into account specific risks of the CGU, as the case may be.

In the fourth quarter of fiscal 2013, we performed our annual goodwill impairment test for our two CGUs, EXFO (formerly NetHawk CGU) and Brix.

NetHawk, acquired in 2010, was identified as a separate cash generating unit (CGU) and the resulting goodwill, recognized upon the acquisition, was allocated to this CGU. During the year ended August 31, 2013, changes in the organizational structure of NetHawk's operations and the centralization of certain of its activities into those of our parent company affected our the CGUs, resulting in NetHawk related goodwill being reallocated to our parent company CGU (EXFO CGU), which represents the lowest level at which goodwill is monitored.

For the EXFO CGU, we used a market-based approach (sales multiples) based on recent comparable transactions in our industry, supplemented by an analysis of our enterprise value derived from our market capitalization to assess the CGU's recoverable amount. For the year ended 2012, we used a combination of a market-based approach (sales multiples), based on recent comparable transactions in our industry, and discounted cash flows to assess the recoverable amount of the NetHawk CGU.

For the Brix CGU, we used a combination of a market-based approach (sales multiples), based on recent comparable transactions in our industry, and discounted cash flows to assess the CGU's recoverable amount.

The sales multiple of recent comparable transactions for both CGUs ranged between 1.2 and 4 times sales. These comparable transactions occurred in calendar 2012 and 2013.

Discounted cash flows for the Brix CGU were based on five-year projections, using a five-year sales CAGR of 23% and a perpetual growth rate of 2% thereafter. We used a discount rate of 18%.

As at August 31, 2013, the recoverable amount for both CGUs exceeded their carrying value.

As at August 31, 2013, the carrying value of goodwill totaled \$27.3 million and was allocated as follows to two CGUs:

EXFO CGU	\$	10,791,000
Brix CGU		16,522,000
Total	\$	<u>27,313,000</u>

## NEW IFRS PRONOUNCEMENTS AND AMENDMENTS

### Adopted during the year

#### *Financial Statement Presentation*

The *Internal Accounting Standard Board* (IASB) amended IAS 1, “*Financial Statement Presentation*”. The amendments to IAS 1 require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be recycled to the statement of earnings in the future. Items that will not be recycled will be presented separately from items that may be recycled in the future, such as unrealized gains and losses on cash-flow hedges. The amendments are effective for annual periods beginning on or after July 1, 2012. We adopted these amendments on September 1, 2012 and classified items of other comprehensive income accordingly.

### Issued but not yet adopted

#### *Financial Instruments*

IFRS 7, “*Financial Instruments: Disclosures*”, has been amended to enhance disclosure requirements related to offsetting of financial assets and liabilities. The amendments are applicable retrospectively for annual periods beginning on or after January 1, 2013. We will adopt these amendments on September 1, 2013 and expect their adoption to have no significant impact on our consolidated financial statements.

IFRS 9, “*Financial Instruments*”, was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39, “*Financial Instruments – Recognition and Measurement*”, for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return on investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. Requirements for financial liabilities were added to IFRS 9 in October 2010, and they largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income. This standard is effective for annual periods beginning on or after January 1, 2015. We have not yet assessed the impact that this new standard is likely to have on our consolidated financial statements.

The IASB issued the following standards: IFRS 10, “*Consolidated Financial Statements*”, IFRS 11, “*Joint Arrangements*”, IFRS 12, “*Disclosure of Interests in Other Entities*”, and IFRS 13, “*Fair Value Measurement*”. Each of the new standards is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. We will adopt these new standards on September 1, 2013 and do not expect them to have a significant impact on our consolidated financial statements.

The following is a brief summary of these new standards:

#### **Consolidation**

IFRS 10, “*Consolidated Financial Statements*”, requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when a company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces Standing Interpretations Committee (“SIC”) 12, “*Consolidation – Special Purpose Entities*” and parts of IAS 27, “*Consolidated and Separate Financial Statements*”.

#### **Joint Arrangements**

IFRS 11, “*Joint Arrangements*”, requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operations. Joint ventures will be accounted for using the equity method of accounting, whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenues and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity-account for interests in joint ventures. IFRS 11 replaces IAS 31, “*Interests in Joint Ventures*”, and SIC 13, “*Jointly Controlled Entities – Non-Monetary Contributions by Venturers*”.

#### **Disclosure of Interests in Other Entities**

IFRS 12, “*Disclosure of Interests in Other Entities*”, establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates and structured entities. This standard carries forward existing disclosures and introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity’s interests in other entities.

#### **Fair Value Measurement**

IFRS 13, “*Fair Value Measurement*”, is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and, in many cases, does not reflect a clear measurement basis or consistent disclosures.

### **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 solutions 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 and complex 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 plans and policies.

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 capital spending in North America, Europe and Asia and by unfavorable general economic conditions. In particular, sales to network operators in North America were significantly and adversely affected by a downturn in the telecommunications industry in 2001 and by the global economic recession in 2009. Challenging market conditions resurfaced in 2012 and continued in 2013 with network operators placing a tight rein on capital expenditures as the global economic environment became uncertain and the European debt crisis persisted, as well as with the complexity of deploying fully converged IP networks. In the event of another recession or slowdown in key geographic regions or markets, we may experience a material adverse impact on our business, operating results and financial condition.

In addition, we are exposed to currency risks due to the export of our products manufactured in Canada, China and Finland; the large majority of these sales are denominated in US dollars and euros. These risks are partially hedged by operating expenses denominated in US dollars and euros, the purchase of raw materials in US dollars as well as forward exchange contracts. Any decrease in the value of the US dollar, compared to the Canadian dollar and the euro, in the coming months would negatively affect our results of operations.

Furthermore, risks and uncertainties related to the telecommunications test and service assurance industry involve the rapid development of new products on a timely manner that may have short lifecycles and require extensive research and development; the difficulty of adequately predicting market size and trends; the ability to quickly adapt our cost structure to changing market conditions in order to achieve profitability; and the difficulty of retaining highly skilled employees.

Also, given our strategic goals for growth and competitive positioning in our industry, we are continuously expanding into international markets, such as the operation of our manufacturing facilities in China and our software development center in India as well as operating other subsidiaries in many countries. 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 different countries.

The economic environment of our industry could also result in some of our customers experiencing difficulties, which, consequently, 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 a debt instrument issued by high-credit quality corporation. 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.

While strategic acquisitions, like those we have made in the past 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, their products, technologies and personnel as well as key personnel retention. Finally, integration of new acquisitions will require the dedication of management resources, which may detract their attention from our day-to-day business and operations.

We depend on a single supplier or a limited number of suppliers for some of the parts used to manufacture our products for which alternative sources may not be readily available. In addition, all our orders are placed through individual purchase orders and, therefore, our suppliers may experience difficulties, suffer from natural disasters, delays or stop supplying parts to us at any time. The reliance on a single source or limited number of suppliers could result in increased costs, delivery problems and reduced control over product pricing and quality. Any interruption or delay in the supply of any of these parts could significantly harm our ability to meet scheduled product deliveries to our customers and cause us to lose sales.

Furthermore, the process of qualifying a new manufacturer for complex parts designed to our specifications, such as our optical, electronic or mechanical parts, is lengthy and would consume a substantial amount of time for our technical personnel and management. If we were required to change a supplier in a short period of time, our business would be disrupted. In addition, we may be unsuccessful in identifying a new supplier capable of meeting and willing to meet our needs on terms that we would find acceptable.

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 at [www.sedar.com](http://www.sedar.com) in Canada or [www.sec.gov/edgar.shtml](http://www.sec.gov/edgar.shtml) in the U.S.

## NON-IFRS MEASURES

We provide non-IFRS measures (gross margin\* and adjusted EBITDA\*\*) as supplemental information regarding our operational performance. We use these measures for the purpose of evaluating our historical and prospective financial performance, as well as our performance relative to our competitors. These measures also help 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 IFRS 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 IFRS. 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 IFRS.

\* Gross margin represents sales less cost of sales, excluding depreciation and amortization.

\*\* Adjusted EBITDA represents net earnings (loss) before interest, income taxes, depreciation and amortization, restructuring charges, changes in the fair value of the cash contingent consideration, stock-based compensation costs, foreign exchange gain or loss and gain from the disposal of discontinued operations.

The following tables summarize the reconciliation of adjusted EBITDA to IFRS net earnings (loss), in thousands of US dollars:

### Adjusted EBITDA (including discontinued operations - unaudited)

	Year ended August 31,		
	2013	2012	2011
IFRS net earnings (loss) for the year	\$ 1,341	\$ (3,593)	\$ 22,120
Add (deduct):			
Depreciation of property, plant and equipment	6,028	6,169	6,669
Amortization of intangible assets	6,643	7,819	9,187
Interest and other income	(113)	(131)	(511)
Income taxes	5,664	3,571	9,015
Restructuring charges	89	2,329	–
Changes in fair value of cash contingent consideration	–	(311)	(2,685)
Stock-based compensation costs	1,768	1,862	2,256
Foreign exchange (gain) loss	(4,082)	657	3,742
Gain on disposal of discontinued operations	–	–	(13,212)
Adjusted EBITDA for the year	\$ 17,338	\$ 18,372	\$ 36,581
Adjusted EBITDA in percentage of total sales	7.2%	7.3%	13.5%

**QUARTERLY SUMMARY FINANCIAL INFORMATION (unaudited)**  
(tabular amounts in thousands of US dollars, except per share data)

	1 <sup>st</sup> quarter	2 <sup>nd</sup> quarter	3 <sup>rd</sup> quarter	4 <sup>th</sup> quarter	Year ended August 31,
<b>2013</b>					
Sales	\$ 59,821	\$ 62,576	\$ 58,865	\$ 60,888	\$ 242,150
Cost of sales <sup>(1)</sup>	\$ 23,657	\$ 23,664	\$ 22,574	\$ 22,574	\$ 92,469
Net earnings (loss)	\$ (1,638)	\$ 39	\$ (862)	\$ 3,802	\$ 1,341
Basic and diluted net earnings (loss) per share	\$ (0.03)	\$ 0.00	\$ (0.01)	\$ 0.06	\$ 0.02
<b>2012</b>					
Sales	\$ 66,388	\$ 66,917	\$ 59,505	\$ 57,156	\$ 249,966
Cost of sales <sup>(1)</sup>	\$ 23,370	\$ 23,616	\$ 23,549	\$ 21,257	\$ 91,972
Net earnings (loss)	\$ 2,887	\$ 954	\$ (3,720)	\$ (3,714)	\$ (3,593)
Basic and diluted net earnings (loss) per share <sup>(2)</sup>	\$ 0.05	\$ 0.02	\$ (0.06)	\$ (0.06)	\$ (0.06)

(1) The cost of sales is exclusive of depreciation and amortization.

(2) Per share data is calculated independently for each quarter presented. Therefore, the sum of this quarterly information does not equal the corresponding annual information.

**Fourth-quarter results**

*Sales*

In the fourth quarter of fiscal 2013, sales were \$60.9 million, compared to \$57.2 million for the same period last year.

In the fourth quarter of fiscal 2013, we benefited from some improvements in market conditions especially in the United States and from strong bookings in the third quarter of fiscal 2013 compared to the same period last year, which resulted in an increase of sales year-over-year.

*Gross margin*

In the fourth quarter of fiscal 2013, our gross margin reached 62.9% compared to 62.8% for the same period last year.

First, in the fourth quarter of fiscal 2013, our gross margin was favorably affected by our product mix, compared to the same period last year. In addition, a higher sales volume in fourth quarter of fiscal 2013 compared to the same period last year resulted in a better absorption of our fixed manufacturing costs, which increased our gross margin year-over-year. Finally, in the fourth quarter of fiscal 2012, we recorded \$264,000 in restructuring charges in the cost of sales (nil in 2013), which negatively impacted our gross margin for that quarter.

However, increased pricing pressure throughout fiscal 2013, compared to 2012, had to some extent a negative impact on our gross margin year-over-year.

Finally, the decrease in the value of the Canadian dollar, compared to the US dollar over the last few months, had a negative impact on our gross margin in the fourth quarter of fiscal 2013 compared to the same period last year; in fact, our procurement costs increased as the Canadian dollar decreased compared to the US dollar, as a significant portion of our raw material purchases are denominated in US dollars and our raw material costs of parts purchased in US dollars are measured in Canadian dollars in our financial statements.

*Net earnings (loss)*

Net earnings amounted to \$3.8 million, or \$0.06 per diluted share, in the fourth quarter of fiscal 2013, compared to a net loss of \$3.7 million, or \$0.06 per share, for the same period last year.

In the fourth quarter of fiscal 2013, a higher gross margin in dollars combined to lower operating expenses compared to the same period last year resulted in higher net earnings year-over-year.

In the fourth quarter of fiscal 2013, our operating expenses decreased year-over-year, especially salaries and benefits as well as travel expenses, due to tight controls on expenses and the impact of our restructuring plan implemented in the fourth quarter of 2012. In addition, this restructuring plan resulted in charges of \$2.3 million in the fourth quarter of fiscal 2012.

Furthermore, in the fourth quarter of fiscal 2013, amortization of intangible assets decreased year-over-year as core technology related to the acquisition of Brix Networks Inc. became fully amortized during fiscal 2013.

Finally, in the fourth quarter of fiscal 2013, the increase in the average value of the US dollar compared to the Canadian dollar and the Indian rupee versus the same period last year, resulted in lower operating expenses year-over-year as a portion of our operating expenses are denominated in these currencies and we report our results in US dollars.

However, in the fourth quarter of fiscal 2013, commission expenses to our sales channels were higher compared to the same period last year, due to a higher sales volume and a shift in mix of products and territories year-over-year, which offset in part the increase in net earnings year-over-year.

In addition to the above-mentioned factors, in the fourth quarter of fiscal 2013, we recorded a foreign exchange gain of \$1.3 million compared to a loss of \$1.9 million for the same period last year due to the fluctuation of the period-end foreign exchange rates. Finally, in the fourth quarter of fiscal 2012, we recorded an income tax expense of \$159,000, although we reported a loss before income taxes as we did not recognize deferred income taxes for some of our subsidiaries at loss and as a significant portion of our foreign exchange loss was created by the translation of financial statements of our foreign operations, and was therefore non-deductible; in the same period this year, the income tax expense was closer to our statutory income tax rate of 27%.