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 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, 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; capacity to adapt our future product offering to future technological changes; 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. This discussion and analysis should be read in conjunction with the consolidated financial statements.

The following discussion and analysis of financial condition and results of operations is dated November 24, 2014.

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

COMPANY OVERVIEW

We are a leading provider of next-generation test, service assurance and end-to-end quality of experience solutions for mobile and fixed network operators and equipment manufacturers in the global telecommunications industry. Our intelligent solutions with contextually relevant analytics improve end-user quality of experience, enhance network performance and drive operational efficiencies throughout the network and service delivery lifecycle. 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 (internet protocol) 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, Internet Protocol (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 across wireline and wireless networks.

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, determine whether or not these elements interoperate with each other effectively when combined to form a network, and assess 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 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, supported by a software development center in India.

We launched 24 new products or major upgrades in fiscal 2014. Key new product introductions during 2014 included, among others an all-in-one optical and Ethernet test module that accelerates the deployment and troubleshooting of wireless backhaul, small cell and metro Ethernet networks; a monitoring solution that offers end-to-end visibility of network infrastructure performance through the distributed polling of millions of network elements; the industry's smallest platform for high-speed, multitechnology testing in the field; a service assurance solution that enables mobile operators to proactively monitor and assure quality of experience of voice-over-LTE (VoLTE) deployments; a tablet-based OTDR series that simplifies and reduces testing time on fixed and mobile networks; and a fully automated fiber inspection probe that eliminates error risks and reduces fiber connector inspection time by more than 50%.

We reported sales of $230.8 million in fiscal 2014, which represents a decrease of 4.7% year-over-year from $242.2 million in 2013.

We reported net earnings of $783,000, or $0.01 per diluted share, in fiscal 2014, compared to $1.3 million, or $0.02 per diluted share, in 2013. Net earnings in fiscal 2014 included $4.1 million in after-tax amortization of intangible assets, $1.7 million in stock-based compensation costs and a foreign exchange gain of $1.6 million. 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.

Adjusted EBITDA (net earnings before interest, income taxes, depreciation and amortization, restructuring charges, stock-based compensation costs and foreign exchange gain) amounted to $14.4 million, or 6.2% of sales, in fiscal 2014, compared to $17.3 million, or 7.2% of sales, in 2013. See further in this document for a complete reconciliation of adjusted EBITDA and IFRS net earnings.

During the third quarter of fiscal 2014, we acquired the assets of ByteSphere LLC, a Boston-area software company specializing in global IT management and network monitoring solutions. This transaction extends our service assurance offering into infrastructure performance visibility through highly scalable device and network element polling. In addition, in the fourth quarter of fiscal 2014, we acquired assets of Aito Technologies Ltd, a Finnish provider of customer experience analytics for mobile network operators. These two acquisitions are immaterial individually and collectively. The purchase prices were allocated to intangible assets.

On January 8, 2014, 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 2,043,101 subordinate voting shares at the prevailing market price. The normal course issuer bid started on January 13, 2014, and will end on January 12, 2015.

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 2012, 2013 and 2014, no customer accounted for more than 10% of our sales, with our top customer representing 4.4%, 6.1% 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)

Consolidated statements of earnings data [1]:	**2014**	2013	2012	**2014**	2013	2012
Sales	**$ 230,806**	$ 242,150	$ 249,966	**100.0 %**	100.0 %	100.0 %
Cost of sales [2]	**86,836**	92,469	91,792	**37.6**	38.2	36.7
Selling and administrative	**86,429**	88,756	94,139	**37.4**	36.6	37.7
Net research and development	**44,846**	45,444	49,854	**19.4**	18.8	19.9
Depreciation of property, plant and equipment	**4,995**	6,028	6,169	**2.2**	2.5	2.5
Amortization of intangible assets	**4,398**	6,643	7,819	**1.9**	2.7	3.1
Changes in the fair value of cash contingent consideration	**–**	–	(311)	**–**	–	(0.1)
Interest and other income	**(326)**	(113)	(131)	**(0.1)**	–	(0.1)
Foreign exchange (gain) loss	**(1,634)**	(4,082)	657	**(0.7)**	(1.7)	0.3
Earnings (loss) before income taxes	**5,262**	7,005	(22)	**2.3**	2.9	–
Income taxes	**4,479**	5,664	3,571	**2.0**	2.3	1.4
Net earnings (loss) for the year	**$ 783**	$ 1,341	$ (3,593)	**0.3 %**	0.6 %	(1.4)%
Basic and diluted net earnings (loss) per share	**$ 0.01**	$ 0.02	$ (0.06)			
Other selected information:						
Gross margin [3]	**$ 143,970**	$ 149,681	$ 158,174	**62.4 %**	61.8 %	63.3 %
Research and development data:						
Gross research and development	**$ 52,423**	$ 54,334	$ 59,282	**22.7 %**	22.4 %	23.7 %
Net research and development	**$ 44,846**	$ 45,444	$ 49,854	**19.4 %**	18.8 %	19.9 %
Restructuring charges included in:						
Cost of sales	**$ –**	$ –	$ 264	**– %**	– %	0.1 %
Selling and administrative expenses	**$ –**	$ –	$ 1,181	**– %**	– %	0.5 %
Net research and development expenses	**$ –**	$ 89	$ 884	**– %**	– %	0.4 %
Adjusted EBITDA [3]	**$ 14,391**	$ 17,338	$ 18,372	**6.2 %**	7.2 %	7.3 %
Consolidated balance sheets data [1]:						
Total assets	**$ 278,031**	$ 281,538	$ 306,683			
Long-term debt (excluding current portion)	**$ –**	$ –	$ 282			

(1) Consolidated statements of earnings and balance sheets data has been derived from our consolidated financial statements prepared according with IFRS, as issued by the IASB, except for non-IFRS measures [3].

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

(3) Refer to page 21 for non-IFRS measures.

RESULTS OF OPERATIONS

Sales and Bookings

Fiscal 2014 vs. 2013

In fiscal 2014, our sales decreased 4.7% to $230.8 million, compared to $242.2 million in 2013, while our bookings increased 3.0% year-over-year to $240.4 million in 2014 from $233.5 million in 2013, for a book-to-bill ratio of 1.04 (0.96 in 2013).

The year-over-year decrease in sales in fiscal 2014 compared to 2013 is mainly explained by the timing and nature of orders received in fiscal 2014, which resulted in a significant increase in our backlog at the end of 2014 compared to 2013. In fact, some orders received in fiscal 2014 were not shipped and/or recognized in sales due to the timing and/or nature of these orders, as in some cases, they involved large systems for which revenue recognition is dependent on installation and customer acceptance.

More precisely, in fiscal 2014, most of the year-over-year decrease in sales in dollars comes from the first half of the year in the Americas, as market conditions in this region proved to be challenging during that period due to order delays and lower spending levels, especially among key customers. Although in the second half of fiscal 2014 we benefited from projects and strategic initiatives that had been pushed out later in fiscal 2014, as well as from late budget approvals from key customers, and we reported a year-over-year increase in sales and bookings during that period, it was not enough to offset the sales decrease attributable to the Americas region in the first half of the year.

In addition to the above-mentioned explanations, during the first half of fiscal 2013, we had benefited from some calendar year-end budget spending on the part of network operators in the Americas, but we did not benefit from such spending in the first half of fiscal 2014 due to the tight budget control during this period, thereby reducing our sales year-over-year. The magnitude of calendar year-end budget spending can fluctuate year-over-year.

Sales to Europe, Middle-East and Africa (EMEA) and Asia-Pacific (APAC) in 2014 also decreased year-over-year, which again is mostly attributable to a timing issue, as bookings have in fact increased year-over-year in both regions.

Furthermore, in fiscal 2014, increased pricing pressure worldwide had a negative impact on our sales and bookings year-over-year.

Finally, we recorded foreign exchange losses of $909,000 on our forward exchange contracts in 2014, compared to foreign exchange gains of $380,000 in 2013, which lowered our sales 0.5% year-over-year.

Overall, over the last four semesters, bookings amounted to $117.7 million, $115.8 million, $116.6 million and $123.8 million respectively, showing a return to growth mode.

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.

In fiscal 2013, market conditions in the telecommunications industry were difficult due to an uncertain macro-economic environment, marked by challenging end-markets in several European countries and uneven network operator spending in the Asia-Pacific region while investments in the Americas have been more robust. Moreover, operators tried to monetize their investments in next-generation fixed and mobile networks as data revenue growth was not keeping pace with the required level of expenditures. Consequently, network operators reassessed 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.

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 a 0.3% decrease in sales 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.

Geographic Distribution

In fiscal 2013 and 2014, 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.

GROSS MARGIN (non-IFRS measure – refer to page 21 of this document)

Gross margin amounted to 62.4%, 61.8% and 63.3% of sales in fiscal 2014, 2013 and 2012 respectively.

Fiscal 2014 vs. 2013

The increase in our gross margin in fiscal 2014 compared to 2013 can be explained by the following factors.

In fiscal 2014, our gross margin was favorably affected by product mix, including some software-intensive products with higher margins. Namely, in fiscal 2013, we shipped large orders of lower-margin copper-access test solutions, which negatively affected our gross margin for that year. We did not have such orders in the same period this year.

However, the following factors partly offset the increase in our gross margin year-over-year.

In fiscal 2014, a lower sales volume compared to 2013 (4.7%), resulted in lower absorption of our fixed manufacturing costs, which decreased our gross margin year-over-year.

In addition, increased pricing pressure in fiscal 2014, compared to 2013, had a negative impact on our gross margin year-over-year.

Furthermore, in fiscal 2014, we recorded an inventory write-off of $4.6 million, compared to $4.1 million in 2013. This represents a negative impact of 0.3% on our gross margin year-over-year.

Finally, in fiscal 2014, we recorded in our sales foreign exchange losses of $909,000 on our forward exchange contracts, compared to foreign exchange gains of $380,000 in 2013, which contributed to decrease our gross margin 0.1% year-over-year.

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 lower-margin copper-access 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 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 lower gains 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, 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 partly offsetting 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 affected our gross margin for that year (0.1%).

Outlook for Fiscal 2015

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 our products mix and sales fluctuations. 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 $86.4 million, $88.8 million and $94.1 million for fiscal 2014, 2013 and 2012 respectively. As a percentage of sales, selling and administrative expenses amounted to 37.4%, 36.6% and 37.7% for fiscal 2014, 2013 and 2012 respectively.

Fiscal 2014 vs. 2013

In fiscal 2014, despite inflation and salary increases, our selling and administrative expenses decreased, compared to 2013, due to tight control on expenses and the increase in the average value of the US dollar, compared to the Canadian dollar as a portion of these expenses are incurred in this currency and we report our results in US dollars.

In addition, in fiscal 2014, commission expenses to our sales channels were lower compared, to 2013, due to a lower sales volume year-over-year.

In fiscal 2014, although our selling and administrative expenses decreased in dollars year-over-year, they increased as a percentage of sales as our sales decreased year-over-year and a large portion of these expenses are relatively fixed in the short term.

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.

Outlook for Fiscal 2015

For fiscal 2015, we expect our selling and administrative expenses to decrease as a percentage of sales and range between 34% and 36%. 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 $52.4 million, $54.3 million and $59.2 million for fiscal 2014, 2013 and 2012 respectively. As a percentage of sales, gross research and development expenses amounted to 22.7%, 22.4% and 23.7% for fiscal 2014, 2013 and 2012 respectively, while net research and development expenses accounted for 19.4%, 18.8% and 19.9% of sales for these respective years.

Fiscal 2014 vs. 2013

In fiscal 2014, the year-over-year increase in the average value of the US dollar compared to the Canadian dollar and the Indian rupee 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.

In addition, in fiscal 2013, our gross research and development expenses included $89,000 in restructuring charges, compared to nil this year.

Otherwise, in fiscal 2014, inflation, salary increases, as well as a shift in the mix and timing of research and development projects resulted in increased gross research and development expenses compared to 2013.

A large portion of our gross research and development expenses are relatively fixed in the short term and they fluctuate in percentage of sales, as sales fluctuate year-over-year.

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 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 this currency 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 $7.6 million, $8.9 million and $9.4 million for fiscal 2014, 2013 and 2012 respectively. As a percentage of gross research and development expenses, tax credits and grants reached 14.5%, 16.4% and 15.9% for fiscal 2014, 2013 and 2012 respectively.

Fiscal 2014 vs. 2013

The decrease in our tax credits and grants in fiscal 2014, compared to 2013, results from the decrease in the statutory Canadian federal and provincial research and development tax credit rates in 2014, as well as from the increase in the average value of the US dollar, compared to the Canadian dollar year-over-year, as our tax credits are denominated in Canadian dollars and we report our results in US dollars.

In fiscal 2014, the decrease in tax credits and grants as percentage of gross research and development expenses, compared to 2013, mainly comes from the decrease in the statutory Canadian federal and provincial research and development tax credit rates.

Fiscal 2013 vs. 2012

The decrease in tax credits and grants in fiscal 2013, compared to 2012 mainly resulted 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 2015

For fiscal 2015, we expect our net research and development expenses to range between 18% and 20% of sales, which take into account the additional reduction of research and development tax credit rates in Canada. 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 2014, depreciation of property, plant and equipment amounted to $5.0 million, compared to $6.0 million and $6.2 million in 2013 and 2012 respectively.

Fiscal 2014 vs. 2013

The decrease in depreciation expense in fiscal 2014, compared to 2013, was due to the fact that some assets became fully depreciated in fiscal 2013 as well as to the increase in the average value of the US dollar versus the Canadian dollar and the Indian rupee year-over-year, as a significant portion of our depreciation expenses are 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 name. In addition, intangible assets include software. These intangible assets resulted in amortization expenses of $4.4 million, $6.6 million and $7.8 million for fiscal 2014, 2013 and 2012 respectively.

The decrease in amortization expenses in fiscal 2014 and in 2013 compared to the previous year 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. In addition, in fiscal 2014 and 2013, the increase in the average value of the US dollar compared to the Canadian dollar versus the previous year had a positive impact on our amortization expenses for those years as a significant portion of these expenses are incurred in Canadian dollars and we report our results in US dollars.

Outlook for Fiscal 2015

We expect amortization of intangible assets to decrease in fiscal 2015 compared to 2014 due to the fact that acquired intangible assets related to NetHawk Oyj, acquired in 2010, will become fully amortized during fiscal 2015. However, that decrease will be partly offset by recently acquired core technologies related to ByteSphere and Aito.

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 result from the translation of cash balances and deferred income taxes denominated in US dollars. We manage our exposure to a currency risk in part with forward exchange contracts. In addition, some of our entities' operating activities are denominated in US dollars, euros and British pounds, which further hedges this risk. However, we remain exposed to a currency risk; 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 $1.6 million in fiscal 2014, compared to $4.1 million in 2013 and a foreign exchange loss of $657,000 in 2012.

Fiscal 2014

In fiscal 2014, the period-end value of the Canadian dollar decreased versus the US dollar and the euro, compared to the previous year end, which resulted in a foreign exchange gain of $1.6 million during the year. The period-end value of the Canadian dollar decreased 3.0% compared to CA$1.0858 = US$1.00 in fiscal 2014, compared to CA$1.0530 = US$1.00 at the end of the previous year, and decreased 2.7% compared to CA$1.4319 = €1.00 in fiscal 2014, compared to CA$1.3936 = €1.00 at the end of the previous year. In fiscal 2014, the average value of the Canadian dollar versus the US dollar was CA$1.0782 = US$1.00.

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 significant foreign exchange gain of $4.1 million during the year. The period-end value of the Canadian dollar decreased 6.3% compared 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 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.

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 2014 vs. 2013

In fiscal 2014, the increase in the average value of the 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 2014 increased 6.3% and 9.7%, respectively, compared to the Canadian dollar and the Indian rupee.

Fiscal 2013 vs. 2012

In fiscal 2013, the increase in the average value of the 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.

INCOME TAXES

We recorded income tax expenses of $4.5 million, $5.7 million and $3.6 million in fiscal 2014, 2013 and 2012 respectively.

In fiscal 2014, we reported income tax expenses of $4.5 million on earnings before income taxes of $5.3 million. In fiscal 2013, we reported income tax expenses of $5.7 million on earnings before income taxes of $7.0 million. These situations 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% for those two fiscal years.

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.

Please refer to note 18 to our consolidated financial statements for a full reconciliation of our income tax provision.

LIQUIDITY AND CAPITAL RESOURCES

Cash Requirements and Capital Resources

As at August 31, 2014, cash and short-term investments totaled $59.8 million, while our working capital was at $109.3 million. Our cash and short-term investments increased $9.6 million in fiscal 2014, compared to 2013. First, in fiscal 2014, operating activities generated $19.8 million in cash. However, in fiscal 2014, we made cash payments of $7.9 million for the purchases of capital assets (including assets of ByteSphere and Aito), $937,000 for the redemption of share capital under our share repurchase program and $307,000 for the final repayment of our long-term debt. In addition, in fiscal 2014, we recorded an unrealized foreign exchange loss of $1.2 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 debt instruments issued by high-credit quality corporations; therefore, we consider the risk of non-performance of these financial instruments to be limited. These debt instruments are 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, 2014, cash balances included an amount of $30.1 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 $15.4 million for working capital and other general corporate purposes and unused lines of credit of $22.0 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, 2014, our commitments under operating leases amount to $2.4 million in 2015, $1.0 million in 2016, $681,000 in 2017, $158,000 in 2018 and $552,000 in 2019 and after, for total commitments of $4.8 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

Cash flows provided by operating activities were $19.8 million in fiscal 2014, compared to cash flows used of $2.0 million in 2013 and cash flows provided of $25.3 million in 2012.

Fiscal 2014 vs. 2013

Cash flows provided by operating activities in fiscal 2014 were attributable to the net earnings after items not affecting cash of $11.5 million and the positive net change in non-cash operating items of $8.3 million; this was mainly due to the positive effect on cash of the $3.6 million decrease in our accounts receivable, due to the decrease in sales year-over-year and the timing of receipts and sales during the year, the $1.4 million decrease in our income taxes and tax credits recoverable mainly due to tax credits earned in previous years received during the year, as well as the $3.8 million increase 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 partly offset by the negative effect on cash of the $734,000 increase in our inventories to meet future demand.

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 $14.8 million increase in our accounts receivable due to the timing of sales during the year, the negative effect on cash of the $4.2 million increase in our income tax and tax credits recoverable due to tax credits earned during the year and not yet recovered, as well as the negative effect on cash of the $2.6 million decrease 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 partly offset by the positive effect on cash of the $2.9 million decrease in our inventories due to the decrease in sales year-over-year and an improved inventory turn during the year.

Investing activities

Cash flows used by investing activities amounted to $8.9 million in fiscal 2014, compared to $5.0 million in 2013 and cash flows provided of $13.1 million in 2012.

Fiscal 2014

In fiscal 2014, we acquired (net of disposal) $1.0 million worth of short-term investments and we paid $7.9 million for the purchase of capital assets, including the assets of ByteSphere and Aito.

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.

Financing activities

Cash flows used by financing activities amounted to $1.0 million in fiscal 2014, compared to $3.6 million in 2013 and $3.3 million in 2012.

Fiscal 2014

In fiscal 2014, we redeemed share capital for a cash consideration of $937,000 and repaid $307,000 of our long-term debt. However, we received $225,000 from the exercise of stock options.

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, repaid $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.

FORWARD EXCHANGE CONTRACTS

We are exposed to a currency risk as a result of our export sales of products manufactured in Canada, China and Finland, the majority of which are denominated in US dollars and euros. In addition, we are exposed to a currency risk as a result of our research and development activities in India (Indian rupees). These risks are partially hedged by forward exchange contracts. Forward exchange contracts, which are designated as cash flow hedging instruments, qualify for hedge accounting.

As at August 31, 2014, we held forward exchange contracts to sell US dollars for Canadian dollars and Indian rupees at various forward rates, which are summarized as follows:

US dollars – Canadian dollars

Expiry dates	**Contractual amounts**	**Weighted average contractual forward rates**
September 2014 to August 2015	$ 22,200,000	1.0666
September 2015 to August 2016	13,400,000	1.0923
September 2016 to December 2016	3,400,000	1.1063
Total	$ 39,000,000	1.0789

US dollars – Indian rupees

Expiry dates	**Contractual amounts**	**Weighted average contractual forward rate**
September 2014 to March 2015	$ 2,800,000	62.11

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 losses of $808,000 and $497,000 as at August 31, 2013 and 2014 respectively. The US dollar – Canadian dollar year-end exchange rate was CA$1.0858 = US$1.00 as at August 31, 2014. The US dollar – Indian rupee year-end exchange rate was INR 60.66 = US$1.00 as at August 31, 2014.

SHARE CAPITAL

Share Capital

As at November 10, 2014, EXFO had 31,643,000 multiple voting shares outstanding, entitling to 10 votes each and 28,682,146 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, 2014, our off-balance sheet arrangements consisted of letters of guarantee amounting to $408,000 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.

STRUCTURED ENTITIES

As at August 31, 2014, we did not have interests in any structured 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.

(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.

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, 2014, we had deferred income tax assets in the balance sheet in the amount of $9.8 million mainly for operating losses in the United States. In order to realize these deferred income tax assets, we need to generate $25 million in pre-tax earnings in the United States, and in order to do so over the estimated recovery period of six years, we must generate a pre-tax earnings compound annual growth rate (CAGR) of 9%, which we believe is probable. Our operating losses in the United States can be carried forward over a twenty-year period.

(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 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 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, 2014, our non-refundable research and development tax credits recognized in the balance sheet amounted to $42.9 million. In order to recover these non-refundable research and development tax credits, we need to generate approximately $277 million (CA$301 million) in pre-tax earnings at the Canadian federal level and approximately $13 million at the Canadian provincial level. In order to generate $277 million in pre-tax earnings at the Canadian Federal level over the estimated recovery period of 18 years, we must generate pre-tax earnings CAGR of 4%, 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 of disposal and its value in use. The fair value less costs of disposal 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, our 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 our historical growth, internal budget, expectations of future revenue growth, sales funnel, 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

The discount rate we use 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 2014, we performed our annual goodwill impairment test for our two CGUs, EXFO and Brix.

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 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 1.9 and 5 times sales. These comparable transactions occurred in calendar 2013 and 2014.

Discounted cash flows for the Brix CGU were based on five-year management projections, using a five-year sales compound annual growth rate (CAGR) of 23% and a perpetual growth rate of 2% thereafter. We used a discount rate of 18%. Based on these assumptions (used in the discounted cash flows calculations) as well as a sales multiple of 2.0 times fiscal 2014 sales, the recoverable amount of the Brix CGU exceeds its carrying amount by 49%. The five-year sales CAGR used in the discounted cash flows calculations differs from past experience; we determined the five-year sales CAGR based on recent market studies, the impact of recently launched and to be launched solutions, as well as our sales funnel.

The Brix CGU's recoverable amount would equal its carrying value using five-year sales CAGR of 8%, which is below our expected of market growth of 10% to 15% (excluding market share gains) over the five-year period used in the discounted cash flows calculations for that CGU, or a sales multiple of 1 time fiscal 2014 sales.

As at August 31, 2014, the recoverable amount for both CGUs exceeded their carrying value.

As at August 31, 2014, the carrying value of goodwill totaled $26.5 million and was allocated as follows to two CGUs:

EXFO CGU	$	10,465,000
Brix CGU		16,023,000
Total	$	26,488,000

NEW IFRS PRONOUNCEMENTS AND AMENDMENTS

Adopted During the Year

We adopted the following amended and new standards, effective September 1, 2013. These changes were made in accordance with the applicable transitional provisions.

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. IFRS 10 replaces Standing Interpretations Committee ("SIC") 12, "*Consolidation — Special Purpose Entities*", and parts of IAS 27, "*Consolidated and Separate Financial Statements*". The adoption of IFRS 10 had no impact on our consolidated 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 are accounted for using the equity method of accounting whereas for a joint operation, the venture recognizes its share of the assets, liabilities, revenues and expenses of the joint operation. IFRS 11 replaces IAS 31, "*Interests in Joint Ventures*", and SIC 13, "*Jointly Controlled Entities — Non-Monetary Contributions by Venturers*". The adoption of IFRS 11 had no impact on our consolidated financial statements.

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. The adoption of IFRS 12 had no impact on our consolidated financial statements.

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. The adoption of IFRS 13 did not require any adjustment to the valuation techniques we used to measure fair value. We provided the required additional disclosure in our consolidated financial statements.

Financial Instruments

IFRS 7, "*Financial Instruments: Disclosures*", has been amended to enhance disclosure requirements related to offsetting of financial assets and liabilities. The adoption of these amendments had no impact on our consolidated financial statements.

Issued but Not Yet Adopted

Financial Instruments

IFRS 9, "*Financial Instruments*", was issued by the IASB in October 2010 and will replace IAS 39, "*Financial Instruments: Recognition and Measurement*". IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. Requirements relating to hedge accounting representing a new hedge accounting model have also been added to IFRS 9. The new standard is effective for annual periods beginning on or after January 1, 2018 and must be applied retrospectively. We have not yet assessed the impact that the new standard will have on our consolidated financial statements.

Revenue from Contracts with Customers

IFRS 15, "*Revenue from Contracts with Customers*", was issued in May 2014. The objective of this new standard is to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability. This new standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. This new standard is effective for annual periods beginning on or after January 1, 2017. Early adoption is permitted. We have not yet assessed the impact that the new standard will have on our consolidated financial statements or whether or not to early adopt the new standard.

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 through 2014 with network operators placing a tight rein on capital expenditures 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.

Our functional currency is the Canadian. We are exposed to a currency risk as a result of our export sales of products manufactured in Canada, China and Finland, the majority of which are denominated in US dollars and euros, while a significant portion of our cost of sales and operating expenses are denominated in Canadian dollars and currencies such as euros, British pounds, Rupees (India) and CNY (China). As a result, even though we manage to some extent our exposure to currency risk with forward exchange contracts (by selling US dollars for Canadian dollars and US dollars for Indian Rupees) and certain cost of sales and operating expenses denominated in currencies other than the Canadian dollar, namely the US dollars and euros, we are exposed to fluctuations in the exchange rates between the Canadian dollar on one hand and the US dollar, euro and other currencies on the other. Any increase in the value of the Canadian dollar relative to the US dollar and other currencies, or any unfavorable variance between the value of the Canadian dollar and the contractual rates of our US dollar - Canadian dollar forward exchange contracts, could result in foreign exchange losses and have a material adverse effect on our operating results. Foreign exchange rate fluctuations also flow through the statement of earnings line items as a significant portion of cost of sales and our operating expenses are denominated in Canadian dollars, euros and Indian rupees, and we report our results in US dollars. Any decrease in the value of the US dollar relative to the Canadian dollar and other currencies, could have a material adverse effect on our operating results.

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, trends and customer needs; 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.

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.

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.

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 debt instruments issued by high-credit quality corporations. 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.

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, or at www.sedar.com in Canada or 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 and foreign exchange gain or loss.

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

Adjusted EBITDA *(unaudited)*

	Year ended August 31,		
	2014	**2013**	**2012**
IFRS net earnings (loss) for the year	$ 783	$ 1,341	$ (3,593)
Add (deduct):			
Depreciation of property, plant and equipment	4,995	6,028	6,169
Amortization of intangible assets	4,398	6,643	7,819
Interest and other income	(326)	(113)	(131)
Income taxes	4,479	5,664	3,571
Restructuring charges	–	89	2,329
Changes in fair value of cash contingent consideration	–	–	(311)
Stock-based compensation costs	1,696	1,768	1,862
Foreign exchange (gain) loss	(1,634)	(4,082)	657
Adjusted EBITDA for the year	$ 14,391	$ 17,338	$ 18,372
Adjusted EBITDA in percentage of total sales	6.2%	7.2%	7.3%

QUARTERLY SUMMARY FINANCIAL INFORMATION [1] (unaudited)
(tabular amounts in thousands of US dollars, except per share data)

	1st quarter	**2nd quarter**	**3rd quarter**	**4th quarter**	**Year ended August 31,**
2014					
Sales	$ 56,003	$ 51,179	$ 63,882	$ 59,742	$ 230,806
Cost of sales [2]	$ 21,185	$ 20,073	$ 23,469	$ 22,109	$ 86,836
Net earnings (loss)	$ (747)	$ (1,339)	$ 1,665	$ 1,204	$ 783
Basic and diluted net earnings (loss) per share [3]	$ (0.01)	$ (0.02)	$ 0.03	$ 0.02	$ 0.01

	1st quarter	**2nd quarter**	**3rd quarter**	**4th quarter**	**Year ended August 31,**
2013					
Sales	$ 59,821	$ 62,576	$ 58,865	$ 60,888	$ 242,150
Cost of sales [2]	$ 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

(1) Quarterly financial information has been prepared in accordance with IFRS as issued by the IASB. The presentation currency is the US dollars, which differs from the functional currency of the company (Canadian dollar).
(2) The cost of sales is exclusive of depreciation and amortization.
(3) Per share data is calculated independently for each quarter presented. Therefore, the sum of this quarterly information does not equal the corresponding annual information.

Quarterly Sales Analysis

Overall in fiscal 2014, sales were 4.7% lower year-over-year at $230.8 million compared to $242.2 million in 2013. Refer to section ''Sales and bookings'' elsewhere in this document for explanations about the year-over-year annual decrease in sales. On a quarterly basis, our sales may fluctuate from quarter to quarter due to timing and magnitude of orders.

In the first two quarters of fiscal 2014, sales were negatively affected by market conditions, especially in the Americas, which have been more challenging than expected due to order delays and lower spending levels, especially among key customers. Projects and strategic initiatives were not cancelled, but rather postponed until later in calendar 2014. In addition, during the second quarter of fiscal 2014, despite the fact that our bookings increased year-over-year, bookings were backend-loaded due to late budget release, which did not leave us enough time to ship and recognize them all in the quarter, thus pushing sales to the next quarter.

In addition, during the first quarter of 2013, we had benefited from some calendar year-end budget spending on the part of network operators in the Americas, but we did not benefit from such spending in the first quarter of fiscal 2014.

Furthermore, in the second quarter of fiscal 2013, we shipped large orders of copper-access products to some tier-1 network operators in the Americas. We did not have such large orders for the same period this year, which reduced our sales year-over-year in the second quarter.

Overall, for the first half of fiscal 2014, bookings reached $116.5 million, compared to $117.7 million for the same period in 2013.

In the third quarter of fiscal 2014, we reported a year-over-year sales increase in dollars in all geographic areas (Americas, Europe, Middle-East and Africa (EMEA) and Asia-Pacific). In fact, in the third quarter of fiscal 2014, our sales were positively affected by late bookings received in the previous quarter (book-to-bill ratio for the second quarter of 2014 was 1.15) that were shipped and recognized in the third quarter. In addition, in the third quarter of fiscal 2014, we benefited from projects and strategic initiatives that were postponed by customers to later in fiscal 2014; this also helped us deliver a 7.6% year-over-year increase in bookings in the third quarter.

In the fourth quarter of fiscal 2014, sales were $59.7 million, slightly down year-over-year compared to $60.9 million for the same period last year. Timing of orders received and shipped during the quarter explains the year-over-year decrease in sales in the fourth quarter of fiscal 2014, compared to the same period last year, as bookings increased 6.3% to $57.3 million during that quarter compared to $54.0 million for the same period last year.

Finally, throughout fiscal 2014, we recorded (in our sales) higher foreign exchange losses on our forward exchange contracts, which had a negative impact on our quarterly sales year-over-year. Overall in fiscal 2014, we recorded in our sales foreign exchange losses of $909,000 compared to foreign exchange gains of $380,000 in 2013.

Fourth-Quarter Results

Gross margin

In the fourth quarter of fiscal 2014, our gross margin reached 63.0%, almost flat compared to 62.9% for the same period last year.

Net earnings

Net earnings amounted to $1.2 million, or $0.02 per diluted share, in the fourth quarter of fiscal 2014, compared to $3.6 million, or $0.06 per share, for the same period last year.

In the fourth quarter of fiscal 2014, we recorded a foreign exchange loss of $334,000 compared to a gain of $1.3 million for the same period last year due to the fluctuation of the period-end foreign exchange rates; this resulted in a $1.6 million decrease in our net earnings year-over-year.

In addition, in the fourth quarter of fiscal 2014, a lower gross margin in dollars (on lower sales) combined to slightly higher operating expenses compared to the same period last year resulted in lower net earnings year-over-year. In the fourth quarter of fiscal 2014, our operating expenses increased year-over-year, especially net research and development expenses due to the decrease in the statutory Canadian federal and provincial research and development tax credit rates.

Finally, in the fourth quarter of fiscal 2014, we recorded an income tax expense of $1.4 million on earnings before income taxes of $2.7 million, for an effective income tax rate of 54.6%, compared to an income tax expense of $1.5 million on earnings before income taxes of $5.3 million for an effective income tax rate of 28.9% for the same period last year; this year-over-year increase in our effective income tax rate resulted in a decrease of our net earnings year-over-year.