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, macro-economic uncertainty and/or recession (including our ability to quickly adapt cost structures with anticipated levels of business and our ability to manage inventory levels with market demand); capital spending and network deployment levels in the telecommunications industry; future economic, competitive, financial and market conditions; limited visibility with regards to customer orders and the timing of such orders; fluctuating exchange rates; consolidation in the global telecommunications test and service assurance industry and increased competition among vendors; concentration of sales; timely release and market acceptance of our new products and other upcoming products; our ability to successfully integrate businesses that we acquire; our ability to successfully expand international operations; 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 March 27, 2013.

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

COMPANY OVERVIEW AND RECENT DEVELOPMENTS

We are a leading provider of next-generation test and service assurance solutions for wireline and wireless network operators and equipment manufacturers in the global telecommunications industry. We offer core-to-edge solutions that assess the performance and reliability of converged, IP (Internet Protocol) fixed and mobile networks. Our test and service assurance solutions specifically target high-growth market opportunities related to optimizing next-generation networks: wireless backhaul, 4G/LTE (long-term evolution), fiber-to-the-home (FTTH)/fiber-to-the-curb (FTTC)/fiber-to-the-node (FTTN), Carrier Ethernet, and 40G/100G network upgrades. Customers on a global basis rely on our test and service assurance solutions to enable their wireline and wireless networks to perform optimally during their complete lifecycles: research, development, manufacturing, installation, maintenance and monitoring.

We reported sales of $62.6 million in the second quarter of fiscal 2013, which represents a decrease of 6.5% compared to the same period last year. We also reported bookings of $53.4 million in the second quarter of fiscal 2013, for a book-to-bill ratio of 0.85, compared to $60.6 million for the same period last year.

Net earnings amounted to $39,000, or $0.00 per diluted share, in the second quarter of fiscal 2013, compared to $954,000, or $0.02 per diluted share for the same period last year. Net earnings for the second quarter of fiscal 2013 included $1.9 million in after-tax amortization of intangible assets, $89,000 in after-tax restructuring charges, $468,000 in stock-based compensation costs and a foreign exchange gain of $1.7 million. Earnings from operations amounted to $452,000, or 0.7% of sales in the second quarter of fiscal 2013, compared to $4.1 million, or 6.1% of sales for the same period last year.

Adjusted EBITDA (net earnings before interest, income taxes, depreciation of property, plant and equipment, amortization of intangible assets, restructuring charges, change in the fair value of the cash contingent consideration, stock-based compensation costs and foreign exchange gain or loss) reached $4.4 million, or 7.1% of sales in the second quarter of fiscal 2013, compared to $7.8 million, or 11.7% of sales for the same period last year. See further in this document for a complete reconciliation of adjusted EBITDA to IFRS net earnings.

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. We expect to use cash, short-term investments or future cash flows from operations to fund the repurchase of shares. The normal course issuer bid started on November 12, 2012, and will end on November 11, 2013, or on an earlier date if we repurchase the maximum number of shares permitted under the bid. The program does not require that we repurchase any specific number of shares, and it may be modified, suspended or terminated at any time and without prior notice. All shares repurchased under the bid will be cancelled.

We launched six new products in the second quarter of fiscal 2013 including amongst others the TravelHawk Pro, a 4G/LTE network troubleshooting tool that has been selected by three of world's top five LTE operators; FTB-88100NGE Power Blazer, the first portable, multiservice test solution supporting transmission rates from 10M to 100G; and packet synchronization functionalities on the FTB-800 NetBlazer series for wireless network deployments. Altogether, we have released 11 new products or major enhancements since the beginning of the fiscal year.

RESULTS OF OPERATIONS

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

	Three months ended February 28, 2013	Three months ended February 29, 2012	Six months ended February 28, 2013	Six months ended February 29, 2012
Sales	**$ 62,576**	$ 66,917	**$ 122,397**	$ 133,305
Cost of sales [1]	**23,664**	23,616	**47,321**	46,986
Selling and administrative	**23,074**	23,676	**45,364**	48,294
Net research and development	**11,960**	12,307	**23,562**	24,790
Depreciation of property, plant and equipment	**1,504**	1,546	**3,109**	3,114
Amortization of intangible assets	**1,922**	1,974	**3,884**	3,895
Change in the fair value of cash contingent consideration	**–**	(311)	–	(311)
Earnings (loss) from operations	**452**	4,109	**(843)**	6,537
Interest income (expenses)	**(25)**	54	**8**	(17)
Foreign exchange gain (loss)	**1,700**	(1,471)	**2,456**	193
Earnings before income taxes	**2,127**	2,692	**1,621**	6,713
Income taxes	**2,088**	1,738	**3,220**	2,872
Net earnings (loss) for the period	**$ 39**	$ 954	**$ (1,599)**	$ 3,841
Basic and diluted net earnings (loss) per share	**$ 0.00**	$ 0.02	**$ (0.03)**	$ 0.06
Other selected information:				
Gross margin [2]	**$ 38,912**	$ 43,301	**$ 75,076**	$ 86,319
Research and development:				
Gross research and development [3]	**$ 14,126**	$ 14,800	**$ 28,024**	$ 29,613
Net research and development [3]	**$ 11,960**	$ 12,307	**$ 23,562**	$ 24,790
Adjusted EBITDA [2]	**$ 4,435**	$ 7,826	**$ 7,155**	$ 14,298

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

(2) Refer to page 12 for non-IFRS measures.

(3) Includes $89 in restructuring charges for the three months and six months ended February 28, 2013 (nil in fiscal 2012).

	Three months ended February 28, 2013	Three months ended February 29, 2012	Six months ended February 28, 2013	Six months ended February 29, 2012
Sales	**100.0 %**	100.0 %	**100.0 %**	100.0 %
Cost of sales (1)	**37.8**	35.3	**38.7**	35.2
Selling and administrative	**36.9**	35.4	**37.1**	36.3
Net research and development	**19.1**	18.4	**19.2**	18.6
Depreciation of property, plant and equipment	**2.4**	2.3	**2.5**	2.3
Amortization of intangible assets	**3.1**	3.0	**3.2**	2.9
Change in fair value of cash contingent consideration	**–**	(0.5)	**–**	(0.2)
Earnings (loss) from operations	**0.7**	6.1	**(0.7)**	4.9
Interest income (expenses)	**–**	0.1	**–**	–
Foreign exchange gain (loss)	**2.7**	(2.2)	**2.0**	0.1
Earnings before income taxes	**3.4**	4.0	**1.3**	5.0
Income taxes	**3.3**	2.6	**2.6**	2.1
Net earnings (loss) for the period	**0.1 %**	1.4 %	**(1.3) %**	2.9 %

Other selected information:

Gross margin (2)	**62.2 %**	64.7 %	**61.3 %**	64.8 %
Research and development:				
Gross research and development (3)	**22.6 %**	22.1 %	**22.9 %**	22.2 %
Net research and development (3)	**19.1 %**	18.4 %	**19.2 %**	18.6 %
Adjusted EBITDA (2)	**7.1 %**	11.7 %	**5.8 %**	10.7 %

(1) The cost of sales is exclusive of depreciation and amortization, shown separately.
(2) Refer to page 12 for non-IFRS measures.
(3) Includes 0.1% of sales in restructuring charges for the three months and six months ended February 28, 2013 (nil in fiscal 2012).

SALES AND BOOKINGS

For the three months ended February 28, 2013, our sales decreased 6.5% to $62.6 million, compared to $66.9 million for the same period last year, and our bookings decreased 11.9% to $53.4 million, compared to $60.6 million for the same period last year, for a book-to-bill ratio of 0.85.

For the six months ended February 28, 2013, our sales decreased 8.2% to $122.4 million, compared to $133.3 million for the same period last year. For the first half of fiscal 2013, our book-to-bill ratio amounted to 0.96.

Over the last quarters, market conditions in the telecommunications industry have been tenuous due to macro-economic uncertainty, the European debt crisis and its ripple effects on other economies, the tightening of capital spending among network operators as well as delays in customers' orders. These market conditions have impacted our sales since the third quarter of fiscal 2012. We also believe these market conditions deteriorated year-over-year, especially in North America and Europe. In addition, in fiscal 2013, calendar year-end budget spending from network operators was even more limited than last year, which further reduced our sales and bookings year-over-year.

Finally, the second quarter is typically lower in terms of bookings, especially in North America, because of holidays and annual budget releases from large customers. In the past, we typically started to benefit from these annual budget releases at the end of the second quarter and we expected some positive impacts in 2013 as well. However, we believe that capital spending budgets in the United States were released a little later in fiscal 2013 because some network operators are moving ahead with large-scale, multi-billion dollar deployments that require additional scrutiny and planning; consequently, certain investment decisions have been pushed back later in 2013, which has affected our sales and bookings so far in fiscal 2013 compared to 2012.

Geographic distribution

In the second quarter of fiscal 2013, sales to the Americas, Europe, Middle-East and Africa (EMEA) and Asia-Pacific (APAC) accounted for 49%, 29% and 22% of sales respectively, compared to 49%, 31% and 20% for the same period last year respectively. In the first half of fiscal 2013, sales to the Americas, EMEA and APAC accounted for 52%, 28% and 20% of sales respectively, compared to 52%, 29% and 19% for the same period last year respectively.

Customer concentration

We sell our products to a broad range of customers, including network service providers, network equipment manufacturers, wireless operators and cable TV operators. In the second quarters of fiscal 2012 and 2013, no customer accounted for more than 10% of our sales, and our top three customers accounted for 13.7% and 13.1% of our sales respectively. In the first halves of fiscal 2012 and 2013, no customer accounted for more than 10% of our sales, and our top three customers accounted for 11.1% and 13.9% of our sales respectively.

GROSS MARGIN (non-IFRS measure – refer to page 12 of this document)

Gross margin reached 62.2% of sales for the three months ended February 28, 2013, compared to 64.7% for the same period last year.

Gross margin amounted to 61.3% of sales for the six months ended February 28, 2013, compared to 64.8% for the same period last year.

The decrease in our gross margin in the second quarter and the first half of fiscal 2013, compared to the same periods last year, can be explained by the following factors.

In the second quarter and the first half of fiscal 2013, our gross margin was negatively affected by the shift in product mix in favor of our physical-layer solutions, compared to the same periods last year. In fact, sales of these products, which typically deliver lower margins than our protocol-layer solutions, represented a larger portion of our sales in the second quarter and the first half of fiscal 2013, compared to the same periods last year. Namely, in the second quarter and the first half of fiscal 2013, we shipped large orders of our copper-access test solutions (included in our physical-layer solutions); that product line typically delivers lower margins.

In addition, a lower sales volume in the second quarter and the first half of fiscal 2013 compared to the same periods last year resulted in a lower absorption of our fixed manufacturing costs, which resulted in a lower gross margin year-over-year.

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, our increased manufacturing activities in China and our tight control over operating 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 customers, under-absorption of fixed manufacturing costs and increases in product offerings by other suppliers in our industry.

SELLING AND ADMINISTRATIVE EXPENSES

For the three months ended February 28, 2013, selling and administrative expenses were $23.1 million, or 36.9% of sales, compared to $23.7 million, or 35.4% of sales for the same period last year.

For the six months ended February 28, 2013, selling and administrative expenses were $45.4 million, or 37.1% of sales, compared to $48.3 million, or 36.3% of sales for the same period last year.

In the second quarter of fiscal 2013, our selling and administrative expenses, especially salaries and benefits as well as travel expenses, decreased year-over-year due in part to the impact of our restructuring plan implemented in the fourth quarter of fiscal 2012.

However, in the second quarter of fiscal 2013, the year-over-year decrease in the average value of the US dollar compared to the Canadian dollar and the euro had a negative impact on our selling and administrative expenses, as a portion of these expenses are incurred in these currencies and we report our results in US dollars.

In the first half of fiscal 2013, our selling and administrative expenses, especially salaries and benefits as well as travel expenses, decreased year-over-year due in part to the impact of our restructuring plan

In addition, in the first half of fiscal 2013, commission expenses to our sales channels were lower compared to the same period last year, mainly due to a lower sales volume year-over-year.

For fiscal 2013, we expect our selling and administrative expenses to decrease as a percentage of sales and range between 34% and 36% of sales. However, any increase in the strength of the Canadian dollar and the euro versus the US dollar would cause our selling and administrative expenses to increase, as a significant portion of these expenses are incurred in these currencies.

RESEARCH AND DEVELOPMENT EXPENSES

Gross research and development expenses

For the three months ended February 28, 2013, gross research and development expenses totaled $14.1 million, or 22.6% of sales, compared to $14.8 million, or 22.1% of sales for the same period last year.

For the six months ended February 28, 2013, gross research and development expenses totaled $28.0 million, or 22.9% of sales, compared to $29.6 million, or 22.2% of sales for the same period last year.

In the second quarter and the first half of fiscal 2013, our gross research and development expenses decreased year-over-year, especially salaries and benefits, due in part to the impact of our restructuring plan implemented in the fourth quarter of fiscal 2012.

In addition, in the second quarter and the first half of fiscal 2013, a shift in the mix and timing of research and development projects resulted in decreased gross research and development expenses compared to the same periods last year, mainly from consultants, subcontracting and material expenses.

However, in the second quarter and the first half in fiscal 2013, our gross research and development expenses included $89,000 in restructuring charges.

Finally, in the second quarter of fiscal 2013, the year-over-year decrease in the average value of the US dollar compared to the Canadian dollar and the euro had a negative impact on our gross research and development expenses, as a portion 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 to grants by a Finnish technology organization on certain research and development projects conducted in Finland.

For the three months ended February 28, 2013, tax credits and grants for research and development activities were $2.2 million, or 15.3% of gross research and development expenses, compared to $2.5 million, or 16.8% of gross research and development expenses for the same period last year.

For the six months ended February 28, 2013, tax credits and grants for research and development activities were $4.5 million, or 15.9% of gross research and development expenses, compared to $4.8 million, or 16.3% of gross research and development expenses for the same period last year.

In the second quarter and the first half of fiscal 2013, tax credits and grants decreased compared to the same periods last year mainly due to the decrease in our gross research and development expenses and mix of projects year-over-year.

For fiscal 2013, we expect our net research and development expenses to decrease as a percentage of sales and range between 17% and 19% of sales. 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.

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 large portion of our foreign exchange gains and losses results from the translation of cash balances and deferred income tax assets 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.

For the three months ended February 28, 2013, we recorded a foreign exchange gain of $1.7 million compared to a foreign exchange loss of $1.5 million for the same period last year.

For the six months ended February 28, 2013, we recorded a foreign exchange gain of $2.5 million compared to $193,000 for the same period last year.

During the second quarter of fiscal 2013, the period-end value of the Canadian dollar significantly decreased versus the US dollar, compared to the previous quarter, which resulted in a foreign exchange gain of $1.7 million during that period. In fact, the period-end value of the Canadian dollar decreased 3.7% to CA$1.0314 = US$1.00 in the second quarter of fiscal 2013, compared to CA$0.9932 = US$1.00 at the end of the previous quarter.

During the same period last year, the period-end value of the Canadian dollar significantly increased versus the US dollar, compared to the previous quarter, which resulted in a foreign exchange loss of $1.5 million during that period. The period-end value of the Canadian dollar increased 3.0% to CA$0.9895 = US$1.00 in the second quarter of fiscal 2012, compared to CA$1.0197 = US$1.00 at the end of the previous quarter.

During the first half of fiscal 2013, the period-end value of the Canadian dollar significantly decreased versus the US dollar, compared to the previous year end, which resulted in a foreign exchange gain of $2.5 million during that period. The period-end value of the Canadian dollar decreased 4.4% to CA$1.0314 = US$1.00 in the first half of fiscal 2013, compared to CA$0.9863 = US$1.00 at the end of the previous year.

During the same period last year, the period-end value of the Canadian dollar slightly decreased versus the US dollar, compared to the previous year end, which resulted in a foreign exchange gain of $193,000 during that period. The period-end value of the Canadian dollar decreased 1.1% to CA$0.9895 = US$1.00 in the first half of fiscal 2012, compared to CA$0.9784 = US$1.00 at the end of the previous year.

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 and euros, and we report our results in US dollars. Consequently, the decrease in the average value of the US dollar in the second quarter of fiscal 2013, compared to these currencies year-over-year, resulted in a negative impact on our financial results. In fact, the average value of the US dollar in the second quarter of fiscal 2013 decreased 1.5% and 1.0% respectively year-over-year, compared to the Canadian dollar and the euro.

INCOME TAXES

For the three months ended February 28, 2013, our income tax expenses totaled $2.1 million, compared to $1.7 million for the same period last year.

For the six months ended February 28, 2013, our income tax expenses amounted to $3.2 million, compared to $2.9 million for the same period last year.

For the three months ended February 28, 2013, we reported income tax expenses of $2.1 million on earnings before income taxes of $2.1 million. For the six months ended February 28, 2013, we reported income tax expenses of $3.2 million on earnings before income taxes of $1.6 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 had some non-deductible loss and 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 operations, and was therefore non-taxable. Otherwise, the actual tax rate would have been closer to the combined Canadian and provincial statutory tax rate of 27% for the period.

For the three months ended February 29, 2012, we reported income tax expenses of $1.7 million on earnings before income taxes of $2.7 million, for an effective income tax rate of 64.6%; this compares to our combined Canadian and provincial statutory tax rate of 28%. This situation mainly results from the fact that we did not recognize deferred income taxes for some of our subsidiaries at loss and had some non-deductible expenses, such as stock-based compensation costs. Also, 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.

For the six months ended February 29, 2012, we reported income tax expenses of $2.9 million on earnings before income taxes of $6.7 million, for an effective income tax rate of 42.8%; this compares to our combined Canadian and provincial statutory tax rate of 28%. This situation mainly resulted from the fact that we did not recognize deferred income taxes for some of our subsidiaries at loss and had some non-deductible loss and expenses, such as stock-based compensation costs. However, during the first half of 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, which reduced our income tax expense for the period.

Please refer to note 6 to our condensed interim consolidated financial statements for a full reconciliation of our income tax provision.

LIQUIDITY AND CAPITAL RESOURCES

Cash requirements and capital resources

As at February 28, 2013, cash and short-term investments totaled $56.4 million, while our working capital was at $111.1 million. Our cash and short-term investments decreased $2.6 million in the second quarter of fiscal 2013, compared to the previous quarter. During the second quarter of fiscal 2013, we made cash payments of $2.5 million, $293,000 and $167,000 respectively for the purchase of capital assets, the repayment of our long-term debt and the redemption of share capital pursuant to our share repurchase program. In addition, we recorded an unrealized foreign exchange loss on our cash and short-term investments of $1.7 million. This unrealized foreign exchange loss resulted from the translation, in US dollars, of our Canadian-dollar-denominated cash and short-term investments and was included in the accumulated other comprehensive income in the balance sheet. However, operating activities generated $2.1 million in cash, which offset in part the decrease in cash and short-term investment compared to the previous quarter.

Our short-term investments consist of a banker acceptance 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, any other potential acquisition, as well as our share repurchase program. As at February 28, 2013, cash balances included an amount of $33.7 million that bears interest at a rate of 1.45%.

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 $22.8 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.

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 $2.1 million for the three months ended February 28, 2013, compared to $13.6 million for the same period last year.

Cash flows used by operating activities were $2.7 million for the six months ended February 28, 2013, compared to cash flows provided of $20.1 million for the same period last year.

Cash flows provided by operating activities in the second quarter of fiscal 2013 were attributable to the net earnings after items not affecting cash of $4.3 million offset by the negative net change in non-cash operating items of $2.2 million; this was mainly due to the negative effect on cash of the decrease of $3.7 million in our accounts payable, accrued liabilities and provisions due to timing of purchases and payments during the quarter as well as the negative effect on cash of the increase of $1.3 million in our income tax and tax credits recoverable due to tax credits earned during the quarter not yet recovered. These negative effects on cash were offset in part by the positive effect on cash of the decrease of $2.0 million in our accounts receivable due to the timing of sales during the quarter and the decrease of $1.2 million in our inventories due to an improved inventory turn during the quarter.

Cash flows used by operating activities in the first half of fiscal 2013 were attributable to the net earnings after items not affecting cash of $5.8 million more than offset by the negative net change in non-cash operating items of $8.5 million; this was mainly due to the negative effect on cash of the increase of $6.1 million in our accounts receivable due to the increase (compared to the second half of fiscal 2012) and timing of sales during the period as well as the negative effect on cash of the increase of $3.2 million in our income tax and tax credits recoverable due to tax credits earned during the period not yet recovered. These negative effects on cash were offset in part by the positive effect on cash of the decrease of $1.1 million in our inventories due to an improved inventory turn during the period.

Investing activities

Cash flows provided by investing activities were $543,000 for the three months ended February 28, 2013, compared to $420,000 for the same period last year.

Cash flows used by investing activities were $1.5 million for the six months ended February 28, 2013, compared to cash flows provided of $28.8 million for the same period last year.

In the second quarter of fiscal 2013, we disposed (net of acquisitions) of $3.0 million worth of short-term investments but paid $2.5 million for the purchase of capital assets.

In the first half of fiscal 2013, we paid $4.5 million for the purchase of capital assets but we disposed (net of acquisitions) of $3.0 million worth of short-term investments.

Financing activities

Cash flows used by financing activities were $424,000 for the three months ended February 28, 2013, compared to $481,000 for the same period last year.

Cash flows used by financing activities were $1.3 million for the six months ended February 28, 2013, compared to $1.6 million for the same period last year.

In the second quarter of fiscal 2013, we repaid $293,000 of our long-term debt and redeemed share capital for a cash consideration of $167,000. However, we received $36,000 from the exercise of stock options.

In the first half of fiscal 2013, we repaid $293,000 of our long-term debt and redeemed share capital for a cash consideration of $1.1 million. However, we received $87,000 from the exercise of stock options.

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 February 28, 2013, we held forward exchange contracts to sell US dollars at various forward rates, which are summarized as follows:

Expiry dates	Contractual amounts	Weighted average contractual forward rates
March 2013 to August 2013	$ 11,400,000	1.0256
September 2013 to August 2014	18,600,000	1.0243
September 2014 to February 2015	6,600,000	1.0401
Total	$ 36,600,000	1.0275

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 $932,000 as at August 31, 2012 and net losses of $364,000 as at February 28, 2013. The quarter-end exchange rate was CA$1.0314 = US$1.00 as at February 28, 2013.

SHARE CAPITAL

Share capital

As at March 27, 2013, EXFO had 31,643,000 multiple voting shares outstanding, entitling to 10 votes each and 28,812,413 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 February 28, 2013, our off-balance sheet arrangements consisted of letters of guarantee amounting to $5.0 million; these letters of guarantee expire at various dates through fiscal 2017. From this amount, we had $0.6 million worth of letters of guarantee for our own selling and purchasing requirements, which were for the most part reserved from one of our lines of credit. The remainder, in the amount of $4.4 million, was used to secure our line of credit in CNY (Chinese currency) of $4.0 million. This line of credit was unused as at February 28, 2013.

SPECIAL PURPOSES ENTITIES

As at February 28, 2013, we did not have interests in any special purposes entities.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

For a description of the critical accounting policies and estimates used in the preparation of our consolidated financial statements, refer to our Annual Report on Form 20-F for the year ended August 31, 2012 filed with the U.S. Securities and Exchange Commission and the Canadian securities commissions.

NEW IFRS PRONOUNCEMENTS AND AMENDMENTS

Refer to note 2 to our condensed interim consolidated financial statements for the three months and six months ended February 28, 2013 and to our consolidated financial statements for the year ended August 31, 2012 for the effect of certain recent accounting pronouncements on our consolidated financial statements.

RISK FACTORS

There have been no material changes from the risk factors disclosed in our Annual Report in Form 20-F for the year ended August 31, 2012.

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 purposes 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 of property, plant and equipment, amortization of intangible assets, restructuring charges, change 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

	Three months ended February 28, 2013	Three months ended February 29, 2012	Six months ended February 28, 2013	Six months ended February 29, 2012
IFRS net earnings (loss) for the period	**$ 39**	$ 954	**$ (1,599)**	$ 3,841
Add (deduct):				
Depreciation of property, plant and equipment	**1,504**	1,546	**3,109**	3,114
Amortization of intangible assets	**1,922**	1,974	**3,884**	3,895
Interest (income) expenses	**25**	(54)	**(8)**	17
Income taxes	**2,088**	1,738	**3,220**	2,872
Restructuring charges	**89**	–	**89**	–
Change in fair value of cash contingent consideration	**–**	(311)	**–**	(311)
Stock-based compensation costs	**468**	508	**916**	1,063
Foreign exchange (gain) loss	**(1,700)**	1,471	**(2,456)**	(193)
Adjusted EBITDA for the period	**$ 4,435**	$ 7,826	**$ 7,155**	$ 14,298
Adjusted EBITDA in percentage of sales	**7.1%**	11.7%	**5.8%**	10.7%

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

	Quarters ended			
	February 28, 2013	**November 30, 2012**	**August 31, 2012**	**May 31, 2012**
Sales	$ 62,576	$ 59,821	$ 57,156	$ 59,505
Cost of sales [(1)]	$ 23,664	$ 23,657	$ 21,257	$ 23,549
Earnings (loss) from operations	$ 452	$ (1,295)	$ (1,678)	$ (4,355)
Net earnings (loss)	$ 39	$ (1,638)	$ (3,714)	$ (3,720)
Basic and diluted net earnings (loss) per share	$ 0.00	$ (0.03)	$ (0.06)	$ (0.06)

	Quarters ended			
	February 29, 2012	**November 30, 2011**	**August 31, 2011**	**May 31, 2011**
Sales	$ 66,917	$ 66,388	$ 64,414	$ 67,630
Cost of sales [(1)]	$ 23,616	$ 23,370	$ 23,447	$ 24,243
Earnings from operations	$ 4,109	$ 2,428	$ 5,878	$ 3,489
Net earnings	$ 954	$ 2,887	$ 4,597	$ 1,757
Basic and diluted net earnings	$ 0.02	$ 0.05	$ 0.08	$ 0.03

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