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 timing and nature of customer orders; longer sales cycles for complex systems involving customers' acceptance delaying revenue recognition; 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 June 23, 2015.

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, 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.

We introduced major enhancements to our analytics platform (EXFO Xtract), service assurance systems and network visibility solutions in the third quarter in order to help network operators take proactive actions that improve customer quality of experience. We also released new capabilities for our iOLM fiber test technology and a fully automated wireless fiber inspection solution, both contributing to our thrust to automate and accelerate fiber deployments in wireless access networks. Following the quarter-end, we accelerated our market-driven strategy by unveiling the most advanced, all-in-one test platform: FTB-1 Pro. This platform combines the unique, quad-port NetBlazer 10G Ethernet module and iSAM software test option. We also launched a new OTDR series and above-mentioned iOLM and fiber inspection probe options for the FTB-1 Pro to greatly accelerate and simplify the turn-up of next-generation fixed and mobile access networks.

We reported sales of $57.8 million in the third quarter of fiscal 2015, compared to $63.9 million for the same period last year, due in part to a significant headwind from a stronger US dollar versus other currencies, compared to the same period last year. Bookings totaled $59.2 million in the third quarter of fiscal 2015, for a book-to-bill ratio of 1.03, compared to $66.5 million for the same period last year.

Net earnings amounted to $563,000, or $0.01 per diluted share, in the third quarter of fiscal 2015, compared to $1.7 million, or $0.03 per share, for the same period last year. Net earnings for the third quarter of fiscal 2015 included $0.4 million in after-tax amortization of intangible assets, $0.4 million in stock-based compensation costs and a foreign exchange loss of $0.2 million.

Adjusted EBITDA (net earnings before interest, income taxes, depreciation and amortization, stock-based compensation costs and foreign exchange gain or loss) reached $4.5 million, or 7.7% of sales in the third quarter of fiscal 2015, compared to $7.3 million, or 11.5% of sales for the same period last year. See page 13 of this document for a complete reconciliation of adjusted EBITDA to IFRS net earnings.

On January 7, 2015, we announced that our Board of Directors had authorized a substantial issuer bid (the "Offer") to purchase for cancellation up to 7,142,857 subordinate voting shares for an aggregate purchase price not to exceed CA$30 million. On February 20, 2015, pursuant to the Offer, we purchased for cancellation 6,521,739 subordinate voting shares for an aggregate purchase price of CA$30 million (US$24.0 million), plus related fees of $0.2 million. We used cash to fund the purchase of shares.

On March 25, 2015, 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 1,397,598 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 March 27, 2015, and will end on March 26, 2016, 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.

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 May 31,		Nine months ended May 31,	
	2015	2014	**2015**	2014
Sales	**$ 57,781**	$ 63,882	**$ 165,495**	$ 171,064
Cost of sales [1]	**22,281**	23,469	**63,064**	64,727
Selling and administrative	**20,489**	21,730	**61,689**	64,975
Net research and development	**10,923**	11,745	**33,087**	33,999
Depreciation of property, plant and equipment	**1,163**	1,219	**3,664**	3,737
Amortization of intangible assets	**444**	1,025	**2,561**	3,281
Interest and other (income) expense	**36**	(220)	**(216)**	(296)
Foreign exchange (gain) loss	**175**	1,126	**(4,787)**	(1,968)
Earnings before income taxes	**2,270**	3,788	**6,433**	2,609
Income taxes	**1,707**	2,123	**3,458**	3,030
Net earnings (loss) for the period	**$ 563**	$ 1,665	**$ 2,975**	$ (421)
Basic and diluted net earnings (loss) per share	**$ 0.01**	$ 0.03	**$ 0.05**	$ (0.01)

Other selected information:

	Three months ended May 31,		Nine months ended May 31,	
	2015	2014	**2015**	2014
Gross margin before depreciation and amortization [2]	**$ 35,500**	$ 40,413	**$ 102,431**	$ 106,337
Research and development:				
Gross research and development	**$ 12,462**	$ 13,616	**$ 37,947**	$ 39,971
Net research and development	**$ 10,923**	$ 11,745	**$ 33,087**	$ 33,999
Adjusted EBITDA [2]	**$ 4,462**	$ 7,345	**$ 8,817**	$ 8,635

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

(2) Refer to page 13 for non-IFRS measures.

	Three months ended May 31,		Nine months ended May 31,	
	2015	**2014**	**2015**	**2014**
Sales	**100.0 %**	100.0 %	**100.0 %**	100.0 %
Cost of sales (1)	**38.6**	36.7	**38.1**	37.8
Selling and administrative	**35.5**	34.0	**37.3**	38.0
Net research and development	**18.9**	18.4	**20.0**	19.9
Depreciation of property, plant and equipment	**2.0**	1.9	**2.2**	2.2
Amortization of intangible assets	**0.8**	1.6	**1.5**	1.9
Interest and other (income) expense	**–**	(0.3)	**(0.1)**	(0.2)
Foreign exchange (gain) loss	**0.3**	1.8	**(2.9)**	(1.1)
Earnings before income taxes	**3.9**	5.9	**3.9**	1.5
Income taxes	**2.9**	3.3	**2.1**	1.7
Net earnings (loss) for the period	**1.0 %**	2.6 %	**1.8 %**	(0.2) %

Other selected information:

Gross margin before depreciation and amortization (2)	**61.4 %**	63.3 %	**61.9 %**	62.2 %
Research and development:				
Gross research and development	**21.6 %**	21.3 %	**22.9 %**	23.4 %
Net research and development	**18.9 %**	18.4 %	**20.0 %**	19.9 %
Adjusted EBITDA (2)	**7.7 %**	11.5 %	**5.3 %**	5.0 %

(1) The cost of sales is exclusive of depreciation and amortization, shown separately.
(2) Refer to page 13 for non-IFRS measures.

SALES AND BOOKINGS

For the three months ended May 31, 2015, our sales amounted to $57.8 million, compared to $63.9 million for the same period last year, while our bookings totaled $59.2 million compared to $66.5 million for the same period last year, for a book-to-bill ratio of 1.03.

For the nine months ended May 31, 2015, our sales reached $165.5 million, compared to $171.1 million for the same period last year. For the nine months of fiscal 2015, bookings amounted to $168.1 million, compared to $183.1 million for the same period last year, for a book-to-bill ratio of 1.02.

In the third quarter and the first nine months of fiscal 2015, we faced a significant headwind from a stronger US dollar, compared to the same periods last year. Given that we generate a portion of our revenue in Canadian dollars and euros but report our results in US dollars, it had a negative impact on our sales year-over-year.

In the third quarter of fiscal 2015, excluding the negative currency impact, the year-over-year decrease in sales mainly comes from our Protocol-layer product line in the Americas and Europe, Middle-East and Africa (EMEA); this was offset in part by increased sales for our Physical-layer product line in the Americas, where we benefited from some improvement year-over-year.

In the first nine months of fiscal 2015, excluding the negative currency impact, sales would have been almost flat year-over-year. In fact, we reported year-over-year sales growth in the Americas, mainly for our Physical-layer product line, which was offset by the decrease in sales in EMEA and to a lesser extent in Asia-Pacific for both our Physical- and Protocol-layer product lines. It should be noted that in the third quarter and in the first nine months of fiscal 2014, market conditions in the Americas were challenging due to order delays and lower spending levels, especially among key customers, which mainly affected our Physical-layer product line sales during these periods. Europe, overall, remained a challenging market due to weaker currencies and economic uncertainties.

Finally, in the third quarter and the first nine months of fiscal 2015, we faced increased competition and pricing pressure, compared to the same periods last year, which negatively affected our sales year-over-year.

In the third quarter and the first nine months of fiscal 2015, our bookings were negatively affected by a stronger US dollar, compared to the Canadian dollar and euro. In the third quarter and the first nine months of fiscal 2015, excluding the negative currency impact, the year-over-year decrease in bookings comes from our Protocol-layer product line; this more than offset the increase in bookings for our Physical-layer product line, especially in the Americas, where we benefited from some improvement year-over-year.

As we gradually evolve from a supplier of dedicated test instruments to a supplier of end-to-end solutions, our quarterly sales and bookings are becoming increasingly subject to quarterly fluctuations, as we are managing more complex, multimillion dollar deals that have prolonged sales and revenue recognition cycles related to our Protocol-layer products; this also explains the year-over-year decrease in sales and bookings in the third quarter and the first nine months of fiscal 2015 for our Protocol-layer product line.

Geographic distribution

In the third quarter of fiscal 2015, sales to the Americas, EMEA and Asia-Pacific accounted for 58%, 23% and 19% of sales respectively, compared to 54%, 28% and 18% for the same period last year respectively. In the first nine months of fiscal 2015, sales to the Americas, EMEA and Asia-Pacific accounted for 53%, 27% and 20% of sales respectively, compared to 50%, 30% and 20% 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 third quarters of fiscal 2014 and 2015, no customer accounted for more than 10% of our sales, and our top three customers accounted for 15.3% and 15.7% of sales respectively. In the first nine months of fiscal 2014 and 2015, no customer accounted for more than 10% of our sales, and our top three customers accounted for 11.9% and 12.8% of our sales respectively.

GROSS MARGIN BEFORE DEPRECIATION AND AMORTIZATION (non-IFRS measure — refer to page 13 of this document)

Gross margin before depreciation and amortization (gross margin) reached 61.4% of sales for the three months ended May 31, 2015, compared to 63.3% for the same period last year.

Gross margin reached 61.9% of sales for the nine months ended May 31, 2015, compared to 62.2% for the same period last year.

In the third quarter, lower sales volume resulted in a lower absorption of our fixed manufacturing costs, reducing our gross margin year-over-year.

In addition, in the third quarter, our gross margin was unfavorably affected by the product mix, compared to the same period last year.

Furthermore, in the third quarter, foreign exchange losses on our forward exchange contracts reduced our sales and negatively affected our gross margin by 0.4%, compared to the same period last year.

However, in the third quarter of fiscal 2015, we reported lower inventory write-down, compared to the same period last year, which increased our gross margin by 0.2% year-over-year.

In the first nine months of fiscal 2015, the slight decrease in our gross margin year-over-year mainly comes from foreign exchange losses on our forward exchange contracts, which reduced our sales and negatively affected our gross margin by 0.2% compared to the same period last year.

In addition, in the first nine months of fiscal 2015, we faced increased competition and pricing pressure for some product lines, compared to the same period last year, which negatively affected our gross margin year-over-year.

However, in the first nine months of fiscal 2015, we reported lower inventory write-down compared to the same period last year, which increased our gross margin by 0.3% year-over-year.

SELLING AND ADMINISTRATIVE EXPENSES

For the three months ended May 31, 2015, selling and administrative expenses were $20.5 million, or 35.5% of sales, compared to $21.7 million, or 34.0% of sales for the same period last year.

For the nine months ended May 31, 2015, selling and administrative expenses were $61.7 million, or 37.3% of sales, compared to $65.0 million, or 38.0% of sales for the same period last year.

In the third quarter and the first nine months of fiscal 2015, our selling and administrative expenses decreased due to the increase in the average value of the US dollar compared to the Canadian dollar and the euro year-over-year, as a portion of our selling and administrative expenses are incurred in these latter two currencies and we report our results in US dollars, and to tight control on expenses.

RESEARCH AND DEVELOPMENT EXPENSES

Gross research and development expenses

For the three months ended May 31, 2015, gross research and development expenses totaled $12.5 million, or 21.6% of sales, compared to $13.6 million, or 21.3% of sales for the same period last year.

For the nine months ended May 31, 2015, gross research and development expenses totaled $37.9 million, or 22.9% of sales, compared to $40.0 million, or 23.4% of sales for the same period last year.

In the third quarter and the first nine months of fiscal 2015, the year-over-year increase in the average value of the US dollar, compared to the Canadian dollar and the euro had a positive impact on our gross research and development expenses as most of these expenses are incurred in these latter two currencies and we report our results in US dollars. This explains most of the year-over-year decrease in gross research and development expenses.

In the first nine months of fiscal 2015, excluding the positive currency impact year-over-year, inflation, salary increases, as well as a shift in the mix and timing of research and development projects slightly increased our gross research and development expenses, compared to the same period last year.

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 May 31, 2015, tax credits and grants for research and development activities were $1.5 million, or 12.3% of gross research and development expenses, compared to $1.9 million, or 13.7% of gross research and development expenses for the same period last year.

For the nine months ended May 31, 2015, tax credits and grants for research and development activities were $4.9 million, or 12.8% of gross research and development expenses, compared to $6.0 million, or 14.9% of gross research and development expenses for the same period last year.

The decrease in our tax credits and grants in the third quarter and the first nine months of fiscal 2015, compared to the same periods last year, results from the decrease in the statutory Canadian federal and provincial research and development tax credit rates, 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 the third quarter and the first nine months of fiscal 2015, the decrease in tax credits and grants as a percentage of gross research and development expenses, compared to the same periods last year, mainly comes from the decrease in the statutory Canadian federal and provincial research and development tax credit rates.

AMORTIZATION OF INTANGIBLE ASSETS

In the third quarter of fiscal 2015, amortization of intangible assets amounted to $0.4 million, compared to $1.0 million for the same period last year.

In the first nine months of fiscal 2015, amortization of intangible assets amounted to $2.6 million, compared to $3.3 million for the same period last year.

The decrease in amortization expenses in the third quarter and the first nine months of fiscal 2015, compared to the same periods last year, is mainly due to the fact that core technology related to the acquisition of NetHawk Oyj (acquired in fiscal 2010) became fully amortized in the third quarter of fiscal 2015, and that the average value of the US dollar increased compared to the Canadian dollar year-over-year, as a significant portion of our amortization expense is incurred in this currency and we report our results in US dollars.

FOREIGN EXCHANGE GAIN (LOSS)

Foreign exchange gains and losses are mainly the result of the translation of operating activities denominated in currencies other than 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 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.

For the three months ended May 31, 2015, we recorded a foreign exchange loss of $0.2 million, compared $1.1 million for the same period last year.

For the nine months ended May 31, 2015, we recorded a foreign exchange gain of $4.8 million, compared to $2.0 million for the same period last year.

During the third quarter of fiscal 2015, the period-end value of the Canadian dollar slightly increased versus the US dollar, compared to the previous quarter, which resulted in a foreign exchange loss of $0.2 million during that period. The period-end value of the Canadian dollar increased 0.5% versus the US dollar to CA$1.2437= US$1.00 in the third quarter of fiscal 2015, compared to CA$1.2503 = US$1.00 at the end of the previous quarter.

During the same period last year, the period-end value of the Canadian dollar increased versus the US dollar and the euro, compared to the previous quarter, which resulted in a foreign exchange loss of $1.1 million during that period. In fact, the period-end value of the Canadian dollar increased 2.1% versus the US dollar to CA$1.0842= US$1.00 in the third quarter of fiscal 2014, compared to CA$1.1075 = US$1.00 at the end of the previous quarter, and increased 3.1% versus the euro to CA$1.4822 = €1.00 in the third quarter of fiscal 2014, compared to CA$1.5291 = €1.00 at the end of the previous quarter.

During the first nine months fiscal 2015, 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 $4.8 million during that period. The period-end value of the Canadian dollar decreased 12.7% versus the US dollar to CA$1.2437 = US$1.00 in the first nine months of fiscal 2015, compared to CA$1.0858 = US$1.00 at the end of the previous year.

During the same period last year, the period-end value of the Canadian dollar significantly decreased versus the US dollar and the euro, compared to the previous year end, which resulted in a foreign exchange gain of $2.0 million during that period. In fact, the period-end value of the Canadian dollar decreased 2.9% versus the US dollar to CA$1.0842 = US$1.00 in the first nine months of fiscal 2014, compared to CA$1.0530 = US$1.00 at the end of the previous year, and decreased 6.4% versus the euro to CA$1.4822 = €1.00 in the first nine months of fiscal 2014, compared to CA$1.3936 = €1.00 at the end of the previous year.

Foreign-exchange-rate fluctuations also flow through the statement of earnings line items as a portion of our sales and a significant portion of our operating expenses are denominated in Canadian dollars and euros, and we report our results in US dollars. In fact, the average value of the US dollar in the third quarter of fiscal 2015 increased 11.1% and 20.8% respectively year-over-year, compared to the Canadian dollar and the euro. During the first nine months of fiscal 2015, it increased 9.3% and 13.5% respectively year-over-year, compared to the Canadian dollar and the euro.

INCOME TAXES

For the three months ended May 31, 2015, we reported income tax expenses of $1.7 million on earnings before income taxes of $2.3 million. For the corresponding period last year, we reported income tax expense of $2.1 million on earnings before income taxes of $3.8 million.

For the nine months ended May 31, 2015, we reported income tax expenses of $3.5 million on earnings before income taxes of $6.4 million. For the corresponding period last year, we reported income tax expenses of $3.0 million on earnings before income taxes of $2.6 million.

These distorted tax rates 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 losses and expenses, such as stock-based compensation costs. In addition, a significant portion of our foreign exchange gain or loss was created by the translation of financial statements of our foreign subsidiaries from their local currency to the functional currency, and was therefore non-taxable or non-deductible. Otherwise, our effective tax rate would have been closer to the combined Canadian and provincial statutory tax rate of 27% for both periods.

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

LIQUIDITY AND CAPITAL RESOURCES

Cash requirements and capital resources

As at May 31, 2015, cash and short-term investments totaled $29.9 million, while our working capital was at $72.7 million. Our cash and short-term investments decreased $3.0 million in the third quarter of fiscal 2015, from the previous quarter. First, in the third quarter of fiscal 2015, operating activities used $1.3 million in cash and we made cash payments of $1.8 million for the purchase of capital assets.

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, as well as potential acquisitions and our share repurchase program. As at May 31, 2015, cash balances included an amount of $14.0 million that bears interest at an annual rate of 1.2%.

We believe that our cash balances and short-term investments of $29.9 million will be sufficient to meet our liquidity and capital requirements for the foreseeable future, including the effect of our share repurchase program. In addition to these assets, we have unused available lines of credit totaling $13.7 million for working capital and other general corporate purposes, and unused lines of credit of $17.5 million for foreign currency exposure related to forward exchange contracts. However, possible operating losses, 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 used by operating activities were $1.3 million for the three months ended May 31, 2015, compared to cash flows generated of $2.9 million for the same period last year.

Cash flows provided by operating activities were $6.4 million for the nine months ended May 31, 2015, compared to $9.9 million for the same period last year.

Cash flows used by operating activities in the third quarter of fiscal 2015 were attributable to the net earnings after items not affecting cash of $3.9 million, more than offset by the negative net change in non-cash operating items of $5.1 million; this was mainly due to the negative effect on cash of the increase of $6.5 million in our accounts receivable due to the sequential increase in sales as well as the timing of receipts and sales during the quarter, the negative effect on cash of the increase of $541,000 in our income tax and tax credits recoverable due to tax credits earned during the quarter not yet recovered, and the negative effect on cash of the increase of $374,000 in our prepaid expenses due to timing of payments during the quarter. These negative effects on cash were offset in part by the positive effect on cash of the decrease of $950,000 in our inventories due to improved inventory turns and the positive effect on cash of the increase of $1.3 million in our accounts payable, accrued liabilities and provisions due to timing of purchases and payments during the quarter.

Cash flows provided by operating activities in the third quarter of fiscal 2014 were attributable to the net earnings after items not affecting cash of $6.1 million offset in part by the negative net change in non-cash operating items of $3.2 million; this was mainly due to the negative effect on cash of the increase of $8.2 million in our accounts receivable due to the increase of sales as well as the timing of receipts and sales during the quarter and the negative effect on cash of the increase of $759,000 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 $727,000 in our inventories due to an increased inventory turn, the positive effect on cash of the decrease of $492,000 in our prepaid expenses due to the timing of payments during the quarter, as well as the positive effect on cash of the increase of $4.6 million in our accounts payable, accrued liabilities and provisions due to timing of purchases and payments during the quarter.

Cash flows provided by operating activities in the first nine months of fiscal 2015 were attributable to the net earnings after items not affecting cash of $9.0 million, offset in part by the negative net change in non-cash operating items of $2.7 million; this was mainly due to the positive effect on cash of the increase of $9.0 million in our accounts payable, accrued liabilities and provisions due to timing of purchases and payments during the period. This positive effect on cash was offset in part by the negative effect on cash of the increase of $7.8 million in our accounts receivable due to the timing of receipts and sales during the period, the negative effect on cash of the increase of $2.0 million in our income tax and tax credits recoverable due to tax credits earned during the period not yet recovered, the negative effect on cash of the increase of $983,000 in our inventories to meet future demand, and the negative effect on cash of the increase of $875,000 in our prepaid expenses due to timing of payments during the period.

Cash flows provided by operating activities in the first nine months of fiscal 2014 were attributable to the net earnings after items not affecting cash of $8.3 million, and the positive net change in non-cash operating items of $1.6 million; this was mainly due to the positive effect on cash of the increase of $10.0 million in our accounts payable, accrued liabilities and provisions due to timing of purchases and payments during the period. This positive effect on cash was offset in part by the negative effect on cash of the increase of $3.7 million in our accounts receivable due to the decrease in sales year-over-year as well as the timing of receipts and sales during the period, the negative effect on cash of the increase of $1.7 million in our income tax and tax credits recoverable due to tax credits earned during the period not yet recovered, and the negative effect on cash of the increase of $2.8 million in our inventories to meet future demand.

Investing activities

Cash flows used by investing activities were $207,000 for the three months ended May 31, 2015, compared to $3.3 million for the same period last year.

Cash flows used by investing activities were $449,000 for the nine months ended May 31, 2015, compared to $5.7 million for the same period last year.

In the third quarter of fiscal 2015, we paid $1.8 million for the purchase of capital assets but we disposed (net of acquisitions) of $1.6 million worth of short-term investments.

For the corresponding period last year, we paid $2.8 million for the purchase of capital assets, including the assets of ByteSphere, and we acquired (net of disposals) $577,000 worth of short-term investments.

In the first nine months of fiscal 2015, we paid $4.6 million for the purchase of capital assets, but we disposed (net of acquisitions) of $4.2 million worth of short-term investments.

For the corresponding period last year, we paid $5.1 million for the purchase of capital assets, including the assets of ByteSphere, and we acquired (net of disposals) $586,000 worth of short-term investments.

Financing activities

Cash flows used by financing activities were $71,000 for the three months ended May 31, 2015, compared to cash flows provided of $30,000 for the same period last year.

Cash flows used by financing activities were $25.2 million for the nine months ended May 31, 2015, compared to $1.0 million for the same period last year.

In the first nine months of fiscal 2015, we redeemed share capital under our share repurchase programs (namely our substantial issuer bid) for a cash consideration of $25.2 million.

For the corresponding period last year, we redeemed share capital for a cash consideration of $937,000 and we made a repayment of $307,000 of our long-term debt. However, we received $225,000 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 May 31, 2015, 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
June 2015 to August 2015	$ 7,700,000	1.1033
September 2015 to August 2016	20,200,000	1.1180
September 2016 to August 2017	8,000,000	1.1530
September 2017 to December 2017	1,600,000	1.2135
Total	$ 37,500,000	1.1266

US dollars – Indian rupees

Expiry dates	Contractual amounts	Weighted average contractual forward rates
June 2015 to August 2015	$ 1,200,000	64.49
September 2015 to April 2016	2,800,000	65.96
Total	$ 4,000,000	65,52

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 $497,000 as at August 31, 2014, and $3.6 million as at May 31, 2015, mainly for our US/Canadian dollars forward exchange contracts. The quarter-end exchange rate was CA$1.2437 = US$1.00 as at May 31, 2015.

SHARE CAPITAL

Share capital

As at June 23, 2015, EXFO had 31,643,000 multiple voting shares outstanding, entitling to 10 votes each and 22,202,627 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 May 31, 2015, our off-balance sheet arrangements consisted of letters of guarantee amounting to $349,000 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 May 31, 2015, we did not have interests in any structured entities.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

For a description of the critical accounting policies, judgments in applying accounting policies as well as estimates and assumptions used in the preparation of our consolidated financial statements, refer to our Annual Report on Form 20-F for the year ended August 31, 2014, 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 unaudited interim consolidated financial statements for the three and nine months ended May 31, 2015 and to our consolidated financial statements for the year ended August 31, 2014 for the effect of certain recent accounting pronouncements on our consolidated financial statements.

RISKS AND UNCERTAINTIES

For the first nine months of fiscal 2015, there have been no material changes from the risk factors disclosed in our Annual Report on Form 20-F for the year ended August 31, 2014.

NON-IFRS MEASURES

We provide non-IFRS measures (gross margin before depreciation and amortization* 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 before depreciation and amortization represents sales less cost of sales, excluding depreciation and amortization.

** Adjusted EBITDA represents net earnings (loss) before interest, income taxes, depreciation and amortization, 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)

	Three months ended May 31,		Nine months ended May 31,	
	2015	2014	**2015**	2014
IFRS net earnings (loss) for the period	**$ 563**	$ 1,665	**$ 2,975**	$ (421)
Add (deduct):				
Depreciation of property, plant and equipment	**1,163**	1,219	**3,664**	3,737
Amortization of intangible assets	**444**	1,025	**2,561**	3,281
Interest and other (income) expense	**36**	(220)	**(216)**	(296)
Income taxes	**1,707**	2,123	**3,458**	3,030
Stock-based compensation costs	**374**	407	**1,162**	1,272
Foreign exchange (gain) loss	**175**	1,126	**(4,787)**	(1,968)
Adjusted EBITDA for the period	**$ 4,462**	$ 7,345	**$ 8,817**	$ 8,635
Adjusted EBITDA in percentage of sales	**7.7%**	11.5%	**5.3%**	5.0%

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

	Quarters ended			
	May 31, 2015	**February 28, 2015**	**November 30, 2014**	**August 31, 2014**
Sales	$ 57,781	$ 50,990	$ 56,724	$ 59,742
Cost of sales [(1)]	$ 22,281	$ 19,546	$ 21,237	$ 22,109
Net earnings	$ 563	$ 931	$ 1,481	$ 1,204
Basic and diluted net earnings per share	$ 0.01	$ 0.02	$ 0.02	$ 0.02

	Quarters ended			
	May 31, 2014	**February 28, 2014**	**November 30, 2013**	**August 31, 2013**
Sales	$ 63,882	$ 51,179	$ 56,003	$ 60,888
Cost of sales [(1)]	$ 23,469	$ 20,073	$ 21,185	$ 22,574
Net earnings (loss)	$ 1,665	$ (1,339)	$ (747)	$ 3,802
Basic and diluted net earnings (loss) per share	$ 0.03	$ (0.02)	$ (0.01)	$ 0.06

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