

**EXFO Inc.**  
**Condensed Unaudited Interim Consolidated Balance Sheets**

(in thousands of US dollars)

	<b>As at November 30, 2014</b>	<b>As at August 31, 2014</b>
	<u>          </u>	<u>          </u>
<b>Assets</b>		
<b>Current assets</b>		
Cash	\$ 52,221	\$ 54,121
Short-term investments	5,389	5,726
Accounts receivable		
Trade	48,074	46,031
Other	2,610	2,001
Income taxes and tax credits recoverable	4,363	3,796
Inventories	34,551	35,232
Prepaid expenses	2,502	2,281
	<u>149,710</u>	<u>149,188</u>
<b>Tax credits recoverable</b>	38,982	41,745
<b>Property, plant and equipment</b>	40,007	42,780
<b>Intangible assets</b>	6,078	7,293
<b>Goodwill</b>	25,140	26,488
<b>Deferred income taxes</b>	10,273	9,816
<b>Other assets</b>	548	721
	<u>\$ 270,738</u>	<u>\$ 278,031</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 35,672	\$ 29,553
Provisions	508	532
Income taxes payable	727	840
Deferred revenue	7,728	8,990
	<u>44,635</u>	<u>39,915</u>
<b>Deferred revenue</b>	2,952	3,319
<b>Deferred income taxes</b>	2,733	3,087
<b>Other liabilities</b>	711	340
	<u>51,031</u>	<u>46,661</u>
<b>Shareholders' equity</b>		
Share capital (note 4)	111,015	111,491
Contributed surplus	16,540	16,503
Retained earnings	115,116	113,635
Accumulated other comprehensive loss	(22,964)	(10,259)
	<u>219,707</u>	<u>231,370</u>
	<u>\$ 270,738</u>	<u>\$ 278,031</u>

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

**EXFO Inc.**  
**Condensed Unaudited Interim Consolidated Statements of Earnings**

(in thousands of US dollars, except share and per share data)

	Three months ended November 30,	
	2014	2013
<b>Sales</b>	\$ 56,724	\$ 56,003
Cost of sales <sup>(1)</sup> (note 5)	21,237	21,185
Selling and administrative (note 5)	21,032	21,708
Net research and development (note 5)	11,658	11,281
Depreciation of property, plant and equipment (note 5)	1,245	1,275
Amortization of intangible assets (note 5)	1,098	1,182
Interest income	(217)	(27)
Foreign exchange gain	(1,975)	(802)
<b>Earnings before income taxes</b>	2,646	201
<b>Income taxes</b> (note 6)	1,165	948
<b>Net earnings (loss) for the period</b>	\$ 1,481	\$ (747)
<b>Basic and diluted net earnings (loss) per share</b>	\$ 0.02	\$ (0.01)
<b>Basic weighted average number of shares outstanding (000's)</b>	60,335	60,217
<b>Diluted weighted average number of shares outstanding (000's)</b> (note 7)	60,980	60,217

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

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

# EXFO Inc.

## Condensed Unaudited Interim Consolidated Statements of Comprehensive Loss

(in thousands of US dollars)

	Three months ended	
	November 30,	
	2014	2013
<b>Net earnings (loss) for the period</b>	\$ 1,481	\$ (747)
Other comprehensive income (loss), net of income taxes		
Items that will not be reclassified subsequently to net earnings		
Foreign currency translation adjustment	(11,735)	(1,948)
Items that may be reclassified subsequently to net earnings		
Unrealized losses on forward exchange contracts	(1,505)	(240)
Reclassification of realized losses on forward exchange contracts in net loss	162	174
Deferred income tax effect of losses on forward exchange contracts	373	18
Other comprehensive loss	(12,705)	(1,996)
<b>Comprehensive loss for the period</b>	\$ (11,224)	\$ (2,743)

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

# EXFO Inc.

## Condensed Unaudited Interim Consolidated Statements of Changes in Shareholders' Equity

(in thousands of US dollars)

	<b>Three months ended November 30, 2013</b>				
	<b>Share Capital</b>	<b>Contributed Surplus</b>	<b>Retained earnings</b>	<b>Accumulated other comprehensive loss</b>	<b>Total shareholders' equity</b>
Balance as at September 1, 2013	\$ 109,837	\$ 17,186	\$ 112,852	\$ (3,423)	\$ 236,452
Exercise of stock options (note 4)	106	-	-	-	106
Reclassification of stock-based compensation costs (note 4)	1,435	(1,435)	-	-	-
Stock-based compensation costs	-	417	-	-	417
Net loss for the period	-	-	(747)	-	(747)
Other comprehensive loss					
Foreign currency translation adjustment	-	-	-	(1,948)	(1,948)
Changes in unrealized losses on forward exchange contracts, net of deferred income taxes of \$18	-	-	-	(48)	(48)
Total comprehensive loss for the period	-	-	(747)	(1,996)	(2,743)
Balance as at November 30, 2013	<u>\$ 111,378</u>	<u>\$ 16,168</u>	<u>\$ 112,105</u>	<u>\$ (5,419)</u>	<u>\$ 234,232</u>

	<b>Three months ended November 30, 2014</b>				
	<b>Share Capital</b>	<b>Contributed Surplus</b>	<b>Retained earnings</b>	<b>Accumulated other comprehensive loss</b>	<b>Total shareholders' equity</b>
Balance as at September 1, 2014	\$ 111,491	\$ 16,503	\$ 113,635	\$ (10,259)	\$ 231,370
Redemption of share capital (note 4)	(919)	66	-	-	(853)
Reclassification of stock-based compensation costs (note 4)	443	(443)	-	-	-
Stock-based compensation costs	-	414	-	-	414
Net earnings for the period	-	-	1,481	-	1,481
Other comprehensive loss					
Foreign currency translation adjustment	-	-	-	(11,735)	(11,735)
Changes in unrealized losses on forward exchange contracts, net of deferred income taxes of \$373	-	-	-	(970)	(970)
Total comprehensive loss for the period	-	-	1,481	(12,705)	(11,224)
Balance as at November 30, 2014	<u>\$ 111,015</u>	<u>\$ 16,540</u>	<u>\$ 115,116</u>	<u>\$ (22,964)</u>	<u>\$ 219,707</u>

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

# EXFO Inc.

## Condensed Unaudited Interim Consolidated Statements of Cash Flows

(in thousands of US dollars)

	Three months ended November 30,	
	2014	2013
<b>Cash flows from operating activities</b>		
Net earnings (loss) for the period	\$ 1,481	\$ (747)
Add (deduct) items not affecting cash		
Stock-based compensation costs	400	463
Depreciation and amortization	2,343	2,457
Deferred revenue	(1,027)	(1,752)
Deferred income taxes	(332)	625
Changes in foreign exchange gain/loss	(1,028)	(108)
	1,837	938
Changes in non-cash operating items		
Accounts receivable	(5,036)	(1,657)
Income taxes and tax credits	(212)	743
Inventories	(1,181)	(2,312)
Prepaid expenses	(336)	171
Other assets	1	6
Accounts payable, accrued liabilities and provisions	6,836	5,485
Other liabilities	(19)	(26)
	1,890	3,348
<b>Cash flows from investing activities</b>		
Additions to short-term investments	(13,691)	(9,781)
Proceeds from disposal and maturity of short-term investments	13,766	9,772
Additions to capital assets	(754)	(701)
	(679)	(710)
<b>Cash flows from financing activities</b>		
Exercise of stock options	–	106
Redemption of share capital	(853)	–
	(853)	106
<b>Effect of foreign exchange rate changes on cash</b>	(2,258)	(365)
<b>Change in cash</b>	(1,900)	2,379
<b>Cash – Beginning of the period</b>	54,121	45,386
<b>Cash – End of the period</b>	\$ 52,221	\$ 47,765
<b>Supplementary information</b>		
Income taxes paid	\$ 367	\$ 642

As at November 30, 2013 and 2014, additions to capital assets amounted to \$1,484 and \$1,045 respectively, and unpaid purchases of capital assets amounted to \$1,014 and \$492 respectively.

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

# EXFO Inc.

## Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

### 1 Nature of Activities and Incorporation

EXFO Inc. and its subsidiaries (together “EXFO” or the company) design, manufacture and market test, service assurance and quality of experience solutions for wireless and wireline network operators and equipment manufacturers in the global telecommunications industry. The company’s core-to-edge solutions assess the performance and reliability of converged Internet protocol (IP) fixed and mobile networks.

EXFO is a company incorporated under the Canada Business Corporations Act and domiciled in Canada. The address of its headquarters is 400 Godin Avenue, Quebec, Province of Quebec, Canada, G1M 2K2.

These condensed interim consolidated financial statements were authorized for issue by the Board of Directors on January 7, 2015.

### 2 Basis of Presentation

These condensed interim consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB) applicable to the preparation of interim financial statements, including IAS 34, “*Interim Financial Reporting*”, and using the same accounting policies and methods used in the preparation of the company’s most recent annual consolidated financial statements. Consequently, these condensed interim consolidated financial statements should be read in conjunction with the company’s most recent annual consolidated financial statements, which have been prepared in accordance with IFRS as issued by the IASB.

#### ***New IFRS Pronouncements***

##### *Financial instruments*

The final version of IFRS 9, “*Financial Instruments*”, was issued in July 2014 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. The company has not yet assessed the impact that the new standard will have on its 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. The company has not yet assessed the impact that the new standard will have on its consolidated financial statements or whether or not to early adopt the new standard.

# EXFO Inc.

## Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

### 3 Financial Instruments

#### *Fair Value of Financial Instruments*

The company classifies its derivative and non-derivative financial assets and liabilities measured at fair value using the fair value hierarchy as follows:

Level 1: Quoted prices (unadjusted) in active market for identical assets or liabilities;

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset and liability, either directly or indirectly;

Level 3: Unobservable inputs for the asset or liability.

The company's short-term investments and forward exchange contracts are measured at fair value at each balance sheet date. The company's short-term investments are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices in active markets. The company's forward exchange contracts are classified within Level 2 of the fair value hierarchy because they are valued using quoted prices and forward exchange rates at the balance sheet dates.

The fair value of forward exchange contracts represents the amount at which they could be settled based on estimated current market rates.

The fair value of derivative and non-derivative financial assets and liabilities measured at fair value by level of fair value hierarchy, is as follows:

	As at November 30, 2014		As at August 31, 2014	
	Level 1	Level 2	Level 1	Level 2
<b>Financial assets</b>				
Short-term investments	\$ 5,389	\$ –	\$ 5,726	\$ –
Forward exchange contracts	\$ –	\$ 48	\$ –	\$ 193
<b>Financial Liabilities</b>				
Forward exchange contracts	\$ –	\$ 2,058	\$ –	\$ 690

#### *Derivative Financial Instruments*

The functional currency of the company is the Canadian dollar. The company is exposed to currency risk as a result of its export sales of products manufactured in Canada, China and Finland, the majority of which are denominated in US dollars and euros. This risk is partially hedged by forward exchange contracts and certain cost of sales and operating expenses (US dollars and euros). In addition, the company is exposed to currency risk as a result of its research and development activities in India (Indian rupees). This risk is partially hedged by forward exchange contracts. Forward exchange contracts, which are designated as cash flow hedging instruments, qualify for hedge accounting.

As at November 30, 2014, the company held contracts to sell US dollars for Canadian dollars and Indian rupees at various forward rates, which are summarized as follows:

# EXFO Inc.

## Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

*US dollars – Canadian dollars*

<u>Expiry dates</u>	<u>Contractual amounts</u>	<u>Weighted average contractual forward rates</u>
December 2014 to August 2015	\$ 18,300	1.0748
September 2015 to August 2016	16,200	1.1001
September 2016 to August 2017	5,400	1.1160
September 2017	200	1.1306
Total	<u>\$ 40,100</u>	<u>1.0908</u>

*US dollars – Indian rupees*

<u>Expiry dates</u>	<u>Contractual amounts</u>	<u>Weighted average contractual forward rate</u>
December 2014 to August 2015	<u>\$ 3,600</u>	<u>63.49</u>

The carrying amount of forward exchange contracts is equal to fair value, which is based on the amount at which they could be settled based on estimated current market rates. The fair value of forward exchange contracts amounted to net losses of \$497,000 as at August 31, 2014, and \$2,010,000 as at November 30, 2014.

As at November 30, 2014, forward exchange contracts in the amount of \$48,000 are presented as current assets in other accounts receivable, forward exchange contracts in the amount of \$1,531,000 are presented as current liabilities in accounts payable and accrued liabilities, and forward exchange contracts of \$527,000 are presented as long-term liabilities in other long-term liabilities in the balance sheet. Forward exchange contracts of \$305,000 included in accounts payable and accrued liabilities are recorded in the statement of earnings; otherwise, other forward exchange contracts are not yet recorded in the statement of earnings.

Based on the portfolio of forward exchange contracts as at November 30, 2014, the company estimates that the portion of the net unrealized losses on these contracts as of that date, which will be realized and reclassified from accumulated other comprehensive income to net earnings over the next 12 months, amounts to \$1,178,000.

During the three months ended November 30, 2013 and 2014, the company recognized within its sales foreign exchange losses on forward exchange contracts of \$84,000 and \$292,000 respectively.



# EXFO Inc.

## Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

### 4 Share Capital

The following tables summarize changes in share capital for the three months ended November 30, 2013 and 2014.

	Three months ended November 30, 2013				
	Multiple voting shares		Subordinate voting shares		Total amount
	Number	Amount	Number	Amount	
Balance as at September 1, 2013	31,643,000	\$ 1	28,401,790	\$ 109,836	\$ 109,837
Exercise of stock options	-	-	25,800	106	106
Redemption of restricted share units	-	-	315,583	-	-
Redemption of deferred share units	-	-	38,010	-	-
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	-	-	-	1,435	1,435
Balance as at November 30, 2013	<u>31,643,000</u>	<u>\$ 1</u>	<u>28,781,183</u>	<u>\$ 111,377</u>	<u>\$ 111,378</u>

	Three months ended November 30, 2014				
	Multiple voting shares		Subordinate voting shares		Total amount
	Number	Amount	Number	Amount	
Balance as at September 1, 2014	31,643,000	\$ 1	28,703,750	\$ 111,490	\$ 111,491
Redemption of restricted share units	-	-	115,669	-	-
Redemption of share capital	-	-	(236,486)	(919)	(919)
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	-	-	-	443	443
Balance as at November 30, 2014	<u>31,643,000</u>	<u>\$ 1</u>	<u>28,582,933</u>	<u>\$ 111,014</u>	<u>\$ 111,015</u>

### 5 Statements of Earnings

Net research and development expenses comprise the following:

	Three months ended November 30,	
	2014	2013
Gross research and development expenses	\$ 13,309	\$ 13,309
Research and development tax credits and grants	(1,651)	(2,028)
Net research and development expenses for the period	<u>\$ 11,658</u>	<u>\$ 11,281</u>

# EXFO Inc.

## Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

Inventory write-down is as follows:

	Three months ended November 30,	
	2014	2013
Inventory write-down for the period	\$ 933	\$ 1,187

Depreciation and amortization expenses by functional area are as follows:

	Three months ended November 30,	
	2014	2013
Cost of sales		
Depreciation of property, plant and equipment	\$ 395	\$ 384
Amortization of intangible assets	671	565
	<u>1,066</u>	<u>949</u>
Selling and administrative expenses		
Depreciation of property, plant and equipment	142	247
Amortization of intangible assets	364	395
	<u>506</u>	<u>642</u>
Net research and development expenses		
Depreciation of property, plant and equipment	708	644
Amortization of intangible assets	63	222
	<u>771</u>	<u>866</u>
	<u>\$ 2,343</u>	<u>\$ 2,457</u>
Depreciation of property, plant and equipment	\$ 1,245	\$ 1,275
Amortization of intangible assets	1,098	1,182
	<u>\$ 2,343</u>	<u>\$ 2,457</u>

Employee compensation comprises the following:

	Three months ended November 30,	
	2014	2013
Salaries and benefits	\$ 30,210	\$ 30,020
Stock-based compensation costs	400	463
Total employee compensation for the period	<u>\$ 30,610</u>	<u>\$ 30,483</u>

# EXFO Inc.

## Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

Stock-based compensation costs by functional area are as follows:

	Three months ended November 30,	
	2014	2013
Cost of sales	\$ 45	\$ 55
Selling and administrative expenses	263	333
Net research and development expenses	92	75
Total stock-based compensation for the period	<u>\$ 400</u>	<u>\$ 463</u>

### 6 Income Taxes

For the three months ended November 30, 2013 and 2014, the reconciliation of the income tax provision calculated using the combined Canadian federal and provincial statutory income tax rate with the income tax provision in the financial statements is as follows:

	Three months ended November 30,	
	2014	2013
Income tax provision at combined Canadian federal and provincial statutory tax rate (27%)	\$ 714	\$ 54
Increase (decrease) due to:		
Foreign income taxed at different rates	(5)	(86)
Non-taxable (income)/loss	831	(422)
Non-deductible expenses	202	226
Foreign exchange effect of translation of foreign subsidiaries	(993)	246
Utilization of previously unrecognized deferred income tax assets	-	(15)
Unrecognized deferred income tax assets on temporary deductible differences and unused tax losses	604	987
Other	(188)	(42)
Income tax provision for the period	<u>\$ 1,165</u>	<u>\$ 948</u>

The income tax provision consists of the following:

	Three months ended November 30,	
	2014	2013
Current	\$ 1,497	\$ 323
Deferred	(332)	625
	<u>\$ 1,165</u>	<u>\$ 948</u>

# EXFO Inc.

## Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

### 7 Earnings per Share

The following table summarizes the reconciliation of the basic weighted average number of shares outstanding and the diluted weighted average number of shares outstanding:

	Three months ended November 30,	
	2014	2013
Basic weighted average number of shares outstanding (000's)	60,335	60,217
Plus dilutive effect of (000's):		
Restricted share units	527	673
Deferred share units	118	114
Stock options	–	32
Diluted weighted average number of shares outstanding (000's)	60,980	61,036
Stock awards excluded from the calculation of diluted weighted average number of shares because their exercise price was greater than the average market price of the common shares (000's)	109	–

For the three months ended November 30, 2013, the diluted amount per share was the same as the basic amount per share since the dilutive effect of stock options, restricted share units and deferred share units was not included in the calculation; otherwise, the effect would have been antidilutive. Accordingly, the diluted amount per share for this period was calculated using the basic weighted average number of shares outstanding.

### 8 Subsequent Event

On January 7, 2015, the company announced that its 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\$30,000,000. The Offer is being made by way of a "modified Dutch Auction" pursuant to which shareholders might tender all or a portion of their shares (i) at a price not less than CA\$4.20 per share and not more than CA\$4.60 per share, in increments of CA\$0.05 per share, or (ii) without specifying a purchase price, in which case their shares would be purchased at the purchase price determined in accordance with the Offer. The Offer will expire on February 13, 2015.