

EXFO Inc.

Condensed Unaudited Interim Consolidated Balance Sheets

(in thousands of US dollars)

	<u>As at November 30, 2012</u>	<u>As at August 31, 2012</u>
Assets		
Current assets		
Cash	\$ 50,818	\$ 58,868
Short-term investments	8,171	8,236
Accounts receivable		
Trade	45,701	37,643
Other	3,773	4,283
Income taxes and tax credits recoverable	8,597	9,024
Inventories	41,065	41,212
Prepaid expenses	3,415	3,800
	<u>161,540</u>	<u>163,066</u>
Tax credits recoverable	40,511	38,397
Property, plant and equipment	49,045	49,848
Intangible assets	12,214	14,132
Goodwill	28,958	29,160
Deferred income taxes	11,946	12,080
	<u>\$ 304,214</u>	<u>\$ 306,683</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 35,202	\$ 32,392
Provisions	853	952
Income taxes payable	1,068	917
Current portion of long-term debt	583	565
Deferred revenue	9,348	10,583
	<u>47,054</u>	<u>45,409</u>
Deferred revenue	4,596	4,997
Long-term debt	291	282
Other liabilities	413	609
Deferred income taxes	2,609	2,105
	<u>54,963</u>	<u>53,402</u>
Shareholders' equity		
Share capital (note 4)	110,835	110,965
Contributed surplus	16,950	17,298
Retained earnings	109,873	111,511
Accumulated other comprehensive income	11,593	13,507
	<u>249,251</u>	<u>253,281</u>
	<u>\$ 304,214</u>	<u>\$ 306,683</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,	
	2012	2011
Sales	\$ 59,821	\$ 66,388
Cost of sales ⁽¹⁾ (note 5)	23,657	23,370
Selling and administrative (note 5)	22,290	24,618
Net research and development (note 5)	11,602	12,483
Depreciation of property, plant and equipment (note 5)	1,605	1,568
Amortization of intangible assets (note 5)	1,962	1,921
Earnings (loss) from operations	(1,295)	2,428
Interest income (expenses)	33	(71)
Foreign exchange gain	756	1,664
Earnings (loss) before income taxes	(506)	4,021
Income taxes (note 6)	1,132	1,134
Net earnings (loss) for the period	\$ (1,638)	\$ 2,887
Basic and diluted net earnings (loss) per share	\$ (0.03)	\$ 0.05
Basic weighted average number of shares outstanding (000's)	60,389	60,341
Diluted weighted average number of shares outstanding (000's) (note 7)	60,389	61,763

(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,	
	2012	2011
Net earnings (loss) for the period	\$ (1,638)	\$ 2,887
Other comprehensive income (loss), net of income taxes		
Items that will not be reclassified subsequently to net earnings		
Foreign currency translation adjustment	(1,708)	(11,827)
Items that may be reclassified subsequently to net earnings		
Unrealized gains on forward exchange contracts	(83)	(819)
Reclassification of realized gains on forward exchange contracts in net earnings (loss)	(199)	(625)
Deferred income tax effect of gains on forward exchange contracts	76	395
	(206)	(1,049)
Other comprehensive loss	(1,914)	(12,876)
Comprehensive loss for the period	\$ (3,552)	\$ (9,989)

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)

	Three months ended November 30, 2011				
	Share Capital	Contributed Surplus	Retained earnings	Accumulated other comprehensive income	Total shareholders' equity
Balance as at September 1, 2011	\$ 110,341	\$ 18,017	\$ 115,104	\$ 21,049	\$ 264,511
Redemption of share capital (note 4)	(244)	(119)	–	–	(363)
Reclassification of stock-based compensation costs	848	(848)	–	–	–
Stock-based compensation costs	–	489	–	–	489
Net earnings for the period	–	–	2,887	–	2,887
Other comprehensive loss					
Foreign currency translation adjustment	–	–	–	(11,827)	(11,827)
Changes in unrealized gains on forward exchange contracts, net of deferred income taxes of \$395	–	–	–	(1,049)	(1,049)
Total comprehensive income (loss) for the period	–	–	2,887	(12,876)	(9,989)
Balance as at November 30, 2011	<u>\$ 110,945</u>	<u>\$ 17,539</u>	<u>\$ 117,991</u>	<u>\$ 8,173</u>	<u>\$ 254,648</u>

	Three months ended November 30, 2012				
	Share Capital	Contributed Surplus	Retained earnings	Accumulated other comprehensive income	Total shareholders' equity
Balance as at September 1, 2012	\$ 110,965	\$ 17,298	\$ 111,511	\$ 13,507	\$ 253,281
Exercise of stock options (note 4)	51	–	–	–	51
Redemption of share capital (note 4)	(793)	(180)	–	–	(973)
Reclassification of stock-based compensation costs	612	(612)	–	–	–
Stock-based compensation costs	–	444	–	–	444
Net loss for the period	–	–	(1,638)	–	(1,638)
Other comprehensive loss					
Foreign currency translation adjustment	–	–	–	(1,708)	(1,708)
Changes in unrealized gains on forward exchange contracts, net of deferred income taxes of \$76	–	–	–	(206)	(206)
Total comprehensive loss for the period	–	–	(1,638)	(1,914)	(3,552)
Balance as at November 30, 2012	<u>\$ 110,835</u>	<u>\$ 16,950</u>	<u>\$ 109,873</u>	<u>\$ 11,593</u>	<u>\$ 249,251</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,	
	2012	2011
Cash flows from operating activities		
Net earnings (loss) for the period	\$ (1,638)	\$ 2,887
Add (deduct) items not affecting cash		
Change in discount on short-term investments	2	31
Stock-based compensation costs	448	555
Depreciation and amortization	3,567	3,489
Deferred revenue	(1,531)	(1,141)
Deferred income taxes	733	718
Change in foreign exchange gain/loss	(23)	(1,214)
	1,558	5,325
 Change in non-cash operating items		
Accounts receivable	(8,104)	(2,897)
Income taxes and tax credits	(1,873)	172
Inventories	(160)	593
Prepaid expenses	359	15
Accounts payable, accrued liabilities and provisions	3,637	3,397
Other liabilities	(195)	(61)
	(4,778)	6,544
 Cash flows from investing activities		
Additions to short-term investments	(24,533)	(57,922)
Proceeds from disposal and maturity of short-term investments	24,527	90,779
Additions to capital assets	(1,989)	(4,486)
	(1,995)	28,371
 Cash flows from financing activities		
Bank loan	–	(785)
Exercise of stock options	51	–
Redemption of share capital	(973)	(363)
	(922)	(1,148)
 Effect of foreign exchange rate changes on cash	(355)	(368)
 Change in cash	(8,050)	33,399
Cash – Beginning of the period	58,868	22,771
Cash – End of the period	\$ 50,818	\$ 56,170
 Supplementary information		
Interest paid	\$ 9	\$ 27
Income taxes paid	\$ 385	\$ 735

As at November 30, 2011 and 2012, unpaid purchases of capital assets amounted to \$1,941 and \$2,133 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 and service assurance solutions for wireless and wireline network operators and equipment manufacturers in the global telecommunications industry. The company offers core-to-edge solutions to 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 9, 2013.

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. Interim results may not necessarily be indicative of results anticipated for the entire year.

New Accounting Standard

Financial statement presentation

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

3 Derivative Financial Instruments

The functional currency of the company is the Canadian dollar. The company is exposed to a 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 (US dollars) and certain operating expenses (US dollars and euros). Forward exchange contracts, which are designated as cash flow hedging instruments, qualify for hedge accounting.

As at November 30, 2012, the company held contracts to sell US dollars for Canadian dollars at various forward rates, which are summarized as follows:

<u>Expiry dates</u>	<u>Contractual amounts</u>	<u>Weighted average contractual forward rates</u>
December 2012 to August 2013	\$ 16,700	1.0243
September 2013 to August 2014	3,600	1.0439
Total	<u>\$ 20,300</u>	<u>1.0277</u>

EXFO Inc.

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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 \$625,000 as at November 30, 2012.

Based on the portfolio of forward exchange contracts as at November 30, 2012, the company estimates that the portion of the net unrealized gains 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 \$510,000.

As at November 30, 2012, forward exchange contracts in the amount of \$510,000 are presented as current assets in other receivable in the balance sheet. These forward exchange contracts are not yet recorded within sales.

During the three months ended November 30, 2011 and 2012, the company recognized within its sales foreign exchange gains on forward exchange contracts of \$433,000 and \$202,000 respectively.

4 Share Capital

On November 7, 2012, the company announced that its Board of Directors approved the renewal of its share repurchase program, by way of a normal course issuer bid on the open market of up to 10% of the issued and outstanding subordinate voting shares, representing 2,072,721 subordinate voting shares at the prevailing market price. The company expects to use cash, short-term investments or future cash flow 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 the company repurchases the maximum number of shares permitted under the bid. The program does not require that the company repurchases 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.

The following tables summarize changes in share capital for the three months ended November 30, 2011 and 2012.

	Three months ended November 30, 2011				
	Multiple voting shares		Subordinate voting shares		Total amount
	Number	Amount	Number	Amount	
Balance as at September 1, 2011	31,643,000	\$ 1	28,621,999	\$ 110,340	\$ 110,341
Redemption of restricted share units	–	–	184,167	–	–
Redemption of share capital	–	–	(63,146)	(244)	(244)
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	–	–	–	848	848
Balance as at November 30, 2011	<u>31,643,000</u>	<u>\$ 1</u>	<u>28,743,020</u>	<u>\$ 110,944</u>	<u>\$ 110,945</u>

EXFO Inc.

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

	Three months ended November 30, 2012				
	Multiple voting shares		Subordinate voting shares		Total amount
	Number	Amount	Number	Amount	
Balance as at September 1, 2012	31,643,000	\$ 1	28,710,891	\$ 110,964	\$ 110,965
Exercise of stock options	–	–	23,275	51	51
Redemption of restricted share units	–	–	127,949	–	–
Redemption of share capital	–	–	(205,123)	(793)	(793)
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	–	–	–	612	612
Balance as at November 30, 2012	<u>31,643,000</u>	<u>\$ 1</u>	<u>28,656,992</u>	<u>\$ 110,834</u>	<u>\$ 110,835</u>

5 Statements of Earnings

Net research and development expenses comprise the following:

	Three months ended November 30,	
	2012	2011
Gross research and development expenses	\$ 13,898	\$ 14,813
Research and development tax credits and grants	(2,296)	(2,330)
	<u>\$ 11,602</u>	<u>\$ 12,483</u>

Depreciation and amortization expenses by functional area are as follows:

	Three months ended November 30,	
	2012	2011
Cost of sales		
Depreciation of property, plant and equipment	\$ 445	\$ 528
Amortization of intangible assets	1,274	1,284
	<u>1,719</u>	<u>1,812</u>
Selling and administrative expenses		
Depreciation of property, plant and equipment	297	283
Amortization of intangible assets	442	474
	<u>739</u>	<u>757</u>
Net research and development expenses		
Depreciation of property, plant and equipment	863	757
Amortization of intangible assets	246	163
	<u>1,109</u>	<u>920</u>
	<u>\$ 3,567</u>	<u>\$ 3,489</u>
Depreciation of property, plant and equipment	\$ 1,605	\$ 1,568
Amortization of intangible assets	1,962	1,921
	<u>\$ 3,567</u>	<u>\$ 3,489</u>

EXFO Inc.

Notes to Condensed Unaudited Interim Consolidated Financial Statements

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Employee compensation comprises the following:

	Three months ended November 30,	
	2012	2011
Salaries and benefits	\$ 31,047	\$ 32,994
Stock-based compensation costs	448	555
Total employee compensation for the period	<u>\$ 31,495</u>	<u>\$ 33,549</u>

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

	Three months ended November 30,	
	2012	2011
Cost of sales	\$ 55	\$ 59
Selling and administrative expenses	313	377
Net research and development expenses	80	119
	<u>\$ 448</u>	<u>\$ 555</u>

6 Income taxes

For the three months ended November 30, 2011 and 2012, 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,	
	2012	2011
Income tax provision at combined Canadian federal and provincial statutory tax rate (27% in 2012 and 28% in 2011)	\$ (137)	\$ 1,126
Increase (decrease) due to:		
Foreign income taxed at different rates	(181)	105
Non-taxable (income)/loss	(792)	707
Non-deductible expenses	201	465
Foreign exchange effect of translation of foreign operations	358	(1,379)
Recognition of previously unrecognized deferred income tax assets	–	(557)
Utilization of previously unrecognized deferred income tax assets	(7)	(28)
Unrecognized deferred income tax assets on temporary deductible differences and unused tax losses	1,639	567
Other	51	128
	<u>\$ 1,132</u>	<u>\$ 1,134</u>

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The income tax provision consists of the following:

	Three months ended November 30,	
	2012	2011
Current	\$ 399	\$ 416
Deferred	733	718
	\$ 1,132	\$ 1,134

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,	
	2012	2011
Basic weighted average number of shares outstanding (000's)	60,389	60,341
Plus dilutive effect of (000's):		
Stock options	32	163
Restricted share units	661	1,151
Deferred share units	133	108
Diluted weighted average number of shares outstanding (000's)	61,215	61,763
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)	121	173

For the three months ended November 30, 2012, the diluted amount per share was the same amount 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.