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 to 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, service assurance and analytics solutions markets and increased competition among vendors; capacity to adapt our future product offering to future technological changes; limited visibility with regard to the timing and nature of customer orders; delay in revenue recognition due to longer sales cycles for complex systems involving customers' acceptance; 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 March 29, 2017.

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 analytics solutions for fixed and mobile communications service providers (CSPs), web-scale operators as well as network equipment manufacturers in the global telecommunications industry. Our intelligent solutions with contextually relevant analytics are designed to improve end-user quality of experience, enhance network performance and drive operational efficiencies throughout the network and service delivery lifecycles. 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 launched four new solutions in the second quarter of fiscal 2017 including an automated inspection tip for testing multifiber connectors on network infrastructures; optical RF over OBSAI (open base station architecture initiative) link test capabilities to complement RF analysis over CPRI (common public radio interface); Fast Short Link, a new feature of our iOLM software on our industry-leading OTDRs that characterizes high-count, optical short links five times faster (less than 10 seconds per fiber) than other industry solutions; and we integrated Ookla's Speedtest technology into our MaxTester broadband test solution to measure throughput (upload and download speeds) over a subscriber's G.fast/DSL or Ethernet circuit.

Our sales increased 12.0% to $60.0 million in the second quarter of fiscal 2017 compared to $53.6 million for the same period last year. Bookings decreased 6.3% to $55.9 million in the second quarter of fiscal 2017, for a book-to-bill ratio of 0.93, from $59.7 million for the same period last year.

Net earnings amounted to $1.0 million, or $0.02 per diluted share, in the second quarter of fiscal 2017, compared to $4.0 million, or $0.07 per diluted share, for the same period last year. Net earnings for the second quarter of fiscal 2017 included $0.6 million in after-tax amortization of intangible assets, $0.4 million in stock-based compensation costs and a foreign exchange loss of $0.3 million. For the same period, last year, net earnings included $0.3 million in after-tax amortization of intangible assets, $0.3 million in stock-based compensation costs and a foreign exchange gain of $1.1 million.

Adjusted EBITDA (net earnings before interest, income taxes, depreciation and amortization, stock-based compensation costs and foreign exchange gain or loss) decreased 7.7% to $4.9 million, or 8.1% of sales, in the second quarter of fiscal 2017, compared to $5.3 million, or 9.9% of sales for the same period last year. See page 14 of this document for a complete reconciliation of adjusted EBITDA to IFRS net earnings.

On October 31, 2016, we acquired substantially all the assets of Absolute Analysis Inc. (Absolute), a privately held company located in the United States, supplying solutions for radio frequency testing of fiber-based radio access networks. The acquisition-date fair value of the total consideration transferred amounted to $8.5 million, and consisted of $5.0 million in cash and the issuance of 793,070 subordinate voting shares, valued at $3.5 million. This acquisition was accounted for by applying the acquisition method as required by IFRS 3, "Business Combinations", and the requirements of IFRS 10, "Consolidated Financial Statements"; consequently, the fair value of the total consideration transferred was allocated to the assets acquired and liabilities assumed based on management's estimate of their fair value as at the acquisition date. The results of operations of the acquired business have been included in our consolidated financial statements since October 31, 2016, being the date of acquisition.

On March 2, 2017, we acquired all issued and outstanding shares of Ontology Partners Limited (Ontology), a privately held company located in the United Kingdom, a supplier of real-time network topology discovery and service-chain mapping. The acquisition-date fair value of the total consideration transferred amounted to $9.0 million and consisted of $7.6 million in cash, net of Ontology's cash of $2.0 million at the acquisition date, plus a cash contingent consideration based on certain sales volume of Ontology products over the 12-month period following the acquisition, valued at $1.4 million at the acquisition date. This acquisition will be accounted for by applying the acquisition method as required by IFRS 3, "Business Combinations", and the requirements of IFRS 10, "Consolidated Financial Statements"; consequently, the fair value of the total consideration transferred will be allocated to the assets acquired and liabilities assumed based on management's estimate of their fair value as at the acquisition date. The results of operations of the acquired business will be included in our consolidated financial statements starting on March 2, 2017, being the date of acquisition. Due to the proximity of the acquisition date to the release date of our interim consolidated financial statements, we have not finalized the initial accounting for the acquisition as the valuation of assets acquired and liabilities assumed has not been completed. We expect to complete the purchase price allocation in the fourth quarter of fiscal 2017.

RESULTS OF OPERATIONS
(in thousands of US dollars, except per share data for the periods indicated)

	Three months ended February 28, 2017	Three months ended February 29, 2016	**Six months ended February 28, 2017**	Six months ended February 29, 2016
Sales	**$ 60,030**	$ 53,597	**$ 121,815**	$ 108,829
Cost of sales[(1)]	**22,989**	18,904	**45,802**	39,041
Selling and administrative	**21,255**	19,565	**42,850**	39,817
Net research and development	**11,264**	10,162	**22,578**	20,095
Depreciation of property, plant and equipment	**962**	924	**1,865**	1,899
Amortization of intangible assets	**768**	286	**1,195**	586
Interest and other income	**(9)**	(470)	**(29)**	(407)
Foreign exchange (gain) loss	**272**	(1,101)	**(240)**	(1,411)
Earnings before income taxes	**2,529**	5,327	**7,794**	9,209
Income taxes	**1,521**	1,364	**3,483**	3,480
Net earnings for the period	**$ 1,008**	$ 3,963	**$ 4,311**	$ 5,729
Basic net earnings per share	**$ 0.02**	$ 0.07	**$ 0.08**	$ 0.11
Diluted net earnings per share	**$ 0.02**	$ 0.07	**$ 0.08**	$ 0.10
Other selected information:				
Gross margin before depreciation and amortization[(2)]	**$ 37,041**	$ 34,693	**$ 76,013**	$ 69,788
Research and development:				
Gross research and development	**$ 12,716**	$ 11,472	**$ 25,356**	$ 22,751
Net research and development	**$ 11,264**	$ 10,162	**$ 22,578**	$ 20,095
Adjusted EBITDA[(2)]	**$ 4,875**	$ 5,280	**$ 11,196**	$ 10,566

(1) The cost of sales is exclusive of depreciation and amortization, shown separately.
(2) Refer to page 14 for non-IFRS measures.

RESULTS OF OPERATIONS
(as a percentage of sales for the periods indicated)

	Three months ended February 28, 2017	Three months ended February 29, 2016	Six months ended February 28, 2017	Six months ended February 29, 2016
Sales	**100.0 %**	100.0 %	**100.0 %**	100.0 %
Cost of sales[(1)]	**38.3**	35.3	**37.6**	35.9
Selling and administrative	**35.4**	36.5	**35.2**	36.6
Net research and development	**18.8**	19.0	**18.5**	18.5
Depreciation of property, plant and equipment	**1.6**	1.7	**1.5**	1.7
Amortization of intangible assets	**1.3**	0.5	**1.0**	0.5
Interest and other income	–	(0.9)	–	(0.4)
Foreign exchange (gain) loss	**0.4**	(2.0)	**(0.1)**	(1.3)
Earnings before income taxes	**4.2**	9.9	**6.3**	8.5
Income taxes	**2.5**	2.5	**2.8**	3.2
Net earnings for the period	**1.7 %**	7.4 %	**3.5 %**	5.3 %

Other selected information:

Gross margin before depreciation and amortization[(2)]	**61.7 %**	64.7 %	**62.4 %**	64.1 %
Research and development:				
Gross research and development	**21.2 %**	21.4 %	**20.8 %**	20.9 %
Net research and development	**18.8 %**	19.0 %	**18.5 %**	18.5 %
Adjusted EBITDA[(2)]	**8.1 %**	9.9 %	**9.2 %**	9.7 %

(1) The cost of sales is exclusive of depreciation and amortization, shown separately.
(2) Refer to page 14 for non-IFRS measures.

RESULTS OF OPERATIONS

SALES AND BOOKINGS

The following tables summarize sales and bookings by product line in thousands of US dollars:

Sales

	Three months ended February 28, 2017	Three months ended February 29, 2016	Six months ended February 28, 2017	Six months ended February 29, 2016
Physical-layer product line	$ 38,038	$ 32,582	$ 80,054	$ 70,059
Protocol-layer product line	22,097	21,990	42,106	40,619
	60,135	54,572	122,160	110,678
Foreign exchange losses on forward exchange contracts	(105)	(975)	(345)	(1,849)
Total sales	$ 60,030	$ 53,597	$ 121,815	$ 108,829

Bookings

	Three months ended February 28, 2017	Three months ended February 29, 2016	Six months ended February 28, 2017	Six months ended February 29, 2016
Physical-layer product line	$ 34,031	$ 34,874	$ 78,121	$ 73,752
Protocol-layer product line	21,992	25,804	44,001	46,273
	56,023	60,678	122,122	120,025
Foreign exchange losses on forward exchange contracts	(105)	(975)	(345)	(1,849)
Total bookings	$ 55,918	$ 59,703	$ 121,777	$ 118,176

Sales by geographic region

The following table summarizes sales by geographic region as a percentage of sales:

	Three months ended February 28, 2017	Three months ended February 29, 2016	Six months ended February 28, 2017	Six months ended February 29, 2016
Americas	50 %	49 %	53 %	52 %
EMEA	29	29	26	27
Asia-Pacific	21	22	21	21
	100 %	100 %	100 %	100 %

Sales

For the three months ended February 28, 2017, our sales increased 12.0% to $60.0 million, from $53.6 million for the same period last year, while our bookings decreased 6.3% to $55.9 million, from $59.7 million for the same period last year, for a book-to-bill ratio of 0.93.

For the six months ended February 28, 2017, our sales increased 11.9% to $121.8 million, from $108.8 million for the same period last year, while our bookings increased 3.0% to $121.8 million, from $118.2 million for the same period last year, for a book-to-bill ratio of 1.00.

In the second quarter of fiscal 2017, we made strong progress in sales in the Americas, mainly for our Physical-layer product line, and to a lesser extent for our Protocol-layer product line, compared to the same period last year. Our robust performance in this region was manifested through heightened penetration of mobile network operators for their fronthaul and backhaul networks, increased traction with fixed network operators for their 100G long-haul and metro links and growing business with web-scale operators for their data center interconnects. In addition, in the second quarter of fiscal 2017, a portion of the increase in sales in the Americas comes from our newly acquired Absolute. However, in the second quarter of fiscal 2016, we received and shipped a $1.7 million order for our analytics solution EXFO Xtract to a Tier-1 network operator but we did not close such a deal this quarter.

In the second quarter of fiscal 2017, sales to the Europe, Middle East and Africa (EMEA) region increased year-over-year, as both product lines delivered increases in sales. The EMEA region is back in growth mode after a period of reduced investments. However, the recent decrease in the value of the British pound compared to the US dollar has to some extent a negative impact on our sales and bookings to this region year-over-year.

In the second quarter of fiscal 2017, we reported a slight year-over-year increase in sales in the Asia-Pacific (APAC) region, mainly for our Protocol-layer product line.

In the first half of fiscal 2017, as mentioned above, we made strong progress in sales in the Americas, mainly for our Physical-layer product line, and to a lesser extent for our Protocol-layer product line, compared to the same period last year. In addition, in the first half of fiscal 2017, a portion of the increase in sales in the Americas comes from our newly acquired Absolute.

In the first half of fiscal 2017, sales to the EMEA region slightly increased year-over-year due to our Physical-layer product line, despite the recent decrease in the value of the British pound compared to the US dollar, which had to some extent a negative impact on our sales and bookings to this region year-over-year.

In the first half of fiscal 2017, sales to the APAC region significantly increased year-over-year as both product lines delivered increases in sales.

Bookings

In the second quarter of fiscal 2017, we reported a year-over-year decrease in total bookings mainly in the Americas and to a lesser extent in the EMEA region.

A significant portion of the year-over-year decrease in total bookings can be explained by the fact that in the second quarter of fiscal 2016, we received significant orders from two network operators in the Americas for our EXFO Xtract solution (protocol-layer product), but we did not close such significant deals this quarter.

In addition, timing of orders received during the quarter explains a portion of the year-over-year decrease in bookings. In fact, bookings for our physical-layer product line had reached record-high levels in the previous quarter and some of the bookings expected in the current quarter were received in early March, which was not the case last year. Overall, after six months into fiscal 2017, bookings slightly increased year-over-year.

In the first half of fiscal 2017, the year-over-year increase in total bookings comes from our physical-layer product line, as bookings for our protocol-layer product line decreased year-over-year. So far in fiscal 2017, our physical-layer product line benefited from heightened penetration of mobile network operators for their fronthaul and backhaul networks, increased traction with fixed network operators for their 100G long-haul and metro links and growing business with web-scale operators for their data center interconnects. In addition, in fiscal 2017, we have benefited to some extent from calendar year-end budget spending on the part of some CSPs in the Americas, versus nominal amount in 2016. The decrease in bookings for our protocol-layer product line is mainly due to the large Xtract solution orders received last year; this was offset in part by the positive impact of the recent acquisition of Absolute.

As we evolve from a supplier of dedicated test instruments to a supplier of end-to-end solutions, our quarterly sales and bookings are increasingly subject to quarterly fluctuations, as we are managing more complex, multi-million dollar deals that have prolonged sales and revenue recognition cycles related to our Protocol-layer products.

Customer concentration

We sell our products to a broad range of customers, including communications service providers, web-scale operators as well as network equipment manufacturers. In the second quarter of fiscal 2017, our top customer accounted for 10.0% of our sales, and our top three customers accounted for 16.6% of sales. In the second quarter of fiscal 2016, no customer accounted for more than 10% of our sales, and our top three customers accounted for 13.3% of sales. In the first half of fiscal 2017, our top customer accounted for 12.0% of our sales, and our top three customers accounted for 19.2% of sales. In the first half of fiscal 2016, no customer accounted for more than 10% of our sales, and our top three customers accounted for 14.6% of our sales.

GROSS MARGIN BEFORE DEPRECIATION AND AMORTIZATION
(non-IFRS measure — refer to page 14 of this document)

Gross margin before depreciation and amortization (gross margin) reached 61.7% of sales for the three months ended February 28, 2017, compared to 64.7% for the same period last year.

Gross margin reached 62.4% of sales for the six months ended February 28, 2017, compared to 64.1% for the same period last year.

In the second quarter and the first half of fiscal 2017, our gross margin was unfavorably affected by product mix compared to the same period last year as our Physical-layer product line represented a larger portion of our sales year-over-year and this product line delivers lower margins than our Protocol-layer product line (protocol-layer products have a richer software content). In addition, as previously mentioned, in the second quarter of 2016, we recognized a large order with a Tier-1 network operator for our EXFO Xtract solution, which had a positive impact on our gross margin during the second quarter and the first half of fiscal 2016, as this product delivers strong margins. Finally, in the second quarter and the first half of fiscal 2017, our gross margin was further affected by an unfavorable product mix within both product lines compared to the same periods last year.

However, in the second quarter and the first half of fiscal 2017, we recorded in our sales lower foreign exchange losses on our forward exchange contracts, compared to the same periods last year, which contributed to the increase in gross margin by 0.6% and 0.5% respectively year-over-year.

In addition, in the second quarter and the first half of fiscal 2017, we recorded lower inventory write-down compared to the same periods last year, which contributed to the increase in gross margin by 0.2% and 0.4% respectively year-over-year.

Finally, in the second quarter and the first half of fiscal 2017, increased sales year-over-year resulted in a better absorption of our fixed manufacturing costs, which had a positive impact on our gross margin compared to the same periods last year.

SELLING AND ADMINISTRATIVE EXPENSES

For the three months ended February 28, 2017, selling and administrative expenses were $21.3 million, or 35.4% of sales, compared to $19.6 million, or 36.5% of sales for the same period last year.

For the six months ended February 28, 2017, selling and administrative expenses were $42.9 million, or 35.2% of sales, compared to $39.8 million, or 36.6% of sales for the same period last year.

In the second quarter and the first half of fiscal 2017, our selling and administrative expenses increased year-over-year due to some additional headcounts to support the growth of our business and following the acquisition of Absolute, inflation and salary increases, as well as one-time acquisition-related costs following the two recent business combinations.

In the second quarter and the first half of fiscal 2017, our selling and administrative expenses decreased as a percentage of sales compared to the same periods last year; this is because our sales increased year-over-year and a large portion of these expenses are relatively fixed in the short term.

RESEARCH AND DEVELOPMENT EXPENSES

Gross research and development expenses

For the three months ended February 28, 2017, gross research and development expenses totaled $12.7 million, or 21.2% of sales, compared to $11.5 million, or 21.4% of sales for the same period last year.

For the six months ended February 28, 2017, gross research and development expenses totaled $25.4 million, or 20.8% of sales, compared to $22.8 million, or 20.9% of sales for the same period last year.

In the second quarter and the first half of fiscal 2017, our gross research and development expenses increased year-over-year due to some additional headcounts to support the growth of our business and following the acquisition of Absolute, inflation, salary increases, as well as a shift in the mix and timing of research and development projects, compared to the same periods last year.

AMORTIZATION OF INTANGIBLE ASSETS

For the three months ended February 28, 2017, amortization of intangible assets amounted to $0.8 million compared to $0.3 million for the same period last year.

For the six months ended February 28, 2017, amortization of intangible assets amounted to $1.2 million compared to $0.6 million for the same period last year.

The increase in our amortization expenses in the second quarter and the first half of fiscal 2017, compared to the same periods last years, was mainly due to the acquisition of Absolute (on October 31, 2016).

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 February 28, 2017, we recorded a foreign exchange loss of $0.3 million compared to a foreign exchange gain of $1.1 million for the same period last year.

For the six months ended February 28, 2017, foreign exchange gain amounted to $0.2 million compared to $1.4 million for the same period last year.

During the second quarter of fiscal 2017, 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 $0.3 million during the quarter. The period-end value of the Canadian dollar increased 1.1% versus the US dollar to CA$1.3280 = US$1.00 in the second quarter of fiscal 2017, compared to CA$1.3428 = US$1.00 at the end of the previous quarter.

During the same period, last year, the period-end value of the Canadian dollar decreased versus the US dollar and the euro, compared to the previous quarter, which resulted in a foreign exchange gain of $1.1 million during the quarter. The period-end value of the Canadian dollar decreased 1.3% versus the US dollar to CA$1.3531 = US$1.00 in the second quarter of fiscal 2016, compared to CA$1.3353 = US$1.00 at the end of the previous quarter, and decreased 4.4% to CA$1.4696 = €1.00 in the second quarter of fiscal 2016, compared to CA$1.4081 = €1.00 at the end of the previous quarter.

During the first half of fiscal 2017, 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 $0.2 million during the period. The period-end value of the Canadian dollar decreased 1.2% versus the US dollar to CA$1.3280 = US$1.00 in the first half of fiscal 2017, compared to CA$1.3116 = US$1.00 at the end of the previous year.

During the same period, last year, the period-end value of the Canadian dollar decreased versus the US dollar, compared to the previous year end, which resulted in a foreign exchange gain of $1.4 million during that period. The period-end value of the Canadian dollar decreased 2.8% versus the US dollar to CA$1.3531 = US$1.00 in the first half of fiscal 2016, compared to CA$1.3157 = US$1.00 at the end of the previous year.

INCOME TAXES

For the three months ended February 28, 2017, we reported income tax expenses of $1.5 million on earnings before income taxes of $2.5 million. For the corresponding period, last year, we reported income tax expenses of $1.4 million on earnings before income taxes of $5.3 million.

For the six months ended February 28, 2017, we reported income tax expenses of $3.5 million on earnings before income taxes of $7.8 million. For the corresponding period, last year, we reported income tax expenses of $3.5 million on earnings before income taxes of $9.2 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. However, a significant portion of our foreign exchange gain or loss was created by the translation of financial statements of our foreign subsidiaries into 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 7 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 February 28, 2017, cash and short-term investments totaled $52.4 million, while our working capital was $84.9 million. Our cash and short-term investments increased by $13.1 million in the second quarter of fiscal 2017, compared to the previous quarter. During the second quarter of fiscal 2017, our operating activities generated $14.4 million in cash. In addition, we recorded an unrealized foreign exchange gain on our cash and short-term investments of $0.4 million. This unrealized foreign exchange gain resulted from the translation, into 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, we made cash payments of $1.7 million for the purchase of capital assets, which reduced our cash.

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 purposes 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.

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 cash payment of $7.6 million for the acquisition of Ontology as well as any potential payment for the cash contingent consideration. In addition to these assets, we have unused available lines of credit totaling $14.8 million for working capital and other general corporate purposes and unused lines of credit of $22.6 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 $14.4 million for the three months ended February 28, 2017, compared to $15.3 million for the same period last year.

Cash flows provided by operating activities were $13.5 million for the six months ended February 28, 2017, compared to $18.6 million for the same period last year.

Cash flows provided by operating activities in the second quarter of fiscal 2017 were attributable to the net earnings after items not affecting cash of $6.5 million, and the positive net change in non-cash operating items of $7.9 million; this was mainly due to the positive effect on cash of the decrease of $5.2 million in our accounts receivable due to the timing of receipts and sales during the quarter, the $0.9 million decrease in our inventories due to increased inventory turnovers, and the $2.0 million increase in our accounts payable, accrued liabilities and provisions due to the timing of purchases and payments during the quarter. These positive effects on cash were offset in part by the negative effect on cash of the $0.2 million increase in our prepaid expenses due to timing of payments during the quarter.

Cash flows provided by operating activities in the second quarter of fiscal 2016 were attributable to the net earnings after items not affecting cash of $7.1 million, and the positive net change in non-cash operating items of $8.2 million; this was mainly due to the positive effect on cash of the decrease of $11.3 million in our accounts receivable due to the timing of receipts and sales during the quarter and the $1.2 million decrease in our income tax and tax credits recoverable due to tax credits earned in previous periods recovered during the current quarter. These positive effects on cash were offset in part by the negative effect on cash of the $2.6 million increase in our inventories to meet future demand and the $1.6 million decrease in our accounts payable, accrued liabilities and provisions due to the timing of purchases and payments during the quarter.

Cash flows provided by operating activities in the first half of fiscal 2017 were attributable to the net earnings after items not affecting cash of $11.0 million, and the positive net change in non-cash operating items of $2.5 million; this was mainly due to the positive effect on cash of the decrease of $2.6 million in our accounts receivable due to the timing of receipts and sales during the period and the $0.6 million increase in our accounts payable, accrued liabilities and provisions due to the timing of purchases and payments during the period. These positive effects on cash were offset in part by the negative effect on cash of the $0.4 million increase in our income tax and tax credits recoverable due to tax credits earned during the period not yet recovered, and the $0.3 million increase in our inventories to meet future demand.

Cash flows provided by operating activities in the first half of fiscal 2016 were attributable to the net earnings after items not affecting cash of $12.3 million, and the positive net change in non-cash operating items of $6.3 million; this was mainly due to the positive effect on cash of the decrease of $9.3 million in our accounts receivable due to the timing of receipts and sales during the period, the $0.9 million decrease in our income tax and tax credits recoverable due to tax credits earned in previous periods recovered during the current period, and the $1.7 million increase in our accounts payable, accrued liabilities and provisions due to the timing of purchases and payments during the period. These positive effects on cash were offset in part by the negative effect on cash of the $5.9 million increase in our inventories to meet future demand.

Investing activities

Cash flows used by investing activities were $1.4 million for the three months ended February 28, 2017, compared to $0.4 million for the same period last year.

Cash flows used by investing activities were $7.9 million for the six months ended February 28, 2017, compared to $1.8 million for the same period last year.

In the second quarter of fiscal 2017, we paid $1.7 million for the purchase of capital assets, but we disposed of $0.3 million worth of short-term investments.

For the corresponding period last year, we paid $0.9 million for the purchase of capital assets, but we disposed of $0.5 million worth of short-term investments.

In the first half of fiscal 2017, we made cash payments of $2.9 million and $5.0 million respectively for the purchase of capital assets and the acquisition of assets of Absolute.

For the corresponding period last year, we paid $2.2 million for the purchase of capital assets, but we disposed of $0.5 million worth of short-term investments.

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 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 February 28, 2017, 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
March 2017 to August 2017	$ 12,000,000	1.3068
September 2017 to August 2018	12,700,000	1.3376
September 2018 to December 2018	2,500,000	1.3585
Total	$ 27,200,000	1.3259

US dollars – Indian rupees

Expiry dates	Contractual amounts	Weighted average contractual forward rates
March 2017 to August 2017	$ 2,400,000	70.81
September 2017 to January 2018	2,000,000	70.76
Total	$ 4,400,000	70.79

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 a net loss of $0.1 million as at August 31, 2016 and a net gain of $0.2 million as at February 28, 2017, mainly for our US/Canadian dollars' forward exchange contracts. The quarter-end exchange rate was CA$1.3280 = US$1.00 as at February 28, 2017.

SHARE CAPITAL

As at March 29, 2017, EXFO had 31,643,000 multiple voting shares outstanding, entitling to 10 votes each and 22,927,189 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, 2017, our off-balance sheet arrangements consisted of letters of guarantee amounting to $0.4 million for our own selling and purchasing requirements, which were reserved from our lines of credit; these letters of guarantee will expire at various dates through fiscal 2020.

STRUCTURED ENTITIES

As at February 28, 2017, 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/A for the year ended August 31, 2016, filed with the U.S. Securities and Exchange Commission and the Canadian securities commissions.

NEW IFRS PRONOUNCEMENTS

Refer to note 2 to our condensed unaudited interim consolidated financial statements for the three and six months ended February 28, 2017 and to our consolidated financial statements for the year ended August 31, 2016, for the effect of certain recent accounting pronouncements on our consolidated financial statements.

RISKS AND UNCERTAINTIES

For the second quarter of fiscal 2017, there have been no material changes from the risk factors disclosed in our Annual Report on Form 20-F/A for the year ended August 31, 2016.

CONTROLS

As described in the Form 20-F/A filed on January 9, 2017, we concluded that EXFO's internal control over financial reporting was not effective as of August 31, 2016, as a result of the identification of a material weakness as we did not maintain sufficient controls over the trade accounts receivable ledger, which included failure to maintain appropriate segregation of duties and lack of supervisory review and monitoring of journal entries recorded to the trade accounts receivable ledger. See item 15(b) of Form 20-F/A filed on January 9, 2017 for more details on the impact of the material weakness on EXFO's financial reporting.

In the second quarter of fiscal 2017, we completed the implementation of our remediation plans to address the material weakness, which included additional segregation of duties. The material weakness cannot be considered remediated until the remedial controls operate for a sufficient period of time and management has time to conclude, through testing, that these controls are operating effectively.

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 plan and forecast future periods as well as 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 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, in thousands of US dollars:

Adjusted EBITDA

	Three months ended February 28, 2017	Three months ended February 29, 2016	Six months ended February 28, 2017	Six months ended February 29, 2016
IFRS net earnings for the period	**$ 1,008**	$ 3,963	**$ 4,311**	$ 5,729
Add (deduct):				
Depreciation of property, plant and equipment	**962**	924	**1,865**	1,899
Amortization of intangible assets	**768**	286	**1,195**	586
Interest and other income	**(9)**	(470)	**(29)**	(407)
Income taxes	**1,521**	1,364	**3,483**	3,480
Stock-based compensation costs	**353**	314	**611**	690
Foreign exchange (gain) loss	**272**	(1,101)	**(240)**	(1,411)
Adjusted EBITDA for the period	**$ 4,875**	$ 5,280	**$ 11,196**	$ 10,566
Adjusted EBITDA as a percentage of sales	**8.1%**	9.9%	**9.2%**	9.7%

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

	Quarters ended			
	February 28, 2017	**November 30, 2016**	**August 31, 2016**	**May 31, 2016**
Sales	$ 60,030	$ 61,785	$ 62,858	$ 60,896
Cost of sales(1)	$ 22,989	$ 22,813	$ 24,145	$ 23,880
Net earnings	$ 1,008	$ 3,303	$ 2,252	$ 919
Basic and diluted net earnings per share	$ 0.02	$ 0.06	$ 0.04	$ 0.02

	Quarters ended			
	February 29, 2016	**November 30, 2015**	**August 31, 2015**	**May 31, 2015**
Sales	$ 53,597	$ 55,232	$ 56,594	$ 57,781
Cost of sales(1)	$ 18,904	$ 20,137	$ 21,975	$ 22,281
Net earnings	$ 3,963	$ 1,766	$ 1,882	$ 563
Basic and diluted net earnings per share	$ 0.07	$ 0.03	$ 0.03	$ 0.01

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