EXFO INC.
Form 6-K
November 24, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer Pursuant to Rule 13a-16 or 15d-16
Under the Securities Exchange Act of 1934

For the month of November 2010

EXFO Inc.
(Translation of registrant's name into English)

400 Godin Avenue, Quebec City, Quebec, Canada G1M 2K2
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F xForm 40-F o

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes oNo x

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-______.

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In November 2010, EXFO Inc., a Canadian corporation, issued its annual audited financial statements and management's discussion and analysis thereof for its fiscal year ended August 31, 2010. At the same time, it also issued a cover letter, its notice of its annual shareholders' meeting, its form of proxy and its management proxy circular. This report of Form 6-K sets forth said documents.

This Form 6-K containing the Corporation's annual audited financial statements and management's discussion and analysis for its fiscal year ended August 31, 2010, a cover letter, its notice of annual shareholders' meeting, its form of proxy and its management proxy circular are hereby incorporated as documents by reference to Form F-3 (Registration Statement under the Securities Act of 1933) declared effective as of July 30, 2001 and to Form F-3 (Registration Statement under the Securities Act of 1933) declared effective as of March 11, 2002 and to amend certain material information as set forth in these two Form F-3 documents.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

EXFO INC.

By: /s/ Germain Lamonde
Name: Germain Lamonde
Title: President and Chief Executive Officer

Date: November 24, 2010

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Independent Auditors' Report

To the Shareholders of EXFO Inc.

We have completed integrated audits of EXFO Inc.'s 2010, 2009 and 2008 consolidated financial statements and of its internal control over financial reporting as at August 31, 2010. Our opinions, based on our audits, are presented below.

Consolidated financial statements

We have audited the accompanying consolidated balance sheets of EXFO Inc. as at August 31, 2010 and August 31, 2009, the consolidated statement of accumulated other comprehensive income for each of the years in the two-year period ended August 31, 2010, and the related consolidated statements of earnings, comprehensive income (loss), retained earnings and contributed surplus and cash flows for each of the years in the three-year period ended August 31, 2010. We have also audited the financial statement schedule, Valuation and Qualifying Accounts in item 8.A. of this Annual Report on Form 20-F. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits of the Company's financial statements as at August 31, 2010 and for each of the years in the three-year period then ended in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. A financial statement audit also includes assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as at August 31, 2010 and August 31, 2009 and the results of its operations and its cash flows for each of the years in the three-year period ended August 31, 2010 in accordance with Canadian generally accepted accounting principles. Furthermore, in our opinion, the financial statement schedule, Valuation and Qualifying Accounts, in Item 8.A. of this Annual Report on Form 20-F presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

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Internal control over financial reporting

We have also audited EXFO Inc.'s internal control over financial reporting as at August 31, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting, appearing in Item 15 on page 138 of this Annual Report on Form 20-F. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Management's Annual Report on Internal Control over Financial Reporting, management has excluded NetHawk Oyj from its assessment of internal control over financial reporting as at August 31, 2010 because it was acquired by EXFO Inc. in a purchase business combination during 2010. We have also excluded NetHawk Oyj from our audit of internal control over financial reporting. NetHawk Oyj is a subsidiary whose total assets and total sales represent 20.2% and 7.1% respectively of the related consolidated financial statement amounts as at and for the year ended August 31, 2010.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as at August 31, 2010 based on criteria established in Internal Control – Integrated Framework issued by the COSO.

/s/ PricewaterhouseCoopers LLP 1

Quebec City, Quebec, Canada
October 12, 2010, except Note 16 d) which is as of November 5, 2010

1 Chartered accountant auditor permit No. 18144

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EXFO INC.
Consolidated Balance Sheets

(in thousands of US dollars)

	As at August 31,	
	2010	2009
Assets		
Current assets		
Cash	$21,440	$9,777
Short-term investments (note 7)	10,379	59,105
Accounts receivable (note 7)		
Trade	50,190	22,933
Other	5,217	2,620
Income taxes and tax credits recoverable	2,604	2,253
Inventories (note 8)	40,328	29,416
Prepaid expenses	2,816	1,842
Future income taxes (note 19)	6,191	5,538
Current assets held for sale (note 4)	3,991	2,727
	143,156	136,211
Tax credits recoverable	29,397	24,961
Forward exchange contracts (note 7)	–	428
Property, plant and equipment (note 9)	23,455	18,801
Intangible assets (note 10)	27,947	16,824
Goodwill (notes 3, 5 and 10)	29,355	17,840
Future income taxes (note 19)	12,884	18,164
Long-term assets held for sale (note 4)	7,308	7,142
	$273,502	$240,371
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 12)	$30,870	$19,803
Income taxes payable	426	–
Current portion of long-term debt (note 13)	568	–
Deferred revenue	10,354	6,481
Current liabilities related to assets held for sale (note 4)	2,531	1,847
	44,749	28,131
Deferred revenue	5,775	4,195
Long-term debt (note 13)	1,419	–
Other liabilities	603	–
Long-term liabilities related to assets held for sale (note 4)	537	–

	53,083	32,326
Commitments (note 14)		
Contingencies (note 15)		
Shareholders’ equity		
Share capital (note 16)	106,126	104,846
Contributed surplus	18,563	17,758
Retained earnings	50,528	43,909
Accumulated other comprehensive income	45,202	41,532
	220,419	208,045
	$273,502	$240,371

On behalf of the Board

/s/ Germain Lamonde	/s/ André Tremblay
GERMAIN LAMONDE	ANDRÉ TREMBLAY
Chairman, President and CEO	Chairman, Audit Committee

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

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EXFO INC.
Consolidated Statements of Earnings

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

	Years ended August 31,		
	2010	2009	2008
Sales (note 21)	$202,757	$153,082	$160,981
Cost of sales (1,2) (note 8)	73,901	57,897	64,364
Gross margin	128,856	95,185	96,617
Operating expenses			
Selling and administrative (1)	66,612	58,067	54,869
Net research and development (1) (note 18)	37,847	27,213	24,580
Amortization of property, plant and equipment	5,757	4,453	4,137
Amortization of intangible assets	7,773	5,033	3,862
Restructuring charges (note 5)	–	963	–
Impairment of goodwill (note 5)	–	21,713	–
Total operating expenses	117,989	117,442	87,448
Earnings (loss) from operations	10,867	(22,257)	9,169
Interest income (expense), net	(292)	592	4,381
Foreign exchange gain (loss)	(1,496)	1,074	404
Earnings (loss) before income taxes (note 19)	9,079	(20,591)	13,954
Income taxes (note 19)			
Current	715	587	(7,154)
Future	4,814	(321)	12,815
Recognition of previously unrecognized future income tax assets	–	–	(5,324)
	5,529	266	337
Earnings (loss) from continuing operations before extraordinary gain	3,550	(20,857)	13,617
Net earnings from discontinued operations (note 4)	3,069	4,272	1,771
Earnings (loss) before extraordinary gain	6,619	(16,585)	15,388
Extraordinary gain (note 3)	–	–	3,036
Net earnings (loss) for the year	$6,619	$(16,585)	$18,424
	$0.06	$(0.34)	$0.20

Basic and diluted earnings (loss) from continuing operations before extraordinary gain per share			
Basic and diluted net earnings (loss) per share	$0.11	$(0.27)	$0.27
Basic weighted average number of shares outstanding (000's)	59,479	61,845	68,767
Diluted weighted average number of shares outstanding (000's) (note 20)	60,616	61,845	69,318
(1) Stock-based compensation costs included in:			
Cost of sales	$138	$133	$138
Selling and administrative	1,042	782	771
Net research and development	470	383	261
Net earnings from discontinued operations	136	111	102
	$1,786	$1,409	$1,272

(2) The cost of sales is exclusive of amortization, shown separately.

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

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EXFO INC.
Consolidated Statements of Comprehensive Income (Loss)
and Accumulated Other Comprehensive Income

(in thousands of US dollars)

Comprehensive income (loss)

	Years ended August 31,		
	2010	2009	2008
Net earnings (loss) for the year	$6,619	$(16,585)	$18,424
Foreign currency translation adjustment	3,728	(10,671)	(2,289)
Changes in unrealized losses on short-term investments	–	22	31
Unrealized gains (losses) on forward exchange contracts	940	(1,467)	962
Reclassification of realized (gains) losses on forward exchange contracts in net earnings (loss)	(1,022)	3,167	(3,915)
Future income tax effect of the above items	24	(528)	909
Comprehensive income (loss)	$10,289	$(26,062)	$14,122

Accumulated other comprehensive income

	Years ended August 31,	
	2010	2009
Foreign currency translation adjustment		
Cumulative effect of prior years	$40,458	$51,129
Current year	3,728	(10,671)
	44,186	40,458
Unrealized gains (losses) on forward exchange contracts		
Cumulative effect of prior years	1,076	(96)
Current year, net of realized gains (losses) and future income taxes	(58)	1,172
	1,018	1,076
Unrealized losses on short-term investments		
Cumulative effect of prior years	(2)	(24)
Current year, net of future income taxes	–	22
	(2)	(2)
Accumulated other comprehensive income	$45,202	$41,532

Total retained earnings and accumulated other comprehensive income amounted to $85,441 and $95,730 as at August 31, 2009 and 2010, respectively.

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

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EXFO INC.
Consolidated Statements of Retained Earnings and Contributed Surplus

(in thousands of US dollars)

Retained earnings

	Years ended August 31,		
	2010	2009	2008
Balance – Beginning of year	$43,909	$60,494	$42,275
Add (deduct)			
Cumulative effect of prior years	–	–	55
Net earnings (loss) for the year	6,619	(16,585)	18,424
Premium on redemption of share capital (note 16)	–	–	(260)
Balance – End of year	$50,528	$43,909	$60,494

Contributed surplus

	Years ended August 31,		
	2010	2009	2008
Balance – Beginning of year	$17,758	$5,226	$4,453
Add (deduct)			
Stock-based compensation costs	1,756	1,407	1,287
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards (note 16)	(954)	(540)	(514)
Discount on redemption of share capital (note 16)	3	11,665	–
Balance – End of year	$18,563	$17,758	$5,226

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

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EXFO INC.
Consolidated Statements of Cash Flows

(in thousands of US dollars)

	Years ended August 31,		
	2010	2009	2008
Cash flows from operating activities			
Net earnings (loss) for the year	$6,619	$(16,585)	$18,424
Add (deduct) items not affecting cash			
Change in discount on short-term investments	19	597	1,035
Stock-based compensation costs	1,786	1,409	1,272
Amortization	13,729	9,674	8,163
Deferred revenue	3,672	1,706	47
Loss on disposal of capital assets	–	237	–
Impairment of goodwill (note 5)	–	21,713	–
Future income taxes	5,787	(300)	8,770
Extraordinary gain (note 3)	–	–	(3,036)
Change in unrealized foreign exchange gain/loss	471	(1,955)	(1,093)
	32,083	16,496	33,582
Change in non-cash operating items			
Accounts receivable	(22,522)	9,654	(4,338)
Income taxes and tax credits	(4,073)	(3,391)	(12,833)
Inventories	(9,302)	2,624	(2,166)
Prepaid expenses	105	(350)	(127)
Accounts payable and accrued liabilities	5,168	(2,409)	(1,416)
Other liabilities	308	–	–
	1,767	22,624	12,702
Cash flows from investing activities			
Additions to short-term investments	(233,388)	(438,460)	(717,020)
Proceeds from disposal and maturity of short-term investments	285,805	456,612	760,310
Additions to capital assets	(8,966)	(6,945)	(6,508)
Business combinations, net of cash acquired (note 3)	(33,042)	(2,414)	(41,016)
	10,409	8,793	(4,234)
Cash flows from financing activities			
Repayment of long-term debt	(274)	–	–
Redemption of share capital (note 16)	(14)	(26,871)	(8,068)
Exercise of stock options	343	56	61
	55	(26,815)	(8,007)
Effect of foreign exchange rate changes on cash	(733)	95	(88)
Change in cash	11,498	4,697	373

Cash – Beginning of year	10,611	5,914	5,541
Cash – End of year	$22,109	$10,611	$5,914
Supplementary information			
Interest paid	$34	$23	$55
Income taxes paid	$796	$86	$759
Cash related to:			
Continuing operations	$21,440	$9,777	$5,329
Discontinued operations (note 4)	669	834	585
	$22,109	$10,611	$5,914

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

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EXFO INC.
Notes to 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 Change in Registered Name

EXFO Inc. (“EXFO”) designs, manufactures and markets 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 IP (Internet protocol) fixed and mobile networks. EXFO’s products are sold in approximately 100 countries around the world.

In February 2010, the company changed its name from EXFO Electro-Optical Engineering Inc. to EXFO Inc.

2 Summary of Significant Accounting Policies

Basis of presentation

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles (“GAAP”) in Canada, and significant differences in measurement and disclosure from U.S. GAAP are set out in note 22. These consolidated financial statements include the accounts of the company and its domestic and international subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Accounting estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting years. Significant estimates include the fair value of financial instruments, the allowance for doubtful accounts receivable, the amount of tax credits recoverable, the provision for excess and obsolete inventories, the estimated useful lives of capital assets, the valuation of long-lived assets, the impairment of goodwill, the valuation allowance for future income taxes, the amount of certain accrued liabilities and deferred revenue, as well as stock-based compensation costs. Actual results could differ from those estimates.

Foreign currency translation

Reporting currency and self-sustaining foreign operations

The principal measurement currency of the company is the Canadian dollar. The company has adopted the US dollar as its reporting currency. The financial statements are translated into the reporting currency using the current rate method. Under this method, assets and liabilities of the company and its self-sustaining foreign operations with functional currency other than the US dollar are translated in US dollars using the exchange rate in effect at the balance sheet date. Revenues and expenses are translated at the monthly average exchange rate. The cumulative foreign currency translation adjustment arising from such translation is included in accumulated other comprehensive income in shareholders’ equity.

Foreign currency transactions

Transactions denominated in currencies other than the measurement currency are translated into the relevant measurement currency as follows: monetary assets and liabilities are translated at the exchange rate in effect on the date of the balance sheet, and revenues and expenses are translated at the exchange rate in effect on the date of the transaction. Non-monetary assets and liabilities are translated at historical rates. Foreign exchange gains and losses arising from such translation are reflected in the statements of earnings.

EXFO INC.
Notes to Consolidated Financial Statements

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

Integrated foreign operations

The financial statements of integrated foreign operations are remeasured into the relevant measurement currency using the temporal method. Under this method, monetary assets and liabilities are remeasured at the exchange rate in effect on the date of the balance sheet. Non-monetary assets and liabilities are remeasured at historical rates, unless such assets and liabilities are carried at market value, in which case they are remeasured at the exchange rate in effect on the date of the balance sheet. Revenues and expenses are remeasured at the monthly average exchange rate. Foreign exchange gains and losses arising from such remeasurement are reflected in the statements of earnings.

In the event that management decides to declare dividends, such dividends would be declared in Canadian dollars.

Forward exchange contracts

Forward exchange contracts are utilized by the company to manage its foreign currency exposure. Forward exchange contracts, which qualify for hedge accounting, are entered into by the company to hedge anticipated US dollar-denominated sales and the related accounts receivable. The company’s policy is not to utilize those derivative financial instruments for trading or speculative purposes.

The company’s forward exchange contracts are recorded at fair value in the balance sheet, and changes in their fair value are reported in other comprehensive income. Any ineffective portion is recognized immediately in the statements of earnings. Upon the recognition of related hedged sales, accumulated changes in fair value are reclassified in sales in the statements of earnings.

Short-term investments

All investments with original terms to maturity of three months or less and that are not required for the purposes of meeting short-term cash requirements are classified as short-term investments. Short-term investments are classified as available-for-sale securities; therefore, they are carried at fair value in the balance sheet, and any changes in their fair value are reflected in other comprehensive income. Upon the disposal or maturity of these assets, accumulated changes in their fair value are reclassified in the statements of earnings.

Interest income on short-term investments is recorded in interest income in the statements of earnings and in cash flows from operating activities in the statements of cash flows.

Inventories

Inventories are valued on an average cost basis, at the lower of cost and net realizable value.

Property, plant and equipment and amortization

Property, plant and equipment are recorded at cost, less related government grants and research and development tax credits. Amortization is provided on a straight-line basis over the estimated useful lives as follows:

	Term
Land improvements	5 years
Buildings	25 years
Equipment	2 to 10 years
Leasehold improvements	The lesser of useful life and remaining lease term

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EXFO INC.
Notes to Consolidated Financial Statements

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

Intangible assets, goodwill and amortization

Intangible assets primarily include the cost of core technology, customer relationships and software, net of accumulated amortization. Amortization is provided on a straight-line basis over the estimated useful lives of five years for core technology, customer relationships and brand name and four and nine years for software.

Goodwill represents the excess of the purchase price of acquired businesses over the fair value of net identifiable assets acquired. Goodwill is not amortized but must be tested for impairment on an annual basis or more frequently if events or circumstances indicate that it might be impaired. Recoverability of goodwill is determined at the reporting unit level, using a two-step approach. First, the carrying value of a reporting unit is compared to its fair value, which is usually determined based on a combination of discounted future cash flows and a market approach. If the carrying value of a reporting unit exceeds its fair value, the second step is performed. In this step, the amount of impairment loss, if any, represents the excess of the carrying value of goodwill over its fair value, and the loss is charged to earnings in the period in which it is incurred. For the purposes of this impairment test, the fair value of goodwill is estimated in the same way as goodwill is determined in business combinations; that is, the excess of the fair value of a reporting unit over the fair value of its net identifiable assets. The company performs its annual impairment test in the third quarter of each fiscal year for all its existing reporting units (note 5).

Impairment of long-lived assets

Long-lived assets are reviewed for impairment when events or circumstances indicate that cost may not be recoverable, and in the period in which they are classified as held for sale. Impairment exists when the carrying amount/value of an asset or group of assets is greater than the undiscounted future cash flows expected to be provided by the asset or group of assets. The amount of impairment loss, if any, is the excess of the carrying value over the fair value. The company usually assesses fair value of long-lived assets based on discounted future cash flows.

Warranty

The company offers its customers warranties of one to three years, depending on the specific products and terms of the purchase agreement. The company’s typical warranties require it to repair or replace defective products during the warranty period at no cost to the customer. Costs related to original warranties are accrued at the time of shipment, based upon estimates of expected rework and warranty costs to be incurred. Costs associated with separately priced extended warranties are expensed as incurred.

Revenue recognition

For products in which software is incidental, the company recognizes revenue when persuasive evidence of an arrangement exists, the product has been delivered, the price is fixed or determinable, and collection of the resulting receivable is reasonably assured. Provisions are made for estimated returns, warranties and support obligations.

For products in which software is not incidental, revenues are separated into two categories: product and post-contract customer support (PCS) revenues, based upon vendor-specific objective evidence of fair value. Product revenues for

these sales are recognized as described above. PCS revenues are deferred and recognized ratably over the years of the support arrangement. PCS revenues are recognized at the time the product is delivered when provided substantially within one year of delivery, the costs of providing this support are insignificant (and accrued at the time of delivery), and no (or infrequent) software upgrades or enhancements are provided.

Maintenance contracts generally include the right to unspecified upgrades and enhancements on a when-and-if-available basis and ongoing customer support. Revenue from these contracts is recognized ratably over the terms of the maintenance contracts on a straight-line basis.

EXFO INC.
Notes to Consolidated Financial Statements

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

Revenue for extended warranties is recognized on a straight-line basis over the warranty period.

For all sales, the company uses a binding purchase order as evidence that a sales arrangement exists.

Delivery generally occurs when the product is handed over to a transporter for shipment.

At the time of the transaction, the company assesses whether the price associated with its revenue transaction is fixed or determinable and whether or not collection is reasonably assured. The company assesses whether the price is fixed or determinable based on the payment terms associated with the transaction. The company assesses collection based on a number of factors, including past transaction history and the creditworthiness of the customer. Generally, collateral or other security is not requested from customers.

Sales arrangements may include acceptance clauses. When a sales arrangement does include an acceptance provision, acceptance occurs upon the earliest of receipt of a written customer acceptance or expiration of the acceptance period. For these sales arrangements, the sale is recognized when acceptance occurs.

Advertising costs

Advertising costs are expensed as incurred.

Government grants

Grants related to operating expenses are included in earnings when the related expenses are incurred. Grants related to capital expenditures are deducted from the related assets. Grants are included in earnings or deducted from the related assets, provided there is reasonable assurance that the company has complied and will comply with all the conditions related to the grant.

Research and development expenses

All expenses related to research, as well as development activities that do not meet generally accepted criteria for deferral are expensed as incurred, net of related tax credits and grants. Development expenses that meet generally accepted criteria for deferral are capitalized, net of related tax credits and grants, and are amortized against earnings over the estimated benefit period. Research and development expenses are mainly comprised of salaries and related expenses, material costs as well as fees paid to third-party consultants.

As at August 31, 2009 and 2010, the company had not deferred any development costs.

Income taxes

The company provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement values and tax values of assets and liabilities as well as the carry-forward of unused tax losses and

deductions, using substantively enacted income tax rates expected to be in effect for the years in which the assets are expected to be realized or the liabilities to be settled.

The company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

EXFO INC.
Notes to Consolidated Financial Statements

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

Earnings per share

Basic earnings per share are determined using the weighted average number of common shares outstanding during the year.

Diluted earnings per share are determined using the weighted average number of common shares outstanding during the year, plus the effect of dilutive potential common shares outstanding during the year. This method requires that diluted earnings per share be calculated (using the treasury stock method) as if all dilutive potential common shares had been exercised at the latest at the beginning of the year or on the date of issuance, as the case may be, and that the funds obtained thereby (plus an amount equivalent to the unamortized portion of related stock-based compensation costs) be used to purchase common shares of the company at the average market price of the common shares during the year.

Stock-based compensation costs

The company accounts for stock-based compensation on stock options, restricted share units and deferred share units, using the fair value-based method. The company accounts for stock-based compensation on stock appreciation rights, using the intrinsic value method. Stock-based compensation costs are amortized to expense over the vesting periods.

New accounting standards and pronouncements

Adopted in fiscal 2010

In February 2008, the Canadian Institute of Chartered Accountants (CICA) issued Section 3064, “Goodwill and Intangible Assets”, which supersedes Section 3062, “Goodwill and Other Intangible Assets” and Section 3450, “Research and Development Costs”. Various changes have been made to other sections of the CICA Handbook for consistency purposes. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill remain unchanged from the standards included in Section 3062. This new section applies to fiscal years beginning on or after October 1, 2008. The company adopted this new standard on September 1, 2009, and its adoption had no material effect on its consolidated financial statements.

In June 2009, the CICA amended section 3862, "Financial Instruments – Disclosures", to include enhanced disclosures on liquidity risk of financial instruments and new disclosures on fair value measurements of financial instruments. The amendments apply to fiscal years ending after September 30, 2009, with early adoption permitted. Section 3862 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under Section 3862 are described below:

- Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities;

- Level 2 – Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;

- Level 3 – Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

The company adopted these amendments on September 1, 2009, and their adoption had no measurement impact on its consolidated financial statements.

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To be adopted after fiscal 2010

In January 2009, the CICA issued Section 1582, "Business Combinations", which replaces Section 1581, "Business Combinations". This new section establishes the standards for the accounting of business combinations and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent consideration and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This standard applies prospectively to business combinations with acquisition dates on or after January 1, 2011; earlier adoption is permitted.

In January 2009, the CICA issued Section 1601, "Consolidated Financial Statements", which replaces Section 1600, "Consolidated Financial Statements", and establishes the standards for preparing consolidated financial statements. This new section applies to fiscal years beginning on or after January 1, 2011; earlier adoption is permitted. The company has not yet determined the impact that adopting this standard will have on its consolidated financial statements.

In January 2009, the CICA issued Section 1602, "Non-controlling Interests", which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. This new section applies to fiscal years beginning on or after January 1, 2011; earlier adoption is permitted as of the beginning of a fiscal year.

Should the company decide to adopt one of these three new sections earlier, it must adopt all three at the same date.

In December, 2009, the CICA's Emerging Issues Committee (EIC) issued EIC-175, "Multiple Deliverable Revenue Arrangements", which will be applicable prospectively (with retrospective adoption permitted) to revenue arrangements with multiple deliverables entered into or materially modified in the first annual period beginning on January 1, 2011. EIC-175 amends the guidance contained in EIC-142, "Revenue Arrangements with Multiple Deliverables", and establishes additional requirements regarding revenue recognition related to multiple deliverables as well as supplementary disclosures. The company will adopt this standard on September 1, 2010 at the same time it will adopt similar new U.S. GAAP requirements (note 22), and is currently evaluating the impact that EIC-175 will have on its consolidated financial statements.

3 Business Combinations

NetHawk Oyj

On March 12, 2010, the company acquired 91% of the issued and outstanding common shares of NetHawk Oyj. Headquartered in Oulu, Finland, NetHawk Oyj was a privately owned company providing 2G, 3G and 4G/LTE protocol analyzers and simulators aimed mostly at network equipment manufacturers and wireless network operators.

On March 15, 2010, the company made a voluntary offer to purchase the remaining issued and outstanding shares; this offer expired on April 30, 2010. Simultaneously, the company entered into a statutory procedure under the

Finnish Companies Act by which it acquired the remaining of the issued and outstanding common shares that were not tendered under the voluntary offer.

Total consideration was comprised of a cash consideration of €37,264,000 (US$51,139,000), including acquisition-related costs of $2,842,000, or €25,121,000 (US$34,438,000), excluding NetHawk's cash of €12,143,000 (US$16,701,000) at the acquisition date, plus a cash contingent consideration of up to €8,700,000 (US$11,000,000) based on a certain sales volume of NetHawk products over the three years following the acquisition. The cash contingent consideration will be accounted for as additional goodwill when the amounts of any contingent consideration can be reasonably estimated and the outcome of the contingency is resolved. Acquisition-related costs include an amount of $780,000 for a statutory transfer tax payable in Finland based on the purchase price of shares.

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This acquisition was accounted for using the purchase method under CICA Handbook Section 1581, “Business Combinations”, and the requirements of Section 1600, “Consolidated Financial Statements”; consequently, the purchase price was allocated to the assets acquired and liabilities assumed based on management’s best estimate of their fair value as of the acquisition date. The results of operations of the acquired business have been included in the consolidated financial statements of the company since March 12, 2010, being the date of acquisition.

The purchase price, including acquisition related costs, was allocated based on the estimated fair value of acquired net assets at the date of acquisition as follows:

Assets acquired, net of cash acquired	
Accounts receivable	$7,710
Inventories	2,315
Other current assets	797
Property, plant and equipment	2,994
Core technology	8,638
Customer relationships	7,180
Other intangible assets	2,033
Current liabilities assumed	
Accounts payable and accrued liabilities	(5,710)
Deferred revenue	(1,615)
Long-term debt	(2,464)
Net identifiable assets acquired	21,878
Goodwill	12,560
Purchase price, net of cash acquired	$34,438

Acquired intangible assets are amortized on a straight-line basis over their estimated useful life of five years.

Upon completion of the final purchase price allocation in the fourth quarter of fiscal 2010, the company revised the estimated fair value assigned to accounts receivable, property, plant and equipment, intangible assets and accounts payable and accrued liabilities. The fair value assigned to accounts receivable decreased by $717,000. The fair value assigned to property, plant and equipment, intangible assets and accounts payable and accrued liabilities increased by $476,000, $1,184,000 and $613,000, respectively. The net increase in the fair value of these net assets reduced goodwill by $330,000.

Future income tax assets at the acquisition date amounted to $8,066,000 and were mainly comprised of net operating losses and research and development expenses carried forward. A valuation allowance of $3,065,000 was recorded against these assets at the acquisition date. In the event that the company would reverse a portion or all of the valuation allowance, the amount of such reversal would reduce the amount of goodwill recognized at the date of acquisition.

Acquired goodwill mainly reflects NetHawk Oyj’s acquired work force. It also reflects the competitive advantages the company expected to realize from NetHawk Oyj’s standing in the wireless protocol testing industry as well as certain synergies with the company’s service assurance products. Acquired goodwill is not deductible for tax purposes.

Navtel Communications Inc.

On March 26, 2008, the company acquired all issued and outstanding shares of Navtel Communications Inc. Based in Toronto, Canada, Navtel Communications Inc. was a privately held company specializing in tests for next-generation Internet protocol networks. On March 26, 2008, Navtel Communications Inc. was liquidated into the parent company.

This acquisition was settled for a total cash consideration of $11,477,000, or $11,332,000 net of $145,000 of cash acquired. The total consideration included acquisition-related costs of $172,000.

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This acquisition was accounted for using the purchase method and, consequently, the results of operations of the acquired business have been included in the consolidated financial statements of the company since March 26, 2008, being the date of acquisition.

The purchase price, including acquisition-related costs, was allocated based on the estimated fair value of acquired net assets at the date of acquisition as follows:

Assets acquired, net of cash acquired	
Accounts receivable	$776
Inventories	447
Other current assets	320
Tax credits	7,074
Core technology	2,919
Future income tax assets	8,586
Current liabilities assumed	
Accounts payable and accrued liabilities	(431)
Deferred revenue	(523)
Future income tax liabilities	(2,737)
Net identifiable assets acquired	16,431
Purchase price, net of cash acquired	11,332
Excess of the fair value of net identifiable assets acquired over the purchase price	$(5,099)

The excess of the fair value of the net identifiable assets acquired over the purchase price in the amount of $5,099,000 has been eliminated in part by fully reducing the value assigned to acquired core technology and related future income tax liabilities. The remaining excess in the amount of $3,036,000 has been presented as an extraordinary gain in the statement of earnings for the year ended August 31, 2008. The basic and diluted extraordinary gain per share amounted to $0.05 for the year ended August 31, 2008.

Brix Networks Inc. (renamed EXFO Service Assurance Inc.)

On April 22, 2008, the company acquired all issued and outstanding shares of Brix Networks Inc. (renamed EXFO Service Assurance Inc.). Based in the Boston, MA area, Brix Networks Inc. was a privately held company offering VoIP and IPTV test solutions across the three areas that most affect the success of a real-time service: signaling quality (signaling path performance), delivery quality (media transport performance) and content quality (overall quality of experience).

This acquisition was settled for a cash consideration of $29,696,000, or $29,684,000 net of $12,000 of cash acquired, plus a cash contingent consideration of $2,414,000; this cash contingent consideration was paid in fiscal 2009 based upon the achievement of a certain bookings volume during the 12 months following the acquisition. The amount paid for the cash contingent consideration increased goodwill.

The purchase price allocation took into account severance expenses of $497,000 (note 5) for the termination of employees of the acquired business.

This acquisition was accounted for using the purchase method and, consequently, the results of operations of the acquired business have been included in the consolidated financial statements of the company since April 22, 2008, being the date of acquisition.

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The purchase price, including acquisition-related costs, was allocated based on the estimated fair value of acquired net assets at the date of acquisition as follows:

Assets acquired, net of cash acquired	
Accounts receivable	$1,106
Inventories	1,229
Other current assets	488
Capital assets	1,097
Core technology	13,765
Future income tax assets	1,641
Current liabilities assumed	
Accounts payable and accrued liabilities	(2,565)
Deferred revenue	(2,445)
Net identifiable assets acquired	14,316
Goodwill	15,368
Purchase price, net of cash acquired	$29,684

Intangible assets are amortized on a straight-line basis over their estimated useful life of five years.

Future income tax assets at the acquisition date amounted to $13,701,000 and were mainly comprised of net operating losses and research and development expenses carried forward. A valuation allowance of $8,195,000 was recorded against these assets at the acquisition date. In the event that the company would reverse a portion or all of the valuation allowance, the amount of such reversal would reduce the amount of goodwill recognized at the date of acquisition.

Acquired goodwill reflects Brix Network's acquired work force. It also reflects the competitive advantages the company expected to realize from Brix Network's standing in the telecommunication service assurance industry. Acquired goodwill is not deductible for tax purposes.

4 Operation Held for Sale Presented as Discontinued Operations

During the fourth quarter of 2010, the company engaged in a plan to sell its Life Sciences and Industrial Division to focus its activities in the telecom test and service assurance market. On October 1st, 2010, the company closed the sale of that Division for a selling price of $24,300,000. As such, this Division has been considered as an operation held for sale and presented as discontinued operations. Assets and liabilities have been reclassified as assets held for sale and liabilities related to assets held for sale and revenues and expenses have been reclassified from continuing operations to discontinued operations for all reporting years. As a result of the classification of the operations of the Life Sciences and Industrial Division as operation held for sale and as discontinued operations, the company has only one operating segment for all reporting years.

The results of the discontinued operations are as follows:

	Years ended August 31,		
	2010	2009	2008
Sales	$25,359	$19,796	$22,809
Gross margin	$13,563	$10,801	$11,549
Earnings from operations	$4,281	$4,179	$2,814
Net earnings from discontinued operations	$3,069	$4,272	$1,771
Basic and diluted net earnings from discontinued operations per share	$0.05	$0.07	$0.02

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The assets and liabilities of the discontinued operations have been reclassified and are presented as assets held for sale and liabilities related to assets held for sale as follows:

	As at August 31,	
	2010	2009
Assets		
Current assets		
Cash	$669	$834
Accounts receivable	84	145
Income taxes and tax credits recoverable	188	100
Inventories	2,670	1,447
Prepaid expenses	158	201
Future income taxes	222	–
Current assets held for sale	3,991	2,727
Tax credits recoverable	2,142	1,801
Property, plant and equipment	349	299
Intangible assets	48	35
Goodwill	4,769	4,638
Future income taxes	–	369
Long-term assets held for sale	7,308	7,142
	$11,299	$9,869
Liabilities		
Current liabilities related to assets held for sale	$2,531	$1,847
Long-term liabilities related to assets held for sale	537	–
	$3,068	$1,847

5 Special Charges

Impairment of goodwill

In the third quarter of fiscal 2009, the company performed its annual impairment test for goodwill for all reporting units. Recoverability of goodwill is determined at the reporting unit level, using a two-step approach. First, the carrying value of the reporting units is compared to their fair value. If the carrying value of a reporting unit exceeds its fair value, the second step is performed to determine the amount of the impairment loss. Following the decrease in the company’s stock price in June 2009, the company came to the conclusion that the carrying value of one of its reporting units exceeded its fair value, and it recorded an impairment charge of $21,713,000 in fiscal 2009, to bring the goodwill of this reporting unit to its fair value. This impairment resulted in a future income tax recovery of $2,070,000.

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Restructuring charges

During fiscal 2009, the company implemented a restructuring plan to align its cost structure to the current economic and market conditions. Under that plan, the company recorded charges of $1,171,000 in severance expenses for the 65 employees who were terminated throughout the company. From that amount, $963,000 are included in the restructuring charges in the statement of earnings for the year ended August 31, 2009 and the remaining of $208,000 is included in net earnings from discontinued operations in the statement of earnings for that year.

The following tables summarize changes in restructuring charges payable since August 31, 2007:

Year ended August 31, 2010

	Balance as at August 31, 2009	Additions	Payments	Balance as at August 31, 2010
Fiscal 2009 plan				
Severance expenses	$ 24	$ –	$ 24	$ –

Year ended August 31, 2009

	Balance as at August 31, 2008	Additions	Payments	Balance as at August 31, 2009
Fiscal 2009 plan				
Severance expenses	$ –	$ 963	$ (939)	$ 24
Fiscal 2008 plan (note 3)				
Severance expenses	292	–	(292)	–
Total for all plans (note 12)	$ 292	$ 963	$ (1,231)	$ 24

Year ended August 31, 2008

	Balance as at August 31, 2007	Additions	Payments	Balance as at August 31, 2008
Fiscal 2008 plan (note 3)				
Severance expenses	$ –	$ 497	$ (205)	$ 292

6 Capital Disclosures

The company is not subject to any external restrictions on its capital.

The company's objectives when managing capital are:

- To maintain a flexible capital structure, which optimizes the cost of capital at acceptable risk;
- To sustain future development of the company, including research and development activities, market development, and potential acquisitions of complementary businesses or products; and
- To provide the company's shareholders with an appropriate return on their investment.

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The company defines its capital as shareholders' equity, excluding accumulated other comprehensive income. Accumulated other comprehensive income's main components are the cumulative foreign currency translation adjustment, which is the result of the translation of the company's consolidated financial statements into US dollars (the reporting currency) as well as after-tax unrealized gains (loss) on forward exchange contracts.

The capital of the company amounted to $166,513,000 and $175,217,000 as at August 31, 2009 and 2010, respectively.

7 Financial Instruments

Financial assets and liabilities are initially recognized at fair value and their subsequent measurement depends on their classification, as described below. Their classification depends on the intended purpose when the financial instruments have been acquired or issued, as well as on their characteristics and their designation by the company.

Classification

Financial assets

Cash	Held for trading
Short-term investments	Available for sale
Accounts receivable	Loans and receivables
Forward exchange contracts	Cash flow hedge

Financial liabilities

Accounts payable and accrued liabilities	Other financial liabilities
Long-term debt	Other financial liabilities
Other liabilities	Other financial liabilities
Forward exchange contracts	Cash flow hedge

Held-for-trading, available-for-sale and cash flow hedge financial assets are subsequently measured at fair value. Loans and receivables and other financial liabilities are subsequently measured at amortized cost using the effective interest method.

Fair value hierarchy

The company's cash, 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 cash and forward exchange contracts are classified within level 2 of the hierarchy because they are valued using quoted prices and forward foreign exchange rates at the balance sheet date.

Market risk

Currency risk

The principal measurement currency of the company is the Canadian dollar. The company is exposed to currency risks as a result of its export sales of products manufactured in Canada and China, the majority of which are denominated in US dollars and euros. These risks are 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.

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As at August 31, 2010, the company held contracts to sell US dollars for Canadian dollars at various forward rates, which are summarized as follows:

Expiry dates	Contractual amounts	Weighted average contractual forward rates
September 2010 to August 2011	$ 29,500	1.0897
September 2011 to August 2012	20,400	1.0802
September 2012 to January 2013	1,500	1.0722
Total	$ 51,400	1.0854

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 $530,000 and $597,000 as at August 31, 2009 and 2010, respectively.

Based on the portfolio of forward exchange contracts as at August 31, 2010, the company estimates that the portion of the 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 $522,000.

As at August 31, 2010, forward exchange contracts, in the amount of $754,000, are presented as current assets in other receivable in the balance sheet and forward exchange contracts, in the amount of $232,000, are presented as current liabilities in the accounts payable and accrued liabilities in the balance sheet (note 12). As at August 31, 2009, forward exchange contracts, in the amount of $874,000, are presented as current assets in other receivable in the balance sheet, forward exchange contracts, in the amount of $428,000, are presented as long-term assets in forward exchange contracts in the balance sheet, and forward exchange contracts, in the amount of $704,000, are presented as current liabilities in the accounts payable and accrued liabilities in the balance sheet (note 12).

During the years ended August 31, 2008, 2009 and 2010, the company recognized within its sales foreign exchange gains (losses) on forward exchange contracts of $4,171,000, $(3,178,000) and $1,517,000, respectively.

The following table summarizes significant financial assets and liabilities that are subject to currency risk as at August 31, 2009 and 2010:

	As at August 31,			
	2010		2009	
	Carrying/ nominal amount (in thousands	Carrying/ nominal amount (in thousands	Carrying/ nominal amount (in thousands	Carrying/ nominal amount (in thousands

	of US dollars)	of euros)	of US dollars)	of euros)
Financial assets				
Cash	$6,947	€1,287	$5,485	€779
Accounts receivable	30,218	3,860	17,397	2,642
	37,165	5,147	22,882	3,421
Financial liabilities				
Accounts payable and accrued liabilities	8,932	438	5,451	332
Forward exchange contracts	5,900	–	5,600	–
	14,832	438	11,051	332
Net exposure	$22,333	€4,709	$11,831	€3,089

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The value of the Canadian dollar compared to the US dollar was CA$1.0967 = US$1.00 and CA$1.0665 = US$1.00 as at August 31, 2009 and 2010, respectively.

The value of the Canadian dollar compared to the euro was CA$1.5741 = €1.00 and CA$1.3515 = €1.00 as at August 31, 2009 and 2010, respectively.

The following sensitivity analysis summarizes the effect that a change in the value of the Canadian dollar (compared to the US dollar and euro) on financial assets and liabilities denominated in US dollars and euros, would have on net earnings, net earnings per diluted share and comprehensive income, based on the foreign exchange rates as at August 31, 2009 and 2010:

- An increase (decrease) of 10% in the period-end value of the Canadian dollar compared to the US dollar would decrease (increase) net earnings by $1,185,000, or $0.02 per diluted share, and $2,101,000, or $0.03 per diluted share, as at August 31, 2009 and 2010, respectively.

- An increase (decrease) of 10% in the period-end value of the Canadian dollar compared to the euro would decrease (increase) net earnings by $445,000, or $0.01 per diluted share, and $621,000, or $0.01 per diluted share, as at August 31, 2009 and 2010, respectively.

- An increase (decrease) of 10% in the period-end value of the Canadian dollar compared to the US dollar would increase (decrease) comprehensive income by $2,500,000 and $3,238,000 as at August 31, 2009 and 2010, respectively.

The impact of the change in the value of the Canadian dollar compared to the US dollar and the euro on these financial assets and liabilities is recorded in the foreign exchange gain or loss line item in the consolidated statements of earnings, except for outstanding forward contracts, which impact is recorded in other comprehensive income. The change in the value of the Canadian dollar compared to the US dollar and the euro also impacts the company’s balances of income tax and tax credits recoverable or payable and future income tax assets and liabilities related to integrated foreign subsidiaries; this may result in additional and significant foreign exchange gain or loss. However, these assets and liabilities are not considered financial instruments and are excluded from the sensitivity analysis above. The foreign exchange rate fluctuations also flow through the statements of earnings line items, as a significant portion of the company’s operating expenses is denominated in Canadian dollars and euros, and the company reports its results in US dollars; that effect is not reflected in the sensitivity analysis above.

Interest rate risk

The company is exposed to interest rate risks through its short-term investments and its long-term debt.

Short-term investments

Short-term investments consist of the following:

	As at August 31,	
	2010	2009
Commercial paper denominated in Canadian dollars, bearing interest at annual rates of 0.6% to 0.9% in 2010 and 0.2% to 0.6% in 2009, maturing in September and October 2010 in fiscal 2010, and between September 2009 and December 2009 in fiscal 2009	$6,383	$45,109
Bankers acceptance denominated in Canadian dollars, bearing interest at an annual rate of 0.8% in 2010 and 0.2% in 2009, maturing in September 2010 in fiscal 2010 and September and October 2009 in fiscal 2009	3,996	13,996
	$10,379	$59,105

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The fair value of short-term investments based on market value amounted to $59,105,000 and $10,379,000 as at August 31, 2009 and 2010, respectively.

Due to their short-term maturity of usually three months or less, the company's short-term investments are not subject to significant fair value interest rate risk. Accordingly, change in fair value has been nominal to the degree that amortized cost has historically approximated the fair value. Any change in fair value of the company's short-term investments, all of which are classified as available for sale, is recorded in other comprehensive income.

Long-term debt

As at August 31, 2010, the company's long-term debt, in the amount of $1,987,000, bears interest at an annual rate of 2.95% and matures in December 2013 (note 13).

Other financial instruments

Cash, accounts receivable and accounts payable and accrued liabilities are non-interest-bearing financial assets and liabilities. Accounts receivable and accounts payable are financial instruments whose carrying value approximates their fair value due to their short-term maturity.

Credit risk

Financial instruments that potentially subject the company to credit risk consist primarily of cash, short-term investments, accounts receivable and forward exchange contracts (with a positive fair value). As at August 31, 2010, the company's short-term investments consist of debt instruments issued by nine (eleven as at August 31, 2009) high-credit quality corporations and trusts. None of these debt instruments are expected to be affected by a significant liquidity risk. The company's cash and forward exchange contracts are held with or issued by high-credit quality financial institutions; therefore, the company considers the risk of non-performance on these instruments to be limited.

Generally, the company does not require collateral or other security from customers for trade accounts receivable; however, credit is extended to customers following an evaluation of creditworthiness. In addition, the company performs ongoing credit reviews of all its customers and establishes an allowance for doubtful accounts receivable when accounts are determined to be uncollectible. Allowance for doubtful accounts amounted to $1,220,000 and $1,243,000 as at August 31, 2009 and 2010, respectively. Bad debt expense amounted to $148,000, $967,000 and $24,000 for the years ended August 31, 2008, 2009 and 2010, respectively.

For the year ended August 31, 2009, one customer represented more than 10% of sales with 13.1% ($20,049,000). In fiscal 2008 and 2010, no customer represented more than 10% of sales.

The following table summarizes the age of trade accounts receivable:

As at August 31,

	2010	2009
Current	$38,663	$16,476
Past due, 0 to 30 days	6,787	3,551
Past due, 31 to 60 days	1,991	1,464
Past due, more than 60 days, less allowance for doubtful accounts of $1,220 and $1,243 as at August 31, 2009 and 2010, respectively.	2,749	1,442
Total accounts receivable	$50,190	$22,933

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Changes in the allowance for doubtful accounts are as follows:

	Years ended August 31,	
	2010	2009
Balance – Beginning of year	$1,220	$305
Addition charged to earnings	150	979
Write-off of uncollectible accounts	–	(45)
Recovery of uncollectible accounts	(127)	(19)
Balance – End of year	$1,243	$1,220

Liquidity risk

Liquidity risk is defined as the potential that the company cannot meet its obligations as they become due.

The following tables summarize the contractual maturity of the company's financial liabilities:

	As at August 31, 2010			
	0-12 months	13-24 months	25-36 months	Over 36 months
Accounts payable and accrued liabilities	$29,711	$–	$–	$–
Long-term debt	568	568	568	283
Forward exchange contracts				
Outflow	29,500	20,400	1,500	–
Inflow	(30,141)	(20,662)	(1,508)	–
Total	$29,638	$306	$560	$283

	As at August 31, 2009		
	0-12 months	13-24 months	25-36 months
Accounts payable and accrued liabilities	$18,160	$–	$–
Forward exchange contracts			
Outflow	27,600	14,600	1,000
Inflow	(27,730)	(14,938)	(1,028)
Total	$18,030	$(338)	$(28)

As at August 31, 2010, the company had $31,819,000 in cash and short-term investments and $50,190,000 in accounts receivable. In addition to these financial assets, the company has unused available lines of credit totaling $14,700,000 for working capital and other general corporate purposes, including potential acquisitions and its share repurchase program as well as unused lines of credit of $16,486,000 for foreign currency exposure related to its forward exchange contracts (note 11).

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8 Inventories

	As at August 31,	
	2010	2009
Raw materials	$21,505	$13,918
Work in progress	1,975	1,801
Finished goods	16,848	13,697
	$40,328	$29,416

The cost of sales comprised almost exclusively the amount of inventory recognized as an expense during the reporting periods, except for the related amortization, which is shown separately in operating expenses.

Inventory write-down amounted to $2,330,000, $2,982,000 and $2,664,000 for the years ended August 31, 2008, 2009 and 2010, respectively.

9 Property, Plant and Equipment

	As at August 31,			
	2010		2009	
	Cost	Accumulated amortization	Cost	Accumulated amortization
Land and land improvements	$2,287	$ 1,200	$2,224	$ 1,157
Buildings	14,395	4,987	12,374	4,354
Equipment	39,734	28,282	34,142	25,420
Leasehold improvements	2,976	1,468	3,076	2,084
	59,392	$ 35,937	51,816	$ 33,015
Less:				
Accumulated amortization	35,937		33,015	
	$23,455		$18,801	

As at August 31, 2008, 2009 and 2010, unpaid purchases of property, plant and equipment amounted to $414,000, $348,000 and $391,000, respectively.

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10 Intangible Assets and Goodwill

Intangible assets

	As at August 31,			
	2010		2009	
	Cost	Accumulated amortization	Cost	Accumulated amortization
Core technology	$34,858	$ 17,496	$33,643	$ 19,468
Customer relationships	6,615	622	–	–
Brand name	659	62	–	–
Software	11,557	7,562	8,966	6,317
	53,689	$ 25,742	42,609	$ 25,785
Less:				
Accumulated amortization	25,742		25,785	
	$27,947		$16,824	

Estimated amortization expense for intangible assets in each of the next five fiscal years amounts to $8,573,000 in 2011, $7,638,000 in 2012, $5,936,000 in 2013, $3,620,000 in 2014 and $1,841,000 in 2015.

Additions to intangible assets for the years ended August 31, 2008, 2009 and 2010 amounted to $14,815,000, $2,543,000 and $19,369,000 respectively.

Goodwill

Changes in the carrying value of goodwill are as follows:

	Years ended August 31,	
	2010	2009
Balance – Beginning of year	$17,840	$37,866
Addition from business combinations (note 3)	12,560	2,414
Impairment (note 5)	–	(21,713)
Foreign currency translation adjustment	(1,045)	(727)
Balance – End of year	$29,355	$17,840

11 Credit Facilities

The company has lines of credit that provide for advances of up to CA$15,000,000 (US$14,065,000) and up to US$2,000,000. These lines of credit bear interest at the Canadian prime rate. As at August 31, 2010, an amount of CA$5,721,000 (US$5,364,000) was drawn from theses lines of credit for letters of guarantee in the normal course of the company's operations. From this amount, the company had $964,000 worth of letters of guarantee for its own selling and purchase requirements, and the remainder of $4,400,000 was used by the company to secure its line of credit in CNY. These lines of credit are subject to a negative pledge whereby the company has agreed with the bank not to pledge its assets to any other party without its consent.

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The company line of credit, in CNY, provides for advances of up to US$4,000,000. This line of credit bears interest at the Chinese prime rate for advances made in CNY and at LIBOR plus 3.5% for advances made in US dollars. As at August 31, 2010, this line of credit was unused.

Finally, the company has lines of credit of US$22,308,000 for the foreign currency risk exposure related to its forward exchange contracts (note 7). As at August 31, 2010, an amount of US$5,822,000 was reserved from these lines of credit. These lines of credit are renewable annually and unsecured.

12 Accounts Payable and Accrued Liabilities

	As at August 31,	
	2010	2009
Trade	$14,244	$8,121
Salaries and social benefits	12,400	8,231
Warranty	579	647
Commissions	831	647
Restructuring charges (note 5)	–	24
Forward exchange contracts (note 7)	232	704
Other	2,584	1,429
	$30,870	$19,803

Changes in the warranty provision are as follows:

	Years ended August 31,	
	2010	2009
Balance – Beginning of year	$647	$920
Provision	810	590
Settlements	(878)	(863)
Balance – End of year	$579	$647

13 Long-Term Debt

Years ended August 31,

	2010	2009
Loan collateralized by assets of NetHawk Oyj denominated in euros (€1,568), bearing interest at 2.95%, repayable in semi-annual installments of $284 (€224), maturing in December 2013 (note 3)	$1,987	$–
Less: current portion	568	–
	$1,419	$–

Capital repayments required in the next four years amount to $568,000 in 2011, $568,000 in 2012, $568,000 in 2013 and $283,000 in 2014.

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14 Commitments

The company entered into operating leases for certain of its premises and equipment, which expire at various dates through June 2017. As at August 31, 2010, minimum rental expenses of these operating leases in each of the next five years will amount to $4,716,000 in 2011, $2,983,000 in 2012, $1,754,000 in 2013, $997,000 in 2014 and $867,000 in 2015. Total commitments for these operating leases amount to $12,498,000.

For the years ended August 31, 2008, 2009 and 2010, rental expenses amounted to $2,199,000, $2,534,000 and $3,798,000, respectively.

15 Contingencies

a) Class action

On November 27, 2001, a class action suit was filed in the United States District Court for the Southern District of New York against the company, four of the underwriters of its Initial Public Offering and some of its executive officers pursuant to the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and Sections 11, 12 and 16 of the Securities Act of 1933. This class action alleges that the company's registration statement and prospectus filed with the Securities and Exchange Commission on June 29, 2000, contained material misrepresentations and/or omissions resulting from (i) the underwriters allegedly soliciting and receiving additional, excessive and undisclosed commissions from certain investors in exchange for which they allocated material portions of the shares issued in connection with the company's Initial Public Offering; and (ii) the underwriters allegedly entering into agreements with customers whereby shares issued in connection with the company's Initial Public Offering would be allocated to those customers in exchange for which customers agreed to purchase additional amounts of shares in the after-market at predetermined prices.

On April 19, 2002, the plaintiffs filed an amended complaint containing master allegations against all of the defendants in all of the 310 cases included in this class action and also filed an amended complaint containing allegations specific to four of the company's underwriters, the company and two of its executive officers. In addition to the allegations mentioned above, the amended complaint alleges that the underwriters (i) used their analysts to manipulate the stock market; and (ii) implemented schemes that allowed issuer insiders to sell their shares rapidly after an initial public offering and benefit from high market prices. As concerns the company and its two executive officers in particular, the amended complaint alleges that (i) the company's registration statement was materially false and misleading because it failed to disclose the additional commissions and compensation to be received by underwriters; (ii) the two named executive officers learned of or recklessly disregarded the alleged misconduct of the underwriters; (iii) the two named executive officers had motive and opportunity to engage in alleged wrongful conduct due to personal holdings of the company's stock and the fact that an alleged artificially inflated stock price could be used as currency for acquisitions; and (iv) the two named executive officers, by virtue of their positions with the company, controlled the company and the contents of the registration statement and had the ability to prevent its issuance or cause it to be corrected. The plaintiffs in this suit seek an unspecified amount for damages suffered.

In July 2002, the issuers filed a motion to dismiss the plaintiffs' amended complaint and a decision was rendered on February 19, 2003. Only one of the claims against the company was dismissed. On October 8, 2002, the claims against its officers were dismissed, without prejudice, pursuant to the terms of Reservation of Rights and Tolling Agreements entered into with the plaintiffs (the "Tolling Agreements"). Subsequent addenda to the Tolling Agreements extended the tolling period through August 27, 2010.

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In June 2004, an agreement of partial settlement was submitted to the court for preliminary approval. The proposed partial settlement was between the plaintiffs, the issuer defendants in the consolidated actions, the issuer officers and directors named as defendants, and the issuers' insurance companies. The court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005, the court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The court also appointed the notice administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members by January 15, 2006. The settlement fairness hearing occurred on April 24, 2006, and the court reserved decision at that time.

While the partial settlement was pending approval, the plaintiffs continued to litigate against the underwriter defendants. The district court directed that the litigation proceed within a number of "focus cases" rather than in all of the 310 cases that have been consolidated. The company's case is not one of these focus cases. On October 13, 2004, the district court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the district court's class certification decision.

On April 6, 2007, the Second Circuit denied the plaintiffs' petition for rehearing of that decision and, on May 18, 2007, the Second Circuit denied the plaintiffs' petition for rehearing en banc. In light of the Second Circuit's opinion, liaison counsel for all issuer defendants, including the company, informed the court that this settlement cannot be approved, because the defined settlement class, like the litigation class, cannot be certified. On June 25, 2007, the district court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and, on September 27, 2007, again moved for class certification. On November 12, 2007, certain defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the district court denied the motions to dismiss, except as to Section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside of the previously certified class period. Briefing on the class certification motion was completed in May 2008. That motion was withdrawn without prejudice on October 10, 2008.

On April 2, 2009, a stipulation and agreement of settlement between the plaintiffs, issuer defendants and underwriter defendants was submitted to the Court for preliminary approval. The Court granted the plaintiffs' motion for preliminary approval and preliminarily certified the settlement classes on June 10, 2009. The settlement fairness hearing was held on September 10, 2009. On October 6, 2009, the Court entered an opinion granting final approval to the settlement and directing that the Clerk of the Court close these actions. On August 26, 2010, based on the expiration of the tolling period stated in the Tolling Agreements, the plaintiffs filed a Notice of Termination of Tolling Agreement and Recommencement of Litigation against the two named executive officers. The plaintiffs stated to the Court that they do not intend to take any further action against the named executive officers at this time. Notices of appeal of the opinion granting final approval have been filed. Given that the settlement remains subject to appeal as of the date of issuance of these financial statements, the ultimate outcome of the contingency is uncertain. However, based on the settlement approved on October 6, 2009, and the related insurance against such claims, management has determined the impact to its financial position and results of operations as at and for the year ended August 31, 2010 to be immaterial.

b) Cash contingent consideration

Following the purchase of assets in fiscal 2009, the company has a cash contingent consideration of up to $825,000 payable based upon the achievement of a certain booking volume in the next six months.

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16 Share Capital

Authorized – unlimited as to number, without par value

Subordinate voting and participating, bearing a non-cumulative dividend to be determined by the Board of Directors, ranking pari passu with multiple voting shares

Multiple voting and participating, entitling to 10 votes each, bearing a non-cumulative dividend to be determined by the Board of Directors, convertible at the holder's option into subordinate voting shares on a one-for-one basis, ranking pari passu with subordinate voting shares

The following table summarizes the share capital activity since August 31, 2007:

	Multiple voting shares		Subordinate voting shares		
	Number	Amount	Number	Amount	Total amount
Balance as at August 31, 2007	36,643,000	$ 1	32,361,561	$ 150,018	$ 150,019
Exercise of stock options (note 17)	–	–	18,500	61	61
Redemption of restricted share units (note 17)	–	–	65,870	–	–
Redemption of deferred share units (note 17)	–	–	20,695	–	–
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	–	–	–	514	514
Redemption of share capital	–	–	(1,682,921)	(7,808)	(7,808)
Balance as at August 31, 2008	36,643,000	1	30,783,705	142,785	142,786
Exercise of stock options (note 17)	–	–	27,500	56	56
Redemption of restricted share units (note 17)	–	–	106,190	–	–
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	–	–	–	540	540
Redemption of share capital	–	–	(8,181,093)	(38,536)	(38,536)
Balance as at August 31, 2009	36,643,000	1	22,736,302	104,845	104,846
Exercise of stock options (note 17)	–	–	83,700	343	343
Redemption of restricted share units (note 17)	–	–	120,307	–	–

Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	–	–	–	954	954
Redemption of share capital	–	–	(3,600)	(17)	(17)
Balance as at August 31, 2010	36,643,000	$1	22,936,709	$106,125	$ 106,126

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a) On November 6, 2008, the company announced that its Board of Directors had authorized a renewal of its share repurchase program, by way of a normal course issuer bid on the open market, of up to 10% of its public float (as defined by the Toronto Stock Exchange), or 2,738,518 subordinate voting shares, at the prevailing market price. The period of the normal course issuer bid commenced on November 10, 2008, and ended on November 9, 2009. All shares repurchased under the bid were cancelled. In fiscal 2009, the company redeemed 488,786 subordinate voting shares for an aggregate net purchase price of $1,416,000. In fiscal 2010, the company did not redeem shares under that program.

b) On November 10, 2008, the company announced that its Board of Directors had authorized a substantial issuer bid (the "Offer") to purchase for cancellation subordinate voting shares for an aggregate purchase price not to exceed CA$30,000,000. On December 18, 2008, pursuant to the Offer, the company purchased for cancellation 7,692,307 subordinate voting shares for the aggregate purchase price of CA$30,000,000 (US$24,879,000), plus related fees of $576,000. The company used cash and short-term investments to fund the purchase of shares.

c) On November 6, 2009, the company announced that its Board of Directors had authorized the second renewal of its share repurchase program, by way of a normal course issuer bid on the open market, of up to 10% of its public float (as defined by the Toronto Stock Exchange), or 2,256,431 million subordinate voting shares, at the prevailing market price. The period of the normal course issuer bid started on November 10, 2009, and ended on November 9, 2010. All shares repurchased under the bid were cancelled. In fiscal 2010, the company redeemed 3,600 shares under that program for an aggregate net purchase price of $14,000.

d) On November 5, 2010 the company announced that its Board of Directors approved the third renewal of its share repurchase program, by way of a normal course issuer bid on the open market of up to 10% of its public float (as defined by the Toronto Stock Exchange), or 2,012,562 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 will start on November 10, 2010, and will end on November 9, 2011, 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.

17 Stock-Based Compensation Plans

The maximum number of additional subordinate voting shares issuable under the Long-Term Incentive Plan and the Deferred Share Unit Plan cannot exceed 6,306,153 shares. The maximum number of subordinate voting shares that may be granted to any individual on an annual basis cannot exceed 5% of the number of outstanding subordinate voting shares. The company settles stock options and redeems restricted share units and deferred share units through the issuance of common shares from treasury.

Long-Term Incentive Plan

In May 2000, the company established a Stock Option Plan for directors, executive officers and employees and those of the company's subsidiaries, as determined by the Board of Directors. In January 2005, the company made certain amendments to the existing Stock Option Plan, including the renaming of the plan to Long-Term Incentive Plan, which includes stock options and restricted share units. This plan was approved by the shareholders of the company.

Stock Options

The exercise price of stock options granted under the Long-Term Incentive Plan is the market price of the common shares on the date of grant. Stock options granted under the plan generally expire 10 years from the date of grant and vest over a four-year period, being the required period of service from employees, generally with 25% vesting on an annual basis commencing on the first anniversary of the date of grant. The Board of Directors may accelerate the vesting of any or all outstanding stock options upon the occurrence of a change of control.

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The following table summarizes stock option activity since August 31, 2007:

	Years ended August 31,					
	2010		2009		2008	
	Number	Weighted average exercise price (CA$)	Number	Weighted average exercise price (CA$)	Number	Weighted average exercise price (CA$)
Outstanding – Beginning of year	1,666,589	$21	1,821,481	$21	1,929,388	$21
Exercised	(83,700)	4	(27,500)	3	(18,500)	3
Forfeited	–	–	(1,000)	6	(8,750)	6
Expired	(234,102)	36	(126,392)	26	(80,657)	29
Outstanding – End of year	1,348,787	$19	1,666,589	$21	1,821,481	$21
Exercisable – End of year	1,348,787	$19	1,660,090	$21	1,762,969	$21

The intrinsic value of stock options exercised during fiscal 2008, 2009 and 2010 was $43,000, $23,000 and $73,000, respectively.

The following table summarizes information about stock options as at August 31, 2010:

		Stock options outstanding and exercisable			
Exercise price (CA$)		Number	Weighted average exercise price (CA$)	Intrinsic value (CA$)	Weighted average remaining contractual life
$	2.50	205,125	$ 2.50	$ 683	2.1 years
$	3.96 to $5.60	313,704	5.14	217	3.7 years
$	6.22 to $9.02	140,216	6.53	–	3.4 years
$	14.27 to $20.00	331,678	15.53	–	1.1 year
$	29.70 to $43.00	220,211	35.26	–	0.4 year
$	51.25 to $68.17	110,523	66.10	–	0.1 year
$	83.66	27,330	83.66	–	0.1 year
		1,348,787	$ 18.94	$ 900	1.9 year

Restricted Share Units (RSUs)

RSUs are "phantom" shares that rise and fall in value based on the market price of the company's subordinate voting shares and are redeemable for actual subordinate voting shares or cash at the discretion of the Board of Directors as determined on the date of grant. Vesting dates are also established by the Board of Directors on the date of grant. The vesting dates are subject to a minimum term of three years and a maximum term of 10 years from the award date, being the required period of service from employees. Fair value of RSUs equals the market price of the common shares on the date of grant. This plan was approved by the shareholders of the company.

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The following table summarizes RSU activity since August 31, 2007:

	Years ended August 31,		
	2010	2009	2008
Outstanding – Beginning of year	1,339,619	847,791	488,015
Granted	415,538	685,972	469,847
Redeemed	(120,307)	(106,190)	(65,870)
Forfeited	(31,802)	(87,954)	(44,201)
Outstanding – End of year	1,603,048	1,339,619	847,791

None of the RSUs outstanding, as at August 31, 2008, 2009 and 2010, were redeemable. The weighted average grant-date fair value of RSUs granted during fiscal 2008, 2009 and 2010 amounted to $5.46, $2.69 and $4.50, respectively.

As at August 31, 2010, the intrinsic value of RSUs outstanding was $8,769,000.

Expected forfeitures are immaterial to the company and are not reflected in the determination of stock-based compensation costs.

As at August 31, 2010, unrecognized stock-based compensation costs of unvested RSUs amounted to $3,460,000. The weighted average period over which they are expected to be recognized is 3.0 years.

Deferred Share Unit Plan

In January 2005, the company established a Deferred Share Unit (DSU) Plan for the members of the Board of Directors as part of their annual retainer fees. Each DSU entitles the Board members to receive one subordinate voting share. DSUs are acquired on the date of grant and will be redeemed in subordinate voting shares when the Board member ceases to be Director of the company. This plan was approved by the shareholders of the company.

The following table summarizes DSU activity since August 31, 2007:

	Years ended August 31,		
	2010	2009	2008
Outstanding – Beginning of year	114,924	79,185	64,718
Granted	20,079	35,739	35,162
Redeemed	–	–	(20,695)

Outstanding – End of year	135,003	114,924	79,185

None of the DSUs outstanding as at August 31, 2008, 2009 and 2010 were redeemable. The weighted average grant-date fair value of DSUs granted during fiscal 2008, 2009 and 2010 amounted to $5.14, $3.19 and $4.79.

As at August 31, 2010, the intrinsic value of DSUs outstanding was $738,000.

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Stock Appreciation Rights Plan

In August 2001, the company established the Stock Appreciation Rights Plan for certain employees. Under that plan, eligible employees are entitled to receive a cash amount equivalent to the difference between the market price of the common shares on the date of exercise and the exercise price determined on the date of grant. Stock appreciation rights granted under the plan generally expire 10 years from the date of grant and vest over a four-year period, being the required period of service from employees, with 25% vesting on an annual basis commencing on the first anniversary of the date of grant. This plan was approved by the shareholders of the company.

The following table summarizes stock appreciation rights activity since August 31, 2007:

	Years ended August 31,					
	2010		2009		2008	
	Number	Weighted average exercise price	Number	Weighted average exercise price	Number	Weighted average exercise price
Outstanding – Beginning of year	40,374	$8	30,700	$10	27,700	$11
Granted	4,000	4	9,674	2	3,000	6
Outstanding – End of year	44,374	$8	40,374	$8	30,700	$10
Exercisable – End of year	28,318	$10	24,475	$11	19,550	$12

The following table summarizes information about stock appreciation rights as at August 31, 2010:

	Stock appreciation rights outstanding		Stock appreciation rights exercisable
Exercise price	Number	Weighted average remaining contractual life	Number
$ 2.36	9,674	8.1 years	2,418
$ 3.74 to $5.59	20,000	5.3 years	15,000
$ 6.28 to $6.50	9,700	6.5 years	5,900
$ 22.25	2,500	0.4 year	2,500

$	45.94	2,500	0.1 year	2,500
		44,374	5.6 years	28,318

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18 Other Disclosures

Net research and development expenses

Net research and development expenses comprise the following:

	Years ended August 31,		
	2010	2009	2008
Gross research and development expenses	$44,551	$33,584	$30,167
Research and development tax credits and grants	(6,704)	(6,371)	(5,587)
	$37,847	$27,213	$24,580

Government grants

The company is entitled to receive grants on certain eligible research and development projects conducted in Finland from TEKES, a Finnish technology organization, which is funding Finnish companies' high technology, research and innovations. The company's eligible research and development projects must be pre-approved by TEKES and the grant is subject to certain conditions. In the event a condition is not met, TEKES can require reimbursement of a portion or the entire amount of the grant received. A liability to repay the funding is recognized in the period in which conditions arise that will cause the funding to be repayable. As at August 31, 2010, the company was in compliance with the conditions of the funding. This funding is presented as a reduction of gross research and development expenses in the statements of earnings. In fiscal 2010, the company recorded $875,000 under that program in the statement of earnings.

Defined contribution plans

The company maintains separate defined contribution plans for certain eligible employees. These plans, which are accounted for on an accrual basis, are summarized as follows:

- Deferred profit-sharing plan

The company maintains a plan for certain eligible employees residing in Canada, under which the company may elect to contribute an amount equal to 2% of an employee's gross salary, provided that the employee has contributed at least 2% of his gross salary to a tax-deferred registered retirement savings plan. Cash contributions to this plan and expenses for the years ended August 31, 2008, 2009 and 2010, amounted to $531,000, $504,000 and $592,000, respectively.

- 401K plan

The company maintains a 401K plan for eligible employees residing in the U.S. Under this plan, the company must contribute an amount equal to 3% of an employee's current compensation. During the years ended August 31, 2008, 2009 and 2010, the company recorded cash contributions and expenses totaling $216,000, $356,000 and $268,000, respectively.

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19 Income Taxes

During fiscal 2008, reductions to the Canadian federal statutory tax rate were substantively enacted. Therefore, Canadian federal future income tax assets decreased by $1,524,000, and generated a future income tax expense in the same amount during the year.

In addition, during fiscal 2008, taking into consideration these new Canadian federal substantively enacted tax rates, the company reviewed its tax strategy for the future use of its Canadian federal operating losses, research and development expenses, certain timing differences and research and development tax credits to minimize income taxes payable on future years' taxable income. Consequently, it amended its prior year's income tax returns to generate a net operating loss to be carried back to prior years, which reinstated previously used research and development tax credits. This resulted in an increase of its future income tax assets of $2,715,000 and an income tax recovery of the same amount in the statement of earnings for the year ended August 31, 2008.

Finally, during fiscal 2008, considering the expected positive impact of the acquisitions of Navtel Communications Inc. and Brix Networks Inc. on future years' taxable income at the United States (federal) level, and because actual taxable income in the United States was greater than initially expected, management concluded that it was more likely than not that all future income tax assets of its existing consolidated U.S. group would be recovered. Consequently, it reversed its valuation allowance against future income tax assets in the amount of $7,617,000. The portion of the valuation allowance that was reversed, and that was attributable to the effects of the Navtel Communications Inc. and Brix Networks Inc. acquisitions, in the amount of $652,000 and $1,641,000, respectively, was included in the purchase price allocation of the related acquired businesses. The remainder of the reversal, in the amount of $5,324,000, has been recorded in income taxes in the statement of earnings for the year ended August 31, 2008.

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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:

	Years ended August 31,		
	2010	2009	2008
Income tax provision at the combined Canadian federal and provincial statutory tax rate (30% in 2010 and 31% in 2009 and 2008)	$2,724	$(6,383)	$4,326
Increase (decrease) due to:			
Foreign income taxed at different rates	(459)	56	162
Non-taxable income	(787)	(211)	(448)
Non-deductible expenses	851	5,200	998
Change in tax rates	97	–	1,522
Change in tax strategy	–	–	(2,715)
Foreign exchange effect of translation of foreign integrated subsidiaries	(55)	189	32
Other	(27)	638	427
Recognition of previously unrecognized future income tax assets	–	–	(5,324)
Utilization of previously unrecognized future income tax assets	(349)	(68)	(1,872)
Unrecognized future income tax assets on temporary deductible differences and unused tax losses and deductions	3,534	845	3,229
	$5,529	$266	$337
The income tax provision consists of the following:			
Current			
Canada	$13	$87	$(7,534)
Other	702	500	380
	715	587	(7,154)
Future			
Canada	4,316	1,045	11,271
Finland	(928)	–	–
United States	(1,501)	(2,511)	376
Other	(258)	368	(189)
	1,629	(1,098)	11,458
Valuation allowance			
Canada	7	236	375
Finland	928	–	–
United States	2,203	604	(4,545)
Other	47	(63)	205

	3,185	777	(3,967)
	4,814	(321)	7,491
	$5,529	$266	$337
The income tax provision for the discontinued operations is as follows:			
Current	$163	$(25)	$59
Future	972	21	1,279
	$1,135	$(4)	$1,338

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	Years ended August 31,		
	2010	2009	2008
Details of the company's income taxes:			
Earnings (loss) before income taxes			
Canada	$12,403	$(15,611)	$15,237
Finland	(1,921)	–	–
United States	(4,546)	(5,026)	(748)
Other	3,143	46	(535)
	$9,079	$(20,591)	$13,954

Significant components of the company's future income tax assets and liabilities are as follows:

	As at August 31,	
	2010	2009
Future income tax assets		
Long-lived assets	$5,473	$5,141
Provisions and accruals	3,797	3,729
Deferred revenue	1,983	1,659
Research and development expenses	9,954	11,756
Losses carried forward	34,322	28,165
	55,529	50,450
Valuation allowance	(21,277)	(15,458)
	34,252	34,992
Future income tax liabilities		
Research and development tax credits	(7,793)	(6,632)
Long-lived assets	(7,161)	(4,658)
Deferred revenue	(223)	–
	(15,177)	(11,290)
Future income tax assets, net	$19,075	$23,702

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As at August 31, 2010, the company had available operating and capital losses in several tax jurisdictions, against which a valuation allowance of $17,401,000 was recorded. The valuation allowance includes $7,670,000 for which subsequently recognized benefits will be allocated to reduce goodwill (note 3). The following table summarizes the year of expiry of these losses by tax jurisdiction:

	Canada				
Year of expiry	Federal	Provincial	Finland	United States	Other
2012	$–	$–	$2,126	$–	$–
2013	–	–	7,122	–	–
2014	–	–	4,307	–	–
2015	1,116	1,116	2,791	–	–
2017	–	–	4	–	–
2018	–	–	368	–	99
2019	–	–	–	741	–
2020	–	–	5,925	3,526	–
2021	–	–	–	10,202	–
2022	–	–	–	9,561	–
2023	–	–	–	6,356	–
2024	–	–	–	3,954	–
2025	–	–	–	8,450	–
2026	1,008	1,008	–	4,126	–
2027	1,279	1,279	–	1,355	–
2028	–	–	–	2,472	–
2029	–	–	–	1,820	–
2030	11	11	–	2,553	–
Indefinite	17,877	18,213	–	8,750	4,810
	$21,291	$21,627	$22,643	$63,866	$4,909

As at August 31, 2010, in addition to operating and capital losses, the company had available research and development expenses in several tax jurisdictions. The following table summarizes the year of expiry of theses research and development expenses by tax jurisdiction:

	Canada			
Year of expiry	Federal	Provincial	Finland	United States
2011	$–	$–	$1,890	$–
2012	–	–	1,584	–
2013	–	–	1,186	1,726

2014	–	–	638	1,404
2015	–	–	163	997
2016	–	–	–	553
Indefinite	27,981	19,437	–	–
	$27,981	$19,437	$5,461	$4,680

A valuation allowance of $3,413,000 was recorded against these assets for which subsequently recognized benefits will be allocated to reduce goodwill (note 3).

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Finally, as at August 31, 2010, the company had non-refundable research and development tax credits in the amount of $29,379,000. The following table summarizes the year of expiry of these non-refundable research and development tax credits by tax jurisdiction:

	Canada	
Year of expiry	Federal	Provincial
2018	$492	$–
2019	1,074	–
2020	1,414	–
2021	1,628	–
2022	1,374	–
2023	1,405	–
2024	358	–
2025	2,820	–
2026	3,142	–
2027	3,607	–
2028	3,950	–
2029	4,076	257
2030	3,582	200
	$28,922	$457

20 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:

	Years ended August 31,		
	2010	2009	2008
Basic weighted average number of shares outstanding (000's)	59,479	61,845	68,767
Plus dilutive effect of:			
Stock options (000's)	228	131	291
Restricted share units (000's)	786	311	181
Deferred share units (000's)	123	94	79
Diluted weighted average number of shares outstanding (000's)	60,616	62,381	69,318
	960	1,602	1,404

Stock awards excluded from the calculation of the diluted weighted average number of shares outstanding because their exercise price was greater than the average market price of the common shares (000's)

For the year ended August 31, 2009, 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.

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21 Segment Information

Sales to external customers by geographic region are detailed as follows:

	Years ended August 31,		
	2010	2009	2008
United States	$76,669	$61,757	$66,847
Canada	18,278	17,331	13,100
Latin America	11,454	7,729	8,381
Americas	106,401	86,817	88,328
United Kingdom	10,936	6,188	5,954
Other	49,288	36,466	41,714
Europe, Middle-East and Africa	60,224	42,654	47,668
China	17,610	13,784	12,018
Other	18,522	9,827	12,967
Asia-Pacific	36,132	23,611	24,985
	$202,757	$153,082	$160,981

Sales were allocated to geographic regions based on the country of residence of the related customers.

Long-lived assets by geographic region are detailed as follows:

	As at August 31,					
	2010			2009		
	Property, plant and equipment	Intangible assets	Goodwill	Property, plant and equipment	Intangible assets	Goodwill
Canada	$13,753	$3,316	$–	$14,714	$4,929	$–
United States	1,829	7,828	17,782	1,015	9,687	17,840
Finland	1,606	14,906	11,573	–	–	–
China	2,665	33	–	2,033	32	–
Other	3,602	1,864	–	1,039	2,176	–

	$23,455	$27,947	$29,355	$18,801	$16,824	$17,840

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22 United States Generally Accepted Accounting Principles

As a registrant with the Securities and Exchange Commission in the United States (SEC), the company is required to reconcile its consolidated financial statements for significant differences in measurement and disclosure between generally accepted accounting principles as applied in Canada (Canadian GAAP) and those applied in the United States (U.S. GAAP). Furthermore, additional significant disclosures required under U.S. GAAP and Regulation S-X of the\ SEC are also provided in the accompanying consolidated financial statements and notes. The following summarizes the significant quantitative differences between Canadian and U.S. GAAP, as well as other significant disclosures required under U.S. GAAP and Regulation S-X of the SEC not already provided in the accompanying consolidated financial statements.

Reconciliation of net earnings (loss) and comprehensive income (loss) to conform to U.S. GAAP

The following summary sets out the significant differences between the company's reported net earnings (loss), net earnings (loss) per share and comprehensive income (loss) under Canadian GAAP as compared to U.S. GAAP. Refer to corresponding explanatory notes in the Reconciliation Items section.

		Years ended August 31,		
		2010	2009	2008
Net earnings (loss) for the year in accordance with Canadian GAAP		$ 6,619	$ (16,585)	$ 18,424
Impairment of goodwill	a)	–	8,406	–
Acquisition-related costs on business combination (note 3)	b)	(2,842)	–	–
Net earnings (loss) for the year in accordance with U.S. GAAP		3,777	(8,179)	18,424
Foreign currency translation adjustment	b)	3,952	(10,671)	(2,289)
Changes in unrealized gains on available-for-sale securities		–	22	31
Unrealized gains (losses) on forward exchange contracts		940	(1,467)	962
Reclassification of realized (gains) losses on forward exchange contracts in net earnings (loss)		(1,022)	3,167	(3,915)
Future income taxes effect of the above items		24	(528)	909
Comprehensive income (loss) under U.S. GAAP		$ 7,671	$ (17,656)	$ 14,122
Out of net earnings (loss):				
		$ 708	$ (12,451)	$ 13,617

Earnings (loss) from continuing operations before extraordinary gain								
Net earnings from discontinued operations	$	3,069	$	4,272		$	1,771	
Earnings (loss) before extraordinary gain	$	3,777	$	(8,179	)	$	15,388	
Extraordinary gain	$	–	$	–		$	3,036	
Basic and diluted earnings (loss) from continuing operations before extraordinary gain per share in accordance with U.S. GAAP	$	0.01	$	(0.20	)	$	0.20	
Basic and diluted net earnings from discontinued operations per share in accordance with U.S. GAAP	$	0.05	$	0.07		$	0.02	
Basic and diluted extraordinary gain per share in accordance with U.S. GAAP	$	–	$	–		$	0.05	
Basic and diluted net earnings (loss) per share in accordance with U.S. GAAP	$	0.06	$	(0.13	)	$	0.27	

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Reconciliation of shareholders’ equity to conform to U.S. GAAP

The following summary sets out the significant differences between the company’s reported shareholders’ equity under Canadian GAAP as compared to U.S. GAAP. Refer to the corresponding explanatory note in the Reconciliation Items section.

		As at August 31,	
		2010	2009
Shareholders’ equity in accordance with Canadian GAAP		$ 220,419	$ 208,045
Goodwill	b)	42	–
Long-term assets held for sale	a)	(3,988)	(3,879)
Cash contingent consideration payable	b)	(2,660)	–
Stock appreciation rights	c)	(73)	(73)
Shareholders’ equity in accordance with U.S. GAAP		$ 213,740	$ 204,093

Statements of cash flows

For the year ended August 31, 2010, cash flows from operating activities under U.S. GAAP were $2,310,000 lower compared to those established under Canadian GAAP; this difference arose from NetHawk’s acquisition-related costs paid during this period and expensed under U.S. GAAP (see reconciliation item a) below). A corresponding difference also impacted cash flows from investing activities. In addition, under U.S. GAAP, the presentation of subtotal before change in non-cash operating items is not permitted.

For the years ended August 31, 2008 and 2009, there were no significant differences between the statements of cash flows under Canadian GAAP as compared to U.S. GAAP, except for the subtotal before change in non-cash operating items, whose presentation is not permitted under U.S. GAAP.

Reconciliation items

a) Goodwill

Under U.S. GAAP, until the adoption of SFAS 142, “Goodwill and Other Intangible Assets”, when assets being tested for recoverability were acquired in business combinations accounted for by the purchase method, the goodwill that arose in these transactions had to be included as part of the asset grouping in determining recoverability. The intangible assets tested for recoverability prior to the adoption of SFAS 142 were acquired in business combinations that were accounted for using the purchase method and, consequently, the company allocated goodwill to those assets on a pro rata basis, using the relative fair values of the long-lived assets and identifiable intangible assets acquired as determined at the date of acquisition. The carrying value of goodwill identified with the impaired intangible assets was written down before any reduction was made to the intangible assets.

Under Canadian GAAP, no allocation of goodwill was required and each asset was tested for recoverability separately based on its pre-tax undiscounted future cash flows over its expected period of use.

As a result of this difference, goodwill under U.S. GAAP was lower compared to Canadian GAAP. Consequently, the amount of goodwill impairment recorded in fiscal 2009 was lower under U.S. GAAP as compared to the amount recorded under Canadian GAAP.

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b) Business combination

The acquisition of NetHawk Oyj has been accounted for using the purchase method under CICA Handbook Section 1581, “Business Combinations”, and the requirements of Section 1600, “Consolidated Financial Statements”. Under U.S. GAAP, this acquisition has been accounted for under ASC Topic 805, “Business Combinations”, and ASC Topic 810, “Consolidation”. Accounting for business combinations under U.S. GAAP differs from CICA Handbook Section 1581. As a result, acquisition-related costs are not included as part of the purchase price but rather expensed as incurred. Consequently, acquisition-related costs of $2,842,000 were expensed during the year ended August 31, 2010 under U.S. GAAP with a corresponding reduction of goodwill. In addition, under U.S. GAAP, any contingent consideration needs to be accounted for at fair value on the acquisition date and remeasured at each reporting period, with any adjustment to its fair value recorded in the statement of earnings. Under Canadian GAAP, a contingent consideration is recorded when management can reasonably estimate the amount and the outcome of the contingency is determined beyond reasonable doubt. The fair value of the cash contingent consideration payable for this acquisition was estimated at €2,099,000 (US$2,660,000 as at August 31, 2010) and recorded in long-term liabilities under U.S. GAAP, with a corresponding increase of goodwill. The fair value of the cash contingent consideration was determined on the date of acquisition (March 12, 2010) based on management’s best estimate of sales over the next three years, and has not changed as at August 31, 2010. Any gains or losses resulting from changes in the fair value of the contingent cash consideration will be recognized in the statements of earnings. The cash contingent consideration payable estimated at closing was translated at the year-end exchange rate as at August 31, 2010.

As a result of these GAAP differences, the foreign currency translation adjustment for the year ended August 31, 2010 was $224,000 higher under U.S. GAAP compared to the amount recognized under Canadian GAAP.

c) Stock-based compensation costs related to stock appreciation rights

Under U.S. GAAP, stock-based compensation costs related to stock appreciation rights must be measured using the fair value-based method at the end of each period. The company uses the Black-Scholes options valuation model to measure the fair value of its stock appreciation rights, based on the same assumptions than those used for stock options. Changes in the fair value of these awards are charged to earnings. Under Canadian GAAP, stock appreciation rights are measured using the intrinsic value method, based on the market price of the common shares at the end of each period, and changes in the intrinsic value of these awards are charged to earnings.

d) Research and development tax credits

Under Canadian GAAP, all research and development tax credits are recorded as a reduction of gross research and development expenses in the statements or earnings. Under U.S. GAAP, tax credits that are refundable against income taxes otherwise payable are recorded in the income taxes. These tax credits amounted to $3,481,000, $4,032,000 and $3,656,000 for fiscal 2008, 2009 and 2010, respectively. This difference has no impact on the net earnings (loss) and the net earnings (loss) per share figures for the reporting years.

e) New accounting standards and pronouncements

Adopted in fiscal 2010

In June 2009, the Financial Accounting Standard Board (FASB) issued guidance now codified as Accounting Standards Codification (ASC) Topic 105, “Generally Accepted Accounting Principles”, which became the single source of authoritative U.S. accounting and reporting standards, along with rules and interpretative releases of the SEC, which are considered sources of authoritative GAAP for SEC registrants. All other non-grandfathered, non-SEC accounting literature not included in the ASC became non-authoritative. Topic 105 did not result in any accounting changes. The company adopted Topic 105 in the first quarter of fiscal 2010 and its adoption had no significant impact on its balance sheets or statements of earnings, but has and will continue to impact its reporting process by eliminating all references to pre-codification standards.

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In December 2007, the FASB issued guidance now codified as ASC Topic 805, "Business Combinations", and ASC Topic 810, "Consolidation". These new standards significantly change the accounting and reporting for business combination transactions and noncontrolling (minority) interests in consolidated financial statements. These standards require prospective application, except for the presentation of noncontrolling interests, which requires retrospective application, and were adopted concurrently for the first annual reporting period beginning on or after December 15, 2008, which for the company was September 1, 2009. The company applied the provisions of Topic 805 and Topic 810 to the acquisition of NetHawk Oyj (note 22 b).

In March 2008, the FASB issued guidance now codified as ASC Topic 815, "Derivatives and Hedging", which requires entities to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Topic 815, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. Topic 815 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The company adopted Topic 815 on September 1, 2009, and its adoption had no significant impact on its consolidated financial statements.

In April 2008, the FASB issued guidance now codified as ASC Topic 350, "Intangibles – Goodwill and Other", which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The intent of this guidance is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset under Topic 805. Topic 350 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The guidance for determining the useful life of a recognized intangible asset shall be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements shall be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. The company adopted Topic 350 on September 1, 2009, and its adoption had no significant impact on its consolidated financial statements.

In April 2009, the FASB issued guidance now codified as ASC Topic 825, "Financial Instruments", which requires disclosures about fair value of financial instruments for annual and interim reporting periods of publicly traded companies and requires those disclosures in summarized financial information at interim reporting periods. The company adopted Topic 825 on September 1, 2009, and its adoption had no significant impact on its consolidated financial statements.

In August 2009, the FASB amended ASC Topic 820, "Fair Value Measurement", to provide clarification as to how to measure the fair value of liabilities in circumstances when a quoted price in an active market for the identical liability is not available. These amendments are effective for the company in the first quarter of fiscal 2010. The company adopted these amendments on September 1, 2009, and their adoption had no significant impact on its consolidated financial statements.

Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements).

The three levels of the fair value hierarchy under topic 820 are described below:

- Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities;
- Level 2 – Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;
- Level 3 – Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

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The new requirements are equivalent to the new Canadian GAAP requirements as disclosed in notes 2 and 7.

To be adopted after fiscal 2010

In October 2009, the FASB issued guidance now codified as ASC Topic 985, "Software", to change the accounting model for revenue arrangements that include both tangible products and software elements. Under this guidance, tangible products containing software components and non-software components that function together to deliver the tangible product's essential functionality are excluded from the software revenue guidance. In addition, hardware components of a tangible product containing software components are always excluded from the software revenue guidance. This guidance is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The company will adopt this standard on September 1, 2010 and is currently evaluating the impact that this guidance may have on its consolidated financial statements.

In October 2009, the FASB amended guidance now codified as Topic 605, "Revenue Recognition", to include a consensus relating to multiple-deliverable revenue arrangements. These amendments significantly change certain guidance pertaining to revenue arrangements with multiple deliverables and modify the separation criteria of Topic 605 by eliminating the criterion for objective and reliable evidence of fair value for the undelivered products or services. The amendments also eliminate the use of the residual method of allocation and require, instead, that arrangement consideration be allocated, at the inception of the arrangement, to all deliverables based on their relative selling price. This guidance is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The company will adopt this standard on September 1, 2010, and is currently evaluating the impact that this guidance may have on its consolidated financial statements.

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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, will, expect, believe, anticipate, intend, could, estimate, continue, or the negative or comparable terminology 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 our ability to successfully integrate our acquired and to-be-acquired businesses; fluctuating exchange rates; consolidation in the global telecommunications test, measurement and service assurance industry and increased competition among vendors; capital spending levels in the telecommunications industry; concentration of sales; the effects of the additional actions we have taken in response to economic uncertainty (including our ability to quickly adapt cost structures with anticipated levels of business, ability to manage inventory levels with market demand); market acceptance of our new products and other upcoming products; limited visibility with regards to customer orders and the timing of such orders; our ability to successfully expand international operations; the retention of key technical and management personnel; and future economic, competitive, financial and market condition. 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 this 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 you that the expectations will prove to have been correct. Accordingly, you should not place undue reliance on these forward-looking statements. These statements speak only as of the date of this document. Unless required by law or applicable regulations, we undertake no obligation to revise or update any of them to reflect events or circumstances that occur after the date of this document.

The following discussion and analysis of the consolidated financial condition and results of operations is dated November 5, 2010.

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

INDUSTRY OVERVIEW

The fundamental drivers toward broadband deployments and fixed-mobile IP (Internet protocol) network convergence are firmly entrenched in the global telecommunications industry despite a slow recovery in the general economic environment. Although network operators are not significantly increasing capital expenditures in calendar 2010, they are spending more in select, high-growth areas to accommodate bandwidth-intensive broadband applications and to facilitate the migration to more flexible and cost-effective fixed and mobile IP networks.

According to Cisco’s updated Visual Networking Index, global IP traffic will quadruple from 2009 to 2014, reaching almost 64 exabytes per month in 2014. (An exabyte is equal to 1 billion gigabytes or 250 million DVDs). Global mobile traffic, a subset of this larger group, is expected to increase 39-fold during the same period. Bandwidth demand is driven by a wide range of applications including various forms of IP video, peer-to-peer file sharing, social

networking, Internet gaming as well as increased penetration of media-rich smartphones and notebooks.

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To support such explosive bandwidth growth, wireline networks are being transformed into next-generation IP-based infrastructures. Legacy SONET/SDH networks, which were established in the mid-1980s, do not have the flexibility to seamlessly mix and transport voice, data and video services. Such networks are not capable of efficiently carrying triple-play services because they were designed for point-to-point voice communication. As a result, new optical transport network (OTN) standards, which are at the very heart of what the industry is labeling next-generation IP networks, have been defined to carry IP applications over Ethernet. Network operators are increasingly turning to such next-generation, IP-based networks in order to offer customers higher-margin triple-play services while lowering their operating costs.

Fiber-to-the-home (FTTH) has also become the access network architecture of choice for wireline operators wishing to provide a superior user experience for a combined voice, data and video offering. This architecture allows operators to meet heightened bandwidth requirements and future-proof their access networks as residential bandwidth demands grow from 1 to 5 Mbit/s (megabits per second) to 30 to 100 Mbit/s required for the long term. Hybrid architectures, combining copper and fiber (fiber-to-the-curb, or FTTC, and fiber-to-the-node, or FTTN), will also increase in the short term, since they are less expensive methods to increase bandwidth and can be mass-deployed quickly.

As bandwidth growth in access networks continues to increase, it has begun placing a strain on metro rings and core networks. It is also driving the need for higher-speed technologies. For example, 43 Gbit/s (gigabits per second) SONET/SDH is becoming mainstream, while a few network operators have already begun 100 Gbit/s Ethernet field trials. In the long run, these solutions will offer a more economical way to add capacity to saturated network links, especially if trenches need to be dug in order to deploy new fiber in metro and long-distance routes.

On the wireless side, operators are also faced with major investments in upcoming years to meet soaring bandwidth demand. Wireless operators are accelerating deployments of 3G networks, fast-tracking 4G/LTE (long-term evolution) adoption, and investing in mobile backhaul networks in order to increase transmission rates for bandwidth-hungry consumers to approach wireline speeds. Furthermore, as these consumers expect wireline and wireless networks to transport any content to any device at any time, both fixed and mobile networks are converging to a common IP-based infrastructure supported by IMS (IP multimedia subsystem) for seamless network interoperability.

These market dynamics affected telecom test and service assurance suppliers in fiscal 2010.

COMPANY OVERVIEW

We are a leading provider of test and service assurance solutions for wireless and wireline network operators and network equipment manufacturers in the global telecommunications industry. We offer core-to-edge solutions to assess the performance and reliability of converged IP (Internet protocol) fixed and mobile networks. Our products are sold in approximately 100 countries around the world.

We were founded in 1985 in Quebec City, Canada. Our original products were focused on the needs of installers and operators of fiber-optic networks. Customers use these field-portable testing products for the installation, maintenance, monitoring and troubleshooting of optical networks. In 1996, we supplemented our product portfolio with an extensive line of high-end products that are mainly dedicated to research and development as well as manufacturing activities of optical component manufacturers and system vendors. Over the past several years, we have enhanced our competitive position through acquisitions of protocol, copper/xDSL and service assurance test businesses for the wireless and wireline telecommunications industry.

In the fourth quarter of 2010, we engaged in a plan to sell our Life Sciences and Industrial Division to focus our activities in the telecom test and service assurance market. We announced and closed the sale of that Division on October 1, 2010 for a selling price of $24.3 million. Consequently, this Division has been considered as an operation held for sale and presented as discontinued operations in our consolidated financial statements. Related assets and liabilities have been reclassified as assets held for sale and liabilities related to assets held for sale and revenues and expenses have been reclassified from continuing operations to discontinued operations for all reporting years. The Life Sciences and Industrial Division included the operations of EFOS Inc. (renamed EXFO Photonic Solutions Inc.), acquired in March 2001 for its precision light-based, adhesive spot-curing technology as well as most of the operations of Burleigh Instruments, Inc. (renamed EXFO Burleigh Products Group Inc.), acquired in December 2000 for its wavelength measurement instruments and nanopositioning alignment systems, which were consolidated since then with those of EXFO Photonic Solutions Inc. The operations of that Division are located in Toronto, Canada.

On March 12, 2010, we acquired 91% of the issued and outstanding common shares of NetHawk Oyj (NetHawk). Headquartered in Oulu, Finland, NetHawk was a privately owned company providing 2G, 3G and 4G/LTE protocol analyzers and simulators aimed mostly at network equipment manufacturers and wireless network operators. On March 15, 2010, we made a voluntary offer to purchase the remaining issued and outstanding shares; this offer expired on April 30, 2010. Simultaneously, we entered into a statutory procedure under the Finnish Companies Act by which we acquired the remaining of the issued and outstanding common shares that were not tendered under the voluntary offer. Total consideration was comprised of a cash consideration of €37.3 million (US$51.1 million), including acquisition-related costs of $2.8 million, or €25.1 million (US$34.4 million), excluding NetHawk’s cash of €12.1 million (US$16.7 million) at the acquisition date, plus a cash contingent consideration of up to €8.7 million (US$11.0 million) based on a certain sales volume of NetHawk products over the three years following the acquisition. The cash contingent consideration will be accounted for as additional goodwill when the amounts of any contingent consideration can be reasonably estimated and the outcome of the contingency is resolved. Acquisition-related costs include an amount of $780,000 for a statutory transfer tax payable in Finland based on the purchase price of shares.

In February 2009, we closed the acquisition of Sweden-based PicoSolve Inc., a supplier of ultra-high-speed optical sampling oscilloscopes for 40G and 100G research and development, manufacturing and deployment applications.

In April 2008, we acquired all issued and outstanding shares of Brix Networks Inc. (renamed EXFO Service Assurance Inc.), for a cash consideration of $32.1 million. Brix Networks, a privately held company located in the Boston, MA area, offers VoIP and IPTV service assurance solutions across the three areas most affecting the success of a real-time service: signaling quality (signaling path performance), delivery quality (media transport performance) and content quality (overall quality of experience). Brix Networks’ service assurance solutions are mainly designed for network service providers (NSPs) and large enterprises.

In March 2008, we acquired all issued and outstanding shares of Navtel Communications Inc., for a cash consideration of $11.3 million. Navtel Communications, a privately held company in Toronto, Canada, is a leading provider of Internet protocol multimedia subsystem (IMS) and VoIP test solutions for network equipment manufacturers (NEMs) and NSP labs. Navtel Communications specializes in testing next-generation IP networks that are increasingly combining wireline and wireless technologies. Subsequent to the acquisition, Navtel Communications was merged into the parent company.

In fiscal 2008, we opened our own manufacturing facilities in Shenzhen, China. With the recent acquisition of NetHawk, which has manufacturing activities in Oulu, Finland, we now have three main manufacturing sites, including our plant in Quebec City. In addition, since fiscal 2008, we have been accelerating the deployment

of a software development center in Pune, India. With the recent acquisition of NetHawk, which has a software development center in Bhubaneswar, India, we now have two development centers in India. This enables us to benefit from the wealth of IP expertise in India, to accelerate product development especially for our wireless and wireline software-intensive protocol test and service assurance solutions to take advantage of a lower cost structure. These two R&D centers also supplement the research and development capabilities of our labs in Boston, Toronto, Montreal and Quebec City, as well as in Oulu, Lappeenranta and Dallas from NetHawk.

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In January 2006, we acquired substantially all the assets of Consultronics Limited (now merged with the parent company), a leading supplier of test equipment for copper-based broadband access networks, for a total cash consideration of $19.1 million. Above and beyond copper/xDSL test solutions, Consultronics had a rich product portfolio for testing next-generation technologies, such as IPTV and VoIP, which are critical for NSPs in their deployment of triple-play services (voice, data, video) over optical and copper links in access networks.

In November 2001, we acquired Avantas Networks Corporation (renamed EXFO Protocol Inc. and now merged with the parent company), a supplier of protocol-testing and optical-network performance management equipment for NSPs. This transaction enabled us to combine optical and protocol test modules inside a single field-portable test platform in order to help our customers increase revenues and reduce operating costs. In October 2002, our wholly-owned subsidiary, EXFO Gnubi, purchased substantially all the assets of gnubi communications, L.P., a supplier of multichannel telecom and datacom testing solutions for the system manufacturer market. EXFO Protocol and EXFO Gnubi were consolidated in Montreal, Canada, in fiscal 2004.

We launched 20 new products in fiscal 2010, including four in the fourth quarter, compared to 26 in fiscal 2009. Key product introductions in fiscal 2010 included among others a new service assurance solution for 4G/LTE mobile networks; an end-to-end IP video service assurance solution; a new standards-based test methodology (EtherSAM) across EXFO’s Ethernet product offering for Carrier Ethernet and mobile backhaul service deployments; a high-resolution optical spectrum analyzer (OSA) for in-depth characterization of optical networks with narrow channel spacing; and an optical modulation analyzer for complete characterization of signals up to 100G. Following the year-end, we released the new FTB-1 platform, a handheld unit optimized for fiber-to-the-home (FTTH) and Ethernet test applications.

We reported record-high sales of $202.8 million for our continuing operations (formerly our Telecom Division) in fiscal 2010, which represented an increase of 32.4% year-over-year. Sales for fiscal 2010 included $14.5 million from newly acquired NetHawk since its acquisition on March 12, 2010. NetHawk’s sales for the period were reduced by $1.3 million to account for an adjustment to deferred revenue in the purchase price allocation. In addition, in fiscal 2010, we believe that we gained market share and we benefited from improving economic and market conditions that mainly contributed to the increase of our sales of optical and copper-access test solutions year-over-year. Also, in fiscal 2010, we recorded in our sales foreign exchange gains on our forward exchange contracts of $1.5 million, compared to foreign exchange losses of $3.2 million in 2009, which contributed to the increase of our sales of $4.7 million year-over-year. Finally, our strong product offering contributed to the increase of our sales year-over-year. In fact, our sales in fiscal 2010 were positively impacted by the recent launches of certain key new products such as the portable test solution for characterizing 100 Gbit/s Ethernet and 40/43 Gbit/s SONET/OTN networks, the FTB-5600 Distributed PMD Analyzer, the new software releases for the IMS InterWatch platform and Packet Blazer product lines that support the migration of voice and video applications to the IPv6 (Internet protocol, version 6), the next-generation FTB-500 multilayer platform, the AXS-200/635 triple-play tester and the optical modulation analyzer for complete characterization of signals up to 100 GBd. Excluding the positive impact of the acquisition of NetHawk and the foreign exchange gains on our forward exchange contracts, our sales would have increased 19.5% year-over-year organically.

We reported GAAP earnings from continuing operations before extraordinary gain of $3.6 million, or $0.06 per diluted share, in fiscal 2010, compared to a loss of $20.9 million, or $0.34 per share, in 2009. Earnings from continuing operations before extraordinary gain for fiscal 2010 included $6.5 million in after-tax amortization of intangible assets and $1.7 million in stock-based compensation costs. Loss from continuing operations before extraordinary gain for fiscal 2009 included a pre-tax impairment of goodwill of $21.7 million and a pre-tax charge of $1.0 million in severance expenses for the 58 employees who were terminated throughout the company. It also included $3.0 million in after-tax amortization of intangible assets and $1.3 million in stock-based compensation

costs.

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EBITDA (including continuing and discontinued operations) were at $27.3 million, or 12.0% of sales in fiscal 2010, compared to $14.5 million, or 8.4% of sales in 2009. EBITDA for fiscal 2009 included pre-tax charges of $1.2 million in severance expenses for the 65 employees who were terminated throughout the company and stock-based compensation costs of $1.4 million ($1.8 million in 2010). However, EBITDA for 2009 included a pre-tax research and development tax credits recovery of $1.9 million. EBITDA represent net earnings (loss) before interest, income taxes, amortization of property, plant and equipment, amortization of intangible assets, impairment of goodwill and extraordinary gain; see further in this document for a comprehensive reconciliation of EBITDA to GAAP net earnings (loss).

In fiscal 2010, we faced a substantial increase in the value of the Canadian dollar versus the US dollar, the euro and the British pound compared to 2009; this had a two-fold negative impact on our financial results. Firstly, the average value of the Canadian dollar versus the US dollar increased 12.8% in fiscal 2010, compared to 2009. Given that most of our sales are denominated in US dollars but a significant portion of our expenses are denominated in Canadian dollars, our financial results were negatively affected as these expenses (denominated in Canadian dollars) increased when translated in US dollars for reporting purposes in fiscal 2010.

Secondly, we recorded a foreign exchange loss of $1.5 million in fiscal 2010, which mainly represents the effect of the increase in the period-end value of the Canadian dollar versus the US dollar, the euro and the British pound on our balance sheet items during that year. In comparison, in fiscal 2009, we reported a foreign exchange gain of $1.1 million following the decrease in the value of the Canadian dollar compared to the US dollar during that year.

On November 6, 2009, we announced that our Board of Directors had authorized the second renewal of our share repurchase program, by way of a normal course issuer bid on the open market, of up to 10% of our public float (as defined by the Toronto Stock Exchange), or 2.3 million subordinate voting shares, at the prevailing market price. The period of the normal course issuer bid started on November 10, 2009, and ended on November 9, 2010. All shares repurchased under the bid were cancelled. In fiscal 2010, we have repurchased 3,600 shares for a total redemption price of $14,000.

On November 5, 2010 we announced that our Board of Directors approved the third renewal of our share repurchase program, by way of a normal course issuer bid on the open market of up to 10% of our public float (as defined by the Toronto Stock Exchange), or 2.0 million of subordinate voting shares at the prevailing market price. We expect to use cash, short-term investments or future cash flow from operations to fund the repurchase of shares. The normal course issuer bid will start on November 10, 2010, and will end on November 9, 2011, or on an earlier date if we repurchase the maximum number of shares permitted under the bid. The program does not require that we repurchase any specific number of shares, and it may be modified, suspended or terminated at any time and without prior notice. All shares repurchased under the bid will be cancelled. We shall provide to any person or company, upon request to our Secretary, at 400 Godin Avenue, Quebec, Province of Quebec, Canada, G1M 2K2, phone number (418) 683-0913 ext. 3704 or fax number (418) 683-9839 a copy of the notice sent to the Toronto Stock Exchange (TSX) according to our normal course issuer bid.

Sales

We sell our products to a diversified customer base in approximately 100 countries through our direct sales force and channel partners like sales representatives and distributors. Most of our sales are denominated in US dollars and euros.

In fiscal 2008 and 2010, no customer accounted for more than 10% of our sales, with our top customer representing 8.4% and 4.9% of our sales, respectively. In fiscal 2009, our top customer accounted for 13.1% of sales.

We believe that we have a vast array of products, a diversified customer base, and a good spread across geographical areas, which provides us with reasonable protection against the concentration of sales and credit risk.

Cost of Sales

The cost of sales includes raw materials, salaries and related expenses for direct and indirect manufacturing personnel (net of government grants), as well as overhead costs. Excess, obsolete and scrapped materials are also included in the cost of sales. However, the cost of sales is exclusive of amortization, which is shown separately in the statements of earnings.

Operating Expenses

We classify our operating expenses into three main categories: selling and administrative expenses, research and development expenses, and amortization expenses.

Selling and administrative expenses consist primarily of salaries and related expenses for personnel, sales commissions, travel expenses, marketing programs, professional services, information systems, human resources and other corporate expenses.

Gross research and development expenses consist primarily of salaries and related expenses for engineers and other technical personnel, material component costs as well as fees paid to third-party consultants. We are eligible to receive research and development tax credits and grants on research and development activities carried out in Canada and Finland. All related research and development tax credits and grants are recorded as a reduction of gross research and development expenses.

OUR STRATEGY, KEY PERFORMANCE INDICATORS AND CAPABILITY TO DELIVER RESULTS

Three-Year Strategic Objectives

Our goal is to become the market leader in the global telecom test and service assurance industry. Given the emergence of IP video, social networking and media-rich smartphones, wireless and wireline network operators and equipment manufacturers are faced with a major spending cycle to meet soaring bandwidth demand on their converged, IP fixed and mobile networks.

To achieve our long-term vision, we plan to:

- Capitalize on bandwidth explosion in the telecom industry with the introduction of innovative, market-driven test and service assurance solutions;
- Focus on the convergence of IP fixed and mobile networks, including emerging technologies like 4G/LTE and high-speed Ethernet;
- Leverage our leadership in optical testing for new opportunities like wireless backhaul, fiber-to-the-home, and 40G and 100G network upgrades;
- Move up the IP networks value chain by leveraging the intelligence, or computing capacities, of our modular test platforms with our service assurance systems to develop a series of value-added solutions; and
- Accelerate profitability through globalization and execution.

In our fiscal 2009 Annual Report, we established three corporate performance objectives to gauge the success of our overall plan over the next three years (2010-2012):

- Increase sales by a CAGR* of 20% or more
- Raise gross margin to 64%
- Double EBITDA** in dollars

* Compound annual growth rate

**EBITDA is defined as net earnings (loss) before interest, income taxes, amortization of property, plant and equipment, amortization of intangible assets, impairment of goodwill and extraordinary gain.

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However, in fiscal 2010, following the recent acquisition of NetHawk and the divestiture of our Life Sciences and Industrial Division following the year-end, we updated our corporate performance objectives for the same three-year period extending from fiscal 2010 to 2012:

- Increase sales by a CAGR of at least 25%
- Raise gross margin to 65%
- Increase EBITDA in dollars by a CAGR of at least 30%

These three-year objectives were established based on results achieved in the past few years as well as on our strategic plan for the next three years. We are witnessing a period of significant investments in the telecom industry and we believe we are well-positioned to take advantage of the wealth of growth opportunities—from the network core to the edge. Namely, we expect to benefit from high-growth sectors like 4G/LTE applications, wireless backhaul, fiber-to-the-home, Carrier Ethernet, as well as 40G and 100G network upgrades to bolster sales and earnings. These objectives will guide our actions in upcoming years as we are committed to maximizing shareholder value.

Results Achieved in Fiscal 2010

Our corporate performance objectives were established and updated taking into account the sales and operating results of our Life Sciences and Industrial Division, which are now presented as discontinued operations in our GAAP figures for fiscal 2008, 2009 and 2010. As such, sales and operating results of that Division were included in the results achieved in fiscal 2010.

In fiscal 2010, sales including those of the discontinued operations increased 32.0% compared to 2009. Our gross margin, including the effect of the discontinued operations, reached 62.4%, 1.1% higher compared to 61.3% in 2009. Finally, EBITDA, including the results of the discontinued operations, amounted to $27.3 million, or 12.0 % of sales in fiscal 2010, representing an increase of 88.8% compared to 2009. See further in this document for a reconciliation of the GAAP sales and GAAP gross margin to the global sales and global gross margin, including the effect of the discontinued operations and a reconciliation of GAAP net earnings (loss) to EBITDA.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's discussion and analysis of financial conditions and results of operations is based on our consolidated financial statements. As previously mentioned, they have been prepared in accordance with Canadian GAAP. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting years. On an ongoing basis, we evaluate these estimates and assumptions, including those related to the fair value of financial instruments, the allowance for doubtful accounts receivable, the amount of tax credits recoverable, the provision for excess and obsolete inventories, the estimated useful lives of capital assets, the valuation of long-lived assets, the impairment of goodwill, the valuation allowance of future income tax assets, the amount of certain accrued liabilities and deferred revenue as well as stock-based compensation costs. We base our estimates and assumptions on historical experience and on other factors that we believe to be reasonable under the circumstances, the result of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates.

The following summarizes our critical accounting policies as well as other policies that require the most significant judgment and estimates in the preparation of our consolidated financial statements.

Revenue recognition. For products in which software is incidental, we recognize revenue when persuasive evidence of an arrangement exists, the product has been delivered, the price is fixed or determinable, and collection of the resulting receivable is reasonably assured. Provisions are made for estimated returns, warranties and support obligations.

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For products in which software is not incidental, revenues are separated into two categories: product and post-contract customer support (PCS) revenues, based upon vendor-specific objective evidence of fair value. Product revenues for these sales are recognized as described above. PCS revenues are deferred and recognized ratably over the years of the support arrangement. PCS revenues are recognized at the time the product is delivered when provided substantially within one year of delivery, the costs of providing this support are insignificant (and accrued at the time of delivery) and no (or infrequent) software upgrades or enhancements are provided.

Maintenance contracts generally include the right to unspecified upgrades and enhancements on a when-and-if-available basis and ongoing customer support. Revenue from these contracts is recognized ratably over the terms of the maintenance contracts on a straight-line basis.

Revenue for extended warranties is recognized on a straight-line basis over the warranty period.

For all sales, we use a binding purchase order as evidence that a sales arrangement exists.

Delivery generally occurs when the product is handed over to a transporter for shipment.

At the time of the transaction, we assess whether the price associated with our revenue transaction is fixed or determinable, and whether or not collection is reasonably assured. We assess whether the price is fixed or determinable based on the payment terms associated with the transaction. We assess collection based on a number of factors, including past transaction history and the creditworthiness of the customer. Generally, collateral or other security is not requested from customers.

Sales arrangements may include acceptance clauses. When a sales arrangement does include an acceptance provision, acceptance occurs upon the earliest of the receipt of a written customer acceptance or the expiration of the acceptance period. For these sales arrangements, the sale is recognized when acceptance occurs.

Allowance for doubtful accounts. We estimate collectability of accounts receivable on an ongoing basis by reviewing balances outstanding over a certain period of time. We determine our allowance for doubtful accounts receivable based on our historical accounts receivable collection experience and on the information that we have about the status of our accounts receivable balances. If the financial conditions of our customers deteriorate, resulting in an impairment of their ability to make required payments, additional allowance may be required, which could adversely affect our future results.

Reserve for excess and obsolete inventories. We state our inventories at the lower of cost, determined on an average cost basis, and net realizable value, and we provide reserves for excess and obsolete inventories. We determine our reserves for excess and obsolete inventories based on the quantities we have on hand versus expected needs for these inventories, so as to support future sales of our products. Expected needs are usually estimated over a twelve-month period. It is possible that additional inventory reserves may occur if future sales are less than our forecasts or if there is a significant shift in product mix compared to our forecasts, which could adversely affect our future results.

Research and development tax credits and government grants. We record research and development tax credits and government grants based on our interpretation of tax laws and grant programs, especially regarding related eligible projects and expenses, and when there is reasonable assurance that we have complied and will continue to comply with all conditions and laws. Also, our judgment and estimates are based on historical experience. It is possible, however, that the tax authorities or the sponsors of the grant programs have a different interpretation of laws and application of conditions related to the programs or that we do not comply with all conditions related

to grants in the future, which could adversely affect our future results. Furthermore, a significant part of our research and development tax credits are refundable against income taxes payable, causing their ultimate realization to be dependent upon the generation of taxable income. If we obtain information that causes our forecast of future taxable income to change or if actual taxable income differs from our forecast, we may have to revise the carrying value of these tax credits, which would affect our results in the period in which the change was made.

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Impairment of long-lived assets and goodwill. Long-lived assets are reviewed for impairment when events or circumstances indicate that cost may not be recoverable. Impairment exists when the carrying amount of an asset, or a group of assets is greater than the undiscounted future cash flows expected to be provided by the asset or the group of assets. The amount of impairment loss, if any, is the excess of the carrying value over the fair value. We assess fair value of long-lived assets based on discounted future cash flows.

We assess impairment of goodwill on an annual basis, or more frequently, if events or circumstances indicate that it might be impaired. Recoverability of goodwill is determined at the reporting unit level, using a two-step approach. First, the carrying value of a reporting unit is compared to its fair value, which is usually determined based on a combination of discounted future cash flows and a market approach. If the carrying value of a reporting unit exceeds its fair value, the second step is performed. In this step, the amount of impairment loss, if any, represents the excess of the carrying value of goodwill over its fair value, and the loss is charged to earnings in the period in which it is incurred. For the purposes of this impairment test, the fair value of goodwill is estimated in the same way as goodwill is determined in business combinations; that is, the excess of the fair value of a reporting unit over the fair value of its net identifiable assets. Future discounted cash flows may be lower than expected and our stock price may decrease to a level that would cause the fair value of our reporting units to be lower than their carrying value. This may lead to goodwill impairment loss in the future.

Future income taxes. We provide for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement values and tax values of assets and liabilities as well as the carry-forward of unused tax losses and deductions, using substantively enacted income tax rates expected for the years in which the assets are expected to be realized or the liabilities to be settled. In assessing the recoverability of our future income tax assets, we consider whether it is more likely than not that some or all of the future income tax assets will not be realized. The ultimate realization of our future income tax assets is dependent upon the generation of sufficient future taxable income during the periods in which those assets are expected to be realized.

Stock-based compensation costs. We account for all forms of employee stock-based compensation using the fair value-based method. This method requires that we make estimates about the expected volatility of our shares, the expected life of the awards and the forfeiture rate.

New accounting standards and pronouncements

Adopted in fiscal 2010

In February 2008, the Canadian Institute of Chartered Accountants (CICA) issued Section 3064, "Goodwill and Intangible Assets", which supersedes Section 3062, "Goodwill and Other Intangible Assets", and Section 3450, "Research and Development Costs". Various changes have been made to other sections of the CICA Handbook for consistency purposes. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill remain unchanged from the standards included in Section 3062. This new section applies to fiscal years beginning on or after October 1, 2008. We adopted this new standard on September 1, 2009, and its adoption had no material effect on our consolidated financial statements.

In June 2009, the CICA amended section 3862, "Financial Instruments – Disclosures", to include enhanced disclosures on liquidity risk of financial instruments and new disclosures on fair value measurements of financial instruments. The amendments apply to fiscal years ending after September 30, 2009, with early adoption permitted. Section 3862 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The

hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under Section 3862 are described below:

- Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities;

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- Level 2 – Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;

- Level 3 – Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

We adopted these amendments on September 1, 2009, and their adoption had no measurement impact on our consolidated financial statements.

To be adopted after fiscal 2010

In January 2009, the CICA issued Section 1582, "Business Combinations", which replaces Section 1581, "Business Combinations". This new section establishes the standards for the accounting of business combinations and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent consideration and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This standard applies prospectively to business combinations with acquisition dates on or after September 1, 2011; earlier adoption is permitted.

In January 2009, the CICA issued Section 1601, "Consolidated Financial Statements", which replaces Section 1600, "Consolidated Financial Statements", and establishes the standards for preparing consolidated financial statements. This new section applies to fiscal years beginning on or after January 1, 2011; earlier adoption is permitted. We have not yet determined the impact that adopting this standard will have on our consolidated financial statements.

In January 2009, the CICA issued Section 1602, "Non-controlling Interests", which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. This new section applies to fiscal years beginning on or after January 1, 2011; earlier adoption is permitted as of the beginning of a fiscal year.

Should we decide to adopt one of these three new sections earlier, we must adopt all three at the same date.

In December 2009, the CICA's Emerging Issues Committee (EIC) issued EIC-175, "Multiple Deliverable Revenue Arrangements", which will be applicable prospectively (with retrospective adoption permitted) to revenue arrangements with multiple deliverables entered into or materially modified in the first annual period beginning on January 1, 2011. EIC-175 amends the guidance contained in EIC-142, "Revenue Arrangements with Multiple Deliverables", and establishes additional requirements regarding revenue recognition related to multiple deliverables as well as supplementary disclosures. We will adopt this standard on September 1, 2010 and we are currently evaluating the impact that EIC-175 will have on our consolidated financial statements.

In February 2008, the Canadian Accounting Standards Board announced that Canadian GAAP, as used by publicly accountable enterprises, will be converged with the International Financial Reporting Standards (IFRS) as issued by the International Accounting Standard Board (IASB). Accordingly, we will adopt these standards during our fiscal year beginning on September 1, 2011 and we will be required to report under IFRS and to provide IFRS comparative information for the fiscal year ending on August 31, 2011. Although the conceptual framework of IFRS is similar to Canadian GAAP, there are significant differences on recognition, measurement and disclosures.

As part of the IFRS conversion project, we have set up an IFRS-dedicated team at different levels of the organization and have also retained the service of an external expert advisor to assist us. A process for reporting regular progress to

senior management and to the Audit Committee on the status of the IFRS conversion project has been established.

The conversion project consists of four phases.

- Diagnostic phase – This phase involves an initial scoping of significant accounting differences between Canadian GAAP and IFRS, a preliminary evaluation of IFRS 1 exemptions for first-time IFRS adopters, and a high-level assessment of potential consequences on financial reporting, business processes, internal controls and information systems.

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- Design and Solutions Development phase – This phase involves a detailed analysis of identified accounting treatment differences, reviewing and approving accounting policy choices, performing a detailed impact assessment and designing changes to systems and business processes, developing IFRS training material, and drafting IFRS financial statement content.

- Implementation phase – This phase involves embedding changes to systems, business processes and internal controls, determining the opening IFRS transition balance sheet and tax impacts, parallel accounting under Canadian GAAP and IFRS, and preparing detailed reconciliations of Canadian GAAP to IFRS financial statements.

- Post-Implementation phase – This phase involves conversion assessment, evaluating improvements for a sustainable operational IFRS model, and testing the internal controls environment.

We have completed the Diagnostic phase to assess and scope the significant differences between existing Canadian GAAP and IFRS as well as the impact on our consolidated financial statements.

We are currently completing the Design and Solutions Development phase to evaluate the overall impact of adopting these new standards on our consolidated financial statements. Following the Diagnostic phase, we have initiated a detailed analysis of the accounting policies affected by the adoption of IFRS, which is expected to be completed throughout calendar 2010.

Significant differences with respect to recognition, measurement, presentation and disclosure of financial information are expected to be in the following key accounting areas:

Key accounting areas		Differences with potential impact
Hedge accounting	·	IAS 39, "Financial Instruments: Recognition and Measurement", does not permit to use the shortcut method to assess hedge effectiveness of hedging relationships. We have elected to use the dollar-offset method, as permitted by IFRS, to assess the effectiveness of our cash flow hedges and we will recalculate the effectiveness with this new method, which may potentially result into ineffectiveness that did not exist under the previous method. However, we do not anticipate significant reclassification of hedge relationships. The review of our documentation was completed as at September 1, 2010, being the transition date.
Presentation of financial statements	·	Under IAS 1, "Presentation of Financial Statements", expenses must be classified by their nature or by their function in the income statement. We elected to present our income statement by function. Accordingly, upon the adoption of IFRS, amortization expenses will be allocated to function rather than being showed as separate lines in the income statement as currently permitted under Canadian GAAP.
Impairment of assets	·	IAS 36, "Impairment of Assets", requires a single-step approach for impairment testing of individual assets or a group of assets in cash generating units (CGUs) on the basis of independent cash inflows whereas Canadian GAAP uses a two-step approach. However, we do not anticipate significant additional impairment due to that one-step approach.

Property, plant and equipment	·	IAS 16, "Property, Plant and Equipment", reinforces the requirement under Canadian GAAP that requires that each part of property, plant and equipment that has a cost that is significant in relation to the overall cost of the item should be depreciated separately. Based on the analysis of our property, plant and equipment, we do not expect additional componentization under IFRS.

Key accounting areas	Differences with potential impact
Leases	· Under IAS 17, "Leases", a lease is classified as either a finance lease or an operating lease. Lease classification depends on whether substantially all the risks and rewards incidental to ownership of the leased assets have been transferred from the lessor to the lessee, and is made at inception of the lease. A number of indicators are used to assist in lease classification; however, quantitative thresholds are not offered as indicators as under current Canadian GAAP. We reviewed all existing significant leases, which are classified as operating leases under Canadian GAAP, and concluded that their classification is in accordance with IAS 17.
Translation of foreign operations	· Under IAS 21, "The Effects of Changes in Foreign Exchange Rates", for foreign entities with the same functional currency as the parent company, the corresponding exchange difference is recognized in the statement of earnings of that entity; and for foreign entities with a functional currency other than the functional currency of the parent company, the corresponding exchange differences should be recognized in a separate component of other comprehensive income. We assessed the functional currency of our foreign operations and concluded that the adoption of IAS 21 will have no impact on our consolidated financial statements.
Business combinations	· As permitted by IFRS 1, "First Time Adoption of International Financial Reporting Standards (IFRS)", we will not apply IFRS 3, "Business Combinations", to business combinations completed before the transition date, that is, September 1, 2010.

This is not an exhaustive list of all the impacts that could occur during the conversion to IFRS. Additionally, we are completing an IFRS financial statement in accordance with IAS 1, "Presentation of Financial Statements". In addition, we analyzed the effects on information technology and internal controls and we do not foresee any significant modifications to our information technology and data systems and internal controls.

In addition, some transitional options permitted under IFRS were analyzed. In most cases, we will opt for a prospective application when the choice is available, namely for business combinations as described above.

We have provided training for key employees and stakeholders. Additional training will be ongoing as necessary until full adoption in fiscal 2012.

As IASB work plan anticipates the completion of several significant projects in calendar years 2010 and 2011, we continue to track the progress of these projects. However, it is difficult to predict the IFRS that will be effective at the end of our first IFRS reporting period. Our decisions may change if previously unconsidered new standards or amendments are introduced before our changeover date.

Our IFRS project is progressing according to plan, and we will provide updates as further progress is achieved and conclusions are reached.

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RESULTS OF OPERATIONS

The following table sets forth Canadian GAAP consolidated financial statements data in thousands of US dollars, except per-share data, and as a percentage of sales for the years indicated:

Consolidated statements of earnings data:	2010	2009	2008	2010	2009	2008
Sales	$202,757	$153,082	$160,981	100.0 %	100.0 %	100.0 %
Cost of sales (1)	73,901	57,897	64,364	36.4	37.8	40.0
Gross margin	128,856	95,185	96,617	63.6	62.2	60.0
Operating expenses						
Selling and administrative	66,612	58,067	54,869	32.9	37.9	34.1
Net research and development	37,847	27,213	24,580	18.7	17.8	15.3
Amortization of property, plant and equipment	5,757	4,453	4,137	2.8	2.9	2.6
Amortization of intangible assets	7,773	5,033	3,862	3.8	3.3	2.3
Restructuring charges	–	963	–	–	0.6	–
Impairment of goodwill	–	21,713	–	–	14.2	–
Total operating expenses	117,989	117,442	87,448	58.2	76.7	54.3
Earnings (loss) from operations	10,867	(22,257)	9,169	5.4	(14.5)	5.7
Interest income (expense), net	(292)	592	4,381	(0.1)	0.4	2.7
Foreign exchange gain (loss)	(1,496)	1,074	404	(0.8)	0.7	0.3
Earnings (loss) before income taxes	9,079	(20,591)	13,954	4.5	(13.5)	8.7
Income taxes						
Current	715	587	(7,154)	0.4	0.4	(4.5)
Future	4,814	(321)	12,815	2.3	(0.2)	8.0
Recognition of previously unrecognized future income tax assets	–	–	(5,324)	–	–	(3.3)
	5,529	266	337	2.7	0.2	0.2
Earnings (loss) from continuing operations before extraordinary gain	3,550	(20,857)	13,617	1.8 %	(13.6) %	8.5 %
Net earnings from discontinued operations	3,069	4,272	1,771			
Earnings (loss) before extraordinary gain	6,619	(16,585)	15,388			
Extraordinary gain	–	–	3,036			
Net earnings (loss) for the year	$6,619	$(16,585)	$18,424			
Basic and diluted earnings (loss) from continuing operations before extraordinary gain per share	$0.06	$(0.34)	$0.20			

Basic and diluted net earnings (loss) per share	$0.11	$(0.27)	$0.27			
Research and development data:						
Gross research and development	$44,551	$33,584	$30,167	22.0 %	21.9 %	18.7 %
Net research and development	$37,847	$27,213	$24,580	18.7 %	17.8 %	15.3 %
Consolidated balance sheets data:						
Total assets	$273,502	$240,371	$293,066			

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

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RESULTS FROM CONTINUING OPERATIONS (formerly the Telecom Division)

SALES

Fiscal 2010 vs. 2009

In fiscal 2010, our sales increased 32.4% to a record-high $202.8 million, compared to $153.1 million in 2009.

The following table summarizes information about our sales for the years ended August 31, 2009 and 2010, in thousands of US dollars:

	Year ended August 31, 2010	Year ended August 31, 2009	Change in $	Change in %
Sales	$ 202,757	$ 153,082	$49,675	32.4 %
(Gains) losses on forward exchange contracts	(1,517)	3,178	(4,695)	
Sales, excluding gains/losses on forward exchange contracts (non-GAAP measure)	201,240	156,260	44,980	28.8
Impact of the recent acquisition (NetHawk)	(14,483)	–	(14,483)	
Organic sales (non-GAAP measure)	$ 186,757	$ 156,260	$30,497	19.5 %

See further in this document for information about non-GAAP financial measures.

First, in fiscal 2010, we believe we gained market share, namely in the optical and copper-access space, which contributed to the increase of our sales year-over-year.

In addition, in fiscal 2010, NetHawk, which was acquired on March 12, 2010, contributed about five and a half months to our sales, which caused them to increase $14.5 million year-over-year. NetHawk's sales for this period were reduced by $1.3 million to account for an adjustment to deferred revenue in the purchase price allocation. NetHawk contributed to the increase of our sales of protocol test solutions year-over-year.

Furthermore, in fiscal 2010, we benefited from improving economic and market conditions following the global economic recession that negatively affected our sales in fiscal 2009, allowing customers to invest in their networks in order to accommodate bandwidth-intensive applications and to facilitate the migration to more flexible and cost-effective fixed and mobile IP architectures. In 2009, many network operators delayed capital-intensive deployment decisions on FTTx rollouts and capacity expansion, opting to increase speed rather than digging trenches to add new fiber-optic cables. However, in fiscal 2010, network operators restarted investing worldwide in capital-intensive deployments and capacity expansion on the basis of the current recovery in the telecom market. These improved market conditions mainly contributed to the increase of our sales of optical and copper-access test solutions.

Finally, in fiscal 2010, we recorded in our sales foreign exchange gains of $1.5 million on our forward exchange contracts, compared to foreign exchange losses of $3.2 million in 2009, which contributed to the increase of our sales of $4.7 million year-over-year.

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In terms of product lines, we reported a sales increase of 43.3% for our protocol test solutions, as they reached a record-high $78.7 million, compared to $54.9 million in 2009. Sales of protocol test solutions in fiscal 2010 included the $14.5 million contribution of newly acquired NetHawk. Excluding sales of newly acquired NetHawk, our sales of protocol test solutions would have increased 16.9% in fiscal 2010 compared to 2009 on the strength of improved market and economic conditions year-over-year. On the other hand, sales of fiscal 2009 included $6.7 million worth of orders shipped to a Tier-1 North American wireless operator for our service assurance solutions. In fiscal 2010, we did not have such a large single order from that customer.

Sales of our optical test solutions increased 14.2% to $109.1 million in fiscal 2010 compared to $95.5 million in 2009. Improved market and economic conditions year-over-year resulted in higher sales in fiscal 2010 as we almost came back to the pre-recession level of 2008. In addition, we believe we gained market share in fiscal 2010. Furthermore, year-end budget flush-outs from some of our customers caused our sales to increase in fiscal 2010, compared to the same period last year. In fiscal 2009, we did not have such level of year-end budget flush-outs as they may vary significantly from year to year. Finally, our sales of fiscal 2010 were positively impacted by the recent launch of significant new products such as our patent-pending distributed PMD analyzer, our next-generation FTB-500 multilayer platform and our optical modulation analyzer for complete characterization of signals up to 100 GBd. These major products contributed to the increase of our sales year-over-year.

Sales of our copper-access test solutions increased 131.2% to $13.4 million compared to $5.8 million in 2009. In fiscal 2010, we reached a multimillion-dollar deal with a Tier-1 European operator for our AXS-200/635 triple-play tester, and recognized $5.3 million of sales to this customer during the year, which contributed for the most part to the year-over-year increase in sales. In addition, this product family benefited from improved market conditions year-over-year as the access segment was severely impacted by the recession in 2009. Finally, in fiscal 2010, our AXS-200/635 triple-play tester was approved by three Tier-1 North American network operators to support their deployment of next-generation VDSL2 services and applications. We believe the combined deals could reach several millions of dollars over the next two or three years or over a mid-term horizon.

Fiscal 2009 vs. 2008

In fiscal 2009, our sales decreased 4.9% to $153.1 million from $161.0 million in 2008.

The following table summarizes information about our sales for the years ended August 31, 2008 and 2009, in thousands of US dollars:

	Year ended August 31, 2009	Year ended August 31, 2008	Change in $	Change in %
Sales	$ 153,082	$ 160,981	$ (7,899)	(4.9) %
(Gains) losses on forward exchange contracts	3,178	(4,171)	7,349	
Sales, excluding gains/losses on forward exchange contracts (non-GAAP measure)	156,260	156,810	(550)	(0.4)
Impact of the recent acquisitions (1)	(25,327)	(5,423)	(19,904)	
Organic sales (non-GAAP measure)	$ 130,933	$ 151,387	$ (20,454)	(13.5) %

(1) Includes Brix Networks and Navtel Communications.

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In fiscal 2009, we reported a year-over-year decrease in sales mainly due to the impact of the worldwide economic recession that affected most of our product lines during that period. In addition, as a portion of our sales are denominated in Canadian dollars, euros or British pounds, the increased strength of the US dollar against these currencies in fiscal 2009, compared to 2008, also had a negative impact on our sales expressed in US dollars, which contributed to the decrease in sales compared to the corresponding period last year. This was amplified by foreign exchange losses on our forward exchange contracts, which are recorded in reduction of sales. In fact, in fiscal 2009, foreign exchange losses on our forward exchange contracts amounted to $3.2 million and accordingly reduced our sales, compared to foreign exchange gains of $4.2 million in 2008, which increased our sales; this represents a decrease in sales of $7.3 million year-over-year. Excluding the impact of gains and losses on forward exchange contracts, our sales would have been relatively flat year-over-year.

However, the decrease in sales in fiscal 2009, compared to the same period last year, was offset in part by the inclusion of the sales of newly acquired Brix Networks and Navtel Communications products. In fact, sales of Brix Network and Navtel Communications amounted to $25.3 million in 2009, compared to $5.4 million in 2008. Brix Networks and Navtel Communications were acquired two months and one month into the third quarter of fiscal 2008, respectively. Excluding sales of Brix Networks and Navtel Communications and the impact of the foreign exchange gains or losses on our forward exchange contracts, our sales would have decreased 13.5% organically year-over-year in 2009, reflecting the impact of the global economic recession and the decrease of the Canadian dollar, euro and British pound compared to the US dollar.

In fiscal 2009, we posted record-high sales and bookings of protocol test solutions, including next-generation IP test solutions and product lines of newly acquired Brix Networks and Navtel Communications. Protocol test solutions sales, buoyed by network capacity upgrades on wireline and wireless networks, increased 63.1% year-over-year (organic growth of 4.8% excluding sales of our new acquisitions of fiscal year 2008) as they reached $54.9 million in 2009, compared to $33.7 million in 2008. During fiscal 2009, we shipped $6.7 million worth of orders to a Tier-1 wireless operator in North America for our service assurance test solutions, which increased our protocol sales year-over-year. However, sales of our optical test solutions decreased 17.5% to $95.5 million, from $115.7 million in 2008. Also, in fiscal 2009, we posted a year-over-year sales decrease of 21.8% ($5.8 million in fiscal 2009, compared to $7.4 million in 2008) for our copper-access test solutions. Our optical business was more affected by difficult market conditions, as many network operators deferred capital-intensive deployment decisions on FTTx rollouts and capacity expansion, opting to increase speed rather than digging trenches to add new fiber-optic cables. We believe that we still gained market share in the optical segment despite our year-on-year revenue decline. The access segment was also severely impacted by the recession, but we believe in this case that we have likely lost some market share from a small overall market presence, as our new products have not yet created a significant impact in the market.

Net bookings

Net accepted orders increased 31.1% year-over-year to a record-high $211.4 million in fiscal 2010 from $161.2 million in 2009, for a book-to-bill ratio of 1.04 in fiscal 2010. In fiscal 2010, as mentioned earlier, we benefited from improving economic and market conditions as well as from our strong product offering. In addition, NetHawk, acquired on March 12, 2010, contributed about five and a half months to our bookings. In fiscal 2009, we were affected by the global economic recession, which had a negative impact on our bookings during that period.

Geographic distribution

Fiscal 2010 vs. 2009

In fiscal 2010, sales to the Americas, Europe, Middle East and Africa (EMEA) and Asia-Pacific (APAC) accounted for 52%, 30% and 18% of sales, respectively, compared to 57%, 28% and 15%, respectively in 2009.

In fiscal 2010, we reported sales increases (in dollars) in every geographic area. In fact, sales to the Americas, EMEA and APAC increased (in dollars) 22.6%, 41.2% and 53.0%, respectively.

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In the Americas, the increase in sales in fiscal 2010, compared to 2009, mainly comes from the United States and Latin America. In fact, we posted year-over-year sales growth of 24.1% and 48.2% in the United States and Latin America, respectively, in fiscal 2010. In Canada, sales slightly increased 5.5% in fiscal 2010, compared to the same period last year. In fiscal 2010, in the United States, we benefited from improving economic and market conditions as well as from year-end budget flush-outs from some of our customers. Also, in fiscal 2010, we recorded foreign exchange gains on our forward exchange contracts, which are included in our sales to the Americas for the most part, compared to significant forward exchange losses for the same periods last year. This contributed to the increase in our sales to this region year-over-year. Excluding the impact of gains and losses on our forward exchange contracts, sales to the United States would have increased 13.8% year-over-year. Furthermore, sales to the United States in fiscal 2010 were positively impacted by the contribution of newly acquired NetHawk. Finally, it should be remembered that in fiscal 2009, we shipped $6.7 million worth of orders to a Tier-1 US-based wireless operator for our service assurance solutions. Excluding this significant order, the increase in sales to the United States would have been even larger year-over-year. In Latin America, we also benefited from an improving economic environment as we won several deals during the year. Sales to this region depend on the timing and scope of our customers' projects. In Canada, sales slightly increased in fiscal 2010 compared to the same period last year. In fact, the increase in sales in Canada comes from the increase in the average value of the Canadian dollar compared to the US dollar year-over-year. In Canadian dollars, sales to Canada decreased 6% year-over-year. In fiscal 2009, we shipped large orders to two Canadian Tier-1 network operators, namely for our protocol and copper-access test solutions. Such large orders did not occur in 2010 in Canada.

The increase in sales in the EMEA market, in dollars, in fiscal 2010, compared to 2009, is due in part to the contribution of Finland-based NetHawk to our sales in this region since its acquisition in mid-March 2010. A large portion of NetHawk's sales are made to the EMEA market. In addition, in fiscal 2010, we shipped $5.3 million worth of orders for our copper-access test solutions to a Tier-1 European operator, which contributed to the increase in sales to this end market year-over-year. Finally, improved economic and market conditions in this region contributed to the increase in our sales year-over-year as carriers are starting to invest in next-generation access and transport networks after several months of delay and spending reductions due to the global economic recession of 2009.

In the APAC market, sales significantly increased in fiscal 2010, compared to 2009. As explained above, we benefited from improving market conditions worldwide in fiscal 2010, which had a positive impact on sales to the APAC market during this period. We are committed to carrying out our strategy to increase our market share with products and solutions developed and targeted for this important market, as well as to expand our market presence. In addition, in fiscal 2010, we benefited from the contribution of newly acquired NetHawk in this region since its acquisition in mid-March 2010.

Fiscal 2009 vs. 2008

In fiscal 2009, sales to the Americas, Europe, Middle East and Africa (EMEA) and Asia-Pacific (APAC) accounted for 57%, 28% and 15% of global sales, respectively, compared to 55%, 30% and 15%, respectively in 2008.

In fiscal 2009, we reported sales decreases (in dollars) in every geographic area. In fact, sales to the Americas, EMEA and APAC decreased (in dollars) 1.7%, 10.5% and 5.5%, respectively.

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In the Americas, the decrease in sales in fiscal 2009, compared to 2008, mostly came from the United States where we posted a year-over-year decrease in sales of 7.6%. The global economic recession in 2009 forced Network Service Providers (NSPs) and Network Equipment Manufacturers (NEMs) to reduce their capital and operating expenses and several customers announced significant reductions in capital expenditures and staffing levels for calendar year 2009 in anticipation of lower revenues; this directly affected our sales in the United States in fiscal 2009, compared to 2008. Also, in fiscal 2009, we recorded significant foreign exchange losses on our forward exchange contracts, which are included in our sales to the Americas for the most part, compared to forward exchange gains in 2008. Excluding the impact of gains and losses on our forward exchange contracts, sales to the United States would have increased 3.6% year-over-year. The decrease in sales to the United States in fiscal 2009 was offset in part by an increase of 32.3% of sales made in Canada, despite the negative impact of a weaker Canadian dollar versus the US dollar year-over-year on our Canadian-dollar-denominated sales. The recession also affected Latin America, where sales decreased 7.8% year-over-year. Finally, the contribution of Brix Networks and Navtel Communications in fiscal 2009 also mitigated the effect of the recession and the currencies on our sales in the United States, as a significant portion of Brix and Navtel sales are made in the United States and Canada.

The decrease in sales in the EMEA market, in dollars, in fiscal 2009, compared to 2008, was also due to the impact of the global recession as we witnessed caution from many of our customers with their fiscal year budgets (calendar 2009). In fact, due to the recession, many Tier-1 carriers in EMEA have postponed or significantly reduced the speed of the migration of their traditional circuit-switched core networks to higher-speed, dense wavelength-division multiplexing (DWDM) and next-generation packet-based architectures, which negatively impacted the sales of our products. Also, as a portion of the orders in this region are denominated in euros or British pounds, the strength of the US dollar against these currencies in fiscal 2009 had a negative impact on our sales expressed in US dollars for this region, which contributed to the decrease in sales compared to 2008.

In the APAC market, sales to China slightly increased year-over-year, despite the recession and the negative impact of currency fluctuations. In fact, the recession in China has been less severe than in the rest of the world, and we were able to mitigate its impact on our sales in that region. However, the rest of Asia has been affected by the general economic conditions and the currency fluctuations, and our sales to the rest of Asia have decreased 24.2% in fiscal 2009 compared to 2008.

We sell our products to a broad range of customers, including network service providers, network equipment manufacturers, wireless operators and cable TV operators. In fiscal 2010, no customer accounted for more than 10% of our sales, and our top three customers accounted for 12.2% of our sales. In fiscal 2009, our top customer accounted for 13.1% ($20.0 million) of our sales, and our top three customers accounted for 20.1% of our sales. With record-high sales in fiscal 2010, the fact that no customer accounted for more than 10% of our sales and that our top three customers accounted for just over 10% of our sales shows that we have a well-diversified customer base.

GROSS MARGIN

Gross margin amounted to 63.6%, 62.2% and 60.0% of sales in fiscal 2010, 2009 and 2008, respectively.

Fiscal 2010 vs. 2009

In fiscal 2010, we recorded in our sales foreign exchange gains totaling $1.5 million on our forward exchange contracts, compared to foreign exchange losses of $3.2 million in 2009. This contributed to a 1% increase in our gross margin year-over-year.

In addition, the acquisition of NetHawk had a positive impact on our gross margin in fiscal 2010 as its products deliver margins well above our average typical gross margin.

Furthermore, in fiscal 2010, a larger portion of our sales came from products manufactured in our facilities in China compared to 2009; those products have a lower cost of goods than those manufactured in our facilities in Canada, thus resulting in an improvement in gross margin year-over-year.

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Also, an increased sales volume year-over-year resulted in an increase in manufacturing activities, allowing us to better absorb our fixed manufacturing costs.

Finally, the increase in the value of the Canadian dollar in 2010 compared to 2009 had a positive impact on our gross margin in 2010; in fact, our procurement costs decreased as the Canadian dollar strengthened compared to the US dollar, since a significant portion of our raw material purchases are denominated in US dollars. This allowed us to improve our gross margin continually over the last few quarters, as our raw material costs of parts purchased in US dollars are measured in Canadian dollars in our financial statements.

On the other hand, in fiscal 2010, our gross margin was negatively affected by the shift in product mix in favor of our copper-access test solutions, as these products deliver lower margins than our other test solutions and we had large orders on which we granted larger discounts.

In addition, the shift in the geographic distribution of our sales in favor of the EMEA and APAC markets in fiscal 2010, compared to 2009, resulted in a lower margin year-over-year. Sales to these markets tend to deliver lower margins than those made in the Americas, as they are made through distribution channels instead of being made directly with the end customers.

Finally, in fiscal 2010, the significant year-over-year increase in the average value of the Canadian dollar versus the US dollar resulted in a higher cost of goods sold expressed in US dollars in the statement of earnings, as a portion of these costs are incurred in Canadian dollars and we report our results in US dollars.

Fiscal 2009 vs. 2008

Despite the negative impact on the gross margin of foreign exchange losses on our forward exchange contracts in fiscal 2009 compared to 2008, which have reduced our sales, we were able to significantly increase our gross margin by 2.2% year-over-year.

The increase in our gross margin in fiscal 2009, compared to 2008, can be explained by the following factors.

First, in fiscal 2009, our gross margin was positively affected by the significant increase in sales of our protocol test solutions year-over-year, including those of newly acquired Brix Networks and Navtel Communications, as these products have better margins than our other test solutions.

Second, during fiscal 2009, the value of the Canadian dollar significantly fluctuated compared to the US dollar, which impacted our gross margin for this period, compared to the same period last year. In fact, since the beginning of fiscal 2009, the value of the Canadian dollar significantly decreased compared to the US dollar; this resulted in a lower cost of goods sold expressed in US dollars in the statement of earnings, thus increasing our gross margin year-over-year. However, the increase in the procurement costs of our raw materials purchased in US dollars, as a result of the recent and significant decrease in the value of the Canadian dollar compared to the US dollar, materialized in fiscal 2009, in line with the inventory turnover rate, as these raw materials are included in the cost of goods sold of products manufactured with these parts.

Furthermore, the operation of our manufacturing facilities in China resulted in a larger portion of our sales coming from products manufactured in China; those products have a lower cost than those manufactured in our facilities in Canada, thus resulting in an improvement in gross margin in fiscal 2009 compared to 2008.

However, foreign exchange losses on our forward exchange contracts recorded in fiscal 2009 ($3.2 million), which are included in our sales, had a negative impact of 0.7% on our gross margin during this period, compared to the positive impact of our foreign exchange gains of $4.2 million, or 1.0% on the gross margin in 2008, for a year-over-year negative impact of 1.7% on our gross margin.

In addition, a lower sales volume in fiscal 2009 compared to 2008 resulted in decreased manufacturing activities and in lower absorption of our fixed manufacturing costs, thus negatively impacting our gross margin year-over-year.

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Finally, in fiscal 2008, we were able to reuse excess inventories that were written off in previous years in the amount of $1.2 million (nominal amount in 2009). This had a one-time positive impact of 0.7% of sales on our gross margin in 2008.

Outlook for fiscal 2011

Considering the expected sales growth in fiscal 2011, the full contribution of newly acquired NetHawk (which delivers higher margins), the expected increase in sales of protocol products, the cost-effective design of our products, our increased manufacturing activities in China and our tight control on operating costs, we expect our gross margin to continue to improve in the future. However, our gross margin may fluctuate quarter-over-quarter as our sales may fluctuate. Furthermore, our gross margin can be negatively affected by increased competitive pricing pressure, customer concentration and/or consolidation, increased obsolescence costs, shifts in customer and product mix, under-absorption of fixed manufacturing costs and increases in product offerings by other suppliers in our industry. Finally, any increase in the strength of the Canadian dollar, compared to the US dollar, may have a negative impact on our gross margin in fiscal 2011 and beyond.