

EXFO INC.  
Form 6-K  
November 23, 2011

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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 2011

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  Form 40-F

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  No

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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TABLE OF CONTENTS

Signatures

Independent Auditor's Report

Consolidated Balance Sheet

Consolidated Statements of Earnings

Consolidated Statements of Comprehensive Income (Loss) and Accumulated Other Comprehensive Income

Consolidated Statements of Retained Earnings and Contributed Surplus

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

Management's Discussion and Analysis of Financial Condition and Results of Operations

Cover Letter

Notice of Annual Meeting of Shareholders

Form of Proxy

Management Proxy Circular

Table of Contents

In November 2011, 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, 2011. 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.

The Form 6-K containing the Corporation's annual audited financial statements and management's discussion and analysis for its fiscal year ended August 31, 2011, 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.

Table of Contents

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 23, 2011

Page 2 of 128

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Table of Contents

Independent Auditor's Report

To the Shareholders of  
EXFO Inc.

We have completed integrated audits of EXFO Inc. and its subsidiaries' 2011, 2010 and 2009 consolidated financial statements and their internal control over financial reporting as at August 31, 2011. Our opinions, based on our audits, are presented below.

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of EXFO Inc. and its subsidiaries, which comprise the consolidated balance sheets as at August 31, 2011 and August 31, 2010 and the consolidated statement of accumulated other comprehensive income for each of the two years in the period ended August 31, 2011, and the consolidated statements of earnings, comprehensive income (loss), retained earnings and contributed surplus and cash flows for each of the three years in the period ended August 31, 2011, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits 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 whether the consolidated financial statements are free from material misstatement. Canadian generally accepted auditing standards also require that we comply with ethical requirements.

Table of Contents

An audit involves performing procedures to obtain audit evidence, on a test basis, about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting principles and policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion on the consolidated financial statements.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of EXFO Inc. and its subsidiaries as at August 31, 2011 and August 31, 2010 and the results of their operations and cash flows for each of the three years in the period ended August 31, 2011 in accordance with Canadian generally accepted accounting principles.

Report on internal control over financial reporting

We have also audited EXFO Inc. and its subsidiaries' internal control over financial reporting as at August 31, 2011, based on criteria established in Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Management's responsibility for internal control over financial reporting

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 the accompanying Management's Report on Internal Control over Financial Reporting.

Auditor's responsibility

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.



Table of Contents

We believe that our audit provides a reasonable basis for our opinion on the company's internal control over financial reporting.

Definition of internal control over financial reporting

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.

Inherent limitations

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.

Opinion

In our opinion, EXFO Inc. and its subsidiaries maintained, in all material respects, effective internal control over financial reporting as at August 31, 2011 based on criteria established in Internal Control – Integrated Framework, issued by COSO.

/s/ PricewaterhouseCoopers LLP 1

Quebec City, Quebec, Canada

October 11, 2011, except Note 16 (e) which is as of November 7, 2011

1 Chartered accountant auditor permit No. 18144



Table of ContentsEXFO Inc.  
Consolidated Balance Sheets

(in thousands of US dollars)

|  | As at August 31, |           |
|--|------------------|-----------|
|  | 2011             | 2010      |
| Assets   |                  |           |
| Current assets   |                  |           |
| Cash   | \$22,771         | \$21,440  |
| Short-term investments (note 7)                              | 47,091           | 10,379    |
| Accounts receivable (note 7)                                 |                  |           |
| Trade  | 45,151           | 50,190    |
| Other  | 6,329            | 5,217     |
| Income taxes and tax credits recoverable                     | 5,414            | 2,604     |
| Inventories (note 8)   | 52,754           | 40,328    |
| Prepaid expenses   | 3,237            | 2,816     |
| Future income taxes (note 19)                                | 6,130            | 6,191     |
| Current assets held for sale (note 4)                        | –                | 3,991     |
|  | 188,877          | 143,156   |
| Tax credits recoverable                                      | 36,627           | 29,397    |
| Forward exchange contracts (note 7)                          | 149              | –         |
| Property, plant and equipment (note 9)                       | 30,566           | 23,455    |
| Intangible assets (note 10)                                  | 22,901           | 27,947    |
| Goodwill (notes 3, 5 and 10)                                 | 30,942           | 29,355    |
| Future income taxes (note 19)                                | 11,024           | 12,884    |
| Long-term assets held for sale (note 4)                      | –                | 7,308     |
|  | \$321,086        | \$273,502 |
| Liabilities  |                  |           |
| Current liabilities  |                  |           |
| Bank loan  | \$784            | \$–       |
| Accounts payable and accrued liabilities (note 12)           | 32,137           | 30,870    |
| Income taxes payable   | 876              | 426       |
| Current portion of long-term debt (note 13)                  | 645              | 568       |
| Deferred revenue   | 10,590           | 10,354    |
| Current liabilities related to assets held for sale (note 4) | –                | 2,531     |
|  | 45,032           | 44,749    |
| Deferred revenue   | 5,704            | 5,775     |
| Long-term debt (note 13)                                     | 968              | 1,419     |
| Other liabilities  | 723              | 603       |
| Future income taxes (note 19)                                | 4,913            | –         |

|  |           |           |
|--|-----------|-----------|
| Long-term liabilities related to assets held for sale (note 4) | –         | 537       |
|  | 57,340    | 53,083    |
| Commitments (note 14)  |           |           |
| Contingency (note 15)  |           |           |
| Shareholders' equity   |           |           |
| Share capital (note 16)  | 110,341   | 106,126   |
| Contributed surplus  | 18,017    | 18,563    |
| Retained earnings  | 69,877    | 50,528    |
| Accumulated other comprehensive income                         | 65,511    | 45,202    |
|  | 263,746   | 220,419   |
|  | \$321,086 | \$273,502 |

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

On behalf of the Board

/s/ Germain Lamonde  
GERMAIN LAMONDE  
Chairman, President and CEO

/s/ Guy Marier  
GUY MARIER  
Chairman, Audit Committee

Table of ContentsEXFO Inc.  
Consolidated Statements of Earnings

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

|  | Years ended August 31, |           |             |
|--|------------------------|-----------|-------------|
|  | 2011                   | 2010      | 2009        |
| Sales (note 21)  | \$269,743              | \$202,757 | \$153,082   |
| Cost of sales (1,2) (note 8)                                     | 100,296                | 73,901    | 57,897      |
| Gross margin   | 169,447                | 128,856   | 95,185      |
| Operating expenses   |                        |           |             |
| Selling and administrative (1)                                   | 87,062                 | 66,612    | 58,067      |
| Net research and development (1) (note 18)                       | 47,927                 | 37,847    | 27,213      |
| Amortization of property, plant and equipment                    | 6,772                  | 5,757     | 4,453       |
| Amortization of intangible assets                                | 9,183                  | 7,773     | 5,033       |
| Restructuring charges (note 5)                                   | –                      | –         | 963         |
| Impairment of goodwill (note 5)                                  | –                      | –         | 21,713      |
| Total operating expenses   | 150,944                | 117,989   | 117,442     |
| Earnings (loss) from operations                                  | 18,503                 | 10,867    | (22,257 )   |
| Interest and other income (expenses)                             | 511                    | (292 )    | 592         |
| Foreign exchange gain (loss)                                     | (3,808 )               | (1,496 )  | 1,074       |
| Earnings (loss) before income taxes (note 19)                    | 15,206                 | 9,079     | (20,591 )   |
| Income taxes (note 19)   | 8,783                  | 5,529     | 266         |
| Net earnings (loss) from continuing operations                   | 6,423                  | 3,550     | (20,857 )   |
| Net earnings from discontinued operations (note 4)               | 12,926                 | 3,069     | 4,272       |
| Net earnings (loss) for the year                                 | \$19,349               | \$6,619   | \$(16,585 ) |
| Basic net earnings (loss) from continuing operations per share   | \$0.11                 | \$0.06    | \$(0.34 )   |
| Diluted net earnings (loss) from continuing operations per share | \$0.10                 | \$0.06    | \$(0.34 )   |
| Basic net earnings (loss) per share                              | \$0.32                 | \$0.11    | \$(0.27 )   |
| Diluted net earnings (loss) per share                            | \$0.31                 | \$0.11    | \$(0.27 )   |
| Basic weighted average number of shares outstanding (000's)      | 60,000                 | 59,479    | 61,845      |

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|   |        |        |        |
|---|--------|--------|--------|
| Diluted weighted average number of shares outstanding (000's) (note 20) | 61,488 | 60,616 | 61,845 |
|---|--------|--------|--------|

(1) Stock-based compensation costs included in:

|   |         |         |       |
|---|---------|---------|-------|
| Cost of sales                             | \$224   | \$138   | \$133 |
| Selling and administrative                | \$1,281 | \$1,042 | \$782 |
| Net research and development              | \$487   | \$470   | \$383 |
| Net earnings from discontinued operations | \$264   | \$136   | \$111 |

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

Table of Contents

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, |           |             |
|--|------------------------|-----------|-------------|
|  | 2011                   | 2010      | 2009        |
| Net earnings (loss) for the year   | \$ 19,349              | \$ 6,619  | \$(16,585 ) |
| Foreign currency translation adjustment  | 19,399                 | 3,728     | (10,671 )   |
| Changes in unrealized losses on short-term investments   | 2                      | –         | 22          |
| Unrealized gains (losses) on forward exchange contracts  | 3,413                  | 940       | (1,467 )    |
| Reclassification of realized (gains) losses on forward exchange contracts in net earnings (loss) | (2,191 )               | (1,022 )  | 3,167       |
| Future income tax effect of the above items  | (314 )                 | 24        | (528 )      |
| Comprehensive income (loss)  | \$ 39,658              | \$ 10,289 | \$(26,062 ) |

Accumulated other comprehensive income

|   | Years ended August 31, |           |
|---|------------------------|-----------|
|   | 2011                   | 2010      |
| Foreign currency translation adjustment                     |                        |           |
| Cumulative effect of prior years                            | \$ 44,186              | \$ 40,458 |
| Current year  | 19,399                 | 3,728     |
|   | 63,585                 | 44,186    |
| Unrealized gains on forward exchange contracts              |                        |           |
| Cumulative effect of prior years                            | 1,018                  | 1,076     |
| Current year, net of realized gains and future income taxes | 908                    | (58 )     |
|   | 1,926                  | 1,018     |
| Unrealized losses on short-term investments                 |                        |           |
| Cumulative effect of prior years                            | (2 )                   | (2 )      |
| Current year  | 2                      | –         |
|   | –                      | (2 )      |
| Accumulated other comprehensive income                      | \$ 65,511              | \$ 45,202 |

Total retained earnings and accumulated other comprehensive income amounted to \$95,730 and \$135,388 as at August 31, 2010 and 2011, respectively.

Table of Contents

EXFO Inc.

Consolidated Statements of Retained Earnings and Contributed Surplus

(in thousands of US dollars)

Retained earnings

|                                  | Years ended August 31, |          |           |
|----------------------------------|------------------------|----------|-----------|
|                                  | 2011                   | 2010     | 2009      |
| Balance – Beginning of year      | \$50,528               | \$43,909 | \$60,494  |
| Add (deduct)                     |                        |          |           |
| Net earnings (loss) for the year | 19,349                 | 6,619    | (16,585 ) |
| Balance – End of year            | \$69,877               | \$50,528 | \$43,909  |

Contributed surplus

|   | Years ended August 31, |          |          |
|---|------------------------|----------|----------|
|   | 2011                   | 2010     | 2009     |
| Balance – Beginning of year   | \$18,563               | \$17,758 | \$5,226  |
| Add (deduct)  |                        |          |          |
| Stock-based compensation costs  | 2,217                  | 1,756    | 1,407    |
| Reclassification of stock-based compensation costs to share capital upon exercise of stock awards (note 16) | (2,763 )               | (954 )   | (540 )   |
| Discount on redemption of share capital (note 16)   | –                      | 3        | 11,665   |
| Balance – End of year   | \$18,017               | \$18,563 | \$17,758 |

Page 9 of 128

Table of ContentsEXFO Inc.  
Consolidated Statements of Cash Flows

(in thousands of US dollars)

|  | Years ended August 31, |            |             |
|--|------------------------|------------|-------------|
|  | 2011                   | 2010       | 2009        |
| <b>Cash flows from operating activities</b>                    |                        |            |             |
| Net earnings (loss) for the year                               | \$19,349               | \$6,619    | \$(16,585 ) |
| Add (deduct) items not affecting cash                          |                        |            |             |
| Change in discount on short-term investments                   | (42 )                  | 19         | 597         |
| Stock-based compensation costs                                 | 2,256                  | 1,786      | 1,409       |
| Amortization   | 15,973                 | 13,729     | 9,674       |
| Deferred revenue   | (1,262 )               | 3,672      | 1,706       |
| Gain on disposal of discontinued operations (note 4)           | (13,212 )              | –          | –           |
| (Gain) loss on disposal of capital assets                      | (568 )                 | –          | 237         |
| Impairment of goodwill (note 5)                                | –                      | –          | 21,713      |
| Future income taxes  | 7,032                  | 5,787      | (300 )      |
| Change in unrealized foreign exchange gain/loss                | 2,130                  | 471        | (1,955 )    |
|  | 31,656                 | 32,083     | 16,496      |
| <b>Change in non-cash operating items</b>                      |                        |            |             |
| Accounts receivable  | 10,066                 | (22,522 )  | 9,654       |
| Income taxes and tax credits                                   | (6,714 )               | (4,073 )   | (3,391 )    |
| Inventories  | (8,751 )               | (9,302 )   | 2,624       |
| Prepaid expenses   | (232 )                 | 105        | (350 )      |
| Accounts payable and accrued liabilities                       | (2,775 )               | 5,168      | (2,409 )    |
| Other liabilities  | 60                     | 308        | –           |
|  | 23,310                 | 1,767      | 22,624      |
| <b>Cash flows from investing activities</b>                    |                        |            |             |
| Additions to short-term investments                            | (516,674 )             | (233,388 ) | (438,460 )  |
| Proceeds from disposal and maturity of short-term investments  | 481,945                | 285,805    | 456,612     |
| Additions to capital assets                                    | (12,164 )              | (8,966 )   | (6,945 )    |
| Proceeds from disposal of capital assets                       | 568                    | –          | –           |
| Net proceeds from disposal of discontinued operations (note 4) | 22,063                 | –          | –           |
| Business combinations, net of cash acquired (note 3)           | (1,049 )               | (33,042 )  | (2,414 )    |
|  | (25,311 )              | 10,409     | 8,793       |
| <b>Cash flows from financing activities</b>                    |                        |            |             |
| Bank loan  | 772                    | –          | –           |
| Repayment of long-term debt                                    | (619 )                 | (274 )     | –           |
| Redemption of share capital                                    | –                      | (14 )      | (26,871 )   |
| Exercise of stock options                                      | 1,452                  | 343        | 56          |
|  | 1,605                  | 55         | (26,815 )   |
| <b>Effect of foreign exchange rate changes on cash</b>         |                        |            |             |
|  | 1,058                  | (733 )     | 95          |
| <b>Change in cash</b>  |                        |            |             |
| Cash – Beginning of year                                       | 22,109                 | 10,611     | 5,914       |
| Cash – End of year   | \$22,771               | \$22,109   | \$10,611    |



Supplementary information

|                                  |           |           |           |
|----------------------------------|-----------|-----------|-----------|
| Interest paid                    | \$ 159    | \$ 34     | \$ 23     |
| Income taxes paid                | \$ 1,878  | \$ 796    | \$ 86     |
| Cash related to:                 |           |           |           |
| Continuing operations            | \$ 22,771 | \$ 21,440 | \$ 9,777  |
| Discontinued operations (note 4) | –         | 669       | 834       |
|                                  | \$ 22,771 | \$ 22,109 | \$ 10,611 |

Table of Contents

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

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.

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.

Table of Contents

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 are designated as cash flow hedging instruments, qualify for hedge accounting. They 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 the interest and other income (expenses) line item 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              | 20 and 25 years                                    |
| Equipment              | 2 to 10 years                                      |
| Leasehold improvements | The lesser of useful life and remaining lease term |

Table of Contents

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 and customer relationships 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 discounted future cash flows. 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 the 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 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 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.

The company's multiple deliverable revenue arrangements may include tangible products (software and/or non-software components), extended warranties, maintenance contracts, post-contract customer support (PCS) on software components as well as installation.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

Since September 1, 2010, when a sales arrangement contains multiple elements and software and non-software components function together to deliver the tangible products' essential functionality, the company allocates revenue to each element based on the relative selling price of each element. Under this approach, the selling price of a deliverable is determined by using a selling price hierarchy which requires the use of vendor-specific objective evidence ("VSOE") of fair value if available, third-party evidence ("TPE") if VSOE is not available, or best estimated selling price ("BESP") if neither VSOE nor TPE are available.

The company establishes VSOE of selling price using the price charged for a deliverable when sold separately and, in some instances, using the price established by management having the relevant authority. TPE of selling price is established by evaluating similar and interchangeable competitor goods or services in sales to similarly situated customers. When VSOE or TPE are not available, the company uses BESP. The company establishes BESP using historical selling price trends, if available, and considering multiple factors including, but not limited to, geography, market conditions, competitive landscape, internal costs and pricing practices. When determining BESP, the company's management applies judgment when establishing pricing strategies and evaluating market conditions and product lifecycles. The determination of BESP is made through consultation with and approval by the company's management. The company may modify or develop new pricing practices and strategies in the future. As these pricing strategies evolve, the company may modify its pricing practices in the future, which may result in changes in BESP. The aforementioned factors may result in a different allocation of revenue to the deliverables in multiple-element arrangements from the current period, which may change the pattern and timing of revenue recognition for these elements but will not change the total revenue recognized for the arrangement.

Maintenance contracts are usually offered to customers for periods of twelve to thirty-six months. They generally include the right to unspecified upgrades and enhancements on a when-and-if-available basis as well as customer service. They qualify as a separate unit of accounting. Revenue from these contracts is recognized ratably over the terms of the maintenance contracts on a straight-line basis. The selling price of the maintenance contracts is determined using VSOE.

Extended warranties are usually offered to customers for periods of twelve to forty-eight months. They qualify as a separate unit of accounting. Revenue from these extended warranties is recognized ratably over the warranty period on a straight-line basis. The selling price of the extended warranties is determined using BESP.

When a sales arrangement contains multiple elements and software and non-software components do not function together to deliver the tangible products' essential functionality, the company allocates revenue between the tangible products and the PCS, if any, based on VSOE of selling price of each element. 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.

Prior to September 1, 2010, for products in which software was incidental, the company recognized revenue when persuasive evidence of an arrangement existed, the product had been delivered, the price was fixed or determinable, and collection of the resulting receivable was reasonably assured. Provisions were made for estimated returns, warranties and support obligations.



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

Advertising costs

Advertising costs are expensed as incurred.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

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, 2010 and 2011, 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.

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.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

New accounting standards and pronouncements

Adopted in fiscal 2011

In December 2009, the Canadian Institute of Chartered Accountants' (CICA) Emerging Issues Committee (EIC) issued EIC-175, "Multiple Deliverable Revenue Arrangements", which is 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 adopted this standard prospectively to arrangements entered into on or after September 1, 2010 and at the same time it adopted similar new U.S. GAAP requirements (note 22); its adoption had no material effect on its consolidated financial statements. However, the description of the company's revenue recognition policy has been modified accordingly.

To be adopted after fiscal 2011

The company will cease to prepare its consolidated financial statements in accordance with Canadian GAAP as set out in Part V of the CICA Handbook – Accounting ("Canadian GAAP") for the periods beginning on September 1, 2011, when it will start to apply as its primary basis of accounting the International Financial Reporting Standards published by the International Accounting Standards Board and set out in Part I of the CICA Handbook – Accounting. Consequently, future accounting changes to Canadian GAAP are not discussed in these consolidated financial statements as they will never be applied by the company.

### 3 Business Combination

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 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 included an amount of \$780,000 for a statutory transfer tax payable in Finland based on the purchase price of shares.

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.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

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.

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.

#### 4 Discontinued Operations

In fiscal 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 1, 2010, the company closed the sale of that Division for total proceeds of \$21,623,000, net of a bank overdraft of \$303,000, selling costs of \$909,000 and future income taxes of \$141,000. As such, this Division has been presented as a discontinued operation in these financial statements. Assets and liabilities for the comparative year ended August 31, 2010 have been reclassified as assets held for sale and liabilities related to assets held for sale; revenues and expenses have been classified as discontinued operations for all years presented.

The results of the discontinued operations are as follows:

|   | Years ended August 31, |          |          |
|---|------------------------|----------|----------|
|   | 2011<br>(30 days)      | 2010     | 2009     |
| Sales   | \$1,991                | \$25,359 | \$19,796 |
| Gross margin  | \$989                  | \$13,563 | \$10,801 |
| Earnings (loss) from operations                             | \$(6 )                 | \$4,281  | \$4,179  |
| Gain from disposal of discontinued operations               | \$13,212               | \$-      | \$-      |
| Net earnings from discontinued operations                   | \$12,926               | \$3,069  | \$4,272  |
| Basic net earnings from discontinued operations per share   | \$0.22                 | \$0.05   | \$0.07   |
| Diluted net earnings from discontinued operations per share | \$0.21                 | \$0.05   | \$0.07   |

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

The assets and liabilities of the discontinued operations as at August 31, 2010 have been reclassified and are presented as assets held for sale and liabilities related to assets held for sale as follows:

## Assets

## Current assets

|  |       |
|--|-------|
| Cash                                     | \$669 |
| Accounts receivable                      | 84    |
| Income taxes and tax credits recoverable | 188   |
| Inventories                              | 2,670 |
| Prepaid expenses                         | 158   |
| Future income taxes                      | 222   |

|                              |       |
|------------------------------|-------|
| Current assets held for sale | 3,991 |
|------------------------------|-------|

|                               |       |
|-------------------------------|-------|
| Tax credits recoverable       | 2,142 |
| Property, plant and equipment | 349   |
| Intangible assets             | 48    |
| Goodwill                      | 4,769 |

|                                |       |
|--------------------------------|-------|
| Long-term assets held for sale | 7,308 |
|--------------------------------|-------|

|  |          |
|--|----------|
|  | \$11,299 |
|--|----------|

## Liabilities

|   |         |
|---|---------|
| Current liabilities related to assets held for sale | \$2,531 |
|---|---------|

|   |     |
|---|-----|
| Long-term liabilities related to assets held for sale | 537 |
|---|-----|

|  |         |
|--|---------|
|  | \$3,068 |
|--|---------|

## 5 Special Charges

## Impairment of goodwill

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.

Restructuring charges

During fiscal 2009, the company implemented a restructuring plan to align its cost structure to the existing 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 were included in the restructuring charges in the statement of earnings for the year ended August 31, 2009 and the remaining amount of \$208,000 was included in net earnings from discontinued operations in the statement of earnings for that year.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

The following tables summarize changes in restructuring charges payable since August 31, 2008:

Year ended August 31, 2010

|                    | Balance as at<br>August 31, 2009 | Additions | Payments | Balance as at<br>August 31, 2010 |
|--------------------|----------------------------------|-----------|----------|----------------------------------|
| Fiscal 2009 plan   |                                  |           |          |                                  |
| Severance expenses | \$ 24                            | \$-       | \$(24 )  | \$ -                             |

Year ended August 31, 2009

|                     | Balance as at<br>August 31, 2008 | Additions | Payments   | Balance as at<br>August 31, 2009 |
|---------------------|----------------------------------|-----------|------------|----------------------------------|
| Fiscal 2009 plan    |                                  |           |            |                                  |
| Severance expenses  | \$ -                             | \$963     | \$(939 )   | \$ 24                            |
| Fiscal 2008 plan    |                                  |           |            |                                  |
| Severance expenses  | 292                              | -         | (292 )     | -                                |
| Total for all plans | \$ 292                           | \$963     | \$(1,231 ) | \$ 24                            |

## 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 that 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.

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 \$175,217,000 and \$198,235,000 as at August 31, 2010 and 2011, 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.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

## 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

|  |                             |
|--|-----------------------------|
| Bank loan                                | Other 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 forward exchange contracts 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, China and Finland, the majority of which are denominated in US dollars and euros. This risk is partially hedged by forward exchange contracts (US dollars) and certain operating expenses (US dollars and euros). Forward exchange contracts, which are designated as cash flow hedging instruments, qualify for hedge accounting.

As at August 31, 2011, 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 2011 to August 2012 | \$ 27,500           | 1.0555                                     |
| September 2012 to July 2013   | 11,400              | 1.0063                                     |
| Total                         | \$ 38,900           | 1.0411                                     |

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 \$597,000 and \$2,278,000 as at August 31, 2010 and 2011, respectively.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

Based on the portfolio of forward exchange contracts as at August 31, 2011, 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 \$1,701,000.

As at August 31, 2011, forward exchange contracts, in the amount of \$1,701,000, are presented as current assets in other receivable in the balance sheet and forward exchange contracts, in the amount of \$149,000, are presented as long-term assets in forward exchange contracts in the balance sheet. As at August 31, 2010, forward exchange contracts, in the amount of \$754,000, were presented as current assets in other receivable in the balance sheet and forward exchange contracts, in the amount of \$232,000, were presented as current liabilities in the accounts payable and accrued liabilities in the balance sheet (note 12).

During the years ended August 31, 2009, 2010 and 2011, the company recognized within its sales foreign exchange gains (losses) on forward exchange contracts of (\$3,178,000), \$1,517,000 and \$2,795,000, respectively.

The following table summarizes significant derivative and non-derivative financial assets and liabilities that are subject to currency risk as at August 31, 2010 and 2011:

|  | As at August 31,  |   |   |   |
|--|---|---|---|---|
|  | 2011  |   | 2010  |   |
|  | Carrying/<br>nominal<br>amount<br>(in<br>thousands<br>of US<br>dollars) | Carrying/<br>nominal<br>amount<br>(in<br>thousands<br>of euros) | Carrying/<br>nominal<br>amount<br>(in<br>thousands<br>of US<br>dollars) | Carrying/<br>nominal<br>amount<br>(in<br>thousands<br>of euros) |
| <b>Financial assets</b>                    |   |   |   |   |
| Cash                                       | \$10,553  | €1,502  | \$6,947   | €1,287  |
| Accounts receivable                        | 25,040  | 4,332   | 30,218  | 3,860   |
|  | 35,593  | 5,834   | 37,165  | 5,147   |
| <b>Financial liabilities</b>               |   |   |   |   |
| Accounts payable and accrued liabilities   | 8,706   | 37  | 8,932   | 438   |
| Forward exchange contracts (nominal value) | 5,400   | –   | 5,900   | –   |
|  | 14,106  | 37  | 14,832  | 438   |
| Net exposure                               | \$21,487  | €5,797  | \$22,333  | €4,709  |

The value of the Canadian dollar compared to the US dollar was CA\$1.0665 = US\$1.00 and CA\$0.9784 = US\$1.00 as at August 31, 2010 and 2011, respectively.

The value of the Canadian dollar compared to the euro was CA\$1.3515 = €1.00 and CA\$1.4094 = €1.00 as at August 31, 2010 and 2011, 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, 2010 and 2011:

- 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 \$2,101,000, or \$0.03 per diluted share, and \$1,943,000, or \$0.03 per diluted share, as at August 31, 2010 and 2011, respectively.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

- An increase (decrease) of 10% in the period-end value of the Canadian dollar compared to the euro would decrease (increase) net earnings by \$621,000, or \$0.01 per diluted share, and \$831,000, or \$0.01 per diluted share, as at August 31, 2010 and 2011, 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 \$3,238,000 and \$2,404,000 as at August 31, 2010 and 2011, 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, its bank loan and its long-term debt.

## Short-term investments

Short-term investments consist of the following:

|  | As at August 31, |                 |
|--|------------------|-----------------|
|  | 2011             | 2010            |
| Commercial paper denominated in Canadian dollars, bearing interest at annual rates of 1.0% to 1.3% in fiscal 2011 and 0.6% to 0.9% in fiscal 2010, maturing between September and November 2011 in fiscal 2011, and in September and October 2010 in fiscal 2010 | \$31,765         | \$6,383         |
| Bankers acceptance denominated in Canadian dollars, bearing interest at annual rates of 1.0% to 1.2% in fiscal 2011 and 0.8% in fiscal 2010, maturing in September and November 2011 in fiscal 2011 and in September 2010 in fiscal 2010                         | 15,326           | 3,996           |
|  | <b>\$47,091</b>  | <b>\$10,379</b> |

The fair value of short-term investments based on market value amounted to \$10,379,000 and \$47,091,000 as at August 31, 2010 and 2011, respectively.



Due to their short-term maturity of usually three months or less, the company's short-term investments are not subject to a 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.

#### Bank loan

As at August 31, 2011, the company's bank loan, in the amount of \$784,000, bears interest at 7.2%. The fair value of the bank loan approximates its carrying value due to its short-term maturity.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

## Long-term debt

As at August 31, 2011, the company's long-term debt, in the amount of \$1,613,000, bears interest at an annual rate of 2.95% and matures in December 2013 (note 13). The fair value of the long-term debt approximates its carrying value due to its relatively short-term maturity.

## 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 fair value approximates their carrying value due to their short-term maturity.

## Credit risk

Financial instruments that potentially subject the company to credit risk consist of cash, short-term investments, accounts receivable and forward exchange contracts (with a positive fair value). As at August 31, 2011, the company's short-term investments consist of debt instruments issued by twelve (nine as at August 31, 2010) 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 \$1,243,000 and \$1,245,000 as at August 31, 2010 and 2011, respectively. Bad debt expense amounted to \$967,000, \$24,000 and \$91,000 for the years ended August 31, 2009, 2010 and 2011, respectively.

In fiscal 2010 and 2011, no customer represented more than 10% of sales. In fiscal 2009, one customer represented more than 10% of sales with 13.1% (\$20,049,000).

The following table summarizes the age of trade accounts receivable:

|   | As at August 31, |          |
|---|------------------|----------|
|   | 2011             | 2010     |
| Current   | \$33,149         | \$38,663 |
| Past due, 0 to 30 days  | 7,299            | 6,787    |
| Past due, 31 to 60 days   | 2,590            | 1,991    |
| Past due, more than 60 days, less allowance for doubtful accounts of \$1,243 and \$1,245 as at August 31, 2010 and 2011, respectively | 2,113            | 2,749    |

|                           |          |          |
|---------------------------|----------|----------|
| Total accounts receivable | \$45,151 | \$50,190 |
|---------------------------|----------|----------|

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

Changes in the allowance for doubtful accounts are as follows:

|                                     | Years ended August 31, |         |
|-------------------------------------|------------------------|---------|
|                                     | 2011                   | 2010    |
| Balance – Beginning of year         | \$1,243                | \$1,220 |
| Addition charged to earnings        | 148                    | 150     |
| Write-off of uncollectible accounts | (111 )                 | –       |
| Recovery of uncollectible accounts  | (35 )                  | (127 )  |
| Balance – End of year               | \$1,245                | \$1,243 |

## 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 derivative and non-derivative financial liabilities:

|  | As at August 31, 2011 |              |              |
|--|-----------------------|--------------|--------------|
|  | 0-12 months           | 13-24 months | 25-36 months |
| Bank loan                                | \$784                 | \$–          | \$–          |
| Accounts payable and accrued liabilities | 30,319                | –            | –            |
| Long-term debt                           | 645                   | 645          | 323          |
| Other liabilities                        | –                     | 201          | –            |
| Forward exchange contracts               |                       |              |              |
| Outflow                                  | 27,500                | 11,400       | –            |
| Inflow                                   | (29,668 )             | (11,725 )    | –            |
| Total                                    | \$29,580              | \$521        | \$323        |

|  | 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            |

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|                            |           |           |          |       |
|----------------------------|-----------|-----------|----------|-------|
| Other liabilities          | –         | 295       | –        | –     |
| Forward exchange contracts |           |           |          |       |
| Outflow                    | 29,500    | 20,400    | 1,500    | –     |
| Inflow                     | (30,141 ) | (20,662 ) | (1,508 ) | –     |
| Total                      | \$29,638  | \$601     | \$560    | \$283 |

As at August 31, 2011, the company had \$69,862,000 in cash and short-term investments and \$45,151,000 in accounts receivable. In addition to these financial assets, the company has unused available lines of credit totaling \$15,465,000 for working capital and other general corporate purposes, including potential acquisitions and its share repurchase program as well as unused lines of credit of \$16,465,000 for foreign currency exposure related to its forward exchange contracts (note 11).

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

## 8 Inventories

|                  | As at August 31, |          |
|------------------|------------------|----------|
|                  | 2011             | 2010     |
| Raw materials    | \$30,280         | \$21,505 |
| Work in progress | 2,206            | 1,975    |
| Finished goods   | 20,268           | 16,848   |
|                  | \$52,754         | \$40,328 |

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

Inventory write-down amounted to \$2,982,000, \$2,664,000 and \$3,577,000 for the years ended August 31, 2009, 2010 and 2011, respectively.

## 9 Property, Plant and Equipment

|                                    | As at August 31, |                          |          |                          |
|------------------------------------|------------------|--------------------------|----------|--------------------------|
|                                    | 2011             |                          | 2010     |                          |
|                                    | Cost             | Accumulated amortization | Cost     | Accumulated amortization |
| Land and land improvements         | \$4,705          | \$ 1,317                 | \$2,287  | \$ 1,200                 |
| Buildings                          | 17,346           | 5,868                    | 14,395   | 4,987                    |
| Equipment                          | 44,034           | 32,470                   | 39,734   | 28,282                   |
| Leasehold improvements             | 3,255            | 2,061                    | 2,976    | 1,468                    |
| Asset under construction (note 14) | 2,942            | —                        | —        | —                        |
|                                    | 72,282           | \$ 41,716                | 59,392   | \$ 35,937                |
| Less:                              |                  |                          |          |                          |
| Accumulated amortization           | 41,716           |                          | 35,937   |                          |
|                                    | \$30,566         |                          | \$23,455 |                          |

As at August 31, 2009, 2010 and 2011, unpaid purchases of property, plant and equipment amounted to \$348,000, \$391,000 and \$2,056,000, respectively.



Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

## 10 Intangible Assets and Goodwill

## Intangible assets

|                          | As at August 31, |                             |          |                             |
|--------------------------|------------------|-----------------------------|----------|-----------------------------|
|                          | 2011             |                             | 2010     |                             |
|                          | Cost             | Accumulated<br>amortization | Cost     | Accumulated<br>amortization |
| Core technology          | \$27,215         | \$ 14,455                   | \$34,858 | \$ 17,496                   |
| Customer relationships   | 7,519            | 2,211                       | 6,615    | 622                         |
| Brand name               | 749              | 220                         | 659      | 62                          |
| Software                 | 13,722           | 9,418                       | 11,557   | 7,562                       |
|                          | 49,205           | \$ 26,304                   | 53,689   | \$ 25,742                   |
| Less:                    |                  |                             |          |                             |
| Accumulated amortization | 26,304           |                             | 25,742   |                             |
|                          | \$22,901         |                             | \$27,947 |                             |

Estimated amortization expense for intangible assets in each of the next five fiscal years amounts to \$8,203,000 in 2012, \$7,034,000 in 2013, \$4,658,000 in 2014, \$2,488,000 in 2015 and \$284,000 in 2016.

Additions to intangible assets for the years ended August 31, 2009, 2010 and 2011 amounted to \$2,543,000, \$19,369,000 and \$1,763,000 respectively.

## Goodwill

Changes in the carrying value of goodwill are as follows:

|   | Years ended August 31, |          |
|---|------------------------|----------|
|   | 2011                   | 2010     |
| Balance – Beginning of year                 | \$29,355               | \$17,840 |
| Addition from business combination (note 3) | –                      | 12,560   |
| Foreign currency translation adjustment     | 1,587                  | (1,045 ) |
| Balance – End of year                       | \$30,942               | \$29,355 |



## 11 Credit Facilities

The company has lines of credit that provide for advances of up to CA\$15,000,000 (US\$15,331,000) and up to US\$2,000,000. These lines of credit bear interest at the Canadian prime rate. As at August 31, 2011, an amount of CA\$4,972,000 (US\$5,082,000) was drawn from these lines of credit for letters of guarantee in the normal course of the company's operations. From this amount, the company had \$682,000 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.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

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, 2011, an amount of CNY5,000,000 (US\$784,000) was drawn from that line of credit.

Finally, the company has lines of credit of US\$20,050,000 for the foreign currency risk exposure related to its forward exchange contracts (note 7). As at August 31, 2011, an amount of US\$3,585,000 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, |          |
|-------------------------------------|------------------|----------|
|                                     | 2011             | 2010     |
| Trade                               | \$15,717         | \$14,244 |
| Salaries and social benefits        | 12,649           | 12,400   |
| Warranty                            | 1,402            | 579      |
| Forward exchange contracts (note 7) | –                | 232      |
| Other                               | 2,369            | 3,415    |
|                                     | \$32,137         | \$30,870 |

Changes in the warranty provision are as follows:

|                             | Years ended August 31, |        |
|-----------------------------|------------------------|--------|
|                             | 2011                   | 2010   |
| Balance – Beginning of year | \$579                  | \$647  |
| Provision                   | 1,608                  | 810    |
| Settlements                 | (785 )                 | (878 ) |
| Balance – End of year       | \$1,402                | \$579  |

## 13 Long-Term Debt

|  | Years ended August 31, |      |
|--|------------------------|------|
|  | 2011                   | 2010 |

|  |         |         |
|--|---------|---------|
| Loan collateralized by assets of NetHawk Oyj denominated in euros (€1,120), bearing interest at 2.95%, repayable in semi-annual installments of \$323 (€224), maturing in December 2013 (note 3) | \$1,613 | \$1,987 |
| Less: current portion  | 645     | 568     |
|  | \$968   | \$1,419 |

Capital repayments required in the next three years amount to \$645,000 in 2012, \$645,000 in 2013 and \$323,000 in 2014.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

14 Commitments

a) Operating leases

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, 2011, minimum rental expenses of these operating leases in each of the next five years will amount to \$4,659,000 in 2012, \$2,519,000 in 2013, \$1,402,000 in 2014, \$1,035,000 in 2015 and \$662,000 in 2016. As at August 31, 2011, total commitments for these operating leases amount to \$10,802,000.

For the years ended August 31, 2009, 2010 and 2011, rental expenses amounted to \$2,534,000, \$3,798,000 and \$5,303,000, respectively.

b) Property, plant and equipment

In fiscal 2011, the company undertook the construction of a new building in Montreal, Canada. As at August 31, 2011, the company has commitments totaling \$15,200,000 (CA\$14,900,000) in relation to this building. The construction is expected to be completed in the third quarter of fiscal 2012.

15 Contingency

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.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

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. Appeals of the opinion granting final approval were filed, all of which were disposed of except the appeals filed by one objector were remanded to the district court to determine standing to appeal. On August 25, 2011, the district court issued an order holding that the final objector had no standing to appeal. The objector has appealed that decision. Given that the district court's August 25, 2011 remains subject to appeal, 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, 2011 to be immaterial.

## 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

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

The following table summarizes the share capital activity since August 31, 2008:

|   | Multiple voting shares |        | Subordinate voting shares |            | Total amount |
|---|------------------------|--------|---------------------------|------------|--------------|
|   | Number                 | Amount | Number                    | Amount     |              |
| 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      |
| Conversion of multiple voting shares into subordinate voting shares                               | (5,000,000 )           | –      | 5,000,000                 | –          | –            |
| Exercise of stock options (note 17)   | –                      | –      | 306,825                   | 1,452      | 1,452        |
| Redemption of restricted share units (note 17)  | –                      | –      | 340,974                   | –          | –            |
| Redemption of deferred shares units (note 17)   | –                      | –      | 37,491                    | –          | –            |
| Reclassification of stock-based compensation costs to share capital upon exercise of stock awards | –                      | –      | –                         | 2,763      | 2,763        |
| Balance as at August 31, 2011   | 31,643,000             | \$ 1   | 28,621,999                | \$ 110,340 | \$ 110,341   |

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. The company redeemed for cancellation 488,786 subordinate voting shares for an aggregate net purchase price



of \$1,416,000 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.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

- 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 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. The company redeemed for cancellation 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 had authorized 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 period of the normal course issuer bid started on November 10, 2010, and will end on November 9, 2011. As at November 7, 2011, the company had redeemed for cancellation 25,055 shares under that program for an aggregate net purchase price of \$144,197.
- e) On November 7, 2011 the company announced that its Board of Directors approved the fourth renewal of its share repurchase program, by way of a normal course issuer bid on the open market of up to 2% of issued and outstanding subordinate voting share, representing 575,690 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, 2011, and will end on November 9, 2012, 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.

The total stock-based compensation costs included in the statements of earnings for the years ended August 31, 2009, 2010 and 2011 amounted to \$1,409,000, \$1,786,000 and \$2,256,000, respectively.

### 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.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

The following table summarizes stock option activity since August 31, 2008:

|                                 | Years ended August 31, |  |            |  |            |  |
|---------------------------------|------------------------|--|------------|--|------------|--|
|                                 | 2011                   |  | 2010       |  | 2009       |  |
|                                 | Number                 | Weighted average exercise price (CA\$) | Number     | Weighted average exercise price (CA\$) | Number     | Weighted average exercise price (CA\$) |
| Outstanding – Beginning of year | 1,348,787              | \$19                                   | 1,666,589  | \$21                                   | 1,821,481  | \$21                                   |
| Exercised                       | (306,825 )             | 5                                      | (83,700 )  | 4                                      | (27,500 )  | 3                                      |
| Forfeited                       | (43,541 )              | 14                                     | –          | –                                      | (1,000 )   | 6                                      |
| Expired                         | (357,064 )             | 48                                     | (234,102 ) | 36                                     | (126,392 ) | 26                                     |
| Outstanding – End of year       | 641,357                | \$9                                    | 1,348,787  | \$19                                   | 1,666,589  | \$21                                   |
| Exercisable – End of year       | 641,357                | \$9                                    | 1,348,787  | \$19                                   | 1,660,090  | \$21                                   |

The intrinsic value of stock options exercised during fiscal 2009, 2010 and 2011 was \$23,000, \$73,000 and \$603,000, respectively.

The following table summarizes information about stock options as at August 31, 2011:

## Stock options outstanding and exercisable

| Exercise price (CA\$) | Number  | Weighted average exercise price (CA\$) | Intrinsic value (CA\$) | Weighted average remaining contractual life |
|-----------------------|---------|--|------------------------|---|
| \$ 2.50               | 112,025 | \$ 2.50                                | \$ 453                 | 1 year                                      |
| 4.64 to               |         |  |                        |   |
| \$ \$6.28             | 243,529 | 5.48                                   | 261                    | 3 years                                     |
| \$ 9.02               | 10,000  | 9.02                                   | –                      | 1 year                                      |
| 14.27 to              |         |  |                        |   |
| \$ \$20.00            | 275,803 | 15.73                                  | –                      | –   |
|                       | 641,357 | \$ 9.42                                | \$ 714                 | 1 year                                      |

Restricted Share Units (RSUs)

RSUs are stock awards 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.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

The following table summarizes RSU activity since August 31, 2008:

|                                 | Years ended August 31, |            |            |
|---------------------------------|------------------------|------------|------------|
|                                 | 2011                   | 2010       | 2009       |
| Outstanding – Beginning of year | 1,603,048              | 1,339,619  | 847,791    |
| Granted                         | 350,382                | 415,538    | 685,972    |
| Redeemed                        | (340,974 )             | (120,307 ) | (106,190 ) |
| Forfeited                       | (60,798 )              | (31,802 )  | (87,954 )  |
| Outstanding – End of year       | 1,551,658              | 1,603,048  | 1,339,619  |

None of the RSUs outstanding, as at August 31, 2009, 2010 and 2011, were redeemable. The weighted average grant-date fair value of RSUs granted during fiscal 2009, 2010 and 2011 amounted to \$2.69, \$4.50 and \$7.26, respectively.

As at August 31, 2011, the intrinsic value of RSUs outstanding was \$10,381,000.

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

As at August 31, 2011, unrecognized stock-based compensation costs of unvested RSUs amounted to \$3,953,000. The weighted average period over which they are expected to be recognized is 2 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 will cease 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, 2008:

|                                 | Years ended August 31, |         |        |
|---------------------------------|------------------------|---------|--------|
|                                 | 2011                   | 2010    | 2009   |
| Outstanding – Beginning of year | 135,003                | 114,924 | 79,185 |
| Granted                         | 12,786                 | 20,079  | 35,739 |
| Redeemed                        | (37,491 )              | –       | –      |

|                           |         |         |         |
|---------------------------|---------|---------|---------|
| Outstanding – End of year | 110,298 | 135,003 | 114,924 |
|---------------------------|---------|---------|---------|

None of the DSUs outstanding as at August 31, 2009, 2010 and 2011 were redeemable. The weighted average grant-date fair value of DSUs granted during fiscal 2009, 2010 and 2011 amounted to \$3.19, \$4.79 and \$7.87, respectively.

As at August 31, 2011, the intrinsic value of DSUs outstanding was \$738,000.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

## 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 generally 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, 2008:

|                                 | Years ended August 31, |                                 |        |                                 |        |                                 |
|---------------------------------|------------------------|---------------------------------|--------|---------------------------------|--------|---------------------------------|
|                                 | 2011                   |                                 | 2010   |                                 | 2009   |                                 |
|                                 | Number                 | Weighted average exercise price | Number | Weighted average exercise price | Number | Weighted average exercise price |
| Outstanding – Beginning of year | 44,374                 | \$8                             | 40,374 | \$8                             | 30,700 | \$10                            |
| Granted                         | 4,500                  | –                               | 4,000  | 4                               | 9,674  | 2                               |
| Exercised                       | (14,750 )              | 5                               | –      | –                               | –      | –                               |
| Expired                         | (5,000 )               | 34                              | –      | –                               | –      | –                               |
| Outstanding – End of year       | 29,124                 | \$3                             | 44,374 | \$8                             | 40,374 | \$8                             |
| Exercisable – End of year       | 10,075                 | \$5                             | 28,318 | \$10                            | 24,475 | \$11                            |

In fiscal 2011, the company paid \$73,000 upon the exercise of stock appreciation rights (nil in 2009 and 2010).

The following table summarizes information about stock appreciation rights as at August 31, 2011:

| Exercise price | Number | Weighted average remaining contractual life | Stock appreciation rights outstanding | Stock appreciation rights exercisable |
|----------------|--------|---|---------------------------------------|---------------------------------------|
|                |        |   | Number                                | Number                                |
|                |        |   |                                       |                                       |



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|    |                |        |         |        |
|----|----------------|--------|---------|--------|
| \$ | –              | 4,500  | 9 years | –      |
| \$ | 2.36           | 9,674  | 7 years | 6,500  |
| \$ | 3.74 to \$4.65 | 10,500 | 5 years | 3,575  |
| \$ | 6.28 to \$6.50 | 4,450  | 5 years | –      |
|    |                | 29,124 | 6 years | 10,075 |

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

## 18 Other Disclosures

Net research and development expenses

Net research and development expenses comprise the following:

|   | Years ended August 31, |          |          |
|---|------------------------|----------|----------|
|   | 2011                   | 2010     | 2009     |
| Gross research and development expenses         | \$57,226               | \$44,551 | \$33,584 |
| Research and development tax credits and grants | (9,299 )               | (6,704 ) | (6,371 ) |
|   | \$47,927               | \$37,847 | \$27,213 |

## 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, 2011, 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 2009, 2010 and 2011, the company recorded nil, \$875,000 and \$2,085,000, respectively, under that program in the statements 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 3% (2% prior to January 2011) of an employee's gross salary, provided that the employee has contributed at least 3% (2% prior to January 2011) 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, 2009, 2010 and 2011, amounted to \$504,000, \$592,000 and \$911,000, 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. In addition, eligible employees may contribute up to the lesser of 1% of eligible compensation or the statutorily prescribed annual limit to the 401K plan. The 401K plan permits, but does not require the company to make additional matching contributions to the 401K plan on behalf of the eligible participants, subject to a maximum of 50% of the first 6% of the participant's current compensation subject to certain legislated maximum contribution limits. During the years ended August 31, 2009, 2010 and 2011, the company recorded cash contributions and expenses totaling \$544,000, \$525,000 and \$680,000, respectively.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

## 19 Income Taxes

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, |          |            |
|--|------------------------|----------|------------|
|  | 2011                   | 2010     | 2009       |
| Income tax provision at the combined Canadian federal and provincial statutory tax rate (29% in 2011, 30% in 2010 and 31% in 2009) | \$4,410                | \$2,724  | \$(6,383 ) |
| Increase (decrease) due to:  |                        |          |            |
| Foreign income taxed at different rates  | (327 )                 | (459 )   | 56         |
| Non-taxable income   | (3,404 )               | (787 )   | (211 )     |
| Non-deductible expenses  | 916                    | 851      | 5,200      |
| Change in tax rates  | –                      | 97       | –          |
| Foreign exchange effect of translation of foreign integrated subsidiaries  | 2,541                  | (55 )    | 189        |
| Other  | (402 )                 | (27 )    | 638        |
| Utilization of previously unrecognized future income tax assets  | (61 )                  | (349 )   | (68 )      |
| Unrecognized future income tax assets on temporary deductible differences and unused tax losses and deductions                     | 5,110                  | 3,534    | 845        |
|  | \$8,783                | \$5,529  | \$266      |
| The income tax provision consists of the following:  |                        |          |            |
| Current  |                        |          |            |
| Canada   | \$9                    | \$13     | \$87       |
| Other  | 1,916                  | 702      | 500        |
|  | 1,925                  | 715      | 587        |
| Future   |                        |          |            |
| Canada   | 5,999                  | 4,316    | 1,045      |
| Finland  | (3,156 )               | (928 )   | –          |
| United States  | (738 )                 | (1,501 ) | (2,511 )   |
| Other  | (296 )                 | (258 )   | 368        |
|  | 1,809                  | 1,629    | (1,098 )   |
| Valuation allowance  |                        |          |            |
| Canada   | 426                    | 7        | 236        |
| Finland  | 3,156                  | 928      | –          |
| United States  | 1,426                  | 2,203    | 604        |
| Other  | 41                     | 47       | (63 )      |

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|   |          |         |         |
|---|----------|---------|---------|
|   | 5,049    | 3,185   | 777     |
|   | 6,858    | 4,814   | (321 )  |
|   | \$8,783  | \$5,529 | \$266   |
| The income tax provision for the discontinued operations is as follows: |          |         |         |
| Current   | \$27     | \$163   | \$(25 ) |
| Future  | (6,649 ) | 972     | 21      |
| Valuation allowance   | 6,823    | -       | -       |
|   | \$201    | \$1,135 | \$(4 )  |

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

|  | Years ended August 31, |          |             |
|--|------------------------|----------|-------------|
|  | 2011                   | 2010     | 2009        |
| Details of the company's income taxes: |                        |          |             |
| Earnings (loss) before income taxes    |                        |          |             |
| Canada                                 | \$21,894               | \$12,403 | \$(15,611 ) |
| Finland                                | (14,760 )              | (1,921 ) | –           |
| United States                          | 3,128                  | (4,546 ) | (5,026 )    |
| Other                                  | 4,944                  | 3,143    | 46          |
|  | \$15,206               | \$9,079  | \$(20,591 ) |

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

|                                      | As at August 31, |           |
|--------------------------------------|------------------|-----------|
|                                      | 2011             | 2010      |
| Future income tax assets             |                  |           |
| Long-lived assets                    | \$5,262          | \$5,473   |
| Provisions and accruals              | 3,279            | 3,797     |
| Deferred revenue                     | 1,983            | 1,983     |
| Research and development expenses    | 5,515            | 9,954     |
| Losses carried forward               | 45,584           | 34,322    |
|                                      | 61,623           | 55,529    |
| Valuation allowance                  | (34,516 )        | (21,277 ) |
|                                      | 27,107           | 34,252    |
| Future income tax liabilities        |                  |           |
| Research and development tax credits | (9,698 )         | (7,793 )  |
| Long-lived assets                    | (5,168 )         | (7,161 )  |
| Deferred revenue                     | –                | (223 )    |
|                                      | (14,866 )        | (15,177 ) |
| Future income tax assets, net        | \$12,241         | \$19,075  |



Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

As at August 31, 2011, the company had available operating losses in several tax jurisdictions, against which a valuation allowance of \$20,889,000 was recorded. The valuation allowance includes \$8,321,000 for which subsequently recognized benefits will be allocated to reduce goodwill. The following table summarizes the year of expiry of these losses by tax jurisdiction:

| Year of expiry | Canada  |            | Finland  | United States | Other   |
|----------------|---------|------------|----------|---------------|---------|
|                | Federal | Provincial |          |               |         |
| 2012           | \$-     | \$-        | \$2,417  | \$-           | \$-     |
| 2013           | -       | -          | 8,096    | -             | -       |
| 2014           | -       | -          | 4,896    | -             | -       |
| 2015           | 1,217   | 1,217      | 3,172    | -             | 67      |
| 2016           | -       | -          | -        | -             | 75      |
| 2017           | -       | -          | 4        | -             | 4       |
| 2018           | -       | -          | 418      | -             | 103     |
| 2019           | -       | -          | -        | 741           | 86      |
| 2020           | -       | -          | 10,197   | 3,470         | -       |
| 2021           | -       | -          | 7,997    | 10,202        | -       |
| 2022           | -       | -          | -        | 7,434         | -       |
| 2023           | -       | -          | -        | 6,033         | -       |
| 2024           | -       | -          | -        | 3,954         | -       |
| 2025           | -       | -          | -        | 8,449         | -       |
| 2026           | 1,099   | 1,099      | -        | 4,126         | -       |
| 2027           | 1,394   | 1,394      | -        | 1,355         | -       |
| 2028           | -       | -          | -        | 2,472         | -       |
| 2029           | -       | -          | -        | 2,621         | -       |
| 2030           | 12      | 12         | -        | 2,713         | -       |
| 2031           | 39      | 39         | -        | 664           | -       |
| Indefinite     | -       | -          | -        | 8,824         | 5,137   |
|                | \$3,761 | \$3,761    | \$37,197 | \$63,058      | \$5,472 |

Furthermore, as at August 31, 2011, the company had available capital losses in Canada amounting to \$73,886,000 at the federal level and \$74,251,000 at the provincial level, against which a valuation allowance of \$9,930,000 was recorded.

As at August 31, 2011, in addition to operating and capital losses, the company had available research and development expenses in several tax jurisdictions. The following table summarizes the carry-forward period of these research and development expenses by tax jurisdiction:

Canada



| Carry-forward period | Federal  | Provincial | Finland | United States |
|----------------------|----------|------------|---------|---------------|
| 2012                 | \$-      | \$-        | \$1,806 | \$-           |
| 2013                 | -        | -          | 1,375   | 1,726         |
| 2014                 | -        | -          | 724     | 1,404         |
| 2015                 | -        | -          | 113     | 997           |
| 2016                 | -        | -          | -       | 553           |
| Indefinite           | 12,293   | 5,925      | -       | -             |
|                      | \$12,293 | \$5,925    | \$4,018 | \$4,680       |

A valuation allowance of \$2,917,000 was recorded against these assets for which subsequently recognized benefits will be allocated to reduce goodwill.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

In the event the company does not generate sufficient taxable income to use the available research and development expenses at the expiry of the carry-forward period in Finland and United States, the unused portion of these expenses will be included in operating losses and deferred over the losses statutory carry-forward period.

Finally, as at August 31, 2011, the company had non-refundable research and development tax credits in the amount of \$36,620,000. The following table summarizes the year of expiry of these non-refundable research and development tax credits by tax jurisdiction:

| Year of expiry | Canada   |            |
|----------------|----------|------------|
|                | Federal  | Provincial |
| 2018           | \$537    | \$-        |
| 2019           | 1,170    | -          |
| 2020           | 1,541    | -          |
| 2021           | 1,774    | -          |
| 2022           | 1,498    | -          |
| 2023           | 1,532    | -          |
| 2024           | 391      | -          |
| 2025           | 3,074    | -          |
| 2026           | 3,425    | -          |
| 2027           | 3,931    | -          |
| 2028           | 4,306    | -          |
| 2029           | 4,443    | 280        |
| 2030           | 4,045    | 206        |
| 2031           | 4,237    | 230        |
|                | \$35,904 | \$716      |

## 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, |        |        |
|---|------------------------|--------|--------|
|   | 2011                   | 2010   | 2009   |
| Basic weighted average number of shares outstanding (000's) | 60,000                 | 59,479 | 61,845 |
| Plus dilutive effect of (000's):                            |                        |        |        |
| Stock options   | 266                    | 228    | 131    |
| Restricted share units                                      | 1,106                  | 786    | 311    |

|   |        |        |        |
|---|--------|--------|--------|
| Deferred share units  | 116    | 123    | 94     |
| Diluted weighted average number of shares outstanding (000's)   | 61,488 | 60,616 | 62,381 |
| 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) | 381    | 960    | 1,602  |

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 year was calculated using the basic weighted average number of shares outstanding.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

## 21 Segment Information

As a result of the disposal of the Life Sciences and Industrial Division in fourth quarter of 2010, the company has only one reportable segment.

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

|                                | Years ended August 31, |           |           |
|--------------------------------|------------------------|-----------|-----------|
|                                | 2011                   | 2010      | 2009      |
| United States                  | \$89,240               | \$76,669  | \$61,757  |
| Canada                         | 30,986                 | 18,278    | 17,331    |
| Latin America                  | 17,303                 | 11,454    | 7,729     |
| Americas                       | 137,529                | 106,401   | 86,817    |
| United Kingdom                 | 15,617                 | 10,936    | 6,188     |
| Other                          | 69,698                 | 49,288    | 36,466    |
| Europe, Middle-East and Africa | 85,315                 | 60,224    | 42,654    |
| China                          | 25,799                 | 17,610    | 13,784    |
| Other                          | 21,100                 | 18,522    | 9,827     |
| Asia-Pacific                   | 46,899                 | 36,132    | 23,611    |
|                                | \$269,743              | \$202,757 | \$153,082 |

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,                    |                      |          |                                     |                      |          |
|--------|-------------------------------------|----------------------|----------|-------------------------------------|----------------------|----------|
|        | 2011                                |                      |          | 2010                                |                      |          |
|        | Property,<br>plant and<br>equipment | Intangible<br>assets | Goodwill | Property,<br>plant and<br>equipment | Intangible<br>assets | Goodwill |
| Canada | \$19,696                            | \$3,164              | \$-      | \$13,753                            | \$3,316              | \$-      |

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|               |          |          |          |          |          |          |
|---------------|----------|----------|----------|----------|----------|----------|
| United States | 1,402    | 4,834    | 17,782   | 1,829    | 7,828    | 17,782   |
| Finland       | 1,544    | 13,324   | 13,160   | 1,606    | 14,906   | 11,573   |
| India         | 4,709    | 43       | –        | 3,134    | 43       | –        |
| China         | 2,696    | 27       | –        | 2,665    | 33       | –        |
| Other         | 519      | 1,509    | –        | 468      | 1,821    | –        |
|               | \$30,566 | \$22,901 | \$30,942 | \$23,455 | \$27,947 | \$29,355 |

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

## 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, |          |              |
|--|------------------------|----------|--------------|
|  | 2011                   | 2010     | 2009         |
| Net earnings (loss) for the year in accordance with Canadian GAAP                                | \$ 19,349              | \$ 6,619 | \$ (16,585 ) |
| Gain on disposal of discontinued operations a )  | 4,130                  | –        | –            |
| Acquisition-related costs on business combination b )  | –                      | (2,842 ) | –            |
| Impairment of goodwill c )   | –                      | –        | 8,406        |
| Changes in fair value of cash contingent consideration b )                                       | 2,685                  | –        | –            |
| Net earnings (loss) for the year in accordance with U.S. GAAP                                    | 26,164                 | 3,777    | (8,179 )     |
| Foreign currency translation adjustment b )  | 19,264                 | 3,952    | (10,671 )    |
| Changes in unrealized losses on available-for-sale securities                                    | 2                      | –        | 22           |
| Unrealized gains (losses) on forward exchange contracts  | 3,413                  | 940      | (1,467 )     |
| Reclassification of realized (gains) losses on forward exchange contracts in net earnings (loss) | (2,191 )               | (1,022 ) | 3,167        |
| Future income taxes effect of the above items  | (314 )                 | 24       | (528 )       |
| Comprehensive income (loss) under U.S. GAAP  | \$ 46,338              | \$ 7,671 | \$ (17,656 ) |

U.S. GAAP net earnings (loss) are comprised of:

|  |           |          |              |
|--|-----------|----------|--------------|
| Net earnings (loss) from continuing operations | \$ 9,108  | \$ 708   | \$ (12,451 ) |
| Net earnings from discontinued operations      | 17,056    | 3,069    | 4,272        |
|  | \$ 26,164 | \$ 3,777 | \$ (8,179 )  |

Basic net and diluted earnings (loss) from continuing operations per share in accordance with U.S. GAAP

|  |         |         |            |
|--|---------|---------|------------|
|  | \$ 0.15 | \$ 0.01 | \$ (0.20 ) |
|--|---------|---------|------------|

Basic and diluted net earnings from discontinued operations per share in accordance with U.S. GAAP

|  |         |         |         |
|--|---------|---------|---------|
|  | \$ 0.28 | \$ 0.05 | \$ 0.07 |
|--|---------|---------|---------|

Basic net earnings (loss) per share in accordance with U.S. GAAP

|  |         |         |            |
|--|---------|---------|------------|
|  | \$ 0.44 | \$ 0.06 | \$ (0.13 ) |
|--|---------|---------|------------|

Diluted net earnings (loss) per share in accordance with U.S. GAAP

|  |         |         |            |
|--|---------|---------|------------|
|  | \$ 0.43 | \$ 0.06 | \$ (0.13 ) |
|--|---------|---------|------------|

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

## 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, |            |
|---|-----|------------------|------------|
|   |     | 2011             | 2010       |
| Shareholders' equity in accordance with Canadian GAAP |     | \$ 263,746       | \$ 220,419 |
| Goodwill  | c ) | 47               | 42         |
| Long-term assets held for sale                        | c ) | —                | (3,988 )   |
| Cash contingent consideration payable                 | b ) | (338 )           | (2,660 )   |
| Stock appreciation rights                             | d ) | (73 )            | (73 )      |
| Shareholders' equity in accordance with U.S. GAAP     |     | \$ 263,382       | \$ 213,740 |

## Statements of cash flows

For the years ended August 31, 2010 and 2011, cash flows from operating activities under U.S. GAAP were \$2,310,000 and \$445,000 lower, respectively, compared to those established under Canadian GAAP; this difference arose from NetHawk's acquisition-related costs paid during these years and expensed under U.S. GAAP (see reconciliation item b) below). Corresponding differences 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 year ended August 31, 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) Gain on disposal of discontinued operations

Under U.S. GAAP, the carrying value of goodwill of the Life Sciences and Industrial Division (discontinued operations) was \$4,130,000 lower than the carrying value under Canadian GAAP. As a result, under U.S. GAAP, the gain on the disposal of that Division was higher for the same amount (see reconciliation item c)).





Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

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 change in 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) on the acquisition date and recorded in long-term liabilities under U.S. GAAP, with a corresponding increase of goodwill. The fair value of the cash contingent consideration has been reassessed as at August 31, 2010 and there was no change since the acquisition. The fair value on the acquisition date and as at August 31, 2010 was based on discounted estimated sales of certain products of NetHawk over the three-year period following the acquisition. The fair value of the cash contingent consideration was remeasured and estimated to €235,000 (US\$338,000) as at August 31, 2011 based on actual sales since the acquisition and forecasted sales from September 2011 to December 2012. The decrease in the fair value of the cash contingent consideration in the amount of €1,864,000 (US\$2,685,000) was recognized in the statement of earnings for the year ended August 31, 2011. The fair value of the cash contingent consideration is determined based on management’s best estimate of sales.

As a result of these GAAP differences, the foreign currency translation adjustment for the year ended August 31, 2011 was \$135,000 lower under U.S. GAAP compared to the amount recognized under Canadian GAAP.

c) 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.

d) 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. 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.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

e) 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 \$4,032,000, \$3,656,000 and \$4,226,000 for fiscal 2009, 2010 and 2011, respectively. This difference has no impact on the net earnings (loss) and the net earnings (loss) per share figures for the reporting years.

f) Gross margin

The cost of sales is exclusive of amortization, shown separately in the statements of earnings. Under U.S. GAAP, the presentation of the gross margin line item, exclusive of amortization, is not permitted.

g) New accounting standards and pronouncements

Adopted in fiscal 2011

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.

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.

The company adopted Topics 985 and 605 on September 1, 2010, at the same time it adopted similar new requirements under Canadian GAAP (note 2); adoption of Topics 985 and 605 had no significant impact on its consolidated financial statements.

To be adopted after fiscal 2011

The company will cease to reconcile its consolidated financial statements to U.S. GAAP for the periods beginning on September 1, 2011 when it will start to apply as its primary basis of accounting the International Financial

Reporting Standards published by the International Accounting Standards Board and set out in Part I of the CICA Handbook – Accounting. Consequently, future accounting changes to U.S. GAAP are not discussed in these consolidated financial statements as they will never be applied by the company.

Table of Contents

EXFO Inc.

Notes to Consolidated Financial Statements

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

Unaudited pro forma information on business combination

Under U.S. GAAP, pro forma information must be provided as though the business combination had occurred at the beginning of the reported periods.

The following unaudited pro forma information reflects the results of operations as if the 2010 acquisition had been completed on September 1, 2008:

|   | Years ended August 31, |             |
|---|------------------------|-------------|
|   | 2010                   | 2009        |
|   |                        | (unaudited) |
| Sales   | \$220,621              | \$191,040   |
| Net earnings (loss)                             | \$2,119                | \$(19,317 ) |
| Basic and diluted net earnings (loss) per share | \$0.04                 | \$(0.31 )   |

Sales and net loss of the acquired company since the acquisition date included in the consolidated statement of earnings for the year ended August 31, 2010 amounted to \$14,483,000 and \$1,999,000, respectively.

Such information is not necessarily indicative of the actual results which would have been achieved, nor is it necessarily indicative of future consolidated results of the company.

Table of Contents

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 economic uncertainty (including our ability to quickly adapt cost structures with anticipated levels of business, ability to manage inventory levels with market demand); future economic, competitive, financial and market condition; capital spending levels in the telecommunications industry; limited visibility with regards to customer orders and the timing of such orders; fluctuating exchange rates; our ability to successfully integrate our acquired and to-be-acquired businesses; consolidation in the global telecommunications test and service assurance industry and increased competition among vendors; concentration of sales; market acceptance of our new products and other upcoming products; our ability to successfully expand international operations; and the retention of key technical and management personnel. Assumptions relating to the foregoing involve judgments and risks, all of which are difficult or impossible to predict and many of which are beyond our control. Other risk factors that may affect our future performance and operations are detailed in our Annual Report, on Form 20-F, and our other filings with the U.S. Securities and Exchange Commission and the Canadian securities commissions. We believe that the expectations reflected in the forward-looking statements are reasonable based on information currently available to us, but we cannot assure 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 7, 2011.

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

**INDUSTRY OVERVIEW**

Market conditions in the telecommunications industry remain tenuous based on weak global economic growth and unresolved sovereign debt issues in Europe. Despite this economic uncertainty, the fundamental drivers toward broadband deployments and fixed-mobile IP (Internet protocol) network convergence are entrenched in the telecommunications industry. Although network operators are not necessarily increasing capital expenditures in calendar 2011, 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 Visual Networking Index, global IP traffic will quadruple from 2010 to 2015, reaching 966 exabytes per year in 2015. (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 26-fold during the same period. This explosive growth is being driven by a proliferation of media-rich communication devices (smartphones and tablets), growing number of

Internet users, faster broadband speeds and increased video usage.



## Table of Contents

To support such 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. These 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 commercial deployments of 100 Gbit/s Ethernet networks are beginning to take place. 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 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 2011.

## COMPANY OVERVIEW

We are a leading provider of next-generation test and service assurance solutions for wireline and wireless network operators and equipment manufacturers in the global telecommunications industry. We offer core-to-edge solutions that assess the performance and reliability of converged, IP fixed and mobile networks. Our test and service assurance solutions specifically target high-growth market opportunities related to optimizing next-generation networks: wireless backhaul, 4G/LTE (long-term evolution), fiber-to-the-home (FTTH)/fiber-to-the-curb (FTTC)/fiber-to-the-node (FTTN), carrier Ethernet, and 40G/100G network upgrades. Customers on a global basis rely on our test and service assurance solutions to enable their wireline and wireless networks to perform optimally during their complete lifecycles: research, development, manufacturing, installation, maintenance and monitoring. Our success has been largely predicated on our core expertise in developing telecom test equipment for wireline network operators and to a lesser extent equipment manufacturers, but over the years we have expanded our offering to wireless network operators, cable television companies, public utilities, private network operators, third-party installers, equipment rental companies, large enterprises, component vendors and laboratory researchers.

We have a staff of approximately 1800 people in 25 countries, supporting more than 2000 telecom customers in approximately 100 countries around the world. We operate three main manufacturing sites, which are located

in Quebec City, Canada, in Shenzhen, China and in Oulu, Finland. We also have six main research and development expertise centers in Boston, Toronto, Montreal, Quebec City, Oulu and Lappeenranta, supplemented by two software development centers in India.

Table of Contents

In June 2011, we undertook the construction of a new building in Montreal, Canada. Total costs for the new building are estimated to approximately \$22 million (CA\$21.5 million). The construction is expected to be completed in the third quarter of fiscal 2012.

In fiscal 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. On October 1, 2010, we closed the sale of that Division for total proceeds of \$21.6 million, net of a bank overdraft of \$303,000, selling costs of \$909,000 and future income taxes of \$141,000. As such, this Division has been presented as a discontinued operation in our consolidated financial statements. Assets and liabilities for the comparative year ended August 31, 2010 have been reclassified as assets held for sale and liabilities related to assets held for sale; revenues and expenses have been classified as discontinued operations for all years presented. 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 were 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 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 included an amount of \$780,000 for a statutory transfer tax payable in Finland based on the purchase price of shares.

We launched 19 new products in fiscal 2011, compared to 20 in fiscal 2010. Key product introductions in fiscal 2011 included EXFO Connect, a software suite of test management solutions for network operators to significantly increase productivity and reduce operating expenses. We also launched our intelligent Optical Link Mapper (iOLM), an innovative test solution that characterizes fiber-to-the-home (FTTH) networks 85% faster than the traditional method through the automated setting of complex OTDR acquisition parameters. In addition, we introduced our FTB-1 platform for FTTH and Ethernet testing applications. Finally, we released BrixHawk DA and BrixHawk SA, fully integrated solutions for the turn-up, troubleshooting and monitoring of 2G, 3G and 4G/LTE wireless networks.

We reported record-high sales of \$269.7 million from our continuing operations (formerly our Telecom Division) in fiscal 2011, which represented an increase of 33.0% year-over-year from \$202.8 million in 2010. Sales for fiscal 2011 included \$29.7 million from NetHawk, which was acquired on March 12, 2010, compared to \$14.5 million in 2010. Excluding the positive impact of the acquisition of NetHawk and the foreign exchange gains on our forward exchange contracts (\$2.8 million in 2011 vs. \$1.5 million in 2010), our sales would have increased 27.1% year-over-year organically.

In fiscal 2011, we believe that we benefited from increased capital-intensive deployments and capacity expansion from wireless and wireline network operators compared to 2010. In addition, in fiscal 2011, we benefited from improved market conditions compared to 2010, following the worldwide economic recession in 2009. Furthermore,

we benefited from our strong product offering that we believe is greatly aligned with the major trend of bandwidth demand. Also, we believe we gained overall market share in fiscal 2011, which contributed also to the increase in our sales year-over-year. Finally, in fiscal 2011, we benefited from larger calendar year-end budget spending from some of our customers, compared to 2010, which increased our sales year-over-year.

Table of Contents

We reported GAAP net earnings from continuing operations of \$6.4 million, or \$0.10 per diluted share, in fiscal 2011, compared to \$3.6 million, or \$0.06 per diluted share, in 2010. Net earnings from continuing operations for fiscal 2011 included \$8.7 million in after-tax amortization of intangible assets and \$2.0 million in stock-based compensation costs. Net earnings from continuing operations for fiscal 2010 included \$6.5 million in after-tax amortization of intangible assets and \$1.7 million in stock-based compensation costs. Earnings from operations (from continuing operations) significantly improved 70.3% year-over-year from \$10.9 million, or 5.4% of sales in fiscal 2010, to \$18.5 million, or 6.9% of sales in 2011, despite a headwind from a stronger Canadian dollar compared to the US dollar year-over-year.

Adjusted EBITDA (net earnings before interest, income taxes, amortization of property, plant and equipment, amortization of intangible assets and gain from disposal of discontinued operations) reached \$30.6 million or 11.3% of global sales in fiscal 2011, compared to \$27.3 million, or 12.0% of global sales in 2010. Adjusted EBITDA in fiscal 2011 included a foreign exchange loss of \$3.8 million (\$1.5 million in 2010). See further in this document for a complete reconciliation of adjusted EBITDA to GAAP net earnings.

In fiscal 2011, we faced a substantial increase in the value of the Canadian dollar versus the US dollar compared to 2010; this had a two-fold negative impact on our financial results. Firstly, the average value of the Canadian dollar versus the US dollar increased 5.6% in fiscal 2011, compared to 2010. Given that a significant portion 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 2011.

Secondly, we recorded a significant foreign exchange loss of \$3.8 million in fiscal 2011, which mainly represents the effect of the 9.0% increase in the period-end value of the Canadian dollar versus the US dollar on our balance sheet items during that year. In comparison, in fiscal 2010, we reported a foreign exchange loss of \$1.5 million following the increase in the value of the Canadian dollar compared to the US dollar, the euro and the British pound during that year.

On November 5, 2010 we announced that our Board of Directors approved the renewal of our share repurchase program, by way of a normal course issuer bid on the open market of up to 10% of our public float (as defined by the Toronto Stock Exchange), or 2.0 million of subordinate voting shares at the prevailing market price. The normal course issuer bid started on November 10, 2010, and will end on November 9, 2011. As at November 7, 2011, the company had redeemed for cancellation 25,055 shares under that program for an aggregate net purchase price of \$144,197.

On November 7, 2011 we announced that our Board of Directors approved the renewal of our share repurchase program, by way of a normal course issuer bid on the open market of up to 2% of the issued and outstanding subordinate voting shares, representing 575,690 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, 2011, and will end on November 9, 2012, 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. 23704 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.



## Table of Contents

### Sales

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

In fiscal 2010 and 2011, no customer accounted for more than 10% of our sales, with our top customer representing 4.9% and 7.2% 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 long-term goal is to become the market leader in the global telecom test and service assurance industry. Given explosive bandwidth demand and IP convergence, 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 goal, 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.



Table of Contents

To gauge the success of our strategy, we had established three corporate performance objectives for the three-year period ending in fiscal 2012:

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

\* 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 and impairment of goodwill. Adjusted EBITDA represents EBITDA excluding the gain from the disposal of discontinued operations.

These three-year objectives were established based on results achieved in the past few years as well as on our strategic plan for that three-year period. We are witnessing a period of significant investments in the telecom industry and we believe that 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 2011

Our corporate performance objectives take 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 2009, 2010 and 2011. As such, sales and operating results of that Division were included in the results achieved in fiscal 2011.

Following are our results after two years into our three-year plan:

#### Corporate Performance Objectives (Fiscal 2010-2012)

| Objectives  | Metrics | Results After Two Years |
|---|---------|-------------------------|
| Increase sales by a CAGR* of at least:                        | 25%     | 25.4%                   |
| Raise gross margin from 61.3% to:                             | 65%     | 62.7%                   |
| Increase adjusted EBITDA** in dollars by a CAGR* of at least: | 30%     | 45.4%                   |

In fiscal 2011, sales including those of the discontinued operations amounted to \$271.7 million, which represents a CAGR of 25.4% after two years. Our gross margin, including the effect of the discontinued operations, reached 62.7%, 0.3% higher compared to 62.4% in 2010. Finally, adjusted EBITDA, including the operating results of the discontinued operations, amounted to \$30.6 million or 11.3 % of sales in fiscal 2011, representing a CAGR of 45.4% after two years. 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 adjusted EBITDA.

Given our strong positioning for key growth opportunities and disciplined focus on execution, we remain committed achieving or finishing close to our three-year corporate performance objectives that reach maturity at the end of fiscal 2012. However, continuing uncertainty in the global economy or possible worldwide recession will impact the achievement of our three-year objectives.



Table of Contents

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.** Our multiple deliverable revenue arrangements may include tangible products (software and/or non-software components), extended warranties, maintenance contracts, post-contract customer support (PCS) on software components as well as installation.

Since September 1, 2010, when a sales arrangement contains multiple elements and software and non-software components function together to deliver the tangible products' essential functionality, we allocate revenue to each element based on the relative selling price of each element. Under this approach, the selling price of a deliverable is determined by using a selling price hierarchy which requires the use of vendor-specific objective evidence ("VSOE") of fair value if available, third-party evidence ("TPE") if VSOE is not available, or best estimated selling price ("BESP") if neither VSOE nor TPE are available.

We establish VSOE of selling price using the price charged for a deliverable when sold separately and, in some instances, using the price established by management having the relevant authority. TPE of selling price is established by evaluating similar and interchangeable competitor goods or services in sales to similarly situated customers. When VSOE or TPE are not available, we use BESP. We establish BESP using historical selling price trends, if available, and considering multiple factors including, but not limited to geography, market conditions, competitive landscape, internal costs and pricing practices. When determining BESP, management applies judgment when establishing pricing strategies and evaluating market conditions and product lifecycles. The determination of BESP is made through consultation with and approval by management. We may modify or develop new pricing practices and strategies in the future. As these pricing strategies evolve, we may modify our pricing practices in the future, which may result in changes in BESP. The aforementioned factors may result in a different allocation of revenue to the deliverables in multiple-element arrangements from the current period, which may change the pattern and timing of revenue recognition for these elements but will not change the total revenue recognized for the arrangement.

Maintenance contracts are usually offered to customers for periods of twelve to thirty-six months. They generally include the right to unspecified upgrades and enhancements on a when-and-if-available basis as well as customer service. They qualify as a separate unit of accounting. Revenue from these contracts is recognized ratably over the terms of the maintenance contracts on a straight-line basis. The selling price of the maintenance contracts is determined using VSOE.

Extended warranties are usually offered to customers for periods of twelve to forty-eight months. They qualify as a separate unit of accounting. Revenue from these extended warranties is recognized ratably over the warranty period on a straight-line basis. The selling price of the extended warranties is determined using BESP.

Table of Contents

When a sales arrangement contains multiple elements and software and non-software components do not function together to deliver the tangible products' essential functionality, we allocate revenue between the tangible products and the PCS, if any, based on VSOE of selling price of each element. 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.

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 grants. We record research and development tax credits and 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.

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.

## Table of Contents

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 stock-based compensation on stock options, restricted share units and deferred share units, 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. We account 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 2011

In December 2009, the Canadian Institute of Chartered Accountants' (CICA) Emerging Issues Committee (EIC) issued EIC-175, "Multiple Deliverable Revenue Arrangements", which is 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 adopted this standard prospectively to arrangements entered into on or after September 1, 2010, and its adoption had no material effect on our consolidated financial statements. However, a description of our revenue recognition policy has been modified accordingly.

Prior to September 1, 2010, for products in which software was incidental, we recognized revenue when persuasive evidence of an arrangement exists, the product had been delivered, the price was fixed or determinable, and collection of the resulting receivable was reasonably assured. Provisions were made for estimated returns, warranties and support obligations. For products in which software was not incidental, revenues were separated into two categories: product and post-contract customer support (PCS) revenues, based upon VSOE of fair value. Product revenues for these sales were recognized as described above. PCS revenues were deferred and recognized ratably over the years of the support arrangement. PCS revenues were recognized at the time the product was delivered when provided substantially within one year of delivery, the costs of providing this support were insignificant (and accrued at the time of delivery), and no (or infrequent) software upgrades or enhancements were provided.

#### To be adopted after fiscal 2011

We will cease to prepare our consolidated financial statements in accordance with Canadian GAAP as set out in Part V of the CICA Handbook – Accounting ("Canadian GAAP") for the periods beginning on September 1, 2011, when we will start to apply as our primary basis of accounting the International Financial Reporting Standards published by the International Accounting Standards Board and set out in Part I of the CICA Handbook – Accounting. Consequently, future accounting changes to Canadian GAAP are not discussed in these consolidated financial statements as they will never be applied by the company.

#### International financial reporting standards (IFRS)

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 ended on August 31, 2011 (current fiscal year). Although the conceptual framework of IFRS is similar to Canadian GAAP, there are significant differences on recognition, measurement and disclosures.



## Table of Contents

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 services 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.
- 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.

In addition, we have completed the Design and Solutions Development phase to evaluate the overall impact of adopting these new standards on our consolidated financial statements. We have also completed a detailed analysis of the accounting policies affected by the adoption of IFRS.

Finally, we have completed the Implementation phase. The opening balance sheet as at September 1, 2010 is finalized while the IFRS model consolidated financial statements are being finalized. We have analyzed the effects on information technology and internal controls and have not identified significant modifications to our information technology, data systems and internal controls. We have provided training for key employees and stakeholders. Additional training will be given when necessary until full adoption in fiscal 2012.

IFRS 1, First-time Adoption of International Financial Reporting Standards, provides guidelines for the initial adoption of IFRS. IFRS 1 requires full retroactive application of applicable IFRS at the end of the first disclosure period. However, IFRS 1 sets out optional exemptions for some specific standards where costs of complying with these requirements may exceed the benefits for users of financial statements. IFRS 1 also sets out compulsory exceptions in specific cases where retroactive application would require management's judgments on past events for which the conclusions are already known.

Our conclusions on the optional exemptions permitted by IFRS 1 as well as significant differences with respect to recognition, measurement, presentation and disclosure of financial information are in the following key accounting areas:



Table of Contents

## a) Tax credits recoverable

Under IFRS, long-term tax credits recoverable must be discounted using risk-free interest rates for the periods when tax credits will be recovered. Under Canadian GAAP, such treatment is not required. As at September 1, 2010, being the transition date, this resulted in a decrease of our long-term tax credits recoverable of \$2.5 million and an increase of our deferred income tax assets of \$678,000, with a net decrease of the opening balance of retained earnings (shareholders' equity) of \$1.8 million. As at August 31, 2011, this resulted in a decrease of our long-term tax credits recoverable of \$2.5 million, an increase of our deferred income tax assets of \$401,000 and a decrease of our deferred tax liabilities of \$276,000. For the year ended August 31, 2011, changes in the discounted value of our long-term tax credits recoverable resulted in an interest income of \$227,000 and a related deferred income tax expense of \$61,000. It also resulted in a net increase of shareholders' equity of \$2,000, which includes a foreign currency translation loss of \$163,000.

## b) 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.

In addition, under IFRS, depreciation must be based on the allocation of the depreciable amount over the asset's estimated useful life. Depreciable amount is defined as the cost of the asset less its residual value. Residual value is defined as the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated cost of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. Under Canadian GAAP, the depreciable amount of an asset is the greater of the cost less salvage value over the life of the asset, and the cost less residual value over the useful life of the asset. Residual value is the estimated net realizable value of an item of property, plant and equipment at the end of its useful life to the company. Salvage value is the estimated net realizable value of an item of property, plant and equipment at the end of its life. Canadian GAAP concept of salvage value and economic life for purposes of calculating depreciation (i.e., the value of an asset at the end of its life) is disallowed under IFRS. On September 1, 2010, this resulted in an increase of the carrying value of property, plant and equipment of \$1.3 million and a decrease of our deferred income tax assets of \$345,000, with a net increase of the opening balance of retained earnings (shareholders' equity) of \$931,000. As at August 31, 2011, this resulted in an increase of our property, plant and equipment of \$1.5 million, a decrease of our deferred tax assets of \$241,000 and an increase of our deferred tax liabilities of \$166,000. For the year ended August 31, 2011, this resulted in a decrease of depreciation of property, plant and equipment of \$117,000 and a deferred income tax expense of \$32,000. It also resulted in a net increase of shareholders' equity of \$171,000, which includes a foreign exchange translation gain of \$86,000.

## c) Business combinations

As permitted by IFRS 1, "First Time Adoption of International Financial Reporting Standards (IFRS)", we will not apply IFRS 3R, "Business Combinations", to business combinations completed before the transition date, that is, September 1, 2010. However, under IAS 37, "Provisions, Contingent Liabilities and Contingent Assets", the cash contingent consideration for the acquisition of NetHawk Oyj, completed before the transition date and outstanding as at September 1, 2010, should be recorded at fair value on that date with a corresponding adjustment to opening retained earnings. Thereafter, the fair value of the cash contingent consideration is re-assessed at the end of each reporting periods and any changes in the fair value will be recognized in the statement of earnings. On September 1, 2010, the fair value of the contingent cash consideration was estimated at \$2.7 million based on information available at that time and recorded in long-term liabilities, with a corresponding decrease of the

opening balance of retained earnings (shareholders' equity). On August 31, 2011, the fair value of the contingent cash consideration was reassessed to \$338,000, based on revised sales forecasts. The change in the fair value in the amount of \$2.7 million, which includes the effect of the foreign currency translation of \$363,000, was recorded in the statement of earnings in fiscal 2011. This also resulted in a net increase of the shareholders' equity of \$2.3 million as at August 31, 2011.

Table of Contents

d) Presentation of financial statements

Under IFRS we elected to present non-refundable research and development tax credits against gross research and development expenses in the statement of earnings as currently required under Canadian GAAP.

e) 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.

f) 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, there was no additional impairment due to that one-step approach.

g) 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.

h) 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.

This is not an exhaustive list of all the impacts that could occur during the conversion to IFRS.

The following tables summarize the impacts that the transition to IFRS will have on our balance sheet items as at September 1, 2010 and August 31, 2011 as well as on our statement of earnings for the year ended August 31, 2011. The reported adjustments have no impact on sales, cost of sales, selling and administrative expenses, as well as net research and development expenses reported under Canadian GAAP for the year ended August 31, 2011.



Table of Contents

As at September 1, 2010

|                               | Note   | Assets    | Liabilities | Shareholders' equity |
|-------------------------------|--------|-----------|-------------|----------------------|
| Under Canadian GAAP           |        | \$273,502 | \$53,083    | \$ 220,419           |
| Tax credits recoverable       | a)     | (2,510 )  | –           | (2,510 )             |
| Property, plant and equipment | b)     | 1,275     | –           | 1,275                |
| Deferred income taxes         | a), b) | 333       | –           | 333                  |
| Cash contingent consideration | c)     | –         | 2,660       | (2,660 )             |
|                               |        | (902 )    | 2,660       | (3,562 )             |
| Under IFRS                    |        | \$272,600 | \$55,743    | \$ 216,857           |

Year ended August 31, 2011

|   | Note   | Earnings from operations | Net earnings | Basic net earnings per share | Diluted net earnings per share |
|---|--------|--------------------------|--------------|------------------------------|--------------------------------|
| Under Canadian GAAP   |        | \$ 18,503                | \$ 19,349    | \$ 0.32                      | \$ 0.31                        |
| Depreciation of property, plant and equipment                 | b)     | 117                      | 117          |                              |                                |
| Change in the fair value of the cash contingent consideration | c)     | 2,685                    | 2,685        |                              |                                |
| Interest income   | a)     | –                        | 227          |                              |                                |
| Deferred income taxes   | a), b) | –                        | (93 )        |                              |                                |
| Under IFRS  |        | \$ 21,305                | \$ 22,285    | \$ 0.37                      | \$ 0.36                        |

As at August 31, 2011

|                               | Note   | Assets    | Liabilities | Shareholders' equity |
|-------------------------------|--------|-----------|-------------|----------------------|
| Under Canadian GAAP           |        | \$321,086 | \$57,340    | \$ 263,746           |
| Tax credits recoverable       | a)     | (2,507 )  | –           | (2,507 )             |
| Property, plant and equipment | b)     | 1,510     | –           | 1,510                |
| Deferred income taxes         | a), b) | 160       | (110 )      | 270                  |
| Cash contingent consideration | c)     | –         | 338         | (338 )               |
|                               |        | (837 )    | 228         | (1,065 )             |
| Under IFRS                    |        | \$320,249 | \$57,568    | \$ 262,681           |

As the IASB continues to amend and add to current IFRS standards with several projects underway, we continue to track the progress of these projects. Our IFRS project is progressing according to plan, and we will provide updates as further progress is achieved.

Table of Contents

## 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:                        | 2011      | 2010      | 2009        | 2011   | 2010    | 2009        |
|--|-----------|-----------|-------------|--------|---------|-------------|
| Sales  | \$269,743 | \$202,757 | \$153,082   | 100.0  | % 100.0 | % 100.0     |
| Cost of sales (1)  | 100,296   | 73,901    | 57,897      | 37.2   | 36.4    | 37.8        |
| Gross margin   | 169,447   | 128,856   | 95,185      | 62.8   | 63.6    | 62.2        |
| Operating expenses   |           |           |             |        |         |             |
| Selling and administrative                                       | 87,062    | 66,612    | 58,067      | 32.3   | 32.9    | 37.9        |
| Net research and development                                     | 47,927    | 37,847    | 27,213      | 17.7   | 18.7    | 17.8        |
| Amortization of property, plant and equipment                    | 6,772     | 5,757     | 4,453       | 2.5    | 2.8     | 2.9         |
| Amortization of intangible assets                                | 9,183     | 7,773     | 5,033       | 3.4    | 3.8     | 3.3         |
| Restructuring charges  | –         | –         | 963         | –      | –       | 0.6         |
| Impairment of goodwill   | –         | –         | 21,713      | –      | –       | 14.2        |
| Total operating expenses   | 150,944   | 117,989   | 117,442     | 55.9   | 58.2    | 76.7        |
| Earnings (loss) from operations                                  | 18,503    | 10,867    | (22,257 )   | 6.9    | 5.4     | (14.5 )     |
| Interest and other income (expenses)                             | 511       | (292 )    | 592         | 0.1    | (0.1 )  | 0.4         |
| Foreign exchange gain (loss)                                     | (3,808 )  | (1,496 )  | 1,074       | (1.4 ) | (0.8 )  | 0.7         |
| Earnings (loss) before income taxes                              | 15,206    | 9,079     | (20,591 )   | 5.6    | 4.5     | (13.4 )     |
| Income taxes   | 8,783     | 5,529     | 266         | 3.2    | 2.7     | 0.2         |
| Net earnings (loss) from continuing operations                   | 6,423     | 3,550     | (20,857 )   | 2.4    | % 1.8   | % (13.6 ) % |
| Net earnings from discontinued operations                        | 12,926    | 3,069     | 4,272       |        |         |             |
| Net earnings (loss) for the year                                 | \$19,349  | \$6,619   | \$(16,585 ) |        |         |             |
| Basic net earnings (loss) from continuing operations per share   | \$0.11    | \$0.06    | \$(0.34 )   |        |         |             |
| Diluted net earnings (loss) from continuing operations per share | \$0.10    | \$0.06    | \$(0.34 )   |        |         |             |
| Basic net earnings (loss) per share                              | \$0.32    | \$0.11    | \$(0.27 )   |        |         |             |
| Diluted net earnings (loss) per share                            | \$0.31    | \$0.11    | \$(0.27 )   |        |         |             |



**Research and development data:**

|                                |          |          |          |      |   |      |   |      |   |
|--------------------------------|----------|----------|----------|------|---|------|---|------|---|
| Gross research and development | \$57,226 | \$44,551 | \$33,584 | 21.2 | % | 22.0 | % | 21.9 | % |
| Net research and development   | \$47,927 | \$37,847 | \$27,213 | 17.7 | % | 18.7 | % | 17.8 | % |

**Consolidated balance sheets data:**

|              |           |           |           |
|--------------|-----------|-----------|-----------|
| Total assets | \$321,086 | \$273,502 | \$240,371 |
|--------------|-----------|-----------|-----------|

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

Table of Contents

## RESULTS FROM CONTINUING OPERATIONS (formerly the Telecom Division)

## SALES

Fiscal 2011 vs. 2010

In fiscal 2011, our sales increased 33.0% to a record-high \$269.7 million, compared to \$202.8 million in 2010.

The following table summarizes information about our sales for the years ended August 31, 2010 and 2011, in thousands of US dollars:

|  | Year ended<br>August 31, 2011 | Year ended<br>August 31, 2010 | Change<br>in \$ | Change<br>in % |   |
|--|-------------------------------|-------------------------------|-----------------|----------------|---|
| Sales  | \$ 269,743                    | \$ 202,757                    | \$66,986        | 33.0           | % |
| Gains on forward exchange contracts  | (2,795 )                      | (1,517 )                      | (1,278 )        |                |   |
| Sales, excluding gains on forward exchange contracts<br>(non-GAAP measure) | 266,948                       | 201,240                       | 65,708          | 32.7           |   |
| Impact of the recent acquisition (NetHawk)                                 | (29,652 )                     | (14,483 )                     | (15,169 )       |                |   |
| Organic sales (non-GAAP measure)   | \$ 237,296                    | \$ 186,757                    | \$50,539        | 27.1           | % |

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

In the last few months, following the worldwide economic recession of 2009, wireless and wireline network operators have been investing in capital-intensive deployments and capacity expansion in order to accommodate bandwidth-intensive applications and to facilitate the migration to more flexible and cost-effective fixed and mobile IP architectures. We believe that our product offering is greatly aligned with the major trend of bandwidth demand, for which network operators are investing. In fiscal 2011, we also believe we gained overall market share, which contributed to the increase of our sales year-over-year. We must also recall that during the first months of fiscal 2010, we were at the beginning of a slow recovery from the economic recession.

In fiscal 2011, NetHawk, which was acquired on March 12, 2010, reported sales of \$29.7 million compared to \$14.5 million in 2010, which contributed to the increase in our sales year-over-year. NetHawk contributed to the increase of our sales of protocol test solutions year-over-year.

Also, in the second quarter of fiscal 2011, we benefited from larger calendar year-end budget spending from some of our customers, compared to 2010, which increased our sales year-over-year. The magnitude of customers' calendar year-end budget spending may fluctuate year-over-year.

Finally, in fiscal 2011, we recorded in our sales foreign exchange gains of \$2.8 million on our forward exchange contracts, compared to \$1.5 million in 2010, which contributed to the increase of our sales year-over-year.

In addition to the above-mentioned explanations about the year-over-year sales increase, the following table summarizes changes in sales by product lines:

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|   | Year ended<br>August 31, 2011 | Year ended<br>August 31, 2010 | Change in<br>% |   |
|---|-------------------------------|-------------------------------|----------------|---|
| Optical test solutions  | \$ 139,525                    | \$ 109,124                    | 27.9           | % |
| Protocol test solutions   | 108,946                       | 78,709                        | 38.4           |   |
| Copper -access test solutions   | 18,477                        | 13,407                        | 37.8           |   |
| Sales, excluding gains on forward exchange contracts (non-GAAP measure) | \$ 266,948                    | \$ 201,240                    | 32.7           | % |

Table of Contents

## Fiscal 2010 vs. 2009

In fiscal 2010, our sales increased 32.4% to \$202.8 million from \$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<br>August 31, 2010 | Year ended<br>August 31, 2009 | Change<br>in \$ | Change<br>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           | % |

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 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. However, in fiscal 2010, network operators restarted investing worldwide in capital-intensive deployments and capacity expansion on the basis of the 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.

In addition to the above-mentioned explanations about the year-over-year sales increase, the following table summarizes changes in sales by product lines:

|                         | Year ended<br>August 31, 2010 | Year ended<br>August 31, 2009 | Change in<br>% |   |
|-------------------------|-------------------------------|-------------------------------|----------------|---|
| Optical test solutions  | \$ 109,124                    | \$ 95,532                     | 14.2           | % |
| Protocol test solutions | 78,709                        | 54,929                        | 43.3           |   |

|   |            |            |        |
|---|------------|------------|--------|
| Copper -access test solutions   | 13,407     | 5,799      | 131.2  |
| Sales, excluding gains on forward exchange contracts (non-GAAP measure) | \$ 201,240 | \$ 156,260 | 28.8 % |

## Table of Contents

### Net bookings

Net accepted orders increased 28.8% year-over-year to a record-high \$272.3 million in fiscal 2011 from \$211.4 million in 2010, for a book-to-bill ratio of 1.01 in fiscal 2011.

Bookings of fiscal 2010 included newly acquired NetHawk for about five and a half months compared to the whole year in 2011. The year-over-year increase in net bookings is mostly explained by generally improved market conditions following the 2009 recession, as well as worldwide capital-intensive deployments and capacity expansion.

### Geographic distribution

In fiscal 2011, sales to the Americas, Europe, Middle East and Africa (EMEA) and Asia-Pacific (APAC) accounted for 51%, 32% and 17% of sales, respectively, compared to 52%, 30% and 18% respectively in 2010 and compared to 57%, 28% and 15% respectively in 2009.

## GROSS MARGIN

Gross margin amounted to 62.8%, 63.6% and 62.2% of sales in fiscal 2011, 2010 and 2009, respectively.

### Fiscal 2011 vs. 2010

The decrease in our gross margin in fiscal 2011 compared to 2010 can be explained by the following factors.

In fiscal 2011, there was an unfavorable wireless product mix, which resulted in a gross margin below our average for this product line.

In addition, in fiscal 2011, our warranty provision and our inventory reserve increased compared to 2010; this resulted in a negative impact on our gross margin year-over-year.

Finally, in fiscal 2011, 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.

However, these negative factors were offset in part by the following elements.

First, the significant year-over-year sales increase (27.1%, exclusive of business combination and foreign exchange gains on forward exchange contracts) resulted in an increase in our manufacturing activities in Canada and China, allowing us to better absorb our fixed manufacturing costs.

In addition, the increase in the value of the Canadian dollar compared to the US dollar over the last few months had a positive impact on our gross margin in fiscal 2011; in fact, our procurement costs decreased as the Canadian dollar strengthened compared to the US dollar, as 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.

### 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.

## Table of Contents

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.

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.

### Outlook for fiscal 2012

Considering the expected sales growth in fiscal 2012, the expected increase in sales of protocol products as well as software-intensive products and services, 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 and warranty 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 2012 and beyond.

## SELLING AND ADMINISTRATIVE

Selling and administrative expenses were \$87.1 million, \$66.6 million and \$58.1 million for fiscal 2011, 2010 and 2009 respectively. As a percentage of sales, selling and administrative expenses amounted to 32.3%, 32.9% and 37.9% for fiscal 2011, 2010 and 2009 respectively.

### Fiscal 2011 vs. 2010

In fiscal 2011, NetHawk, acquired on March 12, 2010, contributed for the whole year to our selling and administrative expenses, which caused them to increase year-over-year. In addition, selling expenses for NetHawk tend to be higher



in percentage of sales than the rest of our business, as NetHawk's sales cycle is much longer and complex than that of most of our other product lines.

In addition, in fiscal 2011, our sales (excluding those of NetHawk) significantly increased compared to 2010, causing our selling expenses to increase year-over-year, namely our commission expenses.

Furthermore, in fiscal 2011, considering our goal of becoming the leading player in the telecom test and service assurance space, we intensified our sales and marketing efforts, both domestic and international, which caused our expenses to increase year-over-year.

## Table of Contents

Finally, in fiscal 2011, the increase (5.6%) in the average value of the Canadian dollar compared to the US dollar had a negative impact on our selling and administrative expenses, since a certain portion of these expenses are denominated in Canadian dollars and we report our results in US dollars, and since these expenses increased year-over-year as our sales grew.

In fiscal 2011, the significant increase in sales year-over-year caused these expenses to significantly decrease as a percentage of sales, as a portion of these expenses is rather fixed.

### Fiscal 2010 vs. 2009

In fiscal 2010, NetHawk, acquired on March 12, 2010, contributed for about five and half months to our selling and administrative expenses, which caused them to increase year-over-year. In addition, as mentioned above, selling expenses for NetHawk tend to be higher in percentage of sales than the rest of our business, as its sales cycle is much longer and complex than that of our other product lines.

Furthermore, in fiscal 2010, the significant increase (12.8%) in the average value of the Canadian dollar compared to the US dollar, year-over-year, had a negative impact on our selling and administrative expenses, since a certain portion of these expenses is denominated in Canadian dollars and since these expenses increased year-over-year as our sales grew.

Finally, in fiscal 2010, our sales (excluding those of NetHawk) significantly increased compared to 2009, causing our selling expenses to increase, namely our commission expenses.

However, given the restructuring actions taken in the end of fiscal 2009 to reduce our costs, we have been able to reduce some of our selling and administrative expenses in fiscal 2010 compared to 2009.

In fiscal 2010, the significant increase in sales year-over-year caused these expenses to significantly decrease as a percentage of sales, as a portion of these expenses is fixed.

### Outlook for fiscal 2012

For fiscal 2012, we expect our selling and administrative expenses to increase in dollars and range between 32% and 34% of sales. In addition, in fiscal 2012, we expect our commission expenses to increase as the sales volume increases. Furthermore, considering our goal of becoming the leading player in the telecom test and service assurance space and to deliver the synergies expected from our recent acquisition, we plan to continue intensifying our sales and marketing efforts, both domestic and international, which will also cause our expenses to rise. Finally, any increase in the strength of the Canadian dollar and the euro versus the US dollar would also cause our selling and administrative expenses to increase, as a portion of these expenses are incurred in Canadian dollars and euros.

## RESEARCH AND DEVELOPMENT

### Gross research and development expenses

Gross research and development expenses totaled \$57.2 million, \$44.6 million and \$33.6 million for fiscal 2011, 2010 and 2009 respectively. As a percentage of sales, gross research and development expenses amounted to 21.2%, 22.0% and 21.9% for fiscal 2011, 2010 and 2009 respectively, while net research and development expenses accounted for 17.7%, 18.7% and 17.8% of sales for these respective years.

Fiscal 2011 vs. 2010

In fiscal 2011, NetHawk, acquired on March 12, 2010, contributed for the whole period to our gross research and development expenses, which caused them to increase year-over-year. NetHawk tends to incur higher research and development expenses in percentage of sales, compared to our other product lines, as its products are more software-intensive.

## Table of Contents

In addition, in fiscal 2011, we intensified our research and development activities, which resulted in increased gross research and development expenses compared to 2010.

Finally, in fiscal 2011, the increase in the average value of the Canadian dollar compared to the US dollar had a negative effect on our gross research and development expenses, as a large portion of these expenses are denominated in Canadian dollars and we report our results in US dollars, and since these expenses increased year-over-year.

The decrease in our gross research and development expenses as a percentage of sales year-over-year is mainly due to the significant increase in sales year-over-year.

### Fiscal 2010 vs. 2009

In fiscal 2010, NetHawk, acquired on March 12, 2010, contributed for about five and a half months to our gross research and development expenses, which caused them to increase year-over-year. As mentioned above, NetHawk tends to incur higher research and development expenses in percentage of sales, compared to our other product lines, as its products are more software-intensive.

In addition, the significant increase (12.8%) in the average value of the Canadian dollar compared to the US dollar year-over-year is also responsible for the significant increase of our gross research and development expenses year-over-year, as a large portion of these expenses are denominated in Canadian dollars and we report our results in US dollars and as these expenses increased year-over-year.

Finally, we intensified our research and development activities, namely in our software development center in Pune, India, and in our service assurance development center, which resulted in increased gross research and development expenses in fiscal 2010, compared to 2009.

### Tax credits and grants

We are entitled to tax credits from the Canadian federal and provincial governments for eligible research and development activities conducted in Canada. We are also eligible to grants by a Finnish technology organization on certain research and development projects conducted in Finland.

Tax credits and grants for research and development activities were \$9.3 million, \$6.7 million and \$6.4 million for fiscal 2011, 2010 and 2009 respectively. As a percentage of gross research and development expenses, tax credits reached 16.2%, 15.0% and 19.0% for fiscal 2011, 2010 and 2009 respectively.

### Fiscal 2011 vs. 2010

In fiscal 2011, the year-over-year increase of research and development activities in Canada, where we are entitled to tax credits, resulted in increased tax credits compared to 2010.

In addition, in fiscal 2011, the increase in the average value of the Canadian dollar compared to the US dollar compared to 2010 had a positive effect on our tax credits as they are denominated in Canadian dollars and we report our results in US dollars, and since these credits increased year-over-year.

Finally, a portion of the year-over-year increase in our tax credits and grants in fiscal 2011, compared to 2010, comes from newly acquired NetHawk, which contributed for the whole year in 2011, compared to about five and half months in 2010.

Fiscal 2010 vs. 2009

A significant portion of the increase in our tax credits and grants in fiscal 2010, compared to 2009, comes from newly acquired NetHawk, which contributed for about five and a half months to our grants. In addition, our research and development tax credits are denominated in Canadian dollars. The significant increase in the average value of the Canadian dollar compared to the US dollar, in fiscal 2010 compared to 2009, had a positive impact on these tax credits expressed in US dollars.

## Table of Contents

### Outlook for fiscal 2012

For fiscal 2012, we expect our net research and development expenses to increase in dollars, and range between 17% and 19% of sales, given our focus on innovation, the addition of software features in our products, our desire to gain market share and our goal to exceed customer needs and expectations. Finally, any increase in the strength of the Canadian dollar and euro versus the US dollar in the upcoming quarters would also cause our net research and development expenses to increase, as a significant portion of these expenses are incurred in Canadian dollars and euros.

### AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT

In fiscal 2011, amortization of property, plant and equipment was \$6.8 million, compared to \$5.8 million in 2010 and \$4.5 million in 2009.

#### Fiscal 2011 vs. 2010

The increase in amortization expense in fiscal 2011, compared to 2010, mainly comes from the acquisition of NetHawk (completed in the third quarter of 2010), the increase in the average value of the Canadian dollar versus the US dollar year-over-year, as well as the additions to property, plant and equipment over the last few quarters.

#### Fiscal 2010 vs. 2009

The increase in amortization expenses in fiscal 2010, compared to 2009, mainly comes from the acquisition of NetHawk in mid-March 2010, the increase in the average value of the Canadian dollar versus the US dollar year-over-year as well as the additions to property, plant and equipment over the last few quarters.

### Outlook for fiscal 2012

For fiscal 2012, considering the expected additions to property, plant and equipment will have on our amortization expenses, we expect our amortization expenses to increase in dollars in 2012.

### AMORTIZATION OF INTANGIBLE ASSETS

In conjunction with the business combinations we completed over the past several years, we recorded intangible assets, primarily consisting of core technology and customer relationships. These intangible assets resulted in amortization expenses of \$9.2 million, \$7.8 million and \$5.0 million for fiscal 2011, 2010 and 2009 respectively.

#### Fiscal 2011 vs. 2010

The increase in amortization expense in fiscal 2011, compared to 2010, mainly comes from the acquisition of NetHawk (completed in the third quarter of fiscal 2010), the increase in the average value of the Canadian dollar versus the US dollar year-over-year, as well as the additions to intangible assets over the last few quarters; this was offset in part by the fact that core technologies related to the acquisition of Consultronics Limited became fully amortized during the second quarter of fiscal 2011.

#### Fiscal 2010 vs. 2009

The increase in amortization expenses in fiscal 2010, compared to 2009, is mainly due to the acquisition of NetHawk in mid-March 2010, as well as to the increase in the average value of the Canadian dollar versus the US dollar year-over-year.

Table of Contents

Outlook for fiscal 2012

For fiscal 2012, considering no business combinations, our amortization expense of intangible assets will decrease as core technologies related to the acquisition of Consultronics Limited became fully amortized during the second quarter of fiscal 2011.

INTEREST AND OTHER INCOME (EXPENSES)

Our interest income mainly resulted from our short-term investments, less interests and bank charges. Interest and other income amounted to \$511,000 in fiscal 2011 compared to interest expense of \$292,000 in fiscal 2010 and interest income of \$592,000 in fiscal 2009.

Fiscal 2011 vs. 2010

In fiscal 2011, we sold non-core capital assets for proceeds of \$568,000, which resulted in a gain for the same amount recorded in the interest and other income (expenses) line item in the statements of earnings for these periods.

Fiscal 2010 vs. 2009

The decrease in our interest income in fiscal 2010 compared to 2009 is mainly due to the decrease of our cash and short-term investments following the cash payment of \$26.9 million for the redemption of share capital in fiscal 2009, in accordance with our share buy-back programs and the cash payment of \$33.0 million for the acquisition of NetHawk in fiscal 2010.

FOREIGN EXCHANGE GAIN (LOSS)

Foreign exchange gains and losses are mainly the result of the translation of operating activities denominated in currencies other than the measurement currency (mainly the Canadian dollar). We manage our exposure to currency risks with forward exchange contracts. In addition, some of our entities' operating activities are denominated in US dollars or other currencies, which further hedges these risks. However, any increase in the value of the Canadian dollar, compared to the US dollar, the euro and the British pound, would have a negative impact on our operating results.

We reported a foreign exchange loss of \$3.8 million in fiscal 2011, compared to \$1.5 million in 2010 and a foreign exchange gain of \$1.1 million in 2009.

Fiscal 2011 vs. 2010

In fiscal 2011, the value of the Canadian dollar significantly increased versus the US dollar, compared to August 31, 2010, which resulted in a large foreign exchange loss of \$3.8 million during the year. In fact, the period-end value of the Canadian dollar increased 9.0% versus the US dollar to CA\$0.9784 = US\$1.00 at the end of fiscal 2011, compared to CA\$1.0665 = US\$1.00 at the end of 2010. In addition, the volume of operations denominated in foreign currencies (including balance sheet items) increased year-over-year, further increasing the exchange loss compared to the same period last year.

Fiscal 2010 vs. 2009



In fiscal 2010, the value of the Canadian dollar increased versus the US dollar, the euro and the British pound, compared to August 31, 2009, which resulted in a foreign exchange loss of \$1.5 million during the year. In fact, the period-end value of the Canadian dollar increased 2.8% versus the US dollar to CA\$1.0665 = US\$1.00 at the end of fiscal 2010, compared to CA\$1.0967 = US\$1.00 at the end of 2009. It increased 16.5% versus the euro to CA\$1.3515 = €1.00, compared to CA\$1.5741 = €1.00 at the end of fiscal 2009. Finally, it increased 9.5% versus the British pound to CA\$1.6337 = 1.00 at the end of fiscal 2010 compared to CA\$1.7888 = 1.00 at the end of 2009. In addition, the volume of operations denominated in foreign currencies (including balance sheet items) increased year-over-year, further increasing the exchange loss compared to the same period last year.

Table of Contents

Foreign exchange rate fluctuations also flow through the P&L line items as a significant portion of our operating items are denominated in Canadian dollars, and we report our results in US dollars. Consequently, the significant increase in the average value of the Canadian dollar in fiscal 2011, compared to 2010, resulted in a significant and negative impact on our financial results of 2011. This was amplified by the fact that our operating activities incurred in Canadian dollars increased year-over-year. In fact, the average value of the Canadian dollar in fiscal 2011 was CA\$0.9894 = US\$1.00 compared to CA\$1.0446 = US\$1.00 in 2010, representing an increase of 5.6% in the average value of the Canadian dollar year-over-year. In fiscal 2010, the average value of the Canadian dollar was CA\$1.0446 = US\$1.00 compared to CA\$1.1782 = US\$1.00 in 2009, representing a increase of 12.8% in the average value of the Canadian dollar year-over-year. This had a significant and negative impact on our financial results of 2010, compared to 2009.

## INCOME TAXES

We recorded income tax expenses of \$8.8 million, \$5.5 million and \$266,000 in fiscal 2011, 2010 and 2009 respectively.

## Fiscal 2011

In fiscal 2011, we reported an income tax expense of \$8.8 million on earnings before income taxes of \$15.2 million, for an effective income tax rate of 57.8%. Our combined Canadian and provincial statutory tax rate is 29%. This situation mainly results from the fact that a significant portion of our foreign exchange loss is created by the translation of financial statements of our foreign integrated subsidiaries, and is therefore non-deductible. In addition, we continue to maintain a valuation allowance for some of our subsidiaries at loss and we have some non-deductible expenses, such as stock-based compensation costs. Otherwise, the actual tax rate would have been closer to the statutory tax rate.

## Fiscal 2010

In fiscal 2010, we reported an income tax expense of \$5.5 million on earnings before income taxes of \$9.1 million, for an effective income tax rate of 60.9%. Our combined Canadian and provincial statutory tax rate was 30%. This situation mainly resulted from the fact that we continued to maintain a valuation allowance for some of our subsidiaries at loss and we had some non-deductible expenses, such as stock-based compensation costs. In addition, a portion of our foreign exchange loss was created by the translation of financial statements of our foreign integrated subsidiaries, and was therefore non-deductible. Otherwise, the actual tax rate would have been closer to the statutory tax rate for that year.

## Fiscal 2009

In fiscal 2009, we reported an income tax expense of \$266,000 on a loss before income taxes of \$20.6 million, for a nominal effective tax rate. Our combined Canadian and provincial statutory tax rate was 31%. This situation mainly resulted from the fact that a significant portion of the impairment of goodwill of \$21.7 million was not deductible for tax purposes. In addition, we continued to maintain a valuation allowance for some of our subsidiaries at loss and we had some non-deductible expenses, such as stock-based compensation costs. On the other hand, a significant portion of our foreign exchange gain was created by the translation of financial statements of our foreign integrated subsidiaries, and was therefore non-taxable. Otherwise, the actual tax rate would have been closer to the statutory tax rate for that year.

## Future income tax assets

As at August 31, 2011, our net future income tax assets recognized in the balance sheet amounted to \$12.2 million, and our non-refundable research and development tax credits amounted to \$36.6 million. In order to realize these future income tax assets and non-refundable research and development tax credits, we need to generate approximately \$240 million (CA\$235 million) in pretax earnings at the Canadian federal level, approximately \$18 million at the Canadian provincial levels, and approximately \$32 million at the United States federal level.

## Table of Contents

### Valuation allowance

As at August 31, 2010 and 2011, we were in a cumulative loss position in certain of our subsidiaries and negative evidence outweighed positive evidence. For these subsidiaries, we maintained a valuation allowance against our net future income tax assets. As at August 31, 2011, the valuation allowance for these subsidiaries amounted to \$25 million and mainly related to operating losses and research and development expenses carried forward. Of the valuation allowance of \$25 million, \$11.4 million related to Brix Networks and NetHawk at the acquisition date. In the event that we reverse a portion of or all the valuation allowance at the acquisition date related to Brix Networks and NetHawk, the amount of such reversal would reduce the amount of goodwill recognized for these acquisitions.

Please refer to note 19 of our consolidated financial statements for more details on income taxes and a full reconciliation of the income tax provision.

### RESULTS OF DISCONTINUED OPERATIONS (formerly the Life Sciences and Industrial Division)

On October 1, 2010, we completed the sale of our Life Sciences and Industrial Division, which contributed to our results for one month in fiscal 2011, compared to the whole year in fiscal 2010. That Division's results from operations of fiscal 2010, 2011 and 2012 were included in net earnings from discontinued operations. Results for fiscal 2011 included the gain on the sale of that Division.

### SALES

In fiscal 2011, sales of the discontinued operations (one-month contribution) amounted to \$2.0 million. They reached \$25.4 million and \$19.8 million in fiscal 2010 and 2009 respectively (full contribution).

### NET EARNINGS

In fiscal 2011, we reported net earnings from discontinued operations of \$12.9 million. Net earnings from discontinued operations in fiscal 2011 included a gain on disposal of discontinued operations of \$13.2 million and \$264,000 in stock-based compensation costs. In fiscal 2010 and 2009, net earnings from discontinued operations amounted to \$3.1 million and \$4.3 million respectively.

### LIQUIDITY AND CAPITAL RESOURCES

#### Cash requirements and capital resources (from continuing operations)

As at August 31, 2011, cash and short-term investments totaled \$69.9 million, while our working capital was at \$143.8 million. Our cash and short-term investments increased \$38.0 million in fiscal 2011, compared to 2010, mainly due to cash flows provided by operating activities of \$23.3 million, the net proceeds of \$22.1 million from the disposal of discontinued operations, the proceeds of \$1.5 million received from the exercise of stock options and the increase of our bank loan of \$772,000. In addition, we recorded an unrealized foreign exchange gain on our cash and short-term investments of \$3.0 million. This unrealized foreign exchange gain resulted from the translation, in US dollars, of our Canadian-dollar and euro-denominated cash and short-term investments, and was included in the accumulated other comprehensive income in the balance sheet. However, these positive effects on cash elements were

offset in part by the net purchases of capital assets of \$11.6 million, the cash payments of \$1.0 million in relation to the acquisition of NetHawk and the repayment of \$619,000 of our long-term debt.

## Table of Contents

Our short-term investments consist of commercial paper issued by twelve (nine as at August 31, 2010) high-credit quality corporations and trusts; therefore, we consider the risk of non-performance of these financial instruments to be limited. None of these debt instruments are expected to be affected by a significant liquidity risk. For the purposes of managing our cash position, we have established a cash management policy, which we follow and monitor on a regular basis. Our short-term investments will be used for working capital and other general corporate purposes, including any payment for the cash contingent consideration related to the acquisition of NetHawk, any other potential acquisition, the construction of our new building in Montreal, Canada as well as our share repurchase program.

Newly acquired NetHawk has a long-term debt denominated in euros amounting to \$1.6 million (€1.1 million) as at August 31, 2011. This debt, which matures in 2013, is collateralized by assets of NetHawk, bears interest at an annual rate of 2.95%, and is repayable in bi-annual installments of \$323,000 (€224,000).

We believe that our cash balances and short-term investments will be sufficient to meet our liquidity and capital requirements for the foreseeable future, including the maximum cash contingent consideration of €8.7 million (US\$12.0 million) that may become payable in conjunction with the acquisition of NetHawk if sales objectives are met, the payment of our long-term debt, the remaining construction costs, over the next nine months, of our new building in Montreal, Canada, estimated at \$15.2 million (CA\$14.9 million), as well as the effect of our normal course issuer bid. In addition to these assets, we have unused available lines of credit totaling \$15.5 million for working capital and other general corporate purposes and unused lines of credit of \$16.5 million for foreign currency exposure related to forward exchange contracts. However, possible operating losses and/or possible investments in or acquisitions of complementary businesses, products or technologies may require additional financing. There can be no assurance that additional debt or equity financing will be available when required or, if available, that it can be secured on satisfactory terms.

As at August 31, 2011, our commitments under operating leases for continuing operations amount to \$4.7 million in 2012, \$2.5 million in 2013, \$1.4 million in 2014, \$1.0 million in 2015 and \$1.2 million in 2016 and after, for total commitments of \$10.8 million.

In addition, in fiscal 2011, we undertook the construction of a new building in Montreal, Canada. As at August 31, 2011, we had commitments totaling \$15,200,000 (CA\$14,900,000) in relation to this building. Total costs for the new building are estimated to approximately \$22 million (CA\$21.5 million). We expect the construction to be completed in the third quarter of fiscal 2012.

### Sources and uses of cash

We finance our operations and meet our capital expenditure requirements mainly through cash flows from operating activities, the use of our cash and short-term investments as well as the issuance of subordinate voting shares.

### Operating activities (including discontinued operations)

Cash flows provided by operating activities were \$23.3 million in fiscal 2011, compared to \$1.8 million in 2010 and \$22.6 million in 2009.

### Fiscal 2011 vs. 2010

Cash flows provided by operating activities in fiscal 2011 were attributable to the net earnings after items not affecting cash of \$31.7 million, offset in part by the negative net change in non-cash operating items of \$8.4 million. The negative net change in non-cash operating items was mainly due to the negative effect on cash of

the increase of \$6.7 million of our income taxes and tax credits recoverable, the negative effect on cash of the increase of \$8.8 million of our inventories and the negative effect on cash of the decrease of \$2.7 million of our accounts payable and accrued liabilities and other liabilities. These negative effects were offset in part by the positive effect on cash of the decrease of \$10.1 million of our accounts receivable. The increase in our income taxes and tax credits is mainly due to the increase in our tax credits recoverable that were earned during the year but not yet recovered. The increase in our inventories is mainly due to the increase in sales activities and the effect of our contingent plan to prevent potential shortage of optical and electronic parts following the natural disaster in Japan during the year. The decrease in our accounts payable and accrued liabilities and other liabilities is due to the timing of purchases and payments in fiscal 2011. Finally, the decrease of our accounts receivable is directly attributable to the timing of sales during the year.

Table of Contents

Fiscal 2010 vs. 2009

Cash flows provided by operating activities in fiscal 2010 were attributable to the net earnings after items not affecting cash of \$32.1 million, largely offset by the negative net change in non-cash operating items of \$30.3 million. The negative net change in non-cash operating items was mainly due to the negative effect on cash of the increase of \$22.5 million of our accounts receivable, the negative effect on cash of the increase of \$9.3 million of our inventories and the negative effect on cash of the increase of \$4.1 million of our income taxes and tax credits recoverable. These were offset in part by the positive effect on cash of the increase of \$5.5 million of our accounts payable and accrued liabilities and other liabilities. The increase of our accounts receivable was directly attributable to the significant increase in sales year-over-year and the timing of sales during the year. The increase in our inventories was mainly due to increased activity levels year-over-year. The increase in our income taxes and tax credits was mainly due to the increase in our tax credits recoverable that were earned during the year but not yet recovered. The increase in our accounts payable and accrued liabilities and other liabilities was due to increased activities year-over-year and the timing of purchases and payments in fiscal 2010.

Investing activities (including discontinued operations)

Cash flows used by investing activities amounted to \$25.3 million in fiscal 2011, compared to cash flows provided of \$10.4 million in 2010 and \$8.8 million in 2009.

Fiscal 2011

In fiscal 2011, we acquired (net of disposal) \$34.7 million worth of short-term investments and we paid \$12.2 million for the purchase of capital assets and \$1.0 million in relation to the acquisition of NetHawk. However, we received \$22.1 million from the disposal of discontinued operations and \$568,000 from the sale of non-core capital assets.

Fiscal 2010

In fiscal 2010, we disposed (net of acquisitions) of \$52.4 million worth of short-term investments but paid \$33.0 million for the acquisition of NetHawk and \$9.0 million for the purchase of capital assets.

Financing activities (including discontinued operations)

Cash flows provided by financing activities amounted to \$1.6 million in fiscal 2011, compared to \$55,000 in 2010 and cash flows used of \$26.8 million in 2009.

Fiscal 2011

In fiscal 2011, our bank loan increased \$772,000 and we received \$1.5 million from the exercise of stock options, but we repaid \$619,000 on our long-term debt.

Fiscal 2010

In fiscal 2010, we made a repayment of our long-term debt of \$274,000 and redeemed share capital for a cash consideration of \$14,000. However, we received \$343,000 from the exercise of stock options.

FORWARD EXCHANGE CONTRACTS



We utilize forward exchange contracts to manage our foreign currency exposure. Our policy is not to utilize those derivative financial instruments for trading or speculative purposes.

Our forward exchange contracts, which are used to hedge anticipated US-dollar-denominated sales, qualify for hedge accounting; therefore, foreign exchange translation gains and losses on these contracts are recognized as an adjustment of the revenues when the corresponding sales are recorded.

Table of Contents

As at August 31, 2011, we held forward exchange contracts to sell US dollars at various forward rates, which are summarized as follows:

| Expiry dates                  | Contractual amounts | Weighted average contractual forward rates |
|-------------------------------|---------------------|--|
| September 2011 to August 2012 | \$27,500,000        | 1.0555                                     |
| September 2012 to July 2013   | 11,400,000          | 1.0063                                     |
| Total                         | \$38,900,000        | 1.0411                                     |

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 \$597,000 and \$2,278,000 as at August 31, 2010 and 2011, respectively. The year-end exchange rate was CA\$0.9784 = US\$1.00 as at August 31, 2011.

**CONTINGENCY**

On November 27, 2001, a class action suit was filed in the United States District Court for the Southern District of New York against EXFO, four of the underwriters of our 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 EXFO'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 EXFO's Initial Public Offering; and (ii) the underwriters allegedly entering into agreements with customers whereby shares issued in connection with EXFO'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 EXFO's underwriters, EXFO and two of our 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 EXFO and our two executive officers in particular, the amended complaint alleges that (i) EXFO'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 EXFO'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 EXFO, 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 EXFO was dismissed. On October 8, 2002, the claims against our 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.

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.

## Table of Contents

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. EXFO’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 EXFO, 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. Appeals of the opinion granting final approval were filed, all of which were disposed of except the appeals filed by one objector were remanded to the district court to determine standing to appeal. On August 25, 2011, the district court issued an order holding that the final objector had no standing to appeal. The objector has appealed that decision. Given that the district court’s August 25, 2011 judgment remains subject to appeal, 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, we have determined the impact to our financial position and results of operations as at and for the year ended August 31, 2011 to be immaterial.

## SHARE CAPITAL

### Share capital

As at November 7, 2011, EXFO had 31,643,000 multiple voting shares outstanding, entitling to 10 votes each and 28,781,111 subordinate voting shares outstanding. The multiple voting shares and the subordinate voting shares are unlimited as to number and without par value. In fiscal 2011, 5 million multiple voting shares were converted into 5 million subordinate voting shares.

## OFF-BALANCE SHEET ARRANGEMENTS

As at August 31, 2011, our off-balance sheet arrangements consisted of letters of guarantee amounting to \$5.1 million; these letters of guarantee expire at various dates through fiscal 2017. From this amount, we had \$0.7 million worth of

letters of guarantee for our own selling and purchasing requirements, which were for the most part reserved from one of our lines of credit. The remainder, in the amount of \$4.4 million, was used to secure our line of credit in CNY (Chinese currency) of \$4 million. An amount of \$784,000 was used from this line of credit as at August 31, 2011.

Table of Contents

VARIABLE INTEREST ENTITY

As of August 31, 2011, we did not have interests in any variable interest entities.

RISKS AND UNCERTAINTIES

Over the past several years, we have managed our business in a difficult environment; focused on research and development programs for new and innovative solutions aimed at expected growth pockets in our sector; continued the development of our domestic and international markets; and made strategic acquisitions. However, we operate in a highly competitive and complex sector that is in constant evolution and, as a result, we encounter various risks and uncertainties that must be given appropriate consideration in our strategic management plans and policies.

Also, our business is subject to the effects of general economic conditions in North America and throughout the world and, more particularly, market conditions in the telecommunications industry. In the past, our operating results were adversely affected by reduced telecom capital spending in North America, Europe and Asia and by unfavorable general economic conditions. In particular, sales to network service providers in North America were significantly and adversely affected by a downturn in 2001 in the telecommunications industry and by the global economic recession in 2009. These recession and downturn affected our key geographic regions or markets. In the event of another recession or slowdown in key geographic regions or markets, we may experience a material adverse impact on our business, operating results and financial conditions.

In addition, we are exposed to currency risks due to the export of our products manufactured in Canada, China and Finland; the large majority of these sales are denominated in US dollars and euros. These risks are partially hedged by operating expenses denominated in US dollars and euros, the purchase of raw materials in US dollars as well as forward exchange contracts. Any decrease in the value of the US dollar compared to the Canadian dollar and the euro in the coming months would negatively affect our results of operations.

While strategic acquisitions, like the recent acquisition of NetHawk, those we have made in the past and possibly others in the future, are essential to our long-term growth, they also expose us to certain risks and uncertainties related to the rapid and effective integration of these businesses, their products, technologies and personnel as well as key personnel retention. Finally, integration of NetHawk will continue to require the dedication of management resources, which may detract their attention from our day-to-day business and operations.

Furthermore, risks and uncertainties related to the telecommunications test and service assurance industry involve the rapid development of new products that may have short lifecycles and require extensive research and development; the difficulty of adequately predicting market size and trends; the difficulty of retaining highly skilled employees; and the ability to quickly adapt our cost structure to changing market conditions in order to achieve profitability.

Also, given our strategic goals for growth and competitive positioning in our industry, we are continuously expanding into international markets, which requires certain actions, such as the operation of our manufacturing facilities in China and software development centers in India. This exposes us to certain risks and uncertainties, namely changes in local laws and regulations, multiple technological standards, protective legislation, pricing pressure, cultural differences and the management of operations in China and India.

The economic environment of our industry could also result in some of our customers experiencing difficulties, which, consequently, could have a negative effect on our results, especially in terms of future sales and recoverability of accounts receivable. However, the sectorial and geographic diversity of our customer base provides us with

a reasonable level of protection in this area. Finally, other financial instruments, which potentially subject us to credit risks, consist mainly of cash, short-term investments and forward exchange contracts. Our short-term investments consist of debt instruments issued by high-credit quality corporations and trusts. Our cash and forward exchange contracts are held with or issued by high-credit quality financial institutions; therefore, we consider the risk of non-performance on these instruments to be limited.

Table of Contents

We depend on a limited number of suppliers for some of the parts used to manufacture our products for which alternative sources may not be readily available. In addition, all our orders are placed through individual purchase orders and, therefore, our suppliers may experience difficulties, suffer from natural disasters, delays or stop supplying parts to us at any time. The reliance on a single source or limited number of suppliers could result in increased costs, delivery problems and reduced control over product pricing and quality. Any interruption or delay in the supply of any of these parts could significantly harm our ability to meet scheduled product deliveries to our customers and cause us to lose sales. Furthermore, the process of qualifying a new manufacturer for complex parts designed to our specifications, such as our optical, electronic or mechanical parts, is lengthy and would consume a substantial amount of time of our technical personnel and management. If we were required to change a supplier in a short period of time, our business would be disrupted. In addition, we may be unsuccessful in identifying a new supplier capable of meeting and willing to meet our needs on terms that we would find acceptable.

For a more complete understanding of risk factors that may affect us, please refer to the risk factors set forth in our disclosure documents published with securities commissions at [www.EXFO.com](http://www.EXFO.com), or at [www.sedar.com](http://www.sedar.com) in Canada or [www.sec.gov/edgar.shtml](http://www.sec.gov/edgar.shtml) in the U.S.

NON-GAAP FINANCIAL MEASURES

We provide non-GAAP financial measures (EBITDA\*, adjusted EBITDA\* and sales, excluding gains/losses on forward exchange contracts and sales of recently acquired businesses, or organic sales) as supplemental information regarding our operational performance. We use these measures for the purposes of evaluating our historical and prospective financial performance, as well as our performance relative to our competitors. These measures also help us to plan and forecast future periods as well as to make operational and strategic decisions. We believe that providing this information to our investors, in addition to the GAAP measures, allows them to see the company's results through the eyes of management, and to better understand our historical and future financial performance.

The presentation of this additional information is not prepared in accordance with GAAP. Therefore, the information may not necessarily be comparable to that of other companies and should be considered as a supplement to, not a substitute for, the corresponding measures calculated in accordance with GAAP.

\*EBITDA is defined as net earnings (loss) before interest, income taxes, amortization of property, plant and equipment, amortization of intangible assets and impairment of goodwill. Adjusted EBITDA represents EBITDA excluding the gain from the disposal of discontinued operations.



Table of Contents

The following tables summarize the reconciliation of EBITDA and adjusted EBITDA to GAAP net earnings (loss) and additional information, in thousands of US dollars:

## EBITDA and adjusted EBITDA (including discontinued operations)

|  | Year ended<br>August 31, 2011 | Year ended<br>August 31, 2010 | Year ended<br>August 31, 2009 |
|--|-------------------------------|-------------------------------|-------------------------------|
| GAAP net earnings (loss) for the year          | \$ 19,349                     | \$ 6,619                      | \$ (16,585 )                  |
| Add (deduct):                                  |                               |                               |                               |
| Amortization of property, plant and equipment  |                               |                               |                               |
| Continuing operations                          | 6,772                         | 5,757                         | 4,453                         |
| Discontinued operations                        | 14                            | 154                           | 154                           |
| Amortization of intangible assets              |                               |                               |                               |
| Continuing operations                          | 9,183                         | 7,773                         | 5,033                         |
| Discontinued operations                        | 4                             | 45                            | 34                            |
| Interest and other income (expenses)           |                               |                               |                               |
| Continuing operations                          | (511 )                        | 292                           | (592 )                        |
| Discontinued operations                        | –                             | 1                             | (5 )                          |
| Income taxes                                   |                               |                               |                               |
| Continuing operations                          | 8,783                         | 5,529                         | 266                           |
| Discontinued operations                        | 201                           | 1,136                         | (5 )                          |
| Impairment of goodwill (continuing operations) | –                             | –                             | 21,713                        |
| EBITDA for the year                            | 43,795                        | 27,306                        | 14,466                        |
| Gain on disposal of discontinued operations    | (13,212 )                     | –                             | –                             |
| Adjusted EBITDA for the year                   | \$ 30,583                     | \$ 27,306                     | \$ 14,466                     |
| Adjusted EBITDA in percentage of total sales   | 11.3 %                        | 12.0 %                        | 8.4 %                         |

## Additional information

|   | Year ended<br>August 31, 2011 | Year ended<br>August 31, 2010 | Year ended<br>August 31, 2009 |
|---|-------------------------------|-------------------------------|-------------------------------|
| Sales from continued operations           | \$ 269,743                    | \$ 202,757                    | \$ 153,082                    |
| Sales from discontinued operations        | 1,991                         | 25,359                        | 19,796                        |
| Total sales                               | \$ 271,734                    | \$ 228,116                    | \$ 172,878                    |
|   | Year ended<br>August 31, 2011 | Year ended<br>August 31, 2010 | Year ended<br>August 31, 2009 |
| Gross margin from continued operations    | \$ 169,447                    | \$ 128,856                    | \$ 95,185                     |
| Gross margin from discontinued operations | 989                           | 13,563                        | 10,801                        |

|                    |            |            |            |
|--------------------|------------|------------|------------|
| Total gross margin | \$ 170,436 | \$ 142,419 | \$ 105,986 |
|--------------------|------------|------------|------------|

Table of Contents

## QUARTERLY SUMMARY FINANCIAL INFORMATION (unaudited)

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

|   | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter | Year ended<br>August 31 |
|---|-------------|-------------|-------------|-------------|-------------------------|
| 2011  |             |             |             |             |                         |
| Sales   | \$65,653    | \$72,046    | \$67,630    | \$64,414    | \$269,743               |
| Cost of sales   | \$24,785    | \$27,821    | \$24,243    | \$23,447    | \$100,296               |
| Gross margin  | \$40,868    | \$44,225    | \$43,387    | \$40,967    | \$169,447               |
| Earnings from operations                                      | \$5,128     | \$6,753     | \$3,459     | \$3,163     | \$18,503                |
| Net earnings from continuing operations                       | \$1,145     | \$1,653     | \$1,735     | \$1,890     | \$6,423                 |
| Net earnings  | \$14,071    | \$1,653     | \$1,735     | \$1,890     | \$19,349                |
| Basic net earnings from continuing operations per share       | \$0.02      | \$0.03      | \$0.03      | \$0.03      | \$0.11                  |
| Diluted net earnings from continuing operations per share (1) | \$0.02      | \$0.03      | \$0.03      | \$0.03      | \$0.10                  |
| Basic net earnings per share (1)                              | \$0.24      | \$0.03      | \$0.03      | \$0.03      | \$0.32                  |
| Diluted net earnings per share (1)                            | \$0.23      | \$0.03      | \$0.03      | \$0.03      | \$0.31                  |

|  | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter | Year ended<br>August 31 |
|--|-------------|-------------|-------------|-------------|-------------------------|
| 2010   |             |             |             |             |                         |
| Sales  | \$40,293    | \$47,951    | \$55,930    | \$58,583    | \$202,757               |
| Cost of sales  | \$14,033    | \$18,818    | \$20,421    | \$20,629    | \$73,901                |
| Gross margin   | \$26,260    | \$29,133    | \$35,509    | \$37,954    | \$128,856               |
| Earnings from operations   | \$1,956     | \$2,657     | \$1,840     | \$4,414     | \$10,867                |
| Net earnings (loss) from continuing operations                             | \$(230)     | \$256       | \$(600)     | \$4,124     | \$3,550                 |
| Net earnings   | \$334       | \$1,154     | \$169       | \$4,962     | \$6,619                 |
| Basic and diluted net earnings (loss) from continuing operations per share | \$(0.00)    | \$0.00      | \$(0.01)    | \$0.07      | \$0.06                  |
| Basic and diluted net earnings per share                                   | \$0.01      | \$0.02      | \$0.00      | \$0.08      | \$0.11                  |

(1) Per share data is calculated independently for each of the quarters presented. Therefore, the sum of this quarterly information does not equal the corresponding annual information.

## Fourth-quarter results

In the fourth quarter of fiscal 2011, sales were \$64.4 million, compared to \$58.6 million in 2010.

In the fourth quarter of fiscal 2011, we reported a year-over-year increase in sales for the following reasons.

In the last few months, wireless and wireline network operators have been investing in capital-intensive deployments and capacity expansion in order to accommodate bandwidth-intensive applications and to facilitate the migration to more flexible and cost-effective fixed and mobile IP architectures. We believe that our product offering is greatly aligned with the major trend of bandwidth demand, for which network operators are investing. In the fourth quarter of fiscal 2011, we also believe we gained market share for certain of our product lines, which contributed to the increase of our sales compared to the same period last year.

Finally, in the fourth quarter of fiscal 2011, we recorded in our sales foreign exchange gains of \$781,000 on our forward exchange contracts, compared to \$285,000 in 2010, which contributed to the increase of our sales year-over-year.

Table of Contents

In the fourth quarter of fiscal 2011, our gross margin reached 63.6% of sales compared to 64.8% for the same period last year. First, in the fourth quarter of fiscal 2011, there was an unfavorable product mix, which resulted in lower margins compared to the same period last year. However, in the fourth quarter of fiscal 2011, we recorded in our sales foreign exchange gains totaling \$781,000 on our forward exchange contracts, compared to foreign exchange losses of \$285,000 in 2010, contributing to the 0.2% increase in our gross margin year-over-year. Finally, the increase in the value of the Canadian dollar in 2011 compared to 2010 had a positive impact on our gross margin in the fourth quarter of 2011; 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 dollar are measured in Canadian dollars in our financial statements.

In the fourth quarter of fiscal 2011, earnings from operations amounted to \$3.2 million, compared to \$4.4 million for the same period last year. Lower margins on sales and increased operating expenses to sustain expected growth of our business in the near future, combined with an increased value of the Canadian dollar compared to the US dollars year-over-year, resulted in lower earnings from operations in the fourth quarter of fiscal 2011 compared to the same period last year.

Net earnings amounted to \$1.9 million, or \$0.03 per diluted share, in the fourth quarter of fiscal 2011, compared to \$5.0 million, or \$0.08 per diluted share, for the same period last year. Lower margins and increased operating expenses in the fourth quarter of fiscal 2011 contributed to the decrease of our net earnings compared to the same period last year. However, in the fourth quarter of fiscal 2010, we recorded a significant pre-tax foreign exchange gain of \$1.8 million compared to a foreign exchange loss of \$57,000 for the same period this year. Finally, in the fourth quarter of fiscal 2011, the average value of the Canadian dollar, compared to the US dollar, increased compared to the same period last year, which had a negative impact on net earnings in the fourth quarter of 2011 compared to 2010, as a portion of our operating expenses are denominated in Canadian dollars and we report our results in US dollars.

Table of Contents

Quebec City, Canada, November 1, 2011

RE: Annual General Meeting of Shareholders

Dear Shareholder,

Fiscal 2011 once again proved to be a highly satisfying year based on delivering exceptional results and executing well against our strategic agenda. When I look back over the past year, the two main elements that stand out are growth and transformation.

Growth

Thanks to the support and confidence of customers worldwide, EXFO increased sales 33.0% (27% organic) to a record \$269.7 million in 2011 on the heels of 32.4% growth (20% organic) in 2010. Consequently, it is fair to say that EXFO gained market share for a 26th consecutive year.

Looking at earnings, we generated a record of \$30.6 million in adjusted EBITDA\* in fiscal 2011. At first glance, adjusted EBITDA increased by a modest 12.0% year-over-year from \$27.3 million in 2010. However, excluding foreign exchange losses of \$3.8 million and \$1.5 million in 2011 and 2010, respectively, our adjusted EBITDA would have been up nearly 20% year-over-year.

Key Accomplishments

Following is a list of our key accomplishments in fiscal 2011:

- Increased sales 33.0% to a record \$269.7 million, or 27.1% on an organic basis;
- Improved Optical, Protocol and Copper Access sales 27.9%, 38.4% and 37.8%, respectively;
- Raised sales by 29.3% in the Americas, 41.7% in Europe, Middle East and Africa (EMEA), and 29.8% in Asia-Pacific;
- Enhanced wireless sales from 0% to 20-22% of total revenues in the last four years;
- Generated a record of \$30.6 million in adjusted EBITDA, or 11.3% of sales (12.7% excluding impact of foreign exchange loss);
  - Delivered \$23.3 million in cash flows from operations; and
  - Strengthened competitive position with new, game-changing solutions.

Transformation

EXFO has transformed itself in a number of ways in order to better position itself for long-term growth opportunities and value-creation objectives:

- We increased our sales in the high-growth wireless market to 20-22% of total revenues in fiscal 2011 from 16-18% in 2010;
- As part of the test and service assurance industry's top-five suppliers, we accelerated the transition from being an "international" to a truly "global" player;
  - We continued to move up the value chain by developing solutions for Tier-1 network operators;
- We divested our Life Sciences and Industrial business in early fiscal 2011 to focus exclusively on the telecom test and service assurance market; and

- We continued evolving from a “box” to “solutions” supplier to help network operators become more productive while reducing their operating expenses.

Table of Contents

Corporate Performance Objectives

Turning to our fiscal 2010-2012 Corporate Performance Objectives, we remain on track two years into our three-year plan with a sales CAGR of 25.4%, gross margin of 62.7%, and a 45.4% CAGR for adjusted EBITDA in dollars.

Despite entering fiscal 2012 amidst a challenging global economy, I remain convinced that telecom is likely the industry with the most economic resilience and that EXFO is better positioned than ever to take advantage of intermediate and long-term growth trends.

| Three-Year Objectives<br>(Base year: FY 2009 which included divested LSI<br>Division) | Results After FY 2011 |
|---|-----------------------|
| Increase sales by at least 25% CAGR   | 25.4% CAGR            |
| Raise gross margin from 61.3% to 65%  | 62.7%                 |
| Increase adjusted EBITDA in dollars by at least 30%<br>CAGR                           | 45.4% CAGR            |

\*EBITDA is defined as net earnings (loss) before interest, income taxes, amortization of property, plant and equipment, amortization of intangible assets and impairment of goodwill. Adjusted EBITDA represents EBITDA excluding the gain from the disposal of discontinued operations.

I will discuss these objectives in greater detail at our upcoming Annual General Meeting of Shareholders. Please consider this letter as a formal invitation to attend our Meeting, which will be held on January 12, 2012, 9 a.m., at the St. Andrews Club & Conference Centre, Room S7 (27th floor), located at 150 King Street West in Toronto.

Details of the business to be conducted at the Meeting are provided in the attached Management Proxy Circular and Notice of Annual General Meeting of Shareholders.

It is important that your shares be represented at the Meeting. **WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, PLEASE COMPLETE, SIGN, DATE AND PROMPTLY RETURN THE ACCOMPANYING PROXY IN THE ENCLOSED POSTAGE-PAID ENVELOPE.**

If you send in your proxy card and then decide to attend the Meeting to vote your shares in person, you may still do so. Your proxy is revocable in accordance with the procedures set forth in the Management Proxy Circular.

On behalf of the Board of Directors, I would like to express our appreciation for your continued interest in EXFO. We look forward to seeing you at the Meeting.

Sincerely,

/s/ Germain Lamonde  
 Germain Lamonde  
 Chairman, President and  
 Chief Executive Officer  
 EXFO Inc.





Table of Contents

EXFO INC.

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NOTICE OF ANNUAL MEETING  
OF SHAREHOLDERS

NOTICE IS HEREBY GIVEN that the Annual Meeting (the "Meeting") of shareholders of EXFO Inc. (the "Corporation") will be held at 9:00 a.m. (Eastern Standard Time), on Thursday, January 12, 2012, at the St. Andrew's Club & Conference Centre, S7 Room (27th Floor), 150 King Street West, Toronto, Ontario, Canada for the following purposes:

1. to receive the consolidated financial statements of the Corporation for the financial year ended August 31, 2011, and the Auditor's report thereon;
2. to elect Directors of the Corporation;
3. to appoint PricewaterhouseCoopers LLP as auditors and to authorize the Audit Committee to fix their remuneration;
4. to transact such further or other business as may properly come before the Meeting or any adjournment or adjournments thereof.

Enclosed is a copy of the 2011 consolidated financial statements, management's discussion and analysis and the Auditor's Report thereon, together with the Management Proxy Circular and a form of Proxy.

DATED at Quebec, Province of Quebec, this 1st day of November, 2011.

BY ORDER OF THE BOARD OF DIRECTORS

/s/ Benoit Ringuette  
Benoit Ringuette  
Secretary

Shareholders unable to attend the Meeting are requested to complete the enclosed proxy form and return it in the envelope provided. To be valid, proxies must reach the office of Canadian Stock Transfer Company Inc. (CST) as administrative agent for CIBC Mellon Trust Company, no later than the last day prior to the date of the Meeting or any reconvening of the Meeting in case of adjournment. Shareholders may also have the proxy form delivered to the Chairman of the Meeting prior to the time of voting on the day of the Meeting or any adjournment

thereof.

Page 81 of 128

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Table of Contents

EXFO INC.

MANAGEMENT PROXY CIRCULAR OF THE CORPORATION  
FOR THE ANNUAL MEETING OF SHAREHOLDERS

THIS PROXY IS SOLICITED BY THE MANAGEMENT OF THE CORPORATION

The undersigned shareholder of EXFO INC. hereby appoints (CHECK EITHER (A) or (B)):

(A) Mr. Germain Lamonde of St-Augustin-de-Desmaures, Quebec, or failing him, Mr. Pierre Plamondon of Quebec,  
o Quebec;

(B) \_\_\_\_\_ of \_\_\_\_\_;  
o  
(Name) (Address)

as the representative of the undersigned to attend, act and vote on behalf of the undersigned at the Annual Meeting of the shareholders (the "Meeting") of the Corporation to be held at the St. Andrew's Club & Conference Centre, 150 King Street West, S7 room (27th Floor), Toronto, Ontario, Canada, on January 12, 2012, at 9:00 o'clock a.m. (Eastern Standard Time) and at any adjournments of such meeting.

The undersigned wishes that all shares represented by this proxy be voted in accordance with the instructions herein below. All shares represented by this proxy will be voted for or be the subject of abstentions, as specified by the shareholder. However, in the absence of instructions, the shares represented by proxy will be voted in favor of each of the proposals set forth herein.

To elect:

(MARK WITH AN X)

|  |                   |  |
|--|-------------------|--|
| Pierre-Paul Allard whose city of residence is indicated in the Management Proxy Circular, as Director of the Corporation.    | FOR<br>ABSTENTION | <input type="radio"/><br><input type="radio"/> |
| Darryl Edwards whose city of residence is indicated in the Management Proxy Circular, as Director of the Corporation.        | FOR<br>ABSTENTION | <input type="radio"/><br><input type="radio"/> |
| Germain Lamonde whose city of residence is indicated in the Management Proxy Circular, as Director of the Corporation.       | FOR<br>ABSTENTION | <input type="radio"/><br><input type="radio"/> |
| Pierre Marcouiller whose city of residence is indicated in the Management Proxy Circular, as Director of the Corporation.    | FOR<br>ABSTENTION | <input type="radio"/><br><input type="radio"/> |
| Guy Marier whose city of residence is indicated in the Management Proxy Circular, as Director of the Corporation.            | FOR<br>ABSTENTION | <input type="radio"/><br><input type="radio"/> |
| Susan Louise Spradley whose city of residence is indicated in the Management Proxy Circular, as Director of the Corporation. | FOR<br>ABSTENTION | <input type="radio"/><br><input type="radio"/> |
| To appoint PricewaterhouseCoopers LLP as auditors and to authorize the Audit Committee to fix their remuneration.            | FOR<br>ABSTENTION | <input type="radio"/><br><input type="radio"/> |

A DISCRETIONARY POWER IS HEREBY CONFERRED as to any amendment or change made to the matters mentioned in the Notice of Meeting or as to such other matters as may legally come before the Meeting. The Management of the Corporation is not aware of any amendments, changes or other matters that may come before the Meeting.

\* A shareholder is entitled to appoint, to attend and DATED this \_\_\_\_\_ day of \_\_\_\_\_ act for and on behalf of such shareholder at the Meeting, a person other than the person mentioned in \_\_\_\_\_ (A) herein above and may do so by checking (B) \_\_\_\_\_ SIGNATURE OF SHAREHOLDER hereinabove and adding the name of such other [ \_\_\_\_\_ ] name of shareholder person in the space reserved for such purpose. [ \_\_\_\_\_ ]

This proxy must be signed by the shareholder or his proxyholder authorized in writing or, if the shareholder is a corporation, under its corporate seal, by a duly authorized officer or proxyholder of the corporation. Please remember to date and sign this proxy. If this proxy is not dated, it will be deemed to bear the date of its mailing by Management.

YOU ARE REFERRED TO THE MANAGEMENT PROXY CIRCULAR APPENDED.

Français au verso

Table of Contents

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NOTICE OF ANNUAL  
MEETING OF SHAREHOLDERS  
And  
MANAGEMENT PROXY CIRCULAR

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November 1, 2011

Page 83 of 128

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Table of Contents

EXFO Inc.

MANAGEMENT PROXY CIRCULAR

SOLICITATION OF PROXIES

This Management Proxy Circular ("Circular") is provided in connection with the solicitation by the Management of EXFO Inc. (the "Corporation" or "EXFO") of proxies to be used at the Annual General Meeting of shareholders (the "Meeting") of the Corporation to be held at the time and place and for the purposes stated in the accompanying Notice of Meeting and at any adjournment thereof. Unless otherwise indicated, the information contained herein is given as of November 1, 2011.

It is expected that the solicitation will be made primarily by mail but proxies may also be solicited personally by officers, employees or agents of the Corporation. The Corporation may also reimburse brokers and other persons holding shares in their names or in the names of nominees, for their costs incurred in sending proxy material to principals and obtaining their proxies. The cost of solicitation will be borne by the Corporation and is expected to be nominal.

APPOINTMENT AND REVOCATION OF PROXIES AND ATTENDANCE OF BENEFICIAL SHAREHOLDERS

The persons named in the enclosed Form of Proxy (the "Form of Proxy") are officers of the Corporation. A shareholder desiring to appoint some other person (who need not be a shareholder) to represent him or her at the Meeting may do so by inserting such person's name in the blank space provided in the Form of Proxy and checking item (B).

To be valid, proxies must be received at the Montreal, Canada office of Canadian Stock Transfer Company Inc. (CST) as administrative agent for CIBC Mellon Trust Company (CIBC Mellon), 320 Bay Street, Banking Hall, Toronto, On M5H 4A6, the transfer agent of the Corporation, no later than the close of business on the last business day preceding the day of the Meeting or any adjournment thereof, or proxies may be delivered to the Chairman of the Meeting on the day of the Meeting or any adjournment thereof. A beneficial shareholder who completes a Form of Proxy and who wishes to attend and vote at the Meeting personally must appoint himself or herself proxy holder in the foregoing manner.

A proxy given pursuant to this solicitation may be revoked by instrument in writing executed by the shareholder or by his or her attorney authorized in writing if such instrument is deposited either at the registered office of the Corporation to the attention of the Corporate Secretary no later than the close of business on the last business day preceding the day of the Meeting or any adjournment thereof or with the Chairman of the Meeting on the day of the Meeting or any adjournment thereof.

VOTING OF PROXIES

The shares represented by proxies appointing the persons, or any one of them, designated by Management thereon to represent the shareholder at the Meeting will be voted in accordance with the instructions given by the shareholder. Unless otherwise indicated, the voting rights attaching to the shares represented by a Form of Proxy will be voted "FOR" in respect of all the proposals described herein.

The Form of Proxy confers discretionary authority upon the persons named therein with respect to amendments or variations to matters identified in the accompanying Notice of Meeting. As at the date hereof, Management is not aware that any other matter is to be presented at the Meeting. If, however, other matters properly come before the Meeting, the persons designated in the Form of Proxy will vote thereon in accordance with their judgment pursuant to the discretionary authority conferred by such proxy with respect to such matters.



Table of Contents

## VOTING SHARES AND PRINCIPAL HOLDERS THEREOF

As at November 1, 2011, 28,784,502 Subordinate Voting Shares and 31,643,000 Multiple Voting Shares were outstanding, being the only classes of shares entitled to be voted at the Meeting. Each holder of Subordinate Voting Shares is entitled to one vote and the holder of Multiple Voting Shares is entitled to 10 votes for each share registered in his or her name at the close of business on November 14, 2011, being the date fixed by the Board of Directors for the purpose of determining registered shareholders entitled to receive the accompanying Notice of Meeting and to vote (the "Record Date"). A list of shareholders entitled to vote as of the Record Date, showing the number of shares held by each shareholder, shall be prepared within 10 days of the Record Date. This list of shareholders will be available for inspection during normal business hours at the Montreal, Canada office of Canadian Stock Transfer Company Inc. (CST) as administrative agent for CIBC Mellon Trust Company, the transfer agent of the Corporation, 2001 University Street, Suite 1600, Montreal, Quebec, Canada, H3A 2A6, and at the Meeting.

Unless otherwise indicated, the resolutions submitted to a vote at the Meeting must be passed by a majority of the votes cast by the holders of Subordinate Voting Shares and Multiple Voting Shares, as a single class, present at the Meeting in person or by proxy and voting in respect of all resolutions to be voted on by the shareholders of the Corporation.

To the knowledge of executive officers and directors of the Corporation, as of November 1, 2011, the only persons who are beneficial owners or who exercise control or direction, directly or indirectly, over shares carrying more than 10% of the voting rights attaching to any class of shares of the Corporation are:

| Name of Shareholder              | Number of Subordinate Voting Shares | Percentage of Voting Rights Attached to All Subordinate Voting Shares | Number of Multiple Voting Shares (1) | Percentage of Voting Rights Attached to All Multiple Voting Shares | Percentage of Voting Rights Attached to All Subordinate and Multiple Voting Shares |
|----------------------------------|-------------------------------------|---|--------------------------------------|--|--|
| Germain Lamonde                  | 4,090,588 (2)                       | 14.21%  | 31,643,000 (3)                       | 100%   | 92.85%   |
| EdgePoint Investment Group, Inc. | 2,891,500                           | 10.05%  | –                                    | –  | 0.84%  |

(1) The holder of Multiple Voting Shares is entitled to 10 votes for each share.

- (2) Mr. Lamonde exercises control over 4,000,000 Subordinate Voting Shares through G. Lamonde Investissements Financiers inc., a company controlled by Mr. Lamonde
- (3) Mr. Lamonde exercises control over this number of Multiple Voting Shares through G. Lamonde Investissements Financiers inc., a company controlled by Mr. Lamonde and through Fiducie Germain Lamonde, a family trust for the benefit of Mr. Lamonde's family.

## ELECTRONIC DELIVERY

The Corporation has a voluntary program for e-mail notification to its shareholders advising them that documents which must be delivered pursuant to securities legislation are available on EXFO's website. Every year, as required by law governing public companies, EXFO delivers documentation to shareholders, such as this Management Proxy Circular and its annual consolidated financial statements together with the auditors' report thereon. EXFO has made the delivery of such documents more convenient for its shareholders, as shareholders who so wish, may be notified by e-mail when the Corporation's documentation is posted in the "Investors" section on its website (www.EXFO.com).

Accordingly such documentation will not be sent in paper form by mail. The Corporation believes that electronic delivery will benefit the environment and reduce its costs. Shareholders who do not consent to receive documentation by e-mail will continue to receive such documentation by mail. Shareholders may also notify the Corporation in writing of their intention not to receive the annual consolidated financial statements together with the auditors' report thereon, neither by e-mail nor by mail.

Registered shareholders can consent to electronic delivery by completing and returning the consent form accompanying this Circular to Canadian Stock Transfer Company Inc. (CST) as administrative agent for CIBC Mellon Trust Company. Unregistered shareholders (i.e. shares are held through a securities broker, bank, trust company or other nominee) can consent to electronic delivery by completing and returning the appropriate form received from the applicable intermediary.

Table of Contents

BUSINESS TO BE TRANSACTED AT THE MEETING

Presentation of the Financial Statements

The consolidated financial statements of the Corporation for the financial year ended August 31, 2011 and the Auditors' report thereon accompanying this Circular will be submitted to shareholders at the Meeting but no vote with respect thereto is required or proposed to be taken.

Election of the Directors

According to the articles of the Corporation, the Board of Directors shall consist of a minimum of three (3) and a maximum of twelve (12) directors. The number of directors is currently fixed to seven (7) and will be fixed to six (6) at the Meeting pursuant to a resolution of the Board of Directors. At the Meeting, Management proposes the six (6) persons named hereafter on pages 4 to 9 as nominees for election as directors to hold office until the next annual meeting or until the office is otherwise vacated in accordance with the Corporation's by-laws.

Management does not anticipate that any of the nominees will be unable, or for any reason whatsoever, be reluctant to fulfill their duties as directors. Should this occur for any reason whatsoever before the election, the persons named in the Form of Proxy reserve the right to vote for another nominee of their choice unless the shareholder specified on the Form of Proxy to abstain from voting for the election of the directors. The election of the directors must be approved by a majority of the votes cast on the matter at the Meeting.

The Corporation's Majority Voting Policy applies to this election. Under such policy, a director who is elected in an uncontested election with a greater number of votes "withheld" than votes "for", such director will be required to tender his or her resignation to the Chair of the Board. This resignation will be effective when accepted by the Board of Directors. Unless extraordinary circumstances apply, the Board of Directors will accept the resignation. The Board of Directors will announce its decision (including the reason for not accepting a resignation) by press release within ninety (90) days of the meeting where the election was held. A copy of the Majority Voting Policy is available on the Corporation's website at [www.EXFO.com](http://www.EXFO.com).

Nomination Process

The Human Resources Committee assists the Board of Directors by identifying individuals qualified to become Board of Directors members, and recommending that the Board of Directors select the director nominees for the next annual meeting of shareholders. In making its recommendations, the Human Resources Committee objectively considers, among others, the competencies and skills (i) that the Board of Directors considers to be necessary for the Board, as a whole, to possess; (ii) that the Board of Directors considers each existing director to possess; and (iii) each new nominee will bring to the board room. Therefore, the competencies and skills, identified by the Human Resources Committee, as a whole, include the skill sets of current members such as financial literacy, wireless and wireline technology and telecommunications industry experience, international experience and other related competencies. Any additional skill sets deemed to be beneficial are considered, assessed and identified in light of the opportunities and risks facing the Corporation when candidates for director positions are considered.

Appointment and Remuneration of Auditors

A firm of auditors is to be appointed by vote of the shareholders at the Meeting to serve as auditors of the Corporation until the close of the next annual meeting. The Audit Committee is to be authorized to fix the remuneration of the auditors so appointed. The Board of Directors and Management, upon the advice of the Audit Committee, recommend that PricewaterhouseCoopers LLP be re-appointed as Auditors of the Corporation. The re-appointment of

PricewaterhouseCoopers LLP must be approved by a majority of the votes cast on the matter at the Meeting.

Table of Contents**NOMINEES FOR ELECTION AS DIRECTORS AND THEIR BENEFICIAL OWNERSHIP OF VOTING SECURITIES**

The following charts and notes set out the name of each of the individuals proposed to be nominated at the Meeting for election as a director of the Corporation. Included in these charts is information relating to the directors' committee memberships, meeting attendance, period of service as a director, principal directorships with other organizations and equity ownership (or over which each of them exercised control or direction) in the Corporation.

**GERMAIN LAMONDE**

St-Augustin-de-Desmaisons, Quebec, Canada  
 Director since September 1985  
 Not Independent (Management)  
 Principal Occupation: Chairman of the Board of Directors, President and Chief Executive Officer, EXFO Inc.

Germain Lamonde, a company founder, has been President and Chief Executive Officer of EXFO since its inception in 1985. He has also been Chairman of the Board since EXFO went public in 2000. Responsible for the overall management and strategic direction of EXFO, Mr. Lamonde has grown the company from the ground up into a global leader in the wireline and wireless telecommunication test and service assurance industry. Mr. Lamonde has served on the board of directors of several organizations such as the Canadian Institute for Photonic Innovations, the POLE QCA Economic Development Corporation and the National Optics Institute of Canada (INO), to name a few. Germain Lamonde holds a bachelor's degree in physics engineering from the University of Montreal's School of Engineering (École Polytechnique), a master's degree in optics from Université Laval in Quebec City, and is also a graduate of the Ivey Executive Management Program offered by the University of Western Ontario.

| Board/Committee Membership         |                              | Attendance (1)            |                      | Principal Board Memberships             |  |
|------------------------------------|------------------------------|---------------------------|----------------------|---|--|
| Chairman of the Board of Directors |                              | 8/8                       | 100%                 | –                                       |  |
| Securities Held                    |                              |                           |                      |   |  |
| As at                              | Subordinate Voting Shares(#) | Multiple Voting Shares(#) | RSUs(#)              | Total Shares and RSUs(#)                | Total Market Value (3) of Shares (2) and RSUs (US\$) |
| August 31, 2011                    | 4,043,348 (4)                | 31,643,000 (5)            | 222,899              | 35,909,247                              | 240,232,862  |
| Options Held as at August 31, 2011 |                              |                           |                      |   |  |
| Date Granted                       | Number(#)                    | Exercise Price (US\$)     | Total Unexercised(#) | Value of Options Unexercised (US\$) (6) |  |
| October 10, 2001                   | 70,000                       |                           | 70,000               | –                                       |  |
| September 25, 2002                 | 50,000                       | 9.13                      | 50,000               | 255,500                                 |  |
| February 1, 2005                   | 17,942                       |                           | 17,942               |   |  |
| December 6, 2005                   | 11,218                       | 1.58                      | 11,218               | 39,113                                  |  |
|                                    |                              |                           | 4.51                 | 21,651                                  |  |

|       |      |         |         |
|-------|------|---------|---------|
|       | 4.76 |         |         |
| Total |      | 149,160 | 316,264 |

- (1) From September 1, 2010 until November 1, 2011, Mr. Lamonde attended 7 meetings in person and 1 meeting by telephone.
- (2) Includes both Subordinate Voting Shares and Multiple Voting Shares.
- (3) The value of unvested RSUs at the financial year-end is the market value of the Subordinate Voting Shares on August 31, 2011, which was US\$6.69 (CA\$6.55). The market value of the Subordinate Voting Shares and Multiple Voting Shares was calculated by using the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and on the NASDAQ National Market on August 31, 2011 using the noon buying rate of the Bank of Canada to convert the NASDAQ National Market closing price to Canadian dollars as required. The actual gains on vesting of RSUs will depend on the value of the Subordinate Voting Shares on the date of vesting. There can be no assurance that these values will be realized.
- (4) Mr. Lamonde exercises control over 4,000,000 of Subordinate Voting Shares through G. Lamonde Investissements Financiers inc., a company controlled by Mr. Lamonde.
- (5) Mr. Lamonde exercises control over this number of Multiple Voting Shares through G. Lamonde Investissements Financiers inc., a company controlled by Mr. Lamonde and through Fiducie Germain Lamonde, a family trust for the benefit of Mr. Lamonde's family.
- (6) Indicates an aggregate value of "in-the-money" unexercised options held at the financial year ended August 31, 2011. "In-the-money" options are options for which the market value of the underlying securities is higher than the exercise price. The value of unexercised in-the-money options at financial year end is the difference between its exercise or base price and the market value of the underlying Subordinate Voting Share as at August 31, 2011, which was US\$6.69 (CA\$6.55). The market value of the Subordinate Voting Shares was calculated by using the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and on the NASDAQ National Market on August 31, 2011 using the noon buying rate of the Bank of Canada to convert the NASDAQ National Market closing price to Canadian dollars as required.

Table of Contents

## PIERRE-PAUL ALLARD

Pleasanton, California, USA  
 Director since September 2008  
 Independent  
 Principal Occupation: Vice-President, Sales and Operations, Global Industries for Cisco Systems Inc. (1)

Pierre-Paul Allard was appointed a member of our Board of Directors in September 2008 and has been a board member of many other technology companies in Canada and in the US. Today, he is also an active philanthropist for l'Institut de Cardiologie de Québec. Mr. Allard is presently Vice-President, Sales and Operations, Global Industries for Cisco Systems Inc., where he has held several senior management positions over the last 18 years. More recently, Mr. Allard was President and CEO of Cisco Systems Canada. Currently, he is responsible for all field operations of Cisco's Global Enterprise Client segment, focusing on new business models, market transition opportunities and increased customer satisfaction. Prior to joining Cisco, Mr. Allard worked for IBM Canada for 12 years. In 2002, Mr. Allard co-chaired the Canadian e-Business Initiative, a private-public partnership aiming to measure the role e-Business plays in increasing productivity levels, job creation and competitive position. In 1998, he was the laureate of the Arista-Sunlife Award, for Top Young Entrepreneur in Large Enterprise, by the Montreal Chamber of Commerce. In 2003, he received the Queen's Golden Jubilee Medal, which highlights significant contributions to Canada. In the same year, he was also awarded the prestigious Trudeau Medal from the University of Ottawa, Tefler School of Management. Pierre-Paul Allard holds a bachelor's and masters' degree in Business Administration from the University of Ottawa, in Canada.

| Board/Committee Membership         |                              | Attendance (2)        |                          | Principal Board Memberships         |                               |
|------------------------------------|------------------------------|-----------------------|--------------------------|-------------------------------------|-------------------------------|
| Board of Directors                 |                              | 8/8                   | 100%                     | –                                   |                               |
| Audit Committee                    |                              | 4/5                   | 80%                      |                                     |                               |
| Human Resources Committee          |                              | 5/5                   | 100%                     |                                     |                               |
| Independent Board of Directors     |                              | 6/7                   | 86%                      |                                     |                               |
| Securities Held                    |                              |                       |                          |                                     |                               |
|                                    |                              |                       |                          |                                     | Total Market Value (3)        |
|                                    |                              |                       |                          |                                     | of Shares (4) and DSUs (US\$) |
| As at                              | Subordinate Voting Shares(#) | DSUs(#)               | Total Shares and DSUs(#) |                                     |                               |
| August 31, 2011                    | 8,000                        | 16,270                | 24,270                   | 162,366                             |                               |
| Options Held as at August 31, 2011 |                              |                       |                          |                                     |                               |
| Date Granted                       | Number(#)                    | Exercise Price (US\$) | Total Unexercised(#)     | Value of Options Unexercised (US\$) |                               |
| –                                  | –                            | –                     | –                        | –                                   |                               |

(1) Cisco Systems Inc. is a leading network equipment manufacturer in the global telecommunications industry.

- (2) From September 1, 2010 until November 1, 2011, Mr. Allard attended 6 meetings in person and 2 meetings by telephone.
- (3) The value of unvested DSUs at the financial year-end is the market value of the Subordinate Voting Shares on August 31, 2011, which was US\$6.69 (CA\$6.55). The market value of the Subordinate Voting Shares was calculated by using the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and on the NASDAQ National Market on August 31, 2011 using the noon buying rate of the Bank of Canada to convert the NASDAQ National Market closing price to Canadian dollars as required. The actual gains on vesting of DSUs will depend on the value of the Subordinate Voting Shares on the date of vesting. There can be no assurance that these values will be realized.
  - (4) Refers to Subordinate Voting Shares.



Table of Contents

## DARRYL EDWARDS

Weston Under Wetherley Warwickshire United Kingdom

Director since September 2011

Independent

Principal Occupation: Executive Consultant

Darryl Edwards was appointed a member of our Board of Directors in September 2011. He brings to EXFO more than 30 years of telecommunications experience gained from a number of senior executive leadership positions; from 2009 to 2011, he was the Chief Executive Officer of AIRCOM International, successfully leading the company through to business sale. Mr. Edwards was previously at Nortel Networks for 17 years, where he held various executive officer positions, including President of EMEA Sales from 2006 to 2009 and in 2009 President of Global Sales (Carrier Networks). He also was the Chief Executive Officer for two of Nortel's key joint ventures, first in the Middle East and later in Germany. Prior to his time at Nortel, Mr. Edwards spent 13 years at GEC-Plessey Telecommunications where he worked in engineering, quality assurance and international sales. Mr. Edwards has held a number of chairs, including Chairman of the Board of Nortel's interests in Turkey, Nortel Netas, which was listed on the Istanbul Stock Exchange. He also was a member of the Advisory Counsel to the Turkish government between 2004 and 2008, and previously served on the UK Government Broadband Stakeholders Group and the Information Age Partnership. Darryl Edwards holds a Higher National Certificate (Physics) from Birmingham Polytechnic in the UK.

| Board/Committee Membership     | Attendance (1) | Principal Board Memberships            |
|--------------------------------|----------------|--|
| Board of Directors             | 2/2 100%       | Aircom International (Africa) Pty Ltd. |
| Audit Committee                | 1/1 100%       |  |
| Human Resources Committee      | 1/1 100%       |  |
| Independent Board of Directors | 2/2 100%       |  |

## Securities Held

| As at August 31, 2011 | Subordinate Voting Shares (#) | DSUs (#) | Total Shares and DSUs (#) | Total Market Value (2) of Shares (3) and DSUs (US\$) |
|-----------------------|-------------------------------|----------|---------------------------|--|
|                       | –                             | –        | –                         | –  |

## Options Held as at August 31, 2011

| Date Granted | Number (#) | Exercise Price (US\$) | Total Unexercised (#) | Value of Options Unexercised (US\$) |
|--------------|------------|-----------------------|-----------------------|-------------------------------------|
| –            | –          | –                     | –                     | –                                   |

- (1) Mr. Edwards joined our Board of Directors in September 2011. From September 1, 2011 until November 1, 2011, Mr. Edward attended 2 meetings in person.
- (2) The value of unvested DSUs at the financial year-end is the market value of the Subordinate Voting Shares on August 31, 2011, which was US\$6.69 (CA\$6.55). The market value of the Subordinate Voting Shares was calculated by using the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and on the NASDAQ National Market on August 31, 2011 using the noon buying rate of the Bank of Canada to convert the NASDAQ National Market closing price to Canadian dollars as required. The actual gains on vesting of DSUs will depend on the value of the Subordinate Voting Shares on the date of vesting. There can be no assurance that these values will be realized.
  - (3) Refers to Subordinate Voting Shares.

Table of Contents

## PIERRE MARCOUILLER

Magog, Quebec, Canada Pierre Marcouiller has served as our Director since May 2000. Mr. Marcouiller is Chairman of the Board and CEO of Camoplast Solideal Inc. a world leader in the design, manufacturing and distribution of off-road tires, rubber tracks, undercarriage systems and wheels and a NA leader in under-the-hood plastic components and assemblies for the automotive industry. Prior to joining Camoplast, Mr. Marcouiller was President and General Manager of Venmar Ventilation Inc. (1988-1996), where he was the controlling shareholder from 1991 to 1996. Mr. Marcouiller is also a Chairman of the Board and Director of Canam Group Inc., an industrial company specialized in the design and fabrication of construction products and solutions in the commercial, industrial, institutional, residential, and bridge and highway infrastructures markets. Mr. Marcouiller also holds directorships in other privately held companies. Pierre Marcouiller holds a bachelor's degree in business administration from the Université du Québec à Trois-Rivières and an MBA from the Université de Sherbrooke.

| Board/Committee Membership     | Attendance (2) | Principal Board Memberships |
|--------------------------------|----------------|-----------------------------|
| Board of Directors             | 7/8 88%        | Canam Group Inc.            |
| Audit Committee                | 5/5 100%       |                             |
| Human Resources Committee      | 5/5 100%       |                             |
| Independent Board of Directors | 7/7 100%       |                             |

## Securities Held

| As at           | Subordinate Voting Shares(#) | DSUs(#) | Total Shares and DSUs(#) | Total Market Value (3) of Shares (4) and DSUs (US\$) |
|-----------------|------------------------------|---------|--------------------------|--|
| August 31, 2011 | 5,000                        | 31,942  | 36,942                   | 247,142  |

## Options Held as at August 31, 2011

| Date Granted     | Number(#) | Exercise Price (US\$) | Total Unexercised(#) | Value of Options Unexercised (US\$) (5) |
|------------------|-----------|-----------------------|----------------------|---|
| October 10, 2001 | 17,966    | 9.13                  | 17,966               | —                                       |
| December 1, 2001 | 1,037     | 12.69                 | 1,037                | —                                       |
| Total            |           |                       | 19,003               | —                                       |

- (1) Camoplast Solideal is a world leader in the design, manufacturing and distribution of off-road tires, rubber tracks, undercarriage systems, wheels, body dressing parts, under-the-hood plastic components and assemblies, molded skis, engine covers, thermal and air induction systems for the construction, agricultural, industrial, powersports, defense and automotive markets (industries).
- (2) From September 1, 2010 until November 1, 2011, Mr. Marcouiller attended 7 meetings in person and no meeting by telephone.
- (3) The value of unvested DSUs at the financial year-end is the market value of the Subordinate Voting Shares on August 31, 2011, which was US\$6.69 (CA\$6.55). The market value of the Subordinate Voting Shares was calculated by using the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and on the NASDAQ National Market on August 31, 2011 using the noon buying rate of the Bank of Canada to convert the NASDAQ National Market closing price to Canadian dollars as required. The actual gains on vesting of DSUs will depend on the value of the Subordinate Voting Shares on the date of vesting. There can be no assurance that these values will be realized.
  - (4) Refers to Subordinate Voting Shares.
- (5) Indicates an aggregate value of “in-the-money” unexercised options held at the financial year ended August 31, 2011. “In-the-money” options are options for which the market value of the underlying securities is higher than the exercise price. The value of unexercised in-the-money options at financial year end is the difference between its exercise or base price and the market value of the underlying Subordinate Voting Share at August 31, 2011, which was US\$6.69 (CA\$6.55). The market value of the Subordinate Voting Shares was calculated by using the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and on the NASDAQ National Market on August 31, 2011 using the noon buying rate of the Bank of Canada to convert the NASDAQ National Market closing price to Canadian dollars as required.

Table of Contents

## GUY MARIER

Lakefield Gore, Quebec, Canada

Guy Marier has served as our Director since January 2004. Formerly President of Bell Québec (1999 to 2003), Mr. Marier completed his successful 33-year career at Bell (1) Director since January 2004 as Executive Vice-President of the Project Management Office, before retiring at the end of 2003. From 1988 to 2004, Mr. Marier headed Bell Canada International's investments and projects in Saudi Arabia and, for the three following years, served as President of Télébec. He then returned to the parent company to hold various senior management positions. Guy Marier holds a Bachelor of Arts from the University of Montreal and a Bachelor of Business Administration from the Université du Québec à Montréal. Executive Consultant

| Board/Committee Membership         |                               | Attendance (2)        |                           | Principal Board Memberships                          |  |
|------------------------------------|-------------------------------|-----------------------|---------------------------|--|--|
| Board of Directors                 |                               | 8/8                   | 100%                      | –  |  |
| Audit Committee                    |                               | 5/5                   | 100%                      |  |  |
| Human Resources Committee          |                               | 5/5                   | 100%                      |  |  |
| Independent Board of Directors     |                               | 7/7                   | 100%                      |  |  |
| Securities Held                    |                               |                       |                           |  |  |
|                                    |                               |                       |                           | Total Market Value (3) of Shares (4) and DSUs (US\$) |  |
| As at August 31, 2011              | Subordinate Voting Shares (#) | DSUs (#)              | Total Shares and DSUs (#) | 220,382  |  |
|                                    | 1,000                         | 31,942                | 32,942                    |  |  |
| Options Held as at August 31, 2011 |                               |                       |                           |  |  |
|                                    |                               |                       |                           | Value of Options Unexercised (US\$) (5)              |  |
| Date Granted                       | Number (#)                    | Exercise Price (US\$) | Total Unexercised (#)     | 25,500   |  |
| March 24, 2004                     | 12,500                        | 4.65                  | 12,500                    |  |  |

- (1) Bell is Canada's largest communications company, providing consumers with solutions to all their communications needs, including telephone services, wireless communications, high-speed Internet, digital television and voice over IP. Bell also offers integrated information and communications technology services to businesses and governments.
- (2) From September 1, 2010 until November 1, 2011, Mr. Marier attended 7 meetings in person and 1 meeting by telephone.
- (3) The value of unvested DSUs at the financial year-end is the market value of the Subordinate Voting Shares on August 31, 2011, which was US\$6.69 (CA\$6.55). The market value of the Subordinate Voting Shares was calculated by using the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and on the NASDAQ National Market on August 31, 2011 using the noon buying rate of the Bank of Canada to convert the NASDAQ National Market closing price to Canadian dollars as required. The actual gains

on vesting of DSUs will depend on the value of the Subordinate Voting Shares on the date of vesting. There can be no assurance that these values will be realized.

(4) Refers to Subordinate Voting Shares.

(5) Indicates an aggregate value of “in-the-money” unexercised options held at the financial year ended August 31, 2011. “In-the-money” options are options for which the market value of the underlying securities is higher than the exercise price. The value of unexercised in-the-money options at financial year end is the difference between its exercise or base price and the market value of the underlying Subordinate Voting Share at August 31, 2011, which was US\$6.69 (CA\$6.55). The market value of the Subordinate Voting Shares was calculated by using the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and on the NASDAQ National Market on August 31, 2011 using the noon buying rate of the Bank of Canada to convert the NASDAQ National Market closing price to Canadian dollars as required.

Table of Contents

## SUSAN LOUISE SPRADLEY

Dallas, Texas  
USA

Director since  
October 2011

Independent

Principal Occupation: Executive Board.  
Executive Consultant

Susan Louise Spradley was appointed a member of our Board of Directors in October 2011. She brings to EXFO more than 20 years of experience in the wireless telecommunications industry in which she has held senior executive positions in sales, product line management, operations, services and customer support. From 2007 to 2011, she was Head of the North American Region at Nokia Siemens Networks and also a member of the company's Executive Board. Prior to joining Nokia Siemens Networks, from 1997 to 2005, Ms. Spradley held prominent leadership roles at Nortel Networks including President of Global Services and Operations, President of Global Product Line Management and North American Sales, and Vice-President of Customer Service and Operations. She also served as Vice-President of Marketing and Product Development for North America at Siemens Communications. In addition, she previously was a member of the National Security Telecommunications Advisory Committee reporting to the President of the United States. Susan Spradley holds a bachelor's degree in Computer Science from the University of Kansas and completed the Advanced Management Program at Harvard University Business School.

| Board/Committee Membership     | Attendance (1) | Principal Board Memberships   |
|--------------------------------|----------------|-------------------------------|
| Board of Directors             | 1/1 100%       | Museum of Nature and Science, |
| Audit Committee                | 1/1 100%       | Dallas, Texas                 |
| Human Resources Committee      | 1/1 100%       | Tango Networks                |
| Independent Board of Directors | 1/1 100%       |                               |

## Securities Held

| As at           | Subordinate<br>Voting Shares (#) | DSUs (#) | Total Shares<br>and DSUs (#) | Total Market<br>Value (2)<br>of Shares (3) and<br>DSUs<br>(US\$) |
|-----------------|----------------------------------|----------|------------------------------|--|
| August 31, 2011 | —                                | —        | —                            | —  |

## Options Held as at August 31, 2011

| Date Granted | Number (#) | Exercise Price (US\$) | Total Unexercised (#) | Value of Options<br>Unexercised<br>(US\$) |
|--------------|------------|-----------------------|-----------------------|---|
| —            | —          | —                     | —                     | —   |

(1) Ms. Spradley joined our Board of Directors in October 2011. From October 1, 2011 until November 1, 2011, Ms. Spradley attended 1 meeting in person.

(2)

The value of unvested DSUs at the financial year-end is the market value of the Subordinate Voting Shares on August 31, 2011, which was US\$6.69 (CA\$6.55). The market value of the Subordinate Voting Shares was calculated by using the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and on the NASDAQ National Market on August 31, 2011 using the noon buying rate of the Bank of Canada to convert the NASDAQ National Market closing price to Canadian dollars as required. The actual gains on vesting of DSUs will depend on the value of the Subordinate Voting Shares on the date of vesting. There can be no assurance that these values will be realized.

(3) Refers to Subordinate Voting Shares.



Table of Contents

The information as to Subordinate Voting Shares and Multiple Voting Shares beneficially owned or over which the above-named individuals exercise control or direction is not within the direct knowledge of the Corporation and has been furnished by the respective individuals. The information as to the Principal Board Memberships is also not within the direct knowledge of the Corporation and has been furnished by the respective individuals.

With the exception of Mr. Darryl Edwards and Ms. Susan Spradley (as disclosed below), none of the individuals who are proposed to be nominated at the Meeting for election as a director of the Corporation:

- (a) is, as at the date hereof, or has been, within 10 years before the date hereof, a director, chief executive officer or chief financial officer of any company that (i) was subject to an order that was issued while such individual was acting in the capacity as director, chief executive officer or chief financial officer, or (ii) was subject to an order that was issued after such individual ceased to be a director, chief executive officer or chief financial officer and which resulted from an event that occurred while that person was acting in the capacity as director, chief executive officer or chief financial officer;
- (b) is, as at the date hereof, or has been within 10 years before the date hereof, a director or executive officer of any company that, while such individual was acting in that capacity, or within a year of that individual ceasing to act in that capacity, became bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver, receiver manager or trustee appointed to hold its assets;
- (c) has, within the 10 years before the date hereof, become bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency, or become subject to or instituted any proceedings, arrangement or compromise with creditors, or had a receiver, receiver manager or trustee appointed to hold his assets; or
- (d) has been subject to (i) any penalties or sanctions imposed by a court relating to securities legislation or by a securities regulatory authority or has entered into a settlement agreement with a securities regulatory authority, or (ii) any other penalties or sanctions imposed by a court or regulatory body that would likely be considered important to a reasonable security holder in deciding whether to vote for such individual.

Mr. Darryl Edwards acted as an executive officer of Nortel Networks Corporation ("Nortel") and its affiliates from 2001 to 2009, most recently acting as President of Global Carrier Sales of Nortel in 2009 and as President, EMEA sales of Nortel from 2006 to 2009. Ms. Susan Spradley acted as an executive officer of Nortel and its affiliates from 1997 to 2005, most recently acting as President of Global Services and Operations of Nortel from 2004 to 2005. Nortel and certain of its affiliates filed for bankruptcy protection in a number of jurisdictions in January 2009.

COMPENSATION OF DIRECTORS AND EXECUTIVE OFFICERS

Compensation Discussion & Analysis

This Compensation Discussion & Analysis focuses primarily on: (i) significant elements of the Corporation's executive compensation program; (ii) principles on which the Corporation makes compensation decisions and determines the amount of each element of executive and director compensation; and (iii) an analysis of the material compensation decisions made by the Human Resources Committee for the financial year ended August 31, 2011.

The following is a discussion of the compensation arrangements with the Corporation's Chief Executive Officer ("CEO"), Chief Financial Officer ("CFO") and each of the three most highly compensated executive officers whose total compensation was, individually, more than CA\$150,000, (the "Named Executive Officers" or "NEOs"). The Corporation's NEOs for the financial year ended August 31, 2011 were, Mr. Germain Lamonde (CEO), Mr. Pierre Plamondon (CFO), Mr. Jon Bradley, Vice-President, Sales — EMEA, Ms. Vivian Hudson, Vice-President, Service Assurance Division and Mr. Dana Yearian, Vice-President, Sales — Americas.

Table of Contents

Members of the Human Resources Committee

During the financial year ended August 31, 2011, the Human Resources Committee was composed of:

- Mr. Guy Marier (Chairman)
  - Mr. Pierre-Paul Allard
  - Mr. Pierre Marcouiller
  - Mr. David A. Thompson
- Mr. André Tremblay (until January 20, 2011)

None of these members were officers or employees, or former officers or employees of the Corporation or its subsidiaries. All of the members of the Human Resources Committee are considered “independent”, as defined in applicable securities legislation. They each have experience in executive compensation either as a chief executive officer of a publicly-traded corporation or as a senior executive officer. The Board of Directors believes that the Human Resources Committee collectively has the knowledge, experience and background required to fulfill its mandate.

Mandate of the Human Resources Committee

The Human Resources Committee of the Board of Directors is responsible for establishing the annual compensation and overseeing the assessment of the performance of all the Corporation’s executive officers, including the President and Chief Executive Officer. This Human Resources Committee also reviews and submits to the Board of Directors the salary structure and the short-term and long-term incentive compensation programs for all employees of the Corporation. The Human Resources Committee also evaluates and makes recommendations to the Board of Directors regarding the compensation of directors, including the number of Deferred Share Units credited to the non-employee directors pursuant to the Deferred Share Unit Plan. The Human Resources Committee’s goal is to develop and monitor executive compensation programs that are consistent with strategic business objectives and shareholders’ interests. Though the Human Resources Committee is responsible for the review and approval of the employees that will receive Restricted Share Units or options to purchase shares of the Corporation, in accordance with policies established by the Board of Directors and the terms of the Long-Term Incentive Plan, these functions may be shared between the Board of Directors and the Human Resources Committee. During the period from September 1, 2010 to August 31, 2011, these functions have been shared by the Board of Directors and the Human Resources Committee but have mainly been performed by the Human Resources Committee.

The Human Resources Committee has reviewed and discussed with the CEO and Vice-President, Human Resources of the Corporation, the compensation disclosure in this document, and has recommended to the Board of Directors that the disclosure be included in this Annual Report.

From September 1, 2010 to November 1, 2011, the Human Resources Committee held five (5) meetings and at four (4) of those meetings executive compensation was discussed. The Human Resources Committee meetings were attended by all the members of the Human Resources Committee, except Mr. Allard who was absent at one meeting. The following table outlines the main activities of the Human Resources Committee during the last financial year:

| Meeting          | Main activities of the Human Resources Committee  |
|------------------|---|
| October 12, 2010 | Review and approval of the Short-Term Incentive Plan for the financial year started September 1, 2010;<br>Review of the proposed salary scales and salary increases for the year started September 1, 2010; |

Review and approval of the compensation plans of executive officers for the financial year started September 1, 2010 being the Base Salary, the Short-Term Incentive Plan and the stock-based compensation delivered through the Long-Term Incentive Plan;  
Review and approval of the stock-based compensation plan for the sales force delivered through the Long-Term Incentive Plan for the financial year started September 1, 2010;  
Review and approval of the quantum for the stock-based compensation plan for the performing employees delivered through the Long-Term Incentive Plan for the financial year started September 1, 2010;  
Review and approval of the executive compensation section of the management proxy circular for the financial year ended August 31, 2010 during a Board of Directors meeting;  
Review of the succession planning program;  
Review of the Management Improvement Performance Program;  
Review of the Mobilization / Motivation Plan;  
Human Resources Integration Plan following acquisition;

Table of Contents

| Meeting          | Main activities of the Human Resources Committee  |
|------------------|---|
| January 12, 2011 | <p>Review of the sales forces achievement and percentage of commissions;</p> <p>Review of a coaching program for the CEO;</p> <p>Selection of new Board Members.</p> <p>Review of the quarterly payments under the Short-Term Incentive Plan for the financial year started September 1, 2010 and being part of the Short-Term Incentive Plan;</p> <p>Review and approval of the stock-based compensation plan for the performing employees delivered through the Long-Term Incentive Plan for the financial year started September 1, 2010;</p> <p>Review and approval of the CEO objectives;</p> <p>Review of the Mobilization / Motivation Plan;</p> <p>Review of the Management Improvement Performance Program;</p> <p>Review of the sales forces commissions plans;</p> <p>Review of a coaching program for the CEO;</p> <p>Selection of new Board Members;</p> <p>Review of the succession planning program.</p> |
| March 31, 2011   | <p>Review of the quarterly payments under the Short-Term Incentive Plan for the financial year started September 1, 2010 and being part of the Short-Term Incentive Plan;</p> <p>Review and approval of the stock-based compensation delivered through the Long-Term Incentive Plan;</p> <p>Review of benchmarks for our sales forces;</p> <p>Review of a coaching program for the CEO;</p> <p>Selection of new Board Members;</p> <p>Review of the succession planning program.</p>  |
| June 28, 2011    | <p>Review of the quarterly payments under the Short-Term Incentive Plan for the financial year started September 1, 2010 and being part of the Short-Term Incentive Plan;</p> <p>Selection of new Board Members;</p> <p>Determination by the Members of their respective DSU percentage of their Annual Retainer.</p>   |
| October 11, 2011 | <p>Review and approval of the Short-Term Incentive Plan for the financial year started September 1, 2011;</p> <p>Review of the proposed salary scales and salary increases for the year started September 1, 2011;</p> <p>Review and approval of the compensation plans of executive officers for the financial year started September 1, 2011 being the Base Salary, the Short-Term Incentive Plan and the stock-based compensation delivered through the Long-Term Incentive Plan;</p> <p>Review and approval of the stock-based compensation plan for the sales force delivered through the Long-Term Incentive Plan for the financial year started September 1, 2011;</p> <p>Review and approval of the quantum for the stock-based compensation plan for the performing employees delivered through the Long-Term Incentive Plan for the financial year started September 1, 2011;</p>                             |

- Review and approval of the executive compensation section of the management proxy circular for the financial year ended August 31, 2011 during a Board of Directors meeting;
- Review of the succession planning program;
- Review of the Mobilization / Motivation Plan;
- Review of a coaching program for the CEO;
- Review and approval of the CEO objectives;
- Review of the 2012 Executive compensation disclosure obligations;
- Review of the Management Improvement Performance Program.

#### Compensation Plan Control - Compensation Consultant and Internal Review

As a general practice, the Corporation's relative position in terms of compensation levels is determined every two years through studies performed by independent consulting firms using a selected reference market of comparable companies. The benchmarking activities are further detailed below under the heading – "Benchmarking".

In 2007, the Corporation engaged two human resources consultants, Mercer (Canada) Ltd. ("Mercer") and Aon Corporation ("Aon"), to advise whether the compensation positioning of the Corporation was still aligned with the comparative market. Further to recommendations from Mercer and Aon, the Corporation decided to gradually align the compensation positioning (for the base salary, short-term and long-term incentives) from the fiftieth percentile to the sixtieth percentile for selected position (the "Target Compensation Positioning") over the following three (3) years.

Table of Contents

In 2008, the Corporation engaged Hewitt Associates LLC to conduct a world-wide market analysis for selected international positions. The survey included annual base salary, bonuses and commission plans.

In 2009, the Corporation appointed Mercer to review the compensation positioning of the Corporation. Mercer confirmed that the Corporation's compensation scheme (base salary, short-term compensation, long-term compensation) was still aligned with the comparative market but some adjustments were proposed to be made for certain executive officers. Considering the overall economic situation, the adjustments proposed by Mercer were postponed.

In 2010, the Corporation engaged Mercer to conduct a study of the Corporation's executive compensation plans. The study examined the total compensation including the fixed components (i.e., base salary, pension, benefits and perquisites) and the variable components (i.e., short-term and long-term incentives). The analysis of Mercer indicated that adjustments were required primarily to base salary levels, long-term incentive plan as well as pension value. Any adjustments were made from a total compensation perspective. Mercer has suggested modifying the compensation philosophy to progressively align the executive compensation toward a total compensation to the fiftieth percentile for expected performance with an opportunity, conditional on performance, to exceed the fiftieth percentile total compensation ("Target Total Compensation"). Further to such recommendations, the Corporation has decided to gradually align over the following three (3) years the compensation positioning according to the Target Total Compensation scheme proposed by Mercer for the compensation plans of the financial year starting September 1, 2010 ("Mercer Three Year Compensation Plan").

In 2011, The Corporation pursued its Mercer Three Year Compensation Plan described above. Therefore, the Corporation did not conduct any study of the Corporation's executive compensation plans in 2011. The Corporation is planning to conduct such survey in 2012 to adjust, as the case may be, its Mercer Three Year Compensation Plan.

In addition, internal pay equity studies are a key factor to complete the compensation review process and indicate where necessary adjustments may be required. During the financial year ended August 31, 2011, this practice continued and certain compensation adjustments were made.

The Human Resources Committee has the authority to retain any independent consultants of its choice to advise its members on total executive compensation policy matters, and to determine the fees and the terms and conditions of the engagement of these consultants. The Human Resources Committee is ultimately responsible for its own decisions, which may take into consideration more than the information and recommendations provided by its compensation consultants or management.

The fees paid to Mercer for consulting services provided to the Human Resources Committee and to the Corporation during the financial year ended August 31, 2011 were as follows:

| Type of Fee  | Financial 2011 Fees | Percentage of Financial 2011 Fees |
|--|---------------------|-----------------------------------|
| Fees for Board of Directors and Human Resources Committee mandates | CA\$7,035           | 43%                               |
| Fees for other Corporation mandates                                | CA\$9,245           | 57%                               |
| Total  | CA\$16,280          | 100%                              |

#### Benchmarking

The Target Total Compensation of senior executives has been reviewed with guidance and advice from Mercer, using a peer group of companies as reference point for determining a competitive total compensation package. The comparator group included private and publicly-traded companies evolving in high technologies, telecommunications and durable-manufacturing goods industries. The selection was based on a number of factors including comparable size, similar service business and relationship to the telecom and life science industries. For certain executives, we emphasized certain comparative companies more than others in determining total compensation based on the responsibilities of such executives. When drawing comparisons to companies significantly larger than Corporation's business, in particular those in the manufacturing goods industry, we did not use compensation arrangements of the most senior executive of that comparator but instead looked to the roles and responsibilities of individuals with equivalent business experience.



## Table of Contents

Mercer used three primary comparator groups in matching incumbent's senior executives to positions of similar responsibility within comparator private and publicly-traded companies:

- (1) 2009 Mercer Benchmark Database, which contains compensation data for selected Canadian companies with median annual revenues of CA\$325 million. The following is a list of the main companies, with a particular emphasis on the High-Technology/Telecommunications and Manufacturing-Durable Goods Industries, servicing industries, revenue categories and geography, used for the purposes of setting 2010 compensation: Arcan Resources Ltd.; Linamar Corporation; Arsenal Energy Inc.; Livingston International; Baytex Energy Trust; Logistec Corporation; Canadian Hydro Developers Inc.; MacDonald, Dettwiler and Associates Corporation – Quebec; Canadian Pacific; Pason Systems Inc.; CE Franklin Ltd.; Precision Drilling Trust; Centerra Gold Inc.; RDM Corporation; Compton Petroleum Corporation; SNC-Lavalin; Computer Modelling Group Ltd.; Softchoice Corp.; Crew Energy Inc.; Stantec Inc.; Enerflex Systems Ltd.; Teck Resources Limited; Labopharm Inc.; TeraGo Networks Inc.; Velan Inc. Mercer can only disclose the identities of the publicly-traded participating organizations due to confidentiality covenants with survey participants;
- (2) 2009 US Mercer Benchmark Database (2,771 participants); and
- (3) 2009 UK Mercer Benchmark Database (193 participants), which contains compensation data for companies in all industries of all sizes and scopes. Focuses on companies with revenues lower than CA\$500 million.

For the executives based outside Canada, their total compensation was aligned at the median of the local market. Mercer cannot disclose the identities of participating organizations within a specific revenue range due to confidentiality covenants with survey participants. Local laws forbid the disclosure of company names when a sampling of companies is extracted from a local database.

### Key Elements and Policies for Compensation of Executive Officers

The Corporation's executive compensation plans are designed to attract, retain and motivate key executives who directly impact the Corporation's long-term success and the creation of shareholder value. In determining executive compensation, the Human Resources Committee considers the following four principles:

- Performance-based: Executive compensation levels reflect both the results of the Corporation and individual results based on specific quantitative and qualitative objectives established at the beginning of each financial year in keeping with the Corporation's long-term strategic objectives.
- Aligned with shareholder interests: An important portion of incentive compensation for executives is composed of equity awards to ensure that executives are aligned with the principles of sustained long-term shareholder value growth.
- Market competitive: Compensation of executives is designed to be externally competitive when compared against executives of comparable peer companies, and in consideration of the Corporation's results.
- Individually equitable: Compensation levels are also designed to reflect individual factors such as scope of responsibility, experience, and performance against individual measures.

### Compensation Elements

The significant elements of the Corporation's 2011 executive compensation program were (i) Base Salary, (ii) the Short-Term Incentive Plan, and (iii) the stock-based incentive compensation delivered through the Long-Term

Incentive Plan. In addition to the foregoing and as the case may be, the Corporation also offered benefit plans and, if applicable, contributed to a Deferred Profit-Sharing Plan or a 401K Plan, as the case may be. To determine appropriate compensation levels for each compensation component, the Human Resources Committee considered all key elements of the executive compensation program. The Human Resources Committee did not assign specific weightings to any key element of the Corporation's 2011 executive compensation program.

Table of Contents

## Base Salaries

In establishing the base salaries of senior officers, including the President and Chief Executive Officer, the Corporation takes into consideration responsibilities, job descriptions and salaries paid by other similar organizations for positions similar in magnitude, scope and complexity. The Human Resources Committee's objective is to align executive compensation levels with the Target Compensation Positioning offered within a reference market of comparable companies that are similar in size to the Corporation, with a particular focus on those within the High-Technology/Telecommunications and Manufacturing-Durable Goods Industries. The Human Resources Committee reviews the base salary of each executive officer on an annual basis at the beginning of each financial year and recommends that the Board of Directors approve appropriate adjustments, if required, within the salary range in order to maintain a competitive position within the market place.

## Short-Term Incentive Compensation

The Short-Term Incentive Plan ("STIP") or the Sales Incentive Plan ("SIP"), as the case may be, provides executive officers with the opportunity to earn annual bonuses based on the Corporation's financial performance and the achievement of strategic corporate (which apply to all employees) and division objectives established on a yearly basis as well as the achievement of personal objectives. Such strategic corporate objectives also apply to all other employees of the Corporation, except the sales force SIP, in their respective STIP. Target payout levels for NEOs eligible for incentive bonuses in the financial year ended August 31, 2011 were established to be in line with the objective of the Human Resources Committee to align compensation with the Target Compensation Positioning offered in the reference market. As per the STIP table below, the plan's objectives are aimed to reward six elements: three elements are shareholder oriented (sales, gross margins and EBITDA), two are customer oriented (on time delivery and quality) and one is based on personal objectives. As per the SIP table below, the plan's objectives are aimed to reward five elements: three elements are shareholder oriented (sales, margins and contribution margins), one is based on personal objectives and one is based on specific incentives.

| Name &<br>Position   | Annual<br>incentive<br>target as %<br>of<br>base salary | Business Performance   |                               |                | Individual<br>Performance<br>Multiplier<br>(2) |
|--|---|--|-------------------------------|----------------|--|
|  |   | Measure  | Weight                        | Multiplier (1) |  |
| Germain<br>Lamonde, CEO  | 60%   |  |                               |                |  |
| Pierre<br>Plamondon,<br>CFO  | 37.5%   | ¥ Sales<br>¥ EBITDA  | Telecom<br>35%                |                |  |
| Vivian<br>Hudson,<br>Vice-President,<br>Service<br>Assurance<br>Division | 32.5%   | ¥ Gross margin<br>¥ Customer<br>satisfaction (3)                               | 20%<br>25%<br>Total: 100%     | 0% to 150%     | 0% to 125%                                     |
| Jon Bradley,<br>Vice-President,<br>Sales-<br>EMEA                        | 66.7%   | ¥ Revenue target<br>(4)<br>¥ Margin target (5)<br>¥ Contribution<br>Margin (6) | 45%<br>30%<br>15%<br>5%<br>5% |                | –  |

|                 |       |                |
|-----------------|-------|----------------|
| Dana Yearian,   | 66.7% | • Personal     |
| Vice-President, |       | objectives (7) |
| Sales-          |       | • Specific     |
| Americas        |       | Incentives (8) |

- (1) For sales, EBITDA and gross margin metrics, NEO begins to be compensated upon attainment of 50% of the target objective and up to the attainment of 150% of the target objective. For customer satisfaction metric, NEO's compensation is pro-rated from a minimal threshold up to the attainment of 150% of the target objective.
- (2) The personal objectives of each NEO are based on the position and role he or she has with the Corporation. Such personal objectives are based mostly on the attainment of departmental objectives and the others objectives are based on the attainment of personal management objectives all of which attainments are determined by an evaluation of the individual's supervisor or the Human Resources Committee, as the case may be.
  - (3) Includes on time delivery and quality.
- (4) The compensation rate for the attainment of revenue targets (billings) is equal to the total billings potential amount of commission on the total billings quotas defined at the beginning of the financial year. A lower rate is applied for less than 70% of the attainment of the objective. The regular rate is applied from 70% to 100% of the attainment of the objective. An accelerator is applied after 100%.
- (5) The commission rate for the attainment of the margin targets is equal to the total margins potential amount of incentives on the total margins quotas defined at the beginning of the financial year. This rate is used for all margins up to 100% attainment of the objective and an accelerator is applied after 100% attainment of the objective.

Table of Contents

- (6) The commission rate for the attainment of the contribution margin targets is equal to the total margins potential amount of incentives on the contribution margins objectives defined at the beginning of the financial year. This rate is used for all margins up to 100% attainment of the objective and an accelerator is applied after 100% attainment of the objective.
- (7) The compensation for personal objectives is a maximum amount based on the quarterly achievement of the sales bookings target for their specific territory. It is pro-rated between 70% and 100% achievement and no compensation will be attributed to this element if less than 70% of the objective is attained.
- (8) Additional bonuses are also available, one being based on revenues and integration of recent acquisitions and the other on the implementation of the Corporation development program. Accordingly, a total sales achievement figure target of recent acquisitions and a commission rate are determined at the beginning of the financial year. The commission rate is applied when total sales achievement figure of recent acquisitions reaches 50% of the target. Another portion of these additional bonuses is based on the result of the implementation of an integration plan following an acquisition. The compensation for the attainment of the implementation of an integration plan following an acquisition target is a maximum amount based on the achievement of such target and is pro-rated up to 100% achievement. The Corporation development program implementation target is determined at the beginning of the financial year. The compensation for the attainment of the Corporation development program target is a maximum amount based on the achievement of such target and is pro-rated up to 100% achievement.

## Long-Term Incentive Compensation

- Long-Term Incentive Plan

The principal component of the long-term incentive compensation offered by the Corporation is made up of the Long-Term Incentive Plan for directors, officers, employees and consultants of the Corporation and its subsidiaries.

Introduced in May 2000, amended in October 2004 and effective in January 2005, the Long-Term Incentive Plan (“LTIP”), is designed to provide directors, officers, employees and consultants with an incentive to create value and accordingly ensures that their interests are aligned with those of the Corporation’s shareholders and to further attract, motivate and retain all of its employees, including the NEOs. The LTIP is subject to Human Resources Committee review to ensure maintenance of its market competitiveness. The Board of Directors has full and complete authority to interpret the Plan and to establish the rules and regulations applying to it and to make all other determinations it deems necessary or useful for the administration of the Plan, provided that such interpretations, rules, regulations and determinations are consistent with the rules of all stock exchanges on which the securities of the Corporation are then traded and with all relevant securities legislation.

The LTIP provides for the issuance of options to purchase Subordinate Voting Shares and the issuance of Restricted Share Units (“RSUs”) redeemable for actual Subordinate Voting Shares or the equivalent in cash to directors, officers, employees and consultants. The Board of Directors upon recommendation of the Human Resources Committee designates the recipients of options or RSUs and determines the number of Subordinate Voting Shares covered by each option or RSU, the dates of vesting, the expiry date and any other conditions relating to these options or RSUs, in each case in accordance with the applicable legislation of the securities regulatory authorities. During the financial year ended August 31, 2011, target awards for eligible officers under the LTIP were established to be in line with the objective of the Human Resources Committee to align compensation with the Target Compensation Positioning offered in the reference market. Each executive is entitled to receive annually RSUs in accordance with the following policy:

| Positions | Grant Levels (1) (% of base salary) |
|-----------|-------------------------------------|
|-----------|-------------------------------------|

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|            |             |
|------------|-------------|
| CEO        | 70%         |
| Other NEOs | 32.5% - 35% |

- (1) Actual grant value may differ from the grant level guidelines as the stock price may vary between the time of the grant and its approval.

Table of Contents

RSU awards are based on the expected impact of the role of the executive officer on the Corporation's performance and strategic development as well as market benchmarking. The Human Resources Committee undertakes an analysis from time to time to determine the possible payouts from the LTIP under various scenarios and at various levels of share price growth to ensure that the LTIP is aligned with the interests of the Corporation's shareholders.

RSUs are also used to attract and retain top executives, as well as in business acquisitions. For the year ended August 31, 2011, the Corporation determined the number of RSUs granted to each executive officer according to their individual contribution, specifically with respect to the additional responsibilities for the integration of business acquisitions and the maximization of their profitability. As disclosed under the section "Summary Compensation Table" hereof, the NEOs were granted RSUs during the last financial year. The purpose of such grant was intended to focus the executives on developing and successfully implementing the continuing growth strategy of the Corporation and to align the executives with the principles of sustained long-term shareholder value growth. The grant was also considered to contribute to the Corporation's objective to align the compensation of the executives with the reference market. The Corporation did not take into account the amount and terms of outstanding options or RSUs neither the restrictions on resale of such units, when determining the grants mentioned above.

The exercise price of the options is determined by the Board of Directors at the time of granting the options, subject to compliance with the rules of all stock exchanges on which the Subordinate Voting Shares are listed and with all relevant securities legislation. In any event, the exercise price may not be lower than the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and the NASDAQ National Market on the last trading day preceding the grant date, using the noon buying rate of the Federal Reserve Bank of New York (for grants of options prior to January 1, 2009) or the Bank of Canada (for grants of options on or after January 1, 2009) on the grant date to convert the NASDAQ National Market closing price to Canadian dollars. Any option issued is non-transferable. At August 31, 2011, there were a total of 641,357 options granted to all LTIP participants and outstanding pursuant to the LTIP having a weighted average exercise price of US\$6.27 (CA\$9.42) per option.

The fair value at the time of grant of a RSU is equal to the market value of Subordinate Voting Shares at the time RSUs are granted. The grant date market value is equal to the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and the NASDAQ National Market on the last trading day preceding the grant date, using the noon buying rate of the Federal Reserve Bank of New York (for grants of RSUs prior to January 1, 2009) or the Bank of Canada (for grants of RSUs on or after January 1, 2009) on the grant date to convert the NASDAQ National Market closing price to Canadian dollars. At the end of financial year ended August 31, 2011, there were a total of 1,551,658 RSUs granted and outstanding pursuant to the LTIP having a weighted average fair value at the time of grant of US\$4.58 (CA\$4.93) per RSU.

The maximum number of Subordinate Voting Shares that are issuable under the Plan shall not exceed 6,306,153 Subordinate Voting Shares, which represents 10.4% of the Corporation's issued and outstanding voting shares as of November 1, 2011. The maximum number of Subordinate Voting Shares that may be granted to any one individual shall not exceed 5% of the number of outstanding Subordinate Voting Shares, which represents 1,439,225 issued and outstanding Subordinate Voting Shares as of November 1, 2011.

Some options granted to directors and employees vest on the first anniversary date of their grant. Some options granted in the financial years ended August 31, 2004 and 2005 vested at a rate of 12.5% six (6) months after the date of grant, 12.5% twelve (12) months after the date of grant and 25% annually thereafter commencing on the second anniversary date of the grant in October 2005. Otherwise all options vest at a rate of 25% annually commencing on the first anniversary date of the grant. All options may be exercised in whole or in part once vested. All of the options that are granted under the Plan must be exercised within a maximum period of ten (10) years following the date of their grant or they will be forfeited.

The vesting dates of RSUs are subject to a minimum term of three years and a maximum term of ten years from the award date. The following table presents, for the last five (5) financial years, the RSUs granted and their respective vesting schedule.



Table of Contents

| Financial year ended | Grant Date       | RSUs granted (#) | Fair Value at the Time of Grant (US\$/RSU) | Vesting schedule   |
|----------------------|------------------|------------------|--|--|
| August 31, 2011      | October 19, 2010 | 30,250           | 6.03                                       | 50% after 3 and 4 years of the grant date.   |
|                      | January 19, 2011 | 119,900          | 9.32                                       |  |
|                      | April 7, 2011    | 7,297            | 8.28                                       |  |
|                      | April 18, 2011   | 8,226            | 8.64                                       |  |
|                      | October 19, 2010 | 56,361           | 6.03                                       | 100% on the fifth anniversary date of the grant subject to early vesting up to 100% on the third or fourth anniversary of the grant when performance objectives related to revenue, as determined by the Board of Directors of the Corporation are fully attained.   |
|                      | October 19, 2010 | 128,348          | 6.03                                       | 100% on the fifth anniversary date of the grant subject to early vesting up to 1/3 on the third anniversary date of the grant and up to 50% of the remaining units on the fourth anniversary date of the grant if performance objectives namely related to long-term growth of revenue and profitability, as determined by the Board of Directors of the Corporation are fully attained. |
| August 31, 2010      | October 20, 2009 | 36,500           | 3.74                                       | 50% after 3 and 4 years of the grant date.   |
|                      | January 19, 2010 | 130,000          | 5.13                                       |  |
|                      | April 7, 2010    | 37,900           | 5.68                                       |  |
|                      | April 7, 2010    | 6,155            | 5.68                                       | 1/3 on the third, fourth and fifth anniversary date of the grant.  |
|                      | July 7, 2010     | 3,759            | 5.32                                       |  |
|                      | October 20, 2009 | 174,686          | 3.74                                       | 100% on the fifth anniversary date of the grant subject to early vesting up to 1/3 on the third anniversary date of the grant and up to 50% of the remaining units on the fourth anniversary date of the grant if performance objectives namely related to long-term growth of revenue and profitability, as determined by the Board of Directors of the Corporation are fu              |