

EXFO ELECTRO OPTICAL ENGINEERING INC
Form 20-F
January 18, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g)
OF THE SECURITIES EXCHANGE ACT OF 1934; or
- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended August 31, 2001
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the transition period _____ to _____

Commission File No. 0-30895

EXFO ELECTRO-OPTICAL ENGINEERING INC. /
EXFO INGENIERIE ELECTRO-OPTIQUE INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

CANADA
(JURISDICTION OF INCORPORATION OR ORGANIZATION)

465 GODIN AVENUE
VANIER, QUEBEC G1M 3G7, CANADA
(418) 683-0211
(ADDRESS, INCLUDING ZIP CODE AND TELEPHONE NUMBER, INCLUDING AREA CODE,
OF REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

None

Securities registered or to be registered pursuant to Section 12(g) of the Act:

Subordinate Voting Shares, no par value

Securities for which there is a reporting obligation pursuant to Section 15(d)
of the Act:

None

As of December 31, 2001, the registrant had 23,525,810 Subordinate Voting Shares
outstanding.

Indicate by check mark whether EXFO (1) has filed all reports required to be
filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the
preceding 12 months (or for such shorter period that EXFO was required to file
such reports), and (2) has been subject to such filing requirements for the past
90 days.

Yes No

Indicate by check mark which financial statement item EXFO has elected to
follow:

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Item 17 [] Item 18 [X]

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PART I.

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not Applicable

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ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

The consolidated balance sheet data as at August 31, 1997 is derived from our unaudited consolidated financial statements not included in this annual report. The consolidated statements of earnings data for the years ended August 31, 1997 and 1998 and the consolidated balance sheets data as at August 31, 1998 and 1999 are derived from our audited consolidated financial statements not included in this annual report. The consolidated statements of earnings data for each of the three years ended August 31, 1999, 2000 and 2001 and the consolidated balance sheets data as at August 31, 2000 and 2001 are derived from our consolidated financial statements that have been audited by PricewaterhouseCoopers LLP, independent auditors, that are included elsewhere in this annual report.

Our consolidated financial statements are prepared in accordance with Canadian GAAP, which differ in certain respects from U.S. GAAP. For a description of the material differences between Canadian GAAP and U.S. GAAP in regard to our consolidated financial statements, see note 19 to our consolidated financial statements. The historical results below are not necessarily indicative of the results to be expected for any future period.

The selected financial data should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report, and "Item 5. Operating and Financial Review and Prospects" of this annual report.

	YEARS ENDED AUGUST 31			
	1997	1998	1999	
	----	----	----	
	(IN THOUSANDS OF US DOLLARS, EXCEPT SHARES)			
CONSOLIDATED STATEMENTS OF EARNINGS DATA:				
AMOUNTS UNDER CANADIAN GAAP				
Sales.....	\$ 24,475	\$ 31,605	\$ 42,166	\$
Cost of sales.....	9,652	11,345	14,998	
	-----	-----	-----	-----
Gross margin.....	14,823	20,260	27,168	
	-----	-----	-----	-----
Operating expenses				
Selling and administrative.....	7,827	9,898	13,279	
Net research and development.....	1,592	3,014	4,315	
Amortization of property, plant and equipment.....	465	609	857	
Amortization of intangible assets.....	14	48	41	
Non-recurring expenses.....	--	--	--	
	-----	-----	-----	-----
Total operating expenses.....	9,898	13,569	18,492	
	-----	-----	-----	-----
Earnings from operations.....	4,925	6,691	8,676	
Interest income (expense)-- net.....	(89)	40	136	

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Foreign exchange gain (loss)	(184)	126	(506)	
Earnings before income taxes and amortization of goodwill	4,652	6,857	8,306	
Income taxes.....	1,582	2,356	2,492	
Earnings before amortization of goodwill.....	3,070	4,501	5,814	
Amortization of goodwill.....	\$ --	\$ --	\$ --	\$ --
Net earnings (loss) for the year.....	\$ 3,070	\$ 4,501	\$ 5,814	\$ --
Basic and diluted net earnings (loss) per share.....	\$ 0.08	\$ 0.12	\$ 0.14	\$ --
Basic weighted average number of shares used in per share calculations.....	38,000	38,000	38,001	
OTHER FINANCIAL DATA:				
Gross research and development.....	\$ 2,753	\$ 4,406	\$ 6,390	\$ --
Net research and development.....	\$ 1,592	\$ 3,014	\$ 4,315	\$ --
Dividends per share				
Class "A" shares.....	\$ --	\$ --	\$ 0.08	\$ --
Class "C" share.....	\$ --	\$ --	\$ 340	\$ --
Class "E" shares.....	\$ 0.005	\$ 0.005	\$ --	\$ --
Class "F" shares.....	\$ --	\$ --	\$ --	\$ --
AMOUNTS UNDER U.S. GAAP				
Sales.....	\$ 26,752	\$ 32,853	\$ 41,858	\$ --
Net earnings (loss) for the year.....	\$ 3,356	\$ 4,538	\$ 5,901	\$ --
Basic and diluted net earnings (loss) per share.....	\$ 0.09	\$ 0.12	\$ 0.15	\$ --
Basic weighted average number of shares used in per share calculations.....	38,000	38,000	38,001	
Dividends per share				
Class "A" shares.....	\$ --	\$ --	\$ 0.08	\$ --
Class "C" share.....	\$ --	\$ --	\$ 333	\$ --
Class "E" shares.....	\$ 0.006	\$ 0.005	\$ --	\$ --
Class "F" shares.....	\$ --	\$ --	\$ --	\$ --

AS AT AUGUST 31,

	1997	1998	1999	
	----	----	----	
	(IN THOUSANDS OF US DOLLARS)			
CONSOLIDATED BALANCE SHEETS DATA:				
AMOUNTS UNDER CANADIAN GAAP				
Cash and cash equivalents.....	\$ 354	\$ 1,262	\$ 423	\$ --
Working capital (1)	5,973	9,797	12,745	
Total assets.....	13,238	17,643	22,840	
Long-term debt (excluding current portion)	20	--	--	
Shareholders' equity.....	\$ 7,644	\$ 12,045	\$ 14,679	\$ --
AMOUNTS UNDER U.S. GAAP				
Cash and cash equivalents.....	\$ --	\$ 1,201	\$ 423	\$ --
Working capital (2)	--	9,179	12,781	
Total assets.....	--	16,785	22,899	
Long-term debt (excluding current portion)	--	--	--	
Shareholders' equity.....	\$ --	\$ 11,318	\$ 14,715	\$ --

- (1) Includes 19,000,000 mandatorily redeemable preferred shares with a nominal carrying value as at August 31, 1997 and 1998 and 800,000 mandatorily redeemable preferred shares with a carrying value of \$543,000 as at August 31, 2000.
- (2) Includes 19,000,000 mandatorily redeemable preferred shares, with a nominal carrying value as at August 31, 1998 and 800,000 mandatorily redeemable preferred shares with a carrying value of \$543,000 as at August 31, 2000.

B. CAPITALIZATION AND INDEBTEDNESS

Not Applicable

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not Applicable

D. RISK FACTORS

RISKS RELATED TO OUR INDUSTRY AND BUSINESS

IF THE DOWNTURN IN THE TELECOMMUNICATIONS INDUSTRY PERSISTS OR WORSENS, DEMAND FOR OUR PRODUCTS WILL CONTINUE TO DROP AND, AS A RESULT, IT COULD CONTINUE TO HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, RESULTS OF OPERATIONS AND FINANCIAL CONDITION.

Due to the downturn in the telecommunications industry and the uncertainty following the tragic events of September 11, 2001, several telecommunications carriers lowered their spending for network installations. Optical equipment manufacturers, in turn, were affected by the downturn and the subsequent buildup of inventories. These market forces on our customers contributed to a significant decline in our sales. If the downturn persists or worsens, demand for our products will drop and, as a result, it could have a material adverse effect on our business, results of operations and financial condition.

WE HAVE ADOPTED MEASURES AND MAY CONTINUE TO ADOPT MEASURES THAT ALIGN OUR COST STRUCTURE TO CHALLENGING MARKET CONDITIONS. IF THE CHALLENGING MARKET CONDITIONS ARE PROLONGED, IT COULD HAVE MATERIAL ADVERSE LONG-TERM EFFECTS ON OUR BUSINESS, RESULTS OF OPERATIONS AND FINANCIAL CONDITION.

We have been forced to re-align our cost structure to market conditions twice during the past year. On June 27, 2001, we announced the reduction of non-customer-related expenses, postponement of plans to build a new facility in the Quebec Metro High-Tech Park, termination of non-core operations at a subsidiary that specialized in manufacturing fiber-optic temperature sensors, and reduction of our workforce by 15%. On December 5, 2001, we announced the lowering of our operating expenses, freeze in employee salaries, and reduction of our workforce by 10%. These and, if needed, subsequent measures could have material adverse long-term effects on our business, results of operations and financial condition if we deplete our pool of highly qualified personnel; if we are unable to sustain research and development efforts for the launch of new products; if we are unable to meet the needs of our customers; and if we are not prepared to ramp up manufacturing when market conditions improve. In addition, if we fail to adopt and implement adequate and pertinent measures on a timely basis to align our cost structure to challenging market conditions, it could have a material adverse long-term effects on our business, results of operations and financial condition.

WE EXPECT THE PRICE OF OUR EXISTING PRODUCTS TO DECLINE AND IF WE DO NOT REDUCE OUR MANUFACTURING COSTS OR INTRODUCE NEW PRODUCTS WITH HIGHER MARGINS, OUR GROSS MARGINS WILL DECLINE AND WE COULD INCUR LOSSES.

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Reduced demand for fiber-optic test, measurement and automation equipment, in addition to competitiveness in our industry will likely result in the decline of prices for fiber-optic test, measurement and automation equipment. These price declines result from factors such as:

- o increased competition for business;
- o reduced demand;
- o a limited number of potential customers;
- o competition from companies with lower labor and production costs;
- o introduction of new products by competitors;
- o greater economies of scale for higher-volume competitors; and
- o resale of used equipment.

As prices of our existing products are expected to decline, we may have to increase our unit volume sold in order to maintain our existing sales level. Our increased production capacity results in an increase in fixed costs. As a result, we will have to increase the level of sales to maintain operating margins. If we are unable to increase the level of sales, continuously reduce our manufacturing costs or introduce new products with higher margins, our gross margins would decline.

OUR QUARTERLY OPERATING RESULTS ARE SUBJECT TO SIGNIFICANT FLUCTUATIONS AND YOU SHOULD NOT RELY ON THEM AS AN INDICATION OF OUR FUTURE PERFORMANCE.

Our sales and operating results have fluctuated from quarter to quarter in the past and may fluctuate significantly in the future. In addition, our revenue and operating results generally depend on the volume and timing of the orders we receive from customers as well as our ability to fulfill the orders received. Our operating expenses, which include research and development, and selling and administrative expenses, are relatively fixed in the short term. If our revenue is lower than we expect because we sell fewer products than we anticipate or if there is a delay in the release of new products, we may not be able to quickly reduce our operating expenses in response. Factors that could affect the amount and timing of our revenue, and cause quarterly fluctuations in our operating results include:

- o the length of our product sales cycle for certain products, especially those that are higher priced and more complex;
- o the timing of introduction and market acceptance of new products by us, our competitors or our suppliers;
- o our ability to sustain product volumes and high levels of quality across all product lines;
- o the timing of shipments for large orders; and
- o the effect of potential seasonality in sales.

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Our operating results could also be affected by the following factors, some of which we have little or no control over:

- o demand for fiber-optic test, measurement and automation equipment;
- o changes in the capital budgets of our customers, which may cause seasonal or other fluctuations in the product mix, volume, timing and number of orders we receive from our customers;
- o difficulties in collecting accounts receivable;
- o the level of used test, measurement and automation equipment available for resale;

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- o restructuring charges; and
- o general economic conditions.

Due to these factors, you should not rely on quarter-to-quarter comparisons of our results of operations as an indication of our future performance.

IF THE SUPPLY OF HIGH-BANDWIDTH TRANSMISSION NETWORKS SHOULD CONTINUE TO SURPASS DEMAND, OR IF OPTICAL FIBER IS REPLACED BY ANOTHER MEDIUM AS THE PRIMARY SOLUTION FOR BANDWIDTH-INTENSIVE APPLICATIONS, WE COULD EXPERIENCE A SIGNIFICANT LONG-TERM LOSS OF SALES.

Fiber-optic deployment and network capacity increases have slowed during recent months which has affected optical component and network equipment manufacturers and operators causing reduced demand for fiber-optic test, measurement and automation equipment. If such reduced demand should continue over the mid or long term, or if optical fiber is replaced by a higher performance medium, this could have a material adverse effect on our business, financial condition and results of operations.

IF CUSTOMERS FAIL TO MEET THEIR FINANCIAL COMMITMENTS TO US, IT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, RESULTS OF OPERATIONS AND FINANCIAL CONDITION.

The telecommunications industry is undergoing challenging times. Some companies are shutting down their operations or going bankrupt. On occasion, we have had customers who failed to meet their financial commitments to us. We attempt to reduce the possibility of large outstanding bills remaining unpaid by carrying out credit checks on customers and by having a diversified customer base. For example, no customer represented more than 6.4% of our sales in fiscal 2001. However, there is no assurance that such measures will reduce or eliminate our exposure to customer credits risks. If customers fail to meet their financial commitments to us, it could have a material adverse effect on our business, results of operations and financial condition.

AS OUR CUSTOMERS CONSOLIDATE OR ENCOUNTER FINANCIAL DIFFICULTIES, THEY MAY REDUCE OR HALT PURCHASES OF OUR PRODUCTS, WHICH WOULD CAUSE OUR SALES TO DECLINE.

Consolidation in the telecommunications industry could reduce the number of customers to whom our products could be sold. Some of our customers have been subject to consolidation or are encountering financial difficulty and are reducing their orders, renegotiating pricing and

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obtaining products from a source other than us, which cause our sales to decline. In addition, as a result, some of our manufacturer customers may discontinue their relationships with us.

WE DEVOTE CONSIDERABLE TIME AND RESOURCES TO SECURING NEW CUSTOMERS AND IMPROVING SALES TO EXISTING CUSTOMERS. IF WE ARE UNSUCCESSFUL, OUR FUTURE OPERATING RESULTS MAY SUFFER.

The long sales cycle for some of our products may cause our sales and operating results to vary significantly from period to period. The period of time between our initial contact with a customer and the receipt of a purchase order may span a year or more. In addition, customers perform and require us to perform, extensive product evaluation and testing of new instruments before purchasing them. If we are unable to satisfy customer demands, considerable

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resources would have been expended without deriving corresponding sales.

OUR CUSTOMERS ARE NOT OBLIGATED TO BUY MATERIAL AMOUNTS OF OUR PRODUCTS AND MAY CANCEL OR DEFER PURCHASES ON SHORT NOTICE.

Our customers typically purchase our products under individual purchase orders and may cancel or defer purchases on short notice without significant penalty. Accordingly, sales in a particular period are difficult to predict. Decreases in purchases, cancellations of purchase orders, or deferrals of purchases may have a material adverse effect on our operating results, particularly if we do not anticipate them.

IF WE FAIL TO PREDICT OUR SUPPLY REQUIREMENTS ACCURATELY, WE WILL HAVE EXCESS INVENTORY OR INSUFFICIENT INVENTORY, EITHER OF WHICH COULD CAUSE US TO INCUR ADDITIONAL COSTS, EXPERIENCE MANUFACTURING DELAYS OR INVENTORY OBSOLESCENCE.

We provide forecasts of our requirements to some of our suppliers up to six months prior to scheduled delivery of products to our customers. If we overestimate our requirements, we may have excess inventory, which could increase our costs and harm our relationships with our suppliers due to reduced future orders or increase the risk of inventory obsolescence for which eventual write-offs may become necessary. If we underestimate our requirements, we may have an inadequate inventory of parts. Inadequate inventory could interrupt manufacturing of our products and result in delays in shipments. In addition, lead times for materials and parts that we order may be long and depend on factors such as the procedures of, or supply terms with, a specific supplier and demand for each part at a given time.

WE DEPEND ON A SINGLE SUPPLIER OR A LIMITED NUMBER OF SUPPLIERS FOR SOME OF THE KEY COMPONENTS AND MATERIALS IN OUR PRODUCTS, WHICH MAKES US SUSCEPTIBLE TO SUPPLY SHORTAGES OR PRICE FLUCTUATIONS THAT COULD ADVERSELY AFFECT OUR OPERATING RESULTS.

We depend on a limited number of suppliers for some of the parts used to manufacture our products. All our orders are placed through individual purchase orders and, therefore, our suppliers may stop supplying parts to us at any time. The reliance on a single source or limited number of suppliers could result in delivery problems and reduced control over product pricing and quality. Financial difficulties of suppliers could also affect our ability to obtain necessary parts in a timely manner. The process of qualifying a new contract manufacturer for complex products, designed to our specifications, such as our optical and

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mechanical parts, is lengthy and would consume a substantial amount of time of our technical personnel and management. If we sought to change manufacturers in a short period of time, our business would be disrupted. In addition, we may be unsuccessful in identifying a new manufacturer capable of and willing to meet our needs on terms that we would find acceptable.

WE MUST CONTINUE TO OVERCOME SIGNIFICANT AND INCREASING COMPETITION IN OUR INDUSTRY IN ORDER TO GAIN MARKET SHARE AND INCREASE OUR PRODUCTIVITY.

The market for fiber-optic test, measurement and automation equipment is rapidly evolving and is marked by intense competition and technical innovations. We expect the pace of change to accelerate in the future. We also expect new competitors to emerge or current competitors to consolidate as the market for fiber-optic test, measurement and automation equipment evolves in response to technical innovations and economic conditions. Both of these factors

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could intensify the competitive pressures that we face.

Some of our current and potential competitors are global electronic test and measurement manufacturers who complement their broad range of products with fiber-optic test, measurement and monitoring equipment. Competitors, such as Acterna Corporation, Agilent Technologies Inc., ANDO Corporation, Anritsu Corporation, GN Nettest, Newport Corporation and Tektronix, Inc. may have greater financial, technical and marketing resources. Consequently, these competitors may be able to devote greater resources to the development, marketing, sale and support of their products. They may also be better positioned than we are to acquire companies and new technologies that may displace our products or make them obsolete.

IF WE ARE UNABLE TO ADAPT TO CURRENT AND FUTURE CHANGES IN TECHNOLOGY, OUR PRODUCTS MAY BECOME OBSOLETE.

Any failure by us to anticipate or respond to new technological developments and customer requirements could have a material adverse effect on our business, financial condition and results of operations. Moreover, the markets addressed by our current and planned products are rapidly evolving and are characterized by emerging standards and competing technological platforms. There can be no assurance that products destined by us for sale into these markets will adequately address the requirements dictated by evolving standards, or that we will be able to adapt our products to changes in technology. Accordingly, we may invest in products and technologies that never gain market acceptance. Such investments could have a material adverse effect on our business, financial condition and results of operations.

WE MAY NOT BE ABLE TO INTRODUCE NEW AND ENHANCED PRODUCTS ON A TIMELY BASIS, WHICH COULD PREVENT US FROM ACHIEVING OUR GROWTH STRATEGY AND ADVERSELY AFFECT OUR OPERATING RESULTS.

The development of proprietary technologies entails significant technical and business risks and requires substantial expenditures and lead time. If we experience product delays in the future, we may face:

- o customer dissatisfaction;

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- o cancellation of orders;
- o negative publicity;
- o loss of sales;
- o slower market acceptance of our products; and
- o legal actions by customers.

In the future, our efforts to remedy product delays may not be successful and we may lose customers as a result. Delays in bringing to market new products or product enhancements could be exploited by our competitors. If we lose market share as a result of lapses in our product development, our business would suffer.

OUR PRODUCTS MAY HAVE UNFORESEEN DEFECTS THAT COULD HARM OUR REPUTATION, IMPEDE MARKET ACCEPTANCE OF OUR PRODUCTS AND NEGATIVELY IMPACT OUR RESULTS OF OPERATIONS.

As a result of their complexity, our products may contain undetected errors or compatibility problems or regulatory compliance issues, particularly when they are first introduced or when new versions are released. There can be no assurance that, despite our testing, errors will not be found in new products

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after they have been fully deployed and operated under peak stress conditions. If we are unable to fix defects or other problems, we could experience, among other things:

- o loss of customers;
- o damage to our brand reputation;
- o failure to attract new customers or achieve market acceptance;
- o diversion of development and engineering resources;
- o legal actions by our customers, including claims for consequential damages and loss of profits; and
- o legal actions by governmental entities, including actions to impose product recalls and/or forfeitures.

The occurrence of any one or more of the foregoing could seriously harm our business, financial condition and results of operations.

OUR PRODUCTS MAY BE REQUIRED TO CONFORM TO NEW AND UNFORESEEN REGULATORY REQUIREMENTS THAT COULD INCREASE OUR COSTS AND REDUCE OUR MARKET SHARE.

Our products are designed to conform to the regulatory requirements of the countries in which they are marketed. In the event that the technical regulations applicable in a given country are in any way changed, we may be required to modify, redesign or recall some or all of our products in order to continue participating in that market. These changes likely would increase manufacturing costs and could create technical advantages for products marketed by our competitors.

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OUR SALES WOULD SUFFER IF A KEY SALES REPRESENTATIVE OR DISTRIBUTOR STOPPED SELLING OR REDUCED SALES OF OUR PRODUCTS.

We sell substantially all of our products through a network of independent sales representatives and distributors, the majority of whom have exclusive rights to sell our products in specific territories or markets. If we are unable to provide competitive sales commissions, maintain an appropriate sales volume, or offer sufficient channel-support, our independent sales representatives and distributors may discontinue sales of our products and switch to representing one or more of our competitors, which would result in reduced sales for us.

WE CANNOT ASSURE THAT WE WILL SUCCESSFULLY INTEGRATE THE BUSINESSES, PRODUCTS, TECHNOLOGIES OR PERSONNEL OF OUR RECENT AND FUTURE ACQUISITIONS, WHICH MAY HARM OUR BUSINESS.

For our past and future transaction to be successful, we must appropriately integrate the businesses, products, technologies and personnel of Burleigh Instruments, Inc. ("Burleigh"), EXFO Photonic Solutions Inc. ("EXFO Photonic", formerly EFOS Inc.) and EXFO Protocol Inc. ("EXFO Protocol", formerly Avantas Networks Corporation), and those of any future acquisitions, with our own business, products, technologies and personnel in a manner that anticipates or responds to new technological developments and customer requirements on a timely basis. In addition, we must coordinate the operations and technologies of newly acquired companies with our own operations and technologies and manage geographically dispersed operations. Integration requires the dedication of management resources that may distract their attention from our day-to-day business and operations. If we fail to integrate the companies quickly and efficiently, we may not be able to realize the benefits we expect from these transactions and there could be a material adverse effect on our business, financial condition and results of operations.

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WE MAY NOT BE ABLE TO MAKE THE NECESSARY ACQUISITIONS NEEDED FOR THE DEVELOPMENT OF OUR BUSINESS AND ANY ACQUISITIONS WE MAKE COULD DISRUPT OUR BUSINESS AND HARM OUR FINANCIAL CONDITION.

We intend to seek acquisitions of businesses, products and technologies that are complementary to ours. There can be no assurance that we will ultimately make any such acquisition. The consolidation of our competitors may improve their capacity to acquire the same businesses, products and technologies that we wish to acquire.

We have made strategic acquisitions, such as our acquisitions of Nortech Fibronic Inc. ("Nortech"), Burleigh, EXFO Photonic and EXFO Protocol. We anticipate that in the future, as part of our business strategy, we will continue to make strategic acquisitions of complementary companies, products and technologies. In the event of any future acquisition, we could:

- o issue shares that would dilute individual shareholder percentage ownership;
- o incur debt;
- o assume liabilities and commitments;
- o incur expenses related to in-process research and development and amortization of other intangible assets; or

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- o incur significant impairment losses of goodwill related to such acquisitions.

These acquisitions also involve numerous risks, including:

- o problems combining the acquired operations, technologies or products;
- o unanticipated costs or liabilities;
- o diversion of management's attention from our core business;
- o adverse effects on existing business relationships with suppliers and customers;
- o risks associated with entering markets in which we have no or limited prior experience; and
- o potential loss of key employees, particularly those of acquired organizations.

During the fiscal year ended August 31, 2001, our subsidiary Nortech Fibronic Inc., acquired in February 2000, shut down its business operations. Though the impact of this closure is not significant, we cannot assure that we will be able to successfully integrate the other businesses, products, technologies or personnel acquired or that we might acquire in the future, and further divestitures or closures could be necessary which may harm our business.

WE MAY BE SUBJECT TO CERTAIN LIABILITIES ASSUMED IN CONNECTION WITH OUR ACQUISITIONS THAT COULD ADVERSELY AFFECT OUR BUSINESS.

We conduct due diligence in connection with our acquisitions and incorporate indemnification provisions in our acquisition agreements. To the extent that prior owners of any acquired businesses failed to comply with or otherwise violated applicable laws, we may be financially responsible for these violations or otherwise be adversely affected. The discovery of any material liabilities after the closing of the transaction could have a material adverse effect on our financial condition and results of operations. In connection with our acquisition of Burleigh, EXFO Photonic and EXFO Protocol and the acquisition

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by Burleigh Automation Inc. of the assets of Vanguard Technical Solutions, Inc. ("Vanguard"), there may be liabilities that we failed to discover at the time of the acquisition or that we inadequately assessed in our due diligence efforts.

IF WE FAIL TO ADAPT APPROPRIATELY TO THE CHALLENGES ASSOCIATED WITH OPERATING INTERNATIONALLY, THE GROWTH OF OUR BUSINESS MAY BE IMPEDED AND OUR OPERATING RESULTS MAY BE AFFECTED.

For the fiscal year ended August 31, 2001, customers outside of the United States and Canada accounted for 41.7 % of our sales and for the fifteen months ended November 30, 2001, these customers accounted for 41.8 % of our sales. We plan to increase our international sales and have opened offices in Great Britain, China, Japan, and Singapore. Our international sales will be limited if we cannot establish relationships with international distributors, establish additional foreign operations, expand international sales channel management, hire additional personnel and develop relationships with international service providers. Even if we are able to successfully continue our international operations, we may not be able to maintain or increase international market demand for our products. Our international operations are subject to a number of risks, including:

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- o unexpected changes in regulatory requirements, tax rates or tariffs that make our products and services more expensive and therefore less attractive to present and potential customers;
- o challenges in staffing and managing foreign operations due to the limited number of qualified candidates, employment laws and practices in foreign countries, any of which could increase the cost and reduce the efficiency of operating in foreign countries;
- o technology standards that differ from those on which our products are based, which could require expensive redesign and retention of personnel familiar with those standards;
- o longer accounts receivable payment cycles and possible difficulties in collecting payments which may increase our operating costs and hurt our financial performance;
- o political and economic instability; and
- o certification requirements.

Any of these factors could harm our international operations and negatively affect our financial performance. The recurrence of weakness in these economies or of weakness in other foreign economies could have a significant negative effect on our future operating results.

WE RECENTLY IMPLEMENTED AN ENTERPRISE RESOURCE PLANNING (ERP) SYSTEM, AND IF THIS INFORMATION TECHNOLOGY PROJECT PROVES TO BE UNWIELDY OR IF THE SOFTWARE TOOL TURNS OUT TO BE INEFFECTIVE, IT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, RESULTS OF OPERATIONS AND FINANCIAL CONDITION.

We implemented an ERP system in early December 2001 to help increase the efficiency of our operations. This required a significant investment in money, time and resources. More than 400 employees were trained on the software tool and the smooth transition from one system to another has not yet been accomplished. If this information technology project proves to be unwieldy or if the software tool turns out to be ineffective, it could have a material adverse effect on our business, results of operations and financial condition.

WE REQUIRE EMPLOYEES WHO ARE KNOWLEDGEABLE ABOUT THE SPECIALIZED NATURE OF OUR BUSINESS. IF WE ARE UNABLE TO ATTRACT AND RETAIN SUFFICIENT NUMBERS OF HIGHLY

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SKILLED TECHNICAL, SALES AND MARKETING AND OTHER PERSONNEL, OUR OPERATIONS AND FINANCIAL RESULTS WOULD SUFFER.

Due to the specialized nature of our business, we are highly dependent on the continued service of and on the ability to attract and retain, qualified engineering, sales, marketing and senior management personnel in the area of fiber optics. The loss of key employees or management personnel could have a material adverse effect on our business and operating results. We may not be able to continue to attract and retain the qualified personnel necessary for the development of our business.

We must provide significant training for our employee base due to the highly specialized nature of fiber-optic test, measurement and automation equipment. Our current engineering

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personnel may be inadequate and we may fail to assimilate and train new employees. Highly skilled employees with the education and training that we require, especially employees with significant experience and expertise in fiber optics, are in high demand. Once trained, our employees may be hired by our competitors.

OUR BUSINESS STRATEGY AND OUR ABILITY TO MAINTAIN OUR COMPETITIVE POSITION DEPEND ON THE CONTINUED SERVICES OF OUR SENIOR MANAGEMENT TEAM LED BY GERMAIN LAMONDE, OUR CHAIRMAN OF THE BOARD, PRESIDENT AND CHIEF EXECUTIVE OFFICER. THE LOSS OF ANY MEMBER OF THE SENIOR MANAGEMENT TEAM WOULD ADVERSELY AFFECT OUR BUSINESS.

Our ability to maintain our competitive position depends to a significant extent on the efforts and abilities of our senior management, particularly Germain Lamonde, our Chairman of the Board, President and Chief Executive Officer. The managerial, technical and other services of our senior management team would be difficult to replace and if we lose the services of one or more of our executive officers, or if one of them decides to join a competitor or otherwise compete directly or indirectly against us, our business would be seriously harmed. The loss of their services would jeopardize our ability to maintain our competitive position. We do not have "key person" life insurance policies covering any of our employees.

OUR INTELLECTUAL PROPERTY AND PROPRIETARY TECHNOLOGY ARE IMPORTANT TO THE CONTINUED SUCCESS OF OUR BUSINESS. OUR FAILURE TO PROTECT THIS PROPRIETARY TECHNOLOGY MAY SIGNIFICANTLY IMPAIR OUR COMPETITIVE POSITION.

Our success and ability to compete depend to a significant extent on our proprietary technology, since that is how we attempt to keep others from using the innovations that are central to our existing and future products. We currently hold 18 U.S. and 7 Canadian issued patents and have 16 U.S. and 15 Canadian patent applications pending, along with 4 patent applications pending under the Patent Cooperation Treaty. We also rely on a combination of copyright and trademark laws, trade secrets, confidentiality procedures, contractual provisions and license agreements to protect our proprietary technology. We may have to engage in litigation in order to protect our patents and other intellectual property rights, or to determine the validity or scope of the proprietary rights of others. This kind of litigation can be time-consuming and expensive, regardless of whether we win or lose. Because it is critical to our success that we are able to prevent competitors from copying our innovations, we intend to continue to seek patent and trade secret protection for our technologies. The process of seeking patent protection can be long and expensive and we cannot be certain that any currently pending or future applications will

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actually result in issued patents, or that, even if patents are issued, they will be of sufficient scope or strength to provide meaningful protection or any commercial advantage to us. Furthermore, others may develop technologies that are similar or superior to our technology, or design around the patents that we own. We also rely on trade secret protection for our technology, in part through confidentiality agreements with our employees, consultants, distributors and third parties. However, these agreements may be breached or otherwise not effective and we may not have adequate remedies for any breach or shortfall of these agreements. In any case, others may come to know about our trade secrets through a variety of methods. In addition, the laws of some territories in which we sell our products may not protect our intellectual property rights to the same extent as do the laws of Canada and the United States.

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Despite our efforts, our intellectual property rights, particularly our existing or future patents, may be invalidated, circumvented, challenged or required to be licensed to others. Furthermore, others may develop technologies that are similar or superior to our technology, duplicate or reverse engineer our technology, or design around the patents owned or licensed by us. We cannot be sure that the steps that we take to protect our technology will prevent misappropriation or infringement. If we fail to protect our technology so that others may copy or use it, we will be less able to differentiate our products and our sales will decline.

IF OTHERS CLAIM THAT OUR PRODUCTS INFRINGE UPON THEIR INTELLECTUAL PROPERTY RIGHTS, WE MAY BE FORCED TO SEEK EXPENSIVE LICENSES, RE-ENGINEER OUR PRODUCTS, ENGAGE IN EXPENSIVE AND TIME-CONSUMING LITIGATION OR STOP MARKETING THE CHALLENGED PRODUCTS, WHICH COULD ADVERSELY AFFECT OUR ABILITY TO SELL OUR PRODUCTS AND COULD INCREASE OUR COSTS.

Litigation regarding intellectual property rights is common in the technology industry and, for this reason, we expect that third-party infringement claims involving technologies may increase. If an infringement claim is filed against us, we may be prevented from using some of our technologies and may incur significant costs to resolve the claim.

We could incur substantial costs in defending ourselves and our customers against infringement claims. Litigation could also adversely affect sales of the challenged product or technology and divert the efforts of our management and technical personnel. In the event of a claim of infringement, we may be required to obtain one or more licenses from third parties. We cannot assure you that we, or our customers, could obtain necessary licenses from third parties at a reasonable cost or at all. If we fail to obtain a license where one is required, we could incur substantial liabilities and be forced to suspend the marketing of the challenged products.

OUR INSURANCE MAY NOT BE SUFFICIENT TO COVER ALL POTENTIAL LIABILITY. A SUCCESSFUL CLAIM EXCEEDING OUR POLICY LIMITS WILL REDUCE OUR WORKING CAPITAL, INCREASE OUR EXPENSES AND HAVE A NEGATIVE EFFECT ON OUR OPERATING RESULTS.

Our products are designed to help telecommunications carriers and manufacturers of optical components, value-added optical modules and optical networking systems ensure network reliability. The failure of our products to perform to client expectations could give rise to product liability and warranty claims. We carry insurance for product liability and take accounting reserves for warranty claims that we consider adequate in view of industry practice. In addition, we may face other types of claims by third parties in relation to the conduct of our business and a successful claim against us for an amount exceeding our policy limits would force us to use our own resources to pay the

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claim, which could result in a reduction of our working capital available for other uses, increase our expenses and have a negative effect on our financial condition and results of operations.

WE MAY BECOME INVOLVED IN COSTLY AND TIME-CONSUMING LITIGATION THAT MAY SUBSTANTIALLY INCREASE OUR COSTS AND HARM OUR BUSINESS.

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We may from time to time become involved in various lawsuits and legal proceedings. For example, EXFO is a defendant in a putative securities class action filed in the United States District Court for the Southern District of New York. In addition, we have instituted a claim against a former employee of one of our subsidiaries, in relation to a breach of contractual confidentiality obligations. Litigation is subject to inherent uncertainties, and an adverse result in these or other matters that may arise from time to time could have a material adverse effect on our business, results of operations or financial condition.

Any litigation to which we are subject could require significant involvement of our senior management and may divert management attention from our business and operations. For more information about current legal proceedings, see "Item 4B - Legal Proceedings".

FLUCTUATIONS IN THE EXCHANGE RATES BETWEEN THE CANADIAN DOLLAR AND THE US DOLLAR AND OTHER CURRENCIES MAY ADVERSELY AFFECT OUR OPERATING MARGINS.

The majority of our sales is denominated in US dollars. However, a large portion of our operating expenses and capital expenditures are denominated in Canadian dollars. As a result, we are exposed to fluctuations in the exchange rates between the Canadian dollar and the US dollar and other currencies. An increase in the value of the Canadian dollar relative to the US dollar could have a material adverse effect on our operating margins.

UNEXPECTED DECLINES IN OUR RESEARCH AND DEVELOPMENT TAX CREDITS AND GRANTS MAY HAVE AN ADVERSE EFFECT ON OUR BUSINESS.

Our historical operating results reflect substantial benefits from programs sponsored by federal, provincial and state governments for the support of research and development. Research and development tax credits and grants represented 22.7 % of our gross research and development expenses for the year ended August 31, 2001 and 23.2 % for the fifteen months ended November 30, 2001.

If unexpected changes in the laws or government policies terminate or adversely modify the Canadian and Quebec government programs, under which we receive the major part of our research and development tax credits and grants, or if we unexpectedly become unable to participate in or take advantage of these programs, then our net research and development expenses will materially increase. To the extent that we increase our research and development activities outside Canada or Quebec, which could result from, among other things, future acquisitions, the increased activities may not be eligible for these programs. If we are required to decrease our research and development activities, we may be unable to compete effectively.

WE MAY NEED ADDITIONAL CAPITAL, AND MAY NOT BE ABLE TO RAISE ADDITIONAL CAPITAL ON FAVORABLE TERMS OR AT ALL, WHICH COULD LIMIT OUR ABILITY TO GROW AND COULD INCREASE OUR COSTS.

Our future liquidity and capital requirements are difficult to predict because they depend on numerous factors, including the success of our existing

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and new product offerings as well as competing technological and market developments. As a result, we may not be able to generate sufficient cash from our operations to meet additional working capital requirements,

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support additional capital expenditures or take advantage of acquisition opportunities. Accordingly, we may need to raise additional capital in the future.

Our ability to obtain additional financing will be subject to a number of factors, including market conditions and our operating performance. These factors may render the timing, amount, terms and conditions of additional financing unattractive for us. If we raise additional funds by selling equity securities, the relative ownership of our existing investors could be diluted or the new investors could obtain terms more favorable than previous investors. If we raise additional funds through debt financing, we could incur significant borrowing costs. If we are unable to raise additional funds when needed, our ability to operate and grow our business could be impeded.

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ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Our legal name and commercial name is EXFO Electro-Optical Engineering Inc. /EXFO Ingenierie Electro-Optique Inc. Our head office is located at 465 Godin Avenue, Vanier, Quebec, Canada, G1M 3G7 and our telephone number is (418) 683-0211. Our e-mail address is info@exfo.com and our Web site is www.exfo.com. Information on our Web site is not incorporated by reference in this annual report. Our agent for service in the United States is CT Corporation System, 111 Eighth Avenue, New York, New York 10011. This annual report contains trademarks and registered trademarks of EXFO and other companies.

We were incorporated on September 18, 1985 pursuant to the CANADA BUSINESS CORPORATIONS ACT. Since that date, we have amended our articles on various occasions mainly to modify our corporate name and our share capital.

In 1996, GEXFO Investissements Technologiques inc. ("GEXFO"), a company controlled by Germain Lamonde, acquired a majority interest in GAP Optique S.A. ("GAP Optique"), a Swiss limited liability company carrying out activities in the field of fiber-optic testing and measurement technology. In 1996, GEXFO, EXFO, GAP Optique and the University of Geneva entered into agreements whereby GAP Optique, EXFO and GEXFO obtained worldwide exclusive rights to commercially develop, manufacture and market specified technologies relating to fiber-optic telecommunications testing and measurement instruments developed by the University of Geneva. In addition, GAP Optique, EXFO and GEXFO acquired priority rights over the marketing of fiber-optic telecommunication testing and measurement instruments prototypes designed by the University of Geneva. This agreement was renegotiated under similar terms and conditions in 1999 for a five-year term. On June 1, 2000, we acquired the 85% interest held by GEXFO in GAP Optique for a consideration equal to its book value of approximately \$16,000 and GEXFO transferred all of its rights in the agreements to us.

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In February 2000, we acquired all of the shares of Nortech Fibronic Inc., a company specializing in fiber-optic testing and temperature-sensing for a total consideration of \$2.8 million of which \$2.1 million was paid in cash. We also issued C\$800,000 (approximately \$553,000) of Class "G" shares, which were converted into 800,000 preferred shares series 1 in June 2000, and a debenture of \$200,000 (approximately \$138,000) bearing no interest and payable on November 30, 2000. In November 2000, the former shareholders of Nortech agreed with us to make a purchase price adjustment, as a result of which we received \$104,000 in cash from a portion of the purchase price previously held in escrow and reduced the purchase price for the 800,000 preferred shares series 1 from C\$800,000 (\$543,000) to C\$544,000 (\$354,000), which were purchased by us on November 30, 2000 and subsequently cancelled. In June 2001, Nortech ceased operations. The majority of its assets were sold to a third party and we acquired the remaining assets.

In connection with and immediately prior to our initial public offering in July 2000, we modified our authorized share capital to its current status, which consists of:

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- o an unlimited number of subordinate voting shares without par value;
- o an unlimited number of multiple voting shares without par value;
- o an unlimited number of preferred shares without par value, issuable in series; and proceeded with the following exchanges:
- o the 38,000,000 Class "A" shares outstanding at that time were exchanged into 38,000,000 multiple voting shares;
- o the 707,264 Class "F" shares outstanding at that time were exchanged into 707,264 subordinate voting shares;
- o the 800,000 Class "G" shares outstanding at that time were exchanged into 800,000 preferred shares series 1.

The exchange of Class "A" shares into multiple voting shares, of Class "F" shares into subordinate voting shares and of Class "G" shares into preferred shares series 1 was part of our capital reorganization completed prior to our initial public offering and did not involve any disbursement of funds.

On July 6, 2000, we completed our initial public offering as a result of which we issued a total of 8,050,000 subordinate voting shares, including 1,050,000 subordinate voting shares pursuant to the exercise of the over-allotment by the underwriters. All the 8,050,000 subordinate voting shares were sold to the public at an offering price of \$26.00.

On December 20, 2000, we acquired all of the issued and outstanding shares of common stock of Burleigh, Burleigh Instruments GmbH and Burleigh Instruments (U.K.) Ltd. at an aggregate purchase price of approximately US\$189.3 million, comprised of 6,488,816 of our subordinate voting shares and approximately US\$42.5 million in cash pursuant to the terms of an Agreement of Merger and Plan of Reorganization among us, EXFO Sub, Inc. and the selling shareholders, dated November 4, 2000, as amended on December 20, 2000.

Burleigh, which has been in operation for 30 years and had 91 employees as of December 31, 2001, has received industry recognition for its high-performance optical wavelength meters and precision positioning equipment. Its Wavemeter (R) instruments offer one of the highest wavelength measurement accuracy in the industry. These products are able to determine the absolute

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wavelength of a laser under test within 0.3 picometers at 1500 nm. Its Inchworm (R) precision positioning equipment provides nanometer accuracy, which is critical for precision alignment in the optical component manufacturing process. Both of these product lines are supported by a broad proprietary intellectual property portfolio.

In March 2001, we acquired all of the shares of EFOS Inc., a privately held company in Toronto, Canada, for a total consideration of \$111 million, of which \$25 million was paid in cash. We also issued 3,700,000 of our subordinate voting shares. In September 2001, the name EFOS Inc. was changed to EXFO Photonic Solutions Inc.

EXFO Photonic, operating since 1984 and having 52 employees as of December 31, 2001, is recognized as a leader in precision light-based adhesive spot curing as well as curing process control for the global optical component manufacturing market and other non-telecom markets. Its products deliver precise doses of the appropriate spectral light into photo-sensitive

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and heat-cured adhesives to significantly reduce bonding time and increase repeatability in optical component manufacturing. EXFO Photonic light-based curing technologies are supported by an extensive understanding of bonding and material sciences and by a broad intellectual property portfolio, including 11 patents and 11 patents pending.

Also in March 2001, our wholly owned subsidiary, Burleigh Automation Inc. ("Burleigh Automation"), acquired substantially all the assets of Vanguard, a wholly owned subsidiary of DT Industries, Inc. for a purchase price of approximately \$600,000 paid in cash. Vanguard, an automation equipment manufacturer in Tucson, Arizona, specializes in the design and manufacturing of ultra-precision assembly equipment for sensitive process and critical assembly challenges on the production floor. This acquisition, which complements our acquisition of Burleigh fits with our overall strategy to provide customers with a comprehensive solution for the assembly, alignment and testing of optical components and subsystems. Since September 2001, Burleigh Automation has ceased operations and we have been in the process of transferring all material intellectual property assets and most of the physical assets of Burleigh Automation to Burleigh.

We were forced to re-align our cost structure to market conditions twice during the past year. On June 27, 2001, we announced the reduction of non-customer-related expenses, postponement of plans to build a new facility in the Quebec Metro High-Tech Park, termination of non-core operations of Nortech, a subsidiary that specialized in manufacturing fiber-optic temperature sensors, and reduction of our workforce by 15%. On December 5, 2001, we announced the lowering of our operating expenses, a freeze in employee salaries, and the reduction of our workforce by 10%.

In November 2001, we acquired all of the shares of Avantas Networks Corporation and simultaneously changed the name of that company to EXFO Protocol Inc. ("EXFO Protocol"). We paid a total consideration of approximately \$65 million (or \$93 million for the equity minus \$28 million of cash in the hands of the acquired company) to acquire EXFO Protocol. Consideration paid consisted of 4,374,573 of our subordinate voting shares and \$36 million in cash.

EXFO Protocol, a pre-revenue company based in Montreal, Canada operating since 1998 and having 116 employees as of December 31, 2001 is a supplier of fiber-optic testing and optical network performance management equipment that supports a wide range of protocols and data transmission rates.

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B. BUSINESS OVERVIEW

We are a leading designer, manufacturer and marketer of fiber-optic test, measurement and automation solutions for the global telecommunications industry. More than 2,000 customers rely on our test instruments and systems in research and development laboratories and production environments and to enable the world's optical networks to perform impeccably during their complete lifecycles. We currently employ 1,099 employees and our products are distributed in more than 70 countries around the world.

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EXFO was founded in 1985 in Quebec City. Our original products were focused primarily on the needs of installers and operators of fiber-optic networks. These products are marketed in what is known today as our Portable and Monitoring Division. This division markets its products mainly to telecommunications carriers and network service providers. These customers use Portable and Monitoring Division products for installation and maintenance, network monitoring and troubleshooting applications. In 1996, we supplemented our product portfolio with an extensive line of Industrial and Scientific products that are dedicated to the manufacturing as well as research and development markets in the fiber-optic industry. Our Industrial and Scientific products tend to be more complex and higher priced than our Portable and Monitoring products. Industrial and Scientific Division customers include optical component and system manufacturers as well as research and development laboratories. In 1999, we entered the market for remote fiber test systems ("RFTS"). RFTS, which are marketed through our Portable and Monitoring Division, allow carriers to deploy test equipment throughout their networks in order to monitor the integrity of their fiber-optic networks on a continuous basis.

In fiscal 2001, we launched more than 20 products. Key product launches included the FTB-400 Universal Test System, the successor to our highly successful FTB-300 that performs essential tests for DWDM long-haul, metro and access networks; the OWA-9500 Optical Waveguide Analyzer, the industry's first and only commercial refractive index profiler for market-winning planar and arrayed waveguides; the FR-3000 NanoRobot (R) Photonics Alignment System with multi-axis alignment and 0.1 nanometer resolution for automated component manufacturing applications; and the Novacure (R) IR, which uses infrared spot-curing on conventional heat-cured adhesives.

In fiscal 2001, we also opened new sales offices and service centers in Singapore and Beijing to better serve our customers in the Asia-Pacific region. The expansion into the Asia-Pacific market proved to be a winning strategy since sales almost tripled year-over-year in this area. Furthermore, we moved our Paris office to a more spacious location in order to strengthen sales, application engineering and marketing services throughout Europe.

We announced three strategic acquisitions in fiscal 2001 to penetrate new technological sectors and increase our addressable markets. We acquired Burleigh for its wavelength measurement instruments and nano-positioning alignment systems. For almost three decades, Burleigh has advanced the science of interferometric measurement techniques and developed a deep understanding of precision positioning technology. As a result, Burleigh's Wavemeter(TM) products offer one of the highest wavelength measurement accuracy in the industry, while its Inchworm(TM) motor-based precision positioning line enables unmatched position control for optical components and sub-components.

We acquired EXFO Photonic for its precision light-based, adhesive spot-curing technology. EXFO Photonic products deliver precise doses of the

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appropriate spectral light onto photosensitive and heat-cured adhesives to significantly reduce bonding time and increase repeatability in optical component manufacturing. Both Burleigh and EXFO Photonic will add to sales in our Industrial and Scientific Division.

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We acquired EXFO Protocol (formerly Avantas Networks Corporation), a supplier of leading-edge, fiber-optic testing and optical network performance management equipment that supports a wide range of protocols and data transmission rates. EXFO Protocol should increase sales in both product divisions, but initially in our Portable and Monitoring Division.

This latest acquisition will enable us to enter the critical protocol-layer testing market and almost double our addressable market size to an estimated \$3.3 billion, according to reports from Frost and Sullivan, a world-reknown market consulting firm on emerging high-technology and industrial markets. In lay terms, our products test the highway, or the fiber, optical components and value-added optical modules that make up the physical layer of an optical network. Our products also cover the numerous lanes along the highway, or the DWDM wavelengths carrying bandwidth within the optical layer of a network. With the acquisition of EXFO Protocol, our products will also test the traffic, or the bits and bytes running through the protocol layer of a network.

We have received more than 45 industry and commerce awards. In 2001, we were named one of the top 100 employers in Canada by Maclean's, a national current affairs magazine. In 2000, we were selected winners of the Outstanding Corporate Innovator Award by the U.S.-based Product Development and Management Association. Prior to becoming a public company in June 2000, we had been recognized as one of the 50 Best-Managed Private Companies in Canada by Arthur Andersen Consulting and the Financial Post for five consecutive years.

THE EXFO SOLUTION

We believe that we offer the most extensive range of products in the fiber-optic test, measurement, monitoring and automation industry. Our success has been largely predicated on our exclusive focus on fiber optics. Our solution is based on the following key attributes:

MODULAR SYSTEM DESIGN. In 1996, we introduced the first products designed around our modular system design. This system design consists of a Windows-based platform that can accommodate several data acquisition test modules. We have since developed products for each of our divisions based on the same modular design. Our modular design provides the following advantages:

- o Unlike stand-alone units, new test modules can be rapidly developed to address the changing requirements of the industry.
- o As customers' testing requirements change, they can purchase additional modules that are compatible with their previously purchased platforms, thus protecting their initial investments.
- o Our standard graphical user interface reduces training costs because customers are familiar with previously acquired software products.
- o The flexibility of our systems allows customers to develop customized and automated solutions directed at specific

testing requirements.

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HIGH DEGREE OF TECHNOLOGICAL INNOVATION. We continue to be at the forefront of fiber-optic test, measurement and automation technology. For example, in the past we were the first in our industry to develop and market a number of fiber-optic test and measurement products and we have continued to do so through recent product releases:

- o PORTABLE OPTICAL SPECTRUM ANALYZER (OSA). In 2000, we supplied the market with the first OSA to provide lab-quality specifications for rugged, portable use in the field. This instrument is useful for measuring key parameters of each wavelength in a DWDM system.
- o OPTICAL WAVEGUIDE ANALYZER. In 2001, we released our Optical Waveguide Analyzer, which represents the industry's first commercial refractive index profiler for planar and arrayed waveguides. The refractive index profile of next-generation optical devices like arrayed waveguides is a critical parameter to measure in order to control and optimize the manufacturing process.

PRODUCTS OF HIGH QUALITY. Product quality is an integral part of our solution. Our Quebec City-based operations have maintained ISO 9001 certification since 1994 and they are now certified to the new 2000 edition of the standard. Our subsidiaries in Montreal, Toronto and Victor, NY, have rigorous quality assurance programs, but they are not yet certified. Our products meet industry standards, such as those set by Telcordia, formerly Bellcore, IEC, and other industry-leading standards bodies. During manufacturing, each product has a related quality assurance plan, with rigorous checkpoints, to reduce defects to a minimum. Various tasks in the quality assurance process in all our facilities include quality control, conformity testing, product documentation, product improvement, regulatory compliance, metrology and calibration.

SUPERIOR CUSTOMER SUPPORT. We use highly qualified and specialized internal groups to offer pre-sales evaluation, installation, channel and customer training, communications and post-sales support. We believe that this approach provides us with an advantage over our competitors, who often outsource some of these functions. We have two Customer Service Groups, one being responsible for the North American market and the other for our international customers. Our Customer Service Groups are mainly responsible for supporting our sales force, recommending instruments that best match our customers' testing, measurement and automation needs, providing detailed quotations, order management, technical support and training as well as calibration and repair services. Our Communications and Marketing Group, which operates like an internal advertising agency, educates our customers and our sales force by providing detailed marketing and technical information. Literature includes specification sheets, application notes, Web content, product catalogues and a bi-monthly corporate newsletter. Finally, our Writing Services Group provides technical writing for product instruction manuals. Our documentation is available in several different languages.

OUR STRATEGY

We intend to expand our leadership position in the fiber-optic test, measurement and automation industry and to increase our market share through the following initiatives:

EXPAND TECHNOLOGICAL LEADERSHIP. We believe that our ultimate success will depend on our ability to introduce enhanced products that meet the changing needs of our customers. We, therefore, will continue to invest heavily in research and development. We increased gross research and development expenditures 88% to \$17.6 million in fiscal 2001 from \$9.4 million in 2000. Altogether, 46% of our sales in 2001 originated from products that have been on the market for two years or less. We dedicate more than 30% of our employees to research and development, including an advanced research group that carries out research activities, monitors technological trends in the industry and maintains links with numerous universities, industry associations and standards bodies.

INVEST IN STRATEGIC SECTORS. We have established an award-winning innovation process. Our product portfolio review process ensures that our research and development activities are aligned with our corporate strategy. This rigorous review process has led us to focus on the following growth vehicles for the upcoming year: new product rollouts, protocol-layer testing solutions and semi-automated manufacturing solutions.

- o NEW PRODUCT ROLLOUTS. We will continue to roll out disruptive technologies and drive approval of international standards. This initiative has been demonstrated by the recent introduction of our Femtosecond PMD Analyzer, whose revolutionary technology has been accepted as a reference test method by international standards bodies. Our Femtosecond PMD Analyzer enables users to measure the smallest PMD values in narrowband DWDM channels and broadband components in the simplest, fastest and most repeatable manner. This latest breakthrough reflects our commitment to developing leading-edge technologies that have tremendous competitive advantages in high-growth nascent sectors.
- o PROTOCOL-LAYER TESTING SOLUTIONS. We plan to combine newly acquired protocol-layer testing technologies from EXFO Protocol with our physical and optical-layer testing equipment and integrate them inside our FTB-400 UTS field-testing platform. Since the acquisition of EXFO Protocol, we released a Gigabit Ethernet module for our field-testing platform to support increasingly high-speed communications in metro and access areas. In 2002, we intend to launch a fully integrated solution that will enable field technicians to be far more efficient and cost-effective because they will seamlessly carry out physical-, optical- and protocol-layer tests with a single platform in their hands. As a result, we will be providing customers with the most complete and cost-effective DWDM field-testing solution on the market.
- o SEMI-AUTOMATED MANUFACTURING SOLUTIONS. We will extend our involvement in automated component manufacturing by leveraging our expertise in automated test stations. With this vision in mind, we acquired Burleigh for its multi-axis, nano-positioning alignment robots and EXFO Photonic for its precision light-based, adhesive spot-curing systems. We plan to combine these technologies with our automated testing expertise to offer our customers stand-alone products and semi-automated manufacturing solutions that help them increase yields and reduce costs on the production floor. We also intend to seek strategic partnerships with leading system

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integrators in order to allow them to customize our semi-automated solutions

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to the specific processes that continue to be unique and proprietary to each manufacturer.

LEVERAGE OUR MODULAR DESIGN. The modularity and compatibility of our Windows-based platforms enable us to offer the same instrument design to as many as three different market segments with a single research and development project. This practice lessens the number of different designs, including optical, mechanical, electronic and software, that we must develop and manufacture. We capitalize on the flexible architecture of our Windows-based systems to expand our solutions portfolio and to offer specialized products to specific markets. By being able to provide new functionality through the design of a new module rather than through the design of a completely new instrument, we can be quicker to market with new testing technologies and provide more specialized testing solutions.

PURSUE COMPLEMENTARY ACQUISITIONS. We believe that market fragmentation in the test, measurement and automation industry creates opportunities for consolidation. We plan to aggressively pursue strategic acquisitions that will provide us with additional key technologies, complement our product offerings, increase our sales channels and add to our overall level of expertise.

PRODUCTS

Our products are designed for the global fiber-optic test, measurement and automation industry. We have adapted our product divisions to meet the needs of two main markets. Our Portable and Monitoring Division serves telecommunications carriers, cable television companies, public utilities, private network operators, third-party installers and equipment rental companies. This market requires rugged, field-portable and easy-to-use equipment.

Our Industrial and Scientific Division supplies optical component and system manufacturers as well as university and government research laboratories. This market requires highly accurate and reliable instruments and systems that carry out testing in the shortest periods of time possible.

At the core of our test, measurement and automation equipment are our FTB-400 Universal Test System (UTS) and IQ-200 Optical Test System (OTS) platforms. Our FTB-400 UTS provides carriers with a simple, yet efficient way to perform multiple, advanced test operations for installation, maintenance and troubleshooting applications. Our IQ-200 OTS is a scalable unit that is suited for manufacturing, laboratory engineering and research applications. The added benefit of our IQ-200 OTS is that manufacturers can design their own automated test setup or we can customize a setup for them. Our FTB-400 UTS and IQ-200 OTS platforms are fully supported by integrated and highly intuitive graphical user interfaces, enabling the user to easily store, handle and retrieve a large amount of data.

The following table summarizes the principal types of instruments we provide, their typical applications and the format in which we offer them:

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INSTRUMENT TYPE	TYPICAL APPLICATION	FORMAT		
		PORTABLE	HANDHELD	SCIENTIFIC
		FTB 400 UTS MODULES		IQ200 OTS MOD
Optical time domain reflectometers (OTDRs)	Like a radar, it measures the time of arrival of reflections of an optical signal to determine the distance to the breaks or points of excessive loss in a fiber network.	X		
Optical spectrum analyzers	Produces a graphical representation of power versus wavelength for an optical signal. Useful for measuring the drift, power and signal-to-noise ratio for each wavelength in a DWDM system.	X		X
Optical power meters	Measures the power of an optical signal. It is the basic tool for the verification of transmitters, amplifiers and optical transmission path integrity.	X	X	X
Widely tunable lasers	Can produce laser light across a broad range of wavelengths. Used to test DWDM components and value-added optical modules.			X
Narrowly tunable lasers	A laser that can be precisely tuned to simulate a DWDM light sources. Used primarily in testing optical amplifiers.			X
Polarization mode dispersion analyzers	Measures the dispersion of light that is caused by polarization. Generally used to determine the speed-distance limitation of fiber and cables.	X		X
Femtosecond polarization mode dispersion analyzer	Measures very small levels of polarization mode dispersion in DWDM and broadband components in the simplest, fastest and most repeatable manner.			
Multi-wavelength meters	Measures the power and drift for multiple wavelengths in a DWDM system.	X		X
Variable optical attenuators	Used in network simulation setups to provide calibrated variable reduction of the strength of an optical signal.		X	X
Polarization dependent loss meters	Measures the difference in loss of power for the different states of polarization.			X

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Loss test sets	Integrates a power meter and a light source to manually or automatically measure the loss of optical signal along a fiber.	X	X	X
Stable light sources	Emitting diode or lasers used in connection with a power meter to measure signal loss.	X	X	X
Optical fiber parameter analyzer	Measures the geometric and light guiding properties of an optical fiber. Used in new fiber research and development and quality control applications.			
Optical amplifier	Boosts the power of laser sources. Used for the testing and calibration of test systems.			X

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INSTRUMENT TYPE	TYPICAL APPLICATION	FORMAT		
		PORTABLE	HANDHELD	SCIENTIFIC
-----	-----	-----	-----	-----
		FTB 400		IQ200
		UTS MODULES	HANDHELD	OTS MOD
-----	-----	-----	-----	-----
Optical switches	Provides switching between fibers. Used to provide flexible and automated test setups such as the measurement of multiple fibers or components with multiple ports with one instrument.	X		X
Optical power reference module	Provides a highly accurate and traceable measurement of power for the calibration or verification of other power measurement instruments.			X
Broadband source	Used for testing wavelength dependent behavior of fiber cables and DWDM optical components.			X
Talk sets	A device which attaches to an optical fiber and serves as a temporary voice link facilitating coordination of work among installation crews.	X	X	
Optical return loss meters	Combines a laser and a power meter to measure the amount of potentially degrading back reflection.	X	X	X
Visual fault	A visible laser that can be			

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locators	connected to an optical fiber network to help locate breaks or points of excessive loss.	X	X
Live fiber detector	Clips on to a fiber and is used to detect the presence and direction of a signal without interrupting the traffic.		X
Clip-on coupling	Clips to an optical fiber and allows non-invasive testing.		X
Optical waveguide analyzer	Provides the refractive index profile of glass and fused silica-based devices used in next generation networks.		
Light-based curing instrument	Technology by which a dose of energy of a specific wavelength, bandwidth and irradiance is used to cause an adhesive, encapsulant or sealant to change from a liquid to a solid in a small area. Used to bond optical components and sub-components.		
Passive component analyzer	Characterizes passive wavelength-selective devices, such as multiplexers, demultiplexers and add/drop filters, with respect to absolute wavelength in order to guarantee their performance within DWDM systems.		
Gigabit Ethernet tester	Measures data integrity for high-speed internet protocol communications in metro and edge networks.	X	
SONET/ SDH Analyzers	Provide accurate bit-error rate and performance analysis of SONET/SDH overhead format that reflect the quality of a transmission system.		X
Nanorobot photonics alignment system	Offers multi-axis alignment and can position optical devices with a nanometer resolution, which is essential during the alignment of optical components in the manufacturing process.		

PORTABLE AND MONITORING PRODUCTS

We offer an extensive range of products for fiber-optic testing, measurement and monitoring applications. Our test and measurement products are available as handheld test instruments or as field-portable platforms with related modules. Our handheld instruments are durable, compact and easy to use. Our second-generation field-testing platform, the FTB-400 UTS, is available in a two-slot configuration for basic OTDR and optical loss testing, or a seven-slot configuration for high-end DWDM testing, PMD characterization, high fiber-count

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testing as well as OTDR and optical loss testing. We also offer the FTB-100 Mini-OTDR with an integrated power meter option. This cost-effective platform provides field technicians with basic OTDR testing capabilities. Our portable platforms are rugged, Windows-based, battery-powered units. Their large environmentally robust touchscreens are very practical for field use.

Our network monitoring solution is better known as FiberVisor. FiberVisor consists of rack-mounted remote test units that are strategically deployed along a fiber-optic network, and a test system controller that retrieves information in real time from as many remote test units as required. The test system controller is typically located inside a network operations center. The information obtained from these remote test units is combined with data from a geographic information system in our FiberVisor system to pinpoint the exact location of a system failure and rapidly provide the required information to a restoration team. We were first-to-market with DWDM monitoring capabilities on our RFTS, which includes the physical and optical layer. We will further extend its capabilities to the protocol layer with EXFO Protocol's Network Guardian G2, an optical network performance management system that supports a wide range of protocols and data transmission rates.

EXFO Protocol, which is exclusively dedicated to fiber-optic protocol testing, offers the Service Test Gear (STG) Series and Network Guardian G2, a Gigabit Ethernet test module for the FTB-400.

Its portable STG Series supports multi-protocols like Asynchronous Transfer Mode (ATM), Synchronous Optical Network (SONET), Synchronous Digital Hierarchy (SDH), Gigabit Ethernet and Ethernet, as well as data transmission rates from OC-192 (10 Gb/s) down to DS0 (64 kb/s) for the North American standard, and STM-64 (10 Gb/s) down to E0 (64 kb/s) for the equivalent international standard. All of these functionalities are available on a single platform.

EXFO Protocol's remote optical network performance management system, Network Guardian G2, provides real-time surveillance 24 hours per day, seven days per week. A single administrator can simultaneously observe critical quality of service parameters at key locations along the network by relying on data from remote Network Guardians.

INDUSTRIAL AND SCIENTIFIC PRODUCTS

Our Industrial and Scientific product line is mainly built around our IQ-200 OTS platform and is available as modules or stand-alone benchtop instruments. The base platform is a Windows-based system, which includes a Pentium processor, liquid crystal screen and three slots to accept test modules. This base platform can be supplemented by as many as four expansion

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platforms, each capable of housing six additional modules, which can be connected and controlled to provide additional functionality and capacity. These expansion platforms can also be controlled via a personal computer. Altogether, the IQ-200 OTS platform and expansion platforms can hold as many as 27 modules and test as many as 108 channels.

The modular nature of our IQ-200 OTS platform is adapted for complex applications involving the synchronized operation of several instruments.

Our Industrial and Scientific Division also addresses testing problems that cannot be handled by standard modules or stand-alone benchtop instruments. We have dedicated a team of engineers to develop custom-made, integrated test

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systems for customers with specific needs. Some of these integrated test systems, in turn, are modified and offered as off-the-shelf test systems to suit a wider range of customers. In addition, we have created a software development kit for developers who prefer writing their own programs for our instruments. We provide automated systems for assembly, calibration and environmental testing of optical components, value-added optical modules and optical networking systems such as:

- o Multifiber test system Used for quality assurance testing of multifiber patchcords and interconnect assemblies. These devices, including hybrid and fan-out patchcords, are commonly used in fiber systems.

- o Optical calibration test system Used to calibrate power meters, light sources, variable attenuators and optical time domain reflectometers.

- o Environmental test system Allows users to perform long-term qualification testing of optical components and value-added optical modules under varying environmental conditions primarily to ensure compliance with industry standards.

- o DWDM passive component test system Used to automatically characterize all critical specifications, including spectral insertion loss, polarization-dependent loss, and optical return loss, of a DWDM passive component with a high degree of accuracy, ease of use, and speed.

- o Comb Controller Used to adjust the power of bank of DFB-ITU lasers in order to test loading conditions of optical amplifiers.

Burleigh and EXFO Photonic further enhance our Industrial and Scientific Division product portfolio by enabling customers to automate critical steps in the optical component manufacturing process. These critical steps include automated fiber alignment (Burleigh) and precision light-based, adhesive spot curing (EXFO Photonic).

Key products from Burleigh include the FR-3000 NanoRobot(R) Alignment System, which provides multi-axis alignment and can position optical devices with a 0.1 nanometer resolution. Burleigh also offers test and measurement instruments like Optical Channel Analyzers and Passive Component Analyzers.

EXFO Photonic provides precision light-based, adhesive spot-curing technologies as well as curing process control for the global optical component manufacturing market. Its products deliver precise doses of the appropriate spectral light onto photosensitive and heat-cured adhesives to significantly reduce bonding time and increase repeatability in optical component manufacturing. Key products include the Novacure(R) IR, which uses infrared spot-curing on conventional heat-cure adhesives, and Novacure(R), a bonding solution that delivers all the benefits of ultraviolet and visible spot-curing on photosensitive adhesives.

RESEARCH AND DEVELOPMENT

We believe that our future success largely depends on our ability to maintain and enhance our core technology and product functionality. To keep developing new products and enhancements, it is important that we recruit and retain highly skilled engineers, scientists and technicians. As of December 31, 2001, our research and development departments included 315 full-time engineers, scientists and technicians, of whom 46 hold post-graduate degrees. Gross research and development expenditures for fiscal 2001 reached \$17.6 million compared to \$9.4 million for fiscal 2000.

Through a market-oriented, product portfolio review process, we ensure that our investments in research and development are aligned with our customers' needs and strategies. This approach enables us to maximize our returns on research and development investments by focusing our resources on a limited number of prioritized projects. Quarterly product portfolio review meetings enable us to choose a realistic, balanced mix of new products and allocate the necessary resources for their development. All our projects, including those already underway, are reviewed, given a priority rating and allocated budgets and resources. Our existing projects can be stopped or substantially redefined if there have been significant changes in market conditions, or if the project development schedule or budget has been significantly exceeded.

To manage our research projects once they are underway, we use a structured management process known as the stage-gate approach. The stage-gate approach is based on a systematic review of a project's feasibility at various stages of its life cycle. The following are the key review stages of the stage-gate approach:

- o market study and research feasibility;
- o product definition;
- o development feasibility;
- o development;
- o qualification; and
- o transfer to production.

At each stage, we review our project risks, costs and estimated completion time. We compare our design to anticipated market needs and ensure that our project is synchronized with other internal departments and external industry events. The inter-related portfolio review and stage-gate processes

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enabled us to be named winners of the Outstanding Corporate Innovator Award in 2000 by the U.S.-based Product Development and Management Association.

CUSTOMERS

More than 2,000 customers in 70 countries around the world rely on our test instruments and systems in research and development laboratories and production environments and to enable optical networks to perform impeccably during their complete lifecycles. Our customers include telecommunications carriers, cable television companies, public utilities, private network operators, third-party installers, equipment rental companies as well as optical component and system manufacturers. Our top three customers in terms of sales for fiscal 2001 were Verizon Communications, Nortel Networks Corporation and TSH Tech Development, a Chinese-based distributor. During fiscal 2001, no single customer accounted for more than 6.4% of our sales. With regard to geographic distribution, North American customers represented 58.3% of our sales, while international customers accounted for 41.7%. Our international sales are largely handled by a network of distributors around the world.

SALES

We sell our fiber-optic test, measurement and automation products through direct and indirect sales networks in the United States and Canada as well as around the world. We also have two Customer Service Groups to meet the needs of existing and new customers in North America and on the international front. These groups are responsible for providing quotations to customers, supporting our sales force, managing demonstration units, order management, technical support and training as well as calibration and repair services.

UNITED STATES AND CANADA SALES

In the United States and Canada, our direct sales network consists of a vice-president supported by a 45-member team of regional sales managers, sales engineers and application engineers, who are located throughout major metropolitan areas. Our group of sales professionals has a minimum average of 12 years of experience in the fields of telecommunications, fiber optics, or test, measurement and monitoring.

In Canada, the direct to customer sales team addresses the carrier, manufacturing and research and development markets for our test, measurement and monitoring equipment and our manufacturing automation products. Sales personnel are located in metropolitan areas throughout the country.

In the United States, we have adopted a market-specific sales strategy. Different sales organizations have been created to maximize coverage and penetration of our main markets:

- o CARRIER MARKET. This sales team targets customers who own, operate or install networks as their primary business. This market includes telecommunications

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carriers, cable television companies, public utilities, private network operators, as well as third-party installers and equipment rental companies.

- o MANUFACTURING/R&D MARKET. Two sales teams specializing respectively in our test, measurement and monitoring equipment and in our manufacturing automation products target customers

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who research, develop or manufacture optical networking products and components. In this market, some regional sales managers also have direct responsibility for serving our larger manufacturing customers. This organizational structure allows us to adequately cover the demands of a highly technical customer base and to identify and penetrate the large multi-function accounts, diverse and smaller customers, university researchers, military contractors, contract manufacturers and other evolving market segments.

Our main sales office in the United States is located in Richardson, Texas. We also maintain sales personnel in numerous metropolitan areas and rely on more than 20 sales representatives situated throughout the United States.

INTERNATIONAL SALES

Our international sales network includes a vice-president, a general manager in Europe and two sales directors covering Latin America and Asia, all supported by a team of 24 sales professionals. Our direct sales network in Europe is supported by a main office and service center in Paris, France, which maintains our head European sales operations and also provides repair and calibration services for our European, Middle East and African customers. Our main office for Asia is in Singapore and we have also established service centers in Singapore and Beijing to better serve our customer base in the Asia-Pacific region. In addition, we have other sales offices in strategic locations around the world to support our network of distributors and customers. Finally, we rely on more than 50 distributors to support our international sales. We feel that the local presence and cultural attributes of our distributors allow us to better serve our global markets.

MARKETING, COMMUNICATIONS AND CUSTOMER SUPPORT

MARKETING

Our Marketing Group consists of 30 product managers and marketing analysts who have various degrees in engineering, science and business administration. Product managers, with the assistance of marketing analysts, are responsible for all aspects of our marketing program including product strategy, new product introductions, definition of new features and functions, pricing, product launches and advertising campaigns. Marketing analysts help product managers develop marketing programs with tools such as our Web site, CD-ROMs, advertisements, mailouts and customer presentations. We follow up our marketing initiatives by attending industry trade shows. Furthermore, we have implemented a customer relationship management system to compile market and customer information including forecasts, leads and competitive data. We use this information to make strategic business decisions. Finally, our strategic marketing team analyses markets, market trends, compiles competitive information and identifies macro-trends in our sector.

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COMMUNICATIONS

Our Communications Group, which mainly consists of commercial writers and graphic artists, supports our Marketing Group by producing marketing and corporate documentation. Literature includes specification sheets, application notes, product catalogues, advertising copy and a bi-monthly corporate newsletter. Our Communications Group is also responsible for maintaining and updating our Web site.

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CUSTOMER SUPPORT

We have developed a Customer Support Group that serves customers and distributors around the world in English, French, Spanish and German. Our Customer Support Group consists of three distinct units: technical support, order management and a repair and calibration authorization service center. A frequently asked question database is also updated regularly on our Web site.

MANUFACTURING

Manufacturing operations consist mainly of material planning, procurement, sub-assembly, final assembly, testing, software loading, calibration, quality assurance and shipping and billing.

As of December 31, 2001, we had 354 employees involved in our manufacturing operations. Our manufacturing operations, which occupy approximately 139,900 square feet, are spread among four buildings in three cities. We have two buildings that occupy 113,900 square feet in Quebec City, Canada, one building that occupies 10,000 square feet in Victor, United States, and another building that occupies 16,000 square feet in Toronto, Canada. Our manufacturing operations in Quebec City are handled by three inter-related departments:

- o PRODUCTION. Our production department is responsible for manufacturing high-quality products on time. Each cell consists of specialized technicians and has full responsibility over a product group. Technicians are versatile enough so that they can perform specific functions within a cell and they can be transferred to other cells when required to alleviate bottlenecks. Furthermore, this department is responsible for manufacturing schedules, finished goods warehousing, customs management, shipping and billing.
- o PRODUCTION ENGINEERING AND QUALITY. This department, which supports our production cells, acts like a gatekeeper to ensure the quality of our products and the effectiveness of our manufacturing processes. It is responsible for the transfer of products from research and development to manufacturing, product improvement, documentation, metrology, repairs and the quality assurance and regulatory compliance process. Quality assurance represents a key element in our manufacturing operations. We meticulously verify our instruments to ensure that they meet stringent industry requirements and provide our customers with detailed product test sheets. Our quality assurance program in Quebec City has been certified ISO 9001 since 1994.
- o SUPPLY-CHAIN MANAGEMENT. This department is responsible for parts procurement, raw materials and forecasting. Our products consist of optical, electronic and mechanical parts. Approximately one-third of our parts are manufactured to our specifications. Some parts are obtained from single-source suppliers. We manage risks associated with single-source suppliers, as well as parts that are subject to industry shortages or long delivery lead times, through a strategic forecasting process that involves procuring excess inventory where appropriate.

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Manufacturing operations at Burleigh, EXFO Photonic and EXFO Protocol follow a similar process with the exception that some non-critical tasks, such as the stuffing of printed circuit boards, are outsourced.

COMPETITION

The fiber-optic test, measurement and automation industry is highly competitive and subject to rapid change as a result of technological developments and other factors. We compete with many different companies, depending on product family and geographical market. We believe that the main competitive factors in the industry include the following:

- o product performance and reliability;
- o level of technological innovation;
- o product lead times;
- o breadth of product offering;
- o ease of use;
- o customer service and technical support;
- o strength of sales and distribution relationships; and
- o price.

Generally, our competitors fall into two categories. The first category consists of global electronic test and measurement manufacturers, who complement their broad range of products with fiber-optic test, measurement and automation equipment. These companies include Acterna Corporation, Agilent Technologies, Inc., Ando Corporation, Anritsu Corporation, GN Nettest and Tektronix, Inc.

The second category refers to niche companies in the fiber-optic test, measurement and automation industry. These companies typically have limited product lines and in some cases may be geographically limited in their customer base. Such companies include Digital Lightwave, Inc., ILX Lightwave Corporation, JDS Uniphase Corporation, Kingfisher International PTY Ltd., Newport Corporation and Santec Corporation.

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REGULATORY ENVIRONMENT

In most countries where our products are sold, our products must comply with the regulations of one or more governmental entities. These regulations often are complex and vary from country to country. Depending upon the country and the relevant product, the applicable regulations may require product testing, approval, registration, marking and unique design restrictions. Accordingly, we have appointed a team of engineers who are responsible for ensuring that our products comply with all applicable regulations.

In the United States, our products must comply with the regulations of several agencies of the U.S. federal government, including the Federal Communications Commission, or the FCC, the Food and Drug Administration, or the FDA and the Occupational Safety and Health Administration, or OSHA. Under the FCC's regulations, our products must comply with, among other things, rules concerning unintentional radio frequency emissions that interfere with protected radio communications systems. Depending upon the product, compliance with these

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rules may necessitate applying for and obtaining an FCC equipment authorization prior to importing into the United States, or marketing, any units of the relevant product. Additionally, some of our products must comply with the FDA's performance standards and related rules concerning light-emitting products, such as lasers. The FDA's regulations are intended to promote safety by limiting human exposure to harmful electromagnetic radiation. Similarly, our products must comply with OSHA's design safety standards for systems that utilize electricity. These rules are intended to reduce the risk of accidental human electrocution.

Similar regulations apply in other countries. For example, our products are subject to the safety standards of Industry Canada and the Canadian Standards Association with respect to electricity utilization and radio frequency emissions. Other countries in the world require equipment marking in accordance with the standards of the European Community, often referred to as CE marking, testing to ensure compliance with International Electrotechnical Commission standards and other international product approval. Other significant types of regulations not described in this annual report also may apply, depending upon the relevant product and country.

INTELLECTUAL PROPERTY

Our success and ability to compete are dependent in part on our ability to develop and protect our proprietary technology. We file U.S. and Canadian patent applications to protect technology, inventions and improvements important to the development of our business. We also rely on a combination of copyright, trademark, trade secret rights, licensing and confidentiality agreements.

We currently hold 18 U.S.-issued and seven Canadian-issued patents and we have 16 U.S., 15 Canadian and 4 Patent Cooperation Treaty patent applications pending. These issued and pending patents cover various aspects of our products and processes. The expiration dates of our issued patents range from January 16, 2010 to June 14, 2020.

We consider five of our inventions for which patents have either been granted or are pending to be material. These inventions are:

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- o the optical time domain reflectometer with internal reference reflector for which a patent was granted in the United States and is pending in Canada. This invention permits the control of the optical time domain reflectometer detector gain and the determination of the loss of the initial optical connector and is used in most of our optical time domain reflectometer-based products;
- o the measurement of attenuation of optical fibers using bidirectional transmission of information via the fiber for which patents were granted in the United States and Canada. This invention forms the basis of our FOT-920 and FTB-3920 products;
- o an adapter for interconnecting optical fiber connectors for which patents are pending in Canada and the United States. This invention permits a wide variety of connectors to be joined to our test and measurement instruments;
- o the light cure system with closed loop control and work piece recording which is at the heart of the spot-curing systems

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manufactured by EXFO Photonic for which patents were granted in the United States and Canada; and

- o the portable test gear for TDM and packet based communications for which patent applications have been filed in Canada, the United States and pursuant to the Patent Cooperation Treaty form the basis of the technology used by EXFO Protocol for its protocol testing products.

Confidentiality and proprietary information agreements with our senior management, employees and others generally stipulate that all confidential information developed or made known to these individuals by us during the course of their relationship is to be kept confidential and not disclosed to third parties, except in specific circumstances. The agreements also generally provide that all intellectual property developed by the individual in the course of rendering services to us belongs exclusively to us. These efforts afford only limited protection.

LEGAL PROCEEDINGS

On November 27, 2001, a class action suit was filed in the United States District Court for the Southern District of New York by John Williams, and others similarly situated, against us, four of the underwriters of our initial public offering (Merrill Lynch, Pierce, Fenner & Smith, Inc., RBC Dominion Securities Inc., Wit Soundview Corporation and CIBC World Markets Inc.) and Messrs. Germain Lamonde and Pierre Plamondon pursuant to the SECURITIES EXCHANGE ACT OF 1934 and Rule 106-5 promulgated thereunder and sections 11, 12 and 16 of the SECURITIES ACT OF 1933. This class action alleges that our 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 our shares issued in connection with our initial public offering; and (ii) the underwriters allegedly entering into agreements with customers whereby our shares issued in connection with our initial public offering would be allocated to those customers in exchange for which such customers agreed to purchase additional amounts of our shares in the after market at pre-determined prices. The plaintiff in this suit seeks an unspecified amount for

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damages suffered. We believe that our executive officers and we have fully complied with all applicable securities laws and that the claims against our officers and us are without merit. We have referred this matter to our insurers and plan to vigorously defend our position in this litigation. However, we are unable to predict the outcome of this case and if it is adversely determined, it could have certain adverse effects on our business, including potential monetary damages.

On December 12, 2000, GAP Optique instituted legal proceedings with the Jurisdiction des Prud'hommes in Geneva, Switzerland against an ex-employee for breach of a confidentiality obligation as stipulated in his employment contract. GAP is claiming monetary damages only since Swiss law does not allow injunctive relief in this case. Mr. Patrick Stamp was hired by our subsidiary, GAP Optique on May 1, 1998. Mr. Stamp's employment contract contained a confidentiality clause that prohibits disclosure or use of any confidential information he may obtain during the course of his work. The contract provides that this obligation continues for a period of one year following termination of the employment agreement. Mr. Stamp left GAP Optique in February 2000 to create a start-up

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company called LUCIOL Instruments, S.A ("LUCIOL") with the help of two former employees of the University of Geneva. LUCIOL presently manufactures and sells fiber optic test instruments, of which two (a chromatic dispersion analyzer and a photon-counting OTDR) were developed jointly by GAP Optique and the University of Geneva. Mr. Stamp participated in the development of these instruments during employment with GAP Optique and the University. Therefore, it is the contention of GAP Optique that Mr. Stamp is now using illegally, through LUCIOL, the proprietary and confidential information he obtained during his employment in order to market the particular test instruments. A preliminary hearing was held on November 1, 2001 and the proceedings will resume in January 2002.

There are no other legal or arbitration proceedings pending or threatened of which we are aware which may have or have had a significant effect on our financial position.

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C. ORGANIZATIONAL STRUCTURE

As of December 31, 2001, the following chart presents our corporate structure, the jurisdiction of incorporation of our subsidiaries and the percentage of shares that we hold in those subsidiaries.

[GRAPHIC OMITTED]
[ORGANIZATION CHART]

EXFO Electro-Optical Engineering Inc. 18/09/85 (Canada) Operating					
100%	100%	100%	85%	100%	100%
EXFO UK Limited 27/02/01 (United Kingdom) Operating	EXFO Photonic Solutions Inc. (formerly Efos Inc.) (Ontario) Operating	GEXFO Distribution Internationale Inc. 17/12/92 (Quebec) Holding	GAP Optique SA 17/05/94 (Switzerland) Operating	EXFO Asia Pacific Norte PTE Ltd. 18/01/01 (Singapore) Operating	NORTECH 14/01/01 (Canada) Non-Operating
GEXFO					
	100%	100%	100%		100%
	EXFO Europe S.A.R.L. 08/02/94 (France) Operating	EXFO International Services Management LLC 22/11/00 (Hungary)-Operating	EXFO USA Inc. 07/12/00 (Delaware) Holding		NORTECH (Canada) Dissolved
			EXFO USA INC.		
		100%	100%		
		EXFO America Inc. 15/12/92 (Delaware) Operating	Burleigh Instruments Inc. 25/08/72 (New York) Operating		

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BURLEIGH

100%	100%	100%
Burleigh Instruments (UK) Ltd. (United Kingdom) Non-operating	Burleigh Instruments GmbH (Germany) Non-operating	Burleigh Automation Inc. (Delaware) Non-oeprating

D. PROPERTY, PLANT AND EQUIPMENT

Our main offices and facilities are located near Quebec City, Canada where we occupy three buildings. These buildings house our executive and administrative offices, research and development facilities and production facilities. In addition, we maintain sales offices in Brazil, China, France, Germany, Great Britain, Japan, Singapore, Russia and the United States. Burleigh's facilities are located in Victor, in the state of New York, EXFO Photonic is located near Toronto, Canada and EXFO Protocol is located near Montreal, Canada.

During the fiscal year ended August 31, 2001, we increased our manufacturing operations in Quebec City and acquired parcels of adjoining land with a building that we use for warehouse purposes. These improvements were completed at a cost of \$4,601,241, which was financed through our short-term investments. Our plans to build a new 150,000 square foot facility to house research and development, administration and marketing departments in the fall of 2001 were postponed indefinitely in order to align our cost structure to market conditions and mitigate the impact of the slowdown being felt in the telecommunications industry. In addition, during the fiscal year ended August 31, 2001, Burleigh completed expansion of its facilities in New York State that effectively doubled its square footage at a cost of \$362,340 incurred from December 20, 2000, the date we acquired Burleigh, to August 31, 2001.

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In addition, when our subsidiary, Nortech, ceased activities in June 2001, the lease for the premises situated at 500 St-Jean-Baptiste Street, Quebec City was cancelled upon payment of CDN\$51,000 to the landlord.

The following table sets forth information with respect to the main facilities that we occupy as of December 31, 2001.

LOCATION -----	USE OF SPACE -----	SQUARE FOOTAGE -----	TYPE -----
436 Nolin Street Vanier (Quebec)	Manufacturing	44,164	
400 Godin Avenue Vanier (Quebec)	Research and Development, Manufacturing and Administrative	128,800	
465 Godin Avenue Vanier (Quebec)	Executive and Administrative	24,000	
2260 Argentia Road Mississauga (Ontario)	Research and Development, Manufacturing and Administrative	36,000	

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2650 Marie-Curie St-Laurent (Quebec)	Research and Development, Manufacturing and Administrative	26,000
7647 Main Street Fishers Victor (New York)	Research and Development, Manufacturing and Administrative	40,000

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ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis of the consolidated financial condition and results of operations of EXFO Electro-Optical Engineering Inc. (EXFO) for the fiscal years ended August 31, 2001, 2000 and 1999 should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report. Our consolidated financial statements are reported in US dollars and have been prepared in accordance with accounting principles generally accepted in Canada, or Canadian GAAP. To the extent applicable to our consolidated financial statements included elsewhere in this annual report, these principles conform in all material respects with accounting principles generally accepted in the United States, or US GAAP, except as described in note 19 to our consolidated financial statements.

FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements that involve risks and uncertainties. These statements relate to our future plans, objectives, expectations and intentions. We have identified these statements by the use of words such as "may," "will," "expect," "anticipate," "intend," "plan," "estimate," "believe," "continue" or other similar expressions. These forward-looking statements reflect our current expectations and assumptions as to future events that may not prove to be accurate. Our actual results are subject to a number of risks and uncertainties and could differ materially from those discussed in these statements. Factors that could contribute to these differences include, but are not limited to, those discussed in "Item 3 - Risk Factors" of this annual report. In light of the many risks and uncertainties surrounding our business and operations, you should keep in mind that we cannot guarantee that the forward-looking statements described in this annual report will transpire. We undertake no obligation and do not intend to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as may be required under applicable law.

CORPORATE HIGHLIGHTS

EXFO REPORTS STRONG YEAR-END FINANCIAL RESULTS

EXFO announced in October 2001 it had increased sales by 104% to \$146.0 million for the fiscal year ended August 31, 2001 from \$71.6 million in 2000. Net earnings, excluding amortization of goodwill and the after-tax effect of amortization of intangible assets and non-recurring expenses, jumped 139% to \$24.5 million, or \$0.46 per share, for fiscal 2001 from \$10.3 million, or \$0.26 per share, for 2000. Including amortization of intangible assets and goodwill related to acquisitions as well as non-recurring expenses, EXFO's net loss for fiscal 2001 was \$15.3 million, or \$0.29 per share. In comparison, EXFO recorded net earnings of \$9.9 million, or \$0.25 per share, in fiscal 2000.

EXFO ACQUIRES AVANTAS NETWORKS

EXFO reported in August 2001 it had entered into an agreement to acquire Avantas Networks Corporation (now EXFO Protocol Inc.) for \$68 million, or \$96 million for the equity minus \$28 million of cash on hand in that company. Consideration paid consisted of 4.4 million EXFO shares and \$36 million in cash. EXFO Protocol Inc. is a supplier of leading-edge fiber-optic testing and optical network performance management equipment that supports a wide range of protocols and data transmission rates.

EXFO LAUNCHES MORE THAN 20 PRODUCTS IN 2001

EXFO announced in August 2001 it had launched more than 20 products in fiscal 2001. Key product launches included the FTB-400 Universal Test System, which is the industry's first modular platform that can perform essential physical layer tests for DWDM long-haul, metro and access networks; the OWA-9500 Optical Waveguide Analyzer, which represents the industry's first and only commercial refractive index profiler for all-important planar and arrayed waveguides; the FR-3000 NanoRobot(R) Alignment System with multi-axis alignment and 0.1-nanometer resolution for automated component manufacturing applications; and the Novacure(R) IR, which uses infrared spot-curing on conventional heat-cured adhesives.

EXFO OPENS SALES OFFICES AND SERVICE CENTERS IN ASIA

EXFO opened sales offices and service centers in Singapore and Beijing during fiscal 2001 to better serve its customers abroad. The expansion into the Asian market proved to be a winning strategy since sales almost tripled from fiscal 2000 to 2001 in this region. EXFO also relocated its Paris office to strengthen sales, application engineering and marketing services throughout Europe.

EXFO ACQUIRES EFOS

EXFO announced in March 2001 it had acquired EFOS Inc., now EXFO Photonic Solutions Inc., for 3.7 million shares valued at \$85 million and \$25 million in cash. EXFO Photonic Solutions is a leader in precision light-based adhesive spot curing technologies as well as curing process control for the global optical component manufacturing market.

EXFO JOINS TSE 300

EXFO announced in February 2001 it had been added to the Toronto Stock Exchange (TSE) 300 Composite Index as well as the TSE 300 Capped, S&P/TSE Canadian SmallCap and TSE 200 Indices. The TSE 300 Composite Index is a benchmark used to measure the price performance of the broad Canadian equity market.

EXFO ACQUIRES BURLEIGH INSTRUMENTS

EXFO announced in December 2000 it had acquired Burleigh Instruments, Inc. for \$6.5 million shares valued at \$147 million and \$42 million in cash. Burleigh is a leading supplier of DWDM wavelength measurement instruments and

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precision positioning equipment.

INDUSTRY OVERVIEW

OPTICAL NETWORKING MARKET

The past decade has witnessed an explosive growth in the volume of data traffic largely due to the soaring popularity of the Internet and related bandwidth-intensive applications. According to information technology industry analysts, the number of Internet users around the world is expected to increase from 400 million in 2001 to nearly one billion, or 15% of the total population, by 2005. In addition, users are increasingly seeking applications that require a great deal of bandwidth such as video conferencing, video-on-demand, HDTV, e-commerce and rich media streaming.

The dramatic increase in Internet users and in bandwidth-intensive applications has created a tremendous need for high-capacity communication networks. To meet this increasing demand for bandwidth, many telecommunication carriers are designing and installing new networks based on optical fiber, deploying additional fiber within their existing networks or using advances in optical technology such as Dense Wavelength Division Multiplexing, or DWDM. DWDM involves combining beams of light of slightly different wavelengths through a single fiber, with each wavelength carrying its own stream of information. DWDM has wide market acceptance because it incorporates technologies that greatly reduce the cost of optical transmission over long distances and because it provides network flexibility in access and metropolitan areas. According to Kessler Marketing Intelligence (KMI), the global DWDM Transport Equipment Market is expected to increase from \$7.1 billion in 2001 to \$23.2 billion in 2005.

Although the long-term outlook for the telecommunications industry remains robust, 2001 was marked by a slowdown in the overall economy and reduced capital spending in the optical networking market. On the carrier side, we observed a trend towards maximizing existing networks by increasing transmission rates and adding DWDM channels, while delaying deployment of new fiber cables. For optical component and system manufacturers, the slowdown in the buildout of new networks resulted in excess inventories throughout the industry. Despite this over-supply of optical components, the most established component and system manufacturers did not significantly slash their R&D budgets in order to remain competitive in designing next-generation products. As a result, new production lines are still being rolled out in significant numbers.

OPTICAL TEST, MEASUREMENT AND AUTOMATION EQUIPMENT MARKET

Fiber-optic test, measurement and automation equipment is essential for research and development, manufacturing, network installation and maintenance as well as network monitoring.

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Conventional test and measurement instruments used by telecommunication carriers and manufacturers of communications equipment were designed for electrical transmission systems and are unsuitable for optical networking. Unlike traditional electrical transmission systems, which transmit electrical signals along copper wires, fiber-optic transmission systems use pulses of light along glass or plastic fiber, referred to as optical fiber. When light travels along optical fiber and through the optical components and systems that link optical fibers together, it is subject to unwanted effects such as reflection, attenuation, noise and various types of dispersion, all of which degrade signal quality and reduce transmission performance. Fiber-optic test and measurement equipment is critical for measuring these effects and helping carriers and

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manufacturers of optical components, value-added optical modules and optical networking systems ensure network performance, efficiency and reliability.

Data sent along an optical network must respect transmission protocols, such as ATM, SONET, SDH, Ethernet and Gigabit Ethernet, and fall within accepted data transmission rates from 64 kb/s to 10 Gb/s. Otherwise, the information sent from a transmitter will not be understandable to the receiver. Fiber-optic test and measurement equipment like a bit-error rate tester is used to ensure data integrity.

Optical components and value-added optical modules, which make up an optical network, are typically assembled by hand on the production floor. Yields are inevitably low and costs are high. As a result, optical component vendors are increasingly looking for ways to increase efficiency and reduce costs by adopting automated manufacturing solutions. They either build these complex solutions in-house or turn to equipment manufacturers to help them automate critical steps in the manufacturing process such as alignment, curing and optical testing. The latter option enables optical component vendors to devote their scarce technical resources to developing next-generation products instead of manufacturing tools.

The fiber-optic test, measurement and automation market has not been immune to the challenging conditions in the optical networking sector. However, vendors with extensive product portfolios that include advanced optical test instruments were still able to market their products to carriers, who needed to upgrade their networks to higher transmission rates or add DWDM channels. Likewise, test, measurement and automation vendors, whose products increase efficiency and reduce costs on the production floor, still attracted the attention of optical component and system manufacturers, who kept investing in their R&D programs to stay ahead of the competition.

CORPORATE OVERVIEW

EXFO was incorporated on September 18, 1985. Our original products were focused primarily on the needs of installers and operators of fiber-optic networks. These products are marketed in what is known today as our Portable and Monitoring Division. This division markets its products mainly to telecommunication carriers and network service providers. These customers use Portable and Monitoring Division products for installation and maintenance, monitoring and troubleshooting applications. In 1996, we supplemented our product portfolio with an extensive line of Industrial and Scientific products that are dedicated to the research and development as well as manufacturing markets in the fiber-optic industry. Our Industrial

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and Scientific products tend to be more complex and higher priced than our Portable and Monitoring products. Industrial and Scientific Division customers include optical component and system manufacturers as well as research and development laboratories. In fiscal 1999, we entered the market for remote fiber test systems. Remote fiber test systems, which are marketed through our Portable and Monitoring Division, allow carriers to deploy test equipment throughout their networks in order to monitor the integrity of their fiber-optic networks.

In fiscal 2001, we announced three strategic acquisitions to bolster growth in both of our product divisions. We acquired Burleigh Instruments for its wavelength measurement instruments and nano-positioning alignment systems. We added EFOS (renamed EXFO Photonic Solutions) for its precision light-based, adhesive spot-curing technology. Both of these companies are expected to accelerate growth in our Industrial and Scientific Division. Finally, we reached

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an agreement to acquire Avantas Networks, a supplier of leading-edge, fiber-optic testing and optical network performance management equipment that supports a wide range of protocols and data transmission rates. Avantas should increase sales in both product divisions, but initially in our Portable and Monitoring Division.

The Avantas acquisition will enable us to enter the critical protocol-layer testing market and, more importantly, almost double our addressable market size to an estimated \$3.3 billion, according to reports from Frost and Sullivan. In layman's terms, EXFO products test the highway, or the fiber, optical components and value-added optical modules that make up the physical layer of an optical network. Our products also cover the numerous lanes along the highway, or the DWDM wavelengths carrying bandwidth within the optical layer of a network. With the Avantas acquisition, EXFO products will also test the traffic, or the bits and bytes, running through the protocol layer of a network.

We sell our products to more than 2000 customers through our direct sales force and indirectly through distribution channels. Cost of sales include raw materials, salaries and related expenses for direct and indirect manufacturing personnel and manufacturing overhead.

Selling and administrative expenses consist primarily of salaries and related expenses for personnel, sales commissions, travel expenses, marketing programs, professional services, management 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 as well as fees paid to third-party consultants. We are eligible to receive research and development (R&D) tax credits and government grants. Related R&D tax credits and government grants are recorded as a reduction of gross R&D expenses.

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RESULTS OF OPERATIONS

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

YEARS ENDED AUGUST 31,	1999	\$ 2000	2001	1999
Sales	\$ 42,166	\$ 71,639	\$ 146,013	100.0%
Cost of Sales	14,998	24,712	54,946	35.6
Gross margin	27,168	46,297	91,067	64.4
Operating expenses				
Selling and administrative	13,279	24,304	46,236	31.5
Net research and development	4,315	6,402	13,601	10.2
Amortization of property, plant and equipment	857	1,451	3,559	2.0
Amortization of intangible assets	41	47	9,876	0.1
Non-recurring expenses	--	--	3,288	--

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Earnings from operations	8,676	14,723	14,507	20.6
Interest income, net	136	1,480	6,098	0.3
Foreign exchange gain (loss)	(506)	(684)	3,327	(1.2)

Earnings before income taxes and amortization of goodwill	8,306	15,519	23,932	19.7
Income taxes	2,492	5,298	8,150	5.9

Earnings before amortization of goodwill	5,814	10,221	15,782	13.8
Amortization of goodwill	--	297	31,076	--

Net earnings (loss) for the year	\$ 5,814	\$ 9,924	\$ (15,294)	13.8%

Basic and diluted net earnings (loss) per share	\$ 0.14	\$ 0.25	\$ (0.29)	

Research and development data:				
Gross research and development	\$ 6,390	\$ 9,374	\$ 17,601	15.2%
Net research and development	\$ 4,315	\$ 6,402	\$ 13,601	10.2%

Other data (unaudited):				
Adjusted net earnings*	\$ 5,843	\$ 10,252	\$ 24,463	13.9%
Basic and diluted adjusted net earnings per share*	\$ 0.14	\$ 0.26	\$ 0.46	

* net earnings excluding amortization of goodwill and the after-tax effect of amortization of intangible assets and non-recurring expenses. This information may not be comparable to similarly titled measures reported by other companies because it is non-GAAP information.

SALES

Sales totalled \$146.0 million, \$71.6 million and \$42.2 million in fiscal 2001, 2000 and 1999, respectively. Sales increased 104% in fiscal 2001 compared to 2000 due to increased demand for our Industrial and Scientific products as well as our Portable and Monitoring products, market acceptance of several products launched in 2001 and the impact of the Burleigh Instruments and EXFO Photonic Solutions acquisitions completed during the year. In addition, the increase in sales of our Industrial and Scientific products significantly affected our top line because these products have a higher average selling price than Portable and Monitoring products.

Altogether, Industrial and Scientific products accounted for almost 50% of our sales in fiscal 2001 compared to just over 30% in 2000. In fiscal 2002, we expect our Portable

and Monitoring products to regain a larger share of our total sales due to continued carrier spending and the impact of the Avantas acquisition in the second half of the year. Although telecommunication carriers have lowered their capital expenditures for network deployment, they are upgrading networks by

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adding DWDM channels and increasing data transmission rates. As a result, they still need to purchase test and measurement equipment to ensure network reliability. The Avantas acquisition will initially benefit the Portable and Monitoring Division, but it should eventually increase sales in the Industrial and Scientific Division.

Accepted orders increased 53% to \$132.1 million in fiscal 2001 from \$86.2 million for 2000. Our book-to-bill ratio, however, decreased 25% to 0.90 in fiscal 2001 compared to 1.20 in 2000. The decrease in our book-to-bill ratio reflects the downturn in the telecommunications industry, which began impacting our booking in the third quarter of 2001.

In fiscal 2000, sales increased 70% compared to 1999. Growth in sales was mainly due to increased demand for our Industrial and Scientific products as well as a general sales increase in our other products.

North American sales accounted for 58.3%, 61.6% and 56.3% of global sales in fiscal 2001, 2000 and 1999, respectively. International sales represented 41.7%, 38.4% and 43.7% of global sales in fiscal 2001, 2000 and 1999, respectively. The increase in international sales in fiscal 2001 compared to 2000 mainly reflects our sustained efforts to develop the Asian market. We almost tripled our sales in this region and added service centers in Beijing and Singapore to better serve our customers. The jump in North American sales in fiscal 2000 compared to 1999 was the result of our ability to exploit a robust economy in that region during that period.

We sell our products to a broad range of customers including telecommunication carriers, optical component and system manufacturers as well as research and development laboratories. No customer accounted for more than 6.4%, 5.8% and 6.8% of sales in fiscal 2001, 2000 and 1999, respectively.

GROSS MARGIN

Gross margin amounted to 62.4%, 65.5% and 64.4% of sales for fiscal 2001, 2000 and 1999, respectively. Despite the increase in sales of Industrial and Scientific products, which tend to be slightly higher-margin products, gross margin decreased in fiscal 2001 compared to 2000 due to a number of reasons. First of all, we significantly increased our manufacturing capacity as well as hired and trained related manufacturing employees to face current and future demand for our products. Secondly, we re-engineered our manufacturing processes to be more cost-effective and to better mitigate the impact of potential pricing pressure in the future. Thirdly, we acquired EXFO Photonic Solutions, which operates in a market that has relatively lower-margin products. Finally, the slowdown in the telecommunications industry, which affected us mostly in the last quarter of fiscal 2001, prevented us from a better absorption of our fixed costs.

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The improvement in gross margin in fiscal 2000 compared to 1999 reflects the increase in government grants earned in 2000, increased sales of higher-margin products and our cost-reduction manufacturing programs.

Gross margin can be negatively affected by competitive pricing pressure, increases in component costs and obsolescence costs, shifts in product mix, reductions in government grants, under-absorption of manufacturing fixed costs and increases in product offerings by other suppliers in the fiber-optic test, measurement and automation industry.

SELLING AND ADMINISTRATIVE

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Selling and administrative expenses reached \$46.2 million, \$24.3 million and \$13.3 million for fiscal 2001, 2000 and 1999, respectively. As a percentage of sales, selling and administrative expenses amounted to 31.7%, 33.9% and 31.5% for fiscal 2001, 2000 and 1999, respectively. The dollar increase for fiscal 2001 compared to 2000 is directly related to higher commissions resulting from increased sales activity, increased promotional and marketing expenses, expenses to consolidate our sales force in Asia, expenses related to running a public company and the impact of the Burleigh Instruments and EXFO Photonic Solutions acquisitions. The percentage decrease is mainly due to a better absorption of these expenses because sales are increasing at a faster rate than selling and administrative expenses.

The increase in selling and administrative expenses in fiscal 2000 compared to 1999 reflects increased personnel expenses for sales and marketing staff, increased expenses related to customer support, increased sales commissions related to higher sales, increased promotional and marketing expenses as well as the expenses related to running a public company since June 2000. Considering current market conditions, efforts will be undertaken to maintain our selling and administrative expenses at an acceptable level without impeding our efforts to strategically position our company, improve our sales, marketing and customer service teams, integrate our acquired companies and satisfy our customers.

RESEARCH AND DEVELOPMENT

Gross R&D expenses totalled \$17.6 million, \$9.4 million and \$6.4 million for fiscal 2001, 2000 and 1999, respectively. As a percentage of sales, gross R&D expenses were 12.1%, 13.1% and 15.2% for fiscal 2001, 2000 and 1999, respectively. The increase in gross R&D dollars in fiscal 2001 compared to 2000 reflects our commitment to innovation by hiring additional R&D personnel as well as by the acquisitions of Burleigh Instruments and EXFO Photonic Solutions. Taking into account these acquisitions, we added 95 employees to our R&D departments in fiscal 2001, supporting our continued focus on innovative product development. Our sustained efforts in R&D allowed us to launch more than 20 new products in 2001. Altogether, 46% of our sales in fiscal 2001 originated from products that have been on the market for two years or less. This figure confirms our dedication to innovation and our anticipation of customers' needs and expectations.

The decrease, as percentage of sales, in fiscal 2001 compared to 2000 is mainly due to the fact that sales increased at a faster rate than R&D expenses during this period.

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The increase in R&D dollars in fiscal 2000 compared to 1999 reflects the hiring of additional personnel to develop new products and enhance current ones. During fiscal 2000, we added 45 employees to our R&D Department.

Tax credits and grants from federal, provincial and state governments for R&D activities were \$4.0 million, \$3.0 million and \$2.1 million for fiscal 2001, 2000 and 1999, respectively. The increase in tax credits and grants in fiscal 2001 compared to 2000 is directly related to the hiring of additional R&D personnel as well as the impact of the EXFO Photonic Solutions acquisition. The increase in tax credits and grants in fiscal 2000 compared to 1999 is the result of hiring additional R&D personnel.

Tax credits and grants, as a percentage of gross R&D expenses, were 22.7%, 31.7% and 32.5% for fiscal 2001, 2000 and 1999, respectively. The decrease in fiscal 2001 compared to 2000 is related to a reduction in the effective tax credit rate and grants on R&D carried out in Canada. It should be

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noted that R&D carried out by US-based Burleigh Instruments is not eligible for tax credits. As a result, the gross R&D percentage was further reduced in fiscal 2001.

In terms of net R&D expenses, they amounted to 9.3%, 8.9% and 10.2% of sales for fiscal 2001, 2000 and 1999, respectively. We expect to continue investing heavily in R&D in the upcoming year, reflecting our focus on innovation and our desire to exceed our customers' needs and expectations.

AMORTIZATION OF INTANGIBLE ASSETS

In conjunction with the acquisitions of Burleigh Instruments and EXFO Photonic Solutions, we recorded \$54.7 million in intangible assets primarily consisting of core technology. These intangible assets, which are amortized over periods from five months to five years, resulted in an amortization expense of \$9.9 million in fiscal 2001.

NON-RECURRING EXPENSES

In June 2001, we implemented a structured plan to reduce costs and increase efficiency in order to align our cost structure to market conditions and be better positioned amidst a challenging environment.

Under this plan, we incurred non-recurring expenses of \$3.3 million, including \$0.8 million in severance expenses for the 245 employees who were terminated and \$2.5 million in unused facilities and assets. No such expenses were incurred in fiscal 2000 and 1999.

This plan should enable us to reduce our operating expenses by approximately \$8 million in fiscal 2002.

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INTEREST INCOME, NET

Interest income amounted to \$6.1 million, \$1.5 million and \$0.1 million for fiscal 2001, 2000 and 1999, respectively. The increase in our interest income results solely from short-term investments of the remaining net proceeds of our Initial Public Offering on June 29, 2000. The increase in interest income is somewhat offset by interest expenses and bank charges related to borrowings under our lines of credit. Our interest income will decrease in fiscal 2002 because we used short-term investments to pay for cash considerations in recent acquisitions and because interest rates may continue to drop.

FOREIGN EXCHANGE GAIN (LOSS)

Foreign exchange gain amounted to \$3.3 million in fiscal 2001 compared to foreign exchange losses of \$0.7 million in 2000 and \$0.5 million in 1999.

The foreign exchange gain in fiscal 2001 can be mostly attributed to the disposal of short-term investments denominated in US dollars and to the foreign exchange impact on operating activities of Canadian entities denominated in currencies other than the Canadian dollar. Foreign exchange losses incurred in fiscal 2000 and 1999 are solely due to the foreign exchange impact on operating activities of Canadian entities denominated in currencies other than the Canadian dollar.

INCOME TAXES

Our effective income tax rates were 34.1%, 34.1% and 30.0% for fiscal 2001, 2000 and 1999, respectively. Our effective income tax rate was flat in

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fiscal 2001 compared to 2000. The increase from fiscal 1999 to 2000 can be attributed to a decrease in our manufacturing and processing deduction.

AMORTIZATION OF GOODWILL

In conjunction with the acquisitions of Burleigh Instruments and EXFO Photonic Solutions, we recorded \$248.5 million in goodwill. Goodwill, which is amortized over five years, resulted in an amortization expense of \$31.1 million in fiscal 2001.

NET EARNINGS (LOSS)

Net loss amounted to \$15.3 million in fiscal 2001 compared to net earnings of \$9.9 million in 2000 and \$5.8 million in 1999. In terms of per share amounts, we recorded a net loss of \$0.29 in fiscal 2001 compared to net earnings of \$0.25 in 2000 and \$0.14 in 1999.

ADJUSTED NET EARNINGS

As a measure to assess financial performance, we use adjusted net earnings and adjusted net earnings per share. Adjusted net earnings represent net earnings excluding amortization of goodwill and the after-tax effect of amortization of intangible assets and non-recurring

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expenses. Adjusted net earnings amounted to \$24.5 million, \$10.3 million and \$5.8 million in fiscal 2001, 2000 and 1999, respectively. In terms of adjusted net earnings per share, it reached \$0.46, \$0.26 and \$0.14 in fiscal 2001, 2000 and 1999, respectively.

LIQUIDITY AND CAPITAL RESOURCES

Prior to our Initial Public Offering, we had financed operations and met our capital expenditure requirements mainly through cash flows from operations, research and development tax credits and government grants. On June 29, 2000, we closed our Initial Public Offering of 8,050,000 subordinate voting shares at a price of US\$26.00 per share in the United States and Cdn\$38.55 per share in Canada. Total proceeds, including the over-allotment option exercised by the underwriters, were approximately US\$209 million.

CASH POSITION AND SHORT-TERM INVESTMENTS

As at August 31, 2001, cash and cash equivalents as well as short-term investments consisted of \$74.6 million. Our working capital was at \$130.3 million. The announced acquisition of Avantas Networks Corporation will be partially financed with \$8.0 million of cash on hand.

OPERATING ACTIVITIES

Cash flows provided by operating activities were \$3.1 million in fiscal 2001 compared to cash flows used of \$4.0 million in 2000 and cash flows provided of \$3.7 million in 1999. Cash flows provided by operating activities in fiscal 2001 were primarily due to net earnings after items not affecting cash and cash equivalents of \$24.5 million. This figure was mainly offset by an increase of \$20.3 million in inventories required to ensure minimal manufacturing and delivery lead times.

Cash flows used in operating activities in fiscal 2000 were primarily due to net earnings after items not affecting cash and cash equivalents of \$10.9 million. This figure was mainly offset by an increase of \$10.5 million in

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accounts receivable, resulting from higher volumes of sales and \$10.7 million in inventories that were required to ensure minimal manufacturing and delivery lead times.

The major items not affecting cash and cash equivalents consisted of net amortization expenses of \$43.9 million for fiscal 2001 and \$1.0 million for 2000.

FINANCING ACTIVITIES

Cash flows used in financing activities were \$4.6 million in fiscal 2001 compared to cash flows provided of \$172.9 million in 2000 and cash flows used of \$3.3 million in 1999. Cash flows used in financing activities in fiscal 2001 were mainly due to the repayment of bank advances and long-term debt of \$5.4 million. Considering these repayments, we have available credit facilities as at August 31, 2001 that provide for advances of up to \$11.4 million under lines of credit. These lines of credit bear interest at prime rate.

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Cash flows provided by financing activities in fiscal 2000 were the result of the net proceeds of our Initial Public Offering of \$192.9 million less the dividends paid of \$17.6 million. Cash flows used in financing activities in fiscal 1999 were due to the payment of \$3.2 million in dividends that were declared that year. We do not foresee payments of additional dividends during the next three fiscal years.

INVESTING ACTIVITIES

Cash flows provided by investing activities were \$9.2 million in fiscal 2001 compared to cash flows used of \$169.0 million in 2000 and \$1.2 million in 1999.

In fiscal 2001, we disposed of \$93.4 million in short-term investments to finance the \$15.9 million purchase of property, plant and equipment as well as to pay the cash consideration of \$68.3 million for the Burleigh Instruments and EXFO Photonic Solutions acquisitions. Despite these investments, the disposal of short-term investments generated net cash flows of \$9.2 million in fiscal 2001.

The purchases of \$159.8 million in short-term investments from the net proceeds of our Initial Public Offering and of \$7.2 million in property, plant and equipment explain the use of cash flows for investing activities in fiscal 2000. In fiscal 1999, the purchase of \$1.2 million in property, plant and equipment explain the use of cash flows in investing activities. As at August 31, 2001, property, plant and equipment amounted to \$27.1 million, while intangible assets and goodwill related to the acquisitions of Burleigh instruments and EXFO Photonic Solutions totalled \$264.2 million, net of related accumulated amortization.

OUTLOOK

We believe that our existing cash balances and short-term investments, together with cash flows from operations and available credit facilities, will be sufficient to meet our expected liquidity and capital requirements for the upcoming year, taking into account the cash consideration to be paid for the previously announced acquisition of Avantas Networks. However, possible investments in or acquisitions of complementary businesses, products or technologies may require additional financing prior to such time. There can be no assurance that additional debt or equity financing will be available when required or, if available, it can be secured on terms satisfactory to us.

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NEW ACCOUNTING STANDARDS

On August 1, 2001, the Canadian Institute of Chartered Accountants issued section 1581 "Business Combinations," which supersedes section 1580, and issued section 3062 "Goodwill and Other Intangible Assets." Section 1581 requires business combinations initiated after June 30, 2001 or business combinations accounted for by the purchase method with a date of acquisition after June 30, 2001, to be accounted for using the purchase method of accounting. This section also broadens criteria for recording intangible assets separately from goodwill. Upon the adoption of section 3062, recorded goodwill and intangible assets will be evaluated against these new criteria and may result in certain intangible assets being reclassified into

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goodwill or, alternatively, amounts initially recorded as goodwill being separately identified and recognized apart from goodwill as intangible assets. Section 3062 requires the use of a non-amortization approach to account for purchased goodwill and indefinite-lived intangibles. Under the non-amortization approach, goodwill and indefinite-lived intangibles will not be amortized, but instead they will be reviewed for impairment and written down and charged to earnings only in the periods in which the recorded value of goodwill and indefinite-lived intangibles exceed their fair value. This section will be adopted on September 1, 2002.

The impact of adopting section 3062 will allow us to use the non-amortization approach for goodwill and will reduce annual goodwill amortization by approximately \$50 million. Moreover, we will implement a new goodwill impairment methodology and any potential initial impairment losses on goodwill determined by this methodology will be charged to deficit. Any subsequent impairment losses on goodwill will be charged to earnings in the period in which it is incurred.

Under US GAAP, any potential initial impairment losses on goodwill determined by this methodology will be charged to earnings.

For more details on new US accounting standards, see note 19 to our consolidated financial statements.

RISKS AND UNCERTAINTIES

Over the past few years, we have been successful in maintaining a strong rate of growth by effectively managing our activities, by focusing on the research and development of new and innovative products, by penetrating international markets, by seeking and closing important strategic acquisitions and, finally, by attracting and retaining highly skilled employees. However, we operate in a highly competitive field 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 policies.

The main risks and uncertainties related to the fiber-optic test, measurement and automation industry involve the quick development of new products that have short lifecycles and require extensive research and development; the difficulty of attracting and retaining highly skilled employees as well as offering them effective training programs; and the ability to quickly adapt our cost structure to changing market conditions in order to maintain or increase our growth.

In addition, given our strategic goals for growth and competitive positioning in our industry, we are expanding into international markets. This

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exposes us to certain risks and uncertainties related to changes in local laws and regulations, multiple technological standards, protective legislation and pricing pressure.

Furthermore, while the important strategic acquisitions we have made are essential to our long-term growth, they also expose us to certain risks and uncertainties related to the rapid

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and effective integration of these companies as well as their products, technologies and personnel.

We are also exposed to currency risks as a result of the export of our products manufactured in Canada, substantially all of which are denominated in US dollars. These risks are partially hedged by the operating expenses of certain international subsidiaries, the purchase of raw materials in US dollars and forward exchange contracts. (See note 18 to our consolidated financial statements).

Also, an economic slowdown in our industry could result in some of our customers experiencing difficulties and, consequently, this could have a negative effect on our results. 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 principally of cash and cash equivalents, short-term investments and forward exchange contracts. Our short-term investments consist of debt instruments issued by high-credit quality financial institutions and corporations and units of a low-risk mutual fund. Our cash and cash equivalents 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 remote. (See Item 3 for a list of risk factors).

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ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. DIRECTORS AND SENIOR MANAGEMENT

The following table sets forth information about our executive officers, senior managers and directors as of December 31, 2001.

NAME AND MUNICIPALITY OF RESIDENCE	POSITIONS WITH EXFO
GERMAIN LAMONDE Cap-Rouge, Quebec	Chairman of the Board, President and Chief Executive Officer
PIERRE PLAMONDON, CA Quebec City, Quebec	Vice-President, Finance and Chief Financial Officer
MARIO LAROSE Laval, Quebec	Vice-President, Marketing
STEPHEN BULL Lac-Beauport, Quebec	Vice-President, Research and Development

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JEAN-FRANCOIS BOULET Montmagny, Quebec	Vice-President, Human Resources
BRUCE BONINI Fairview, Texas	Vice-President, North American Sales
JUAN-FELIPE GONZALEZ Singapore	Vice-President, International Sales
GREGORY SCHINN Quebec City, Quebec	Chief Technology Officer
PIERRE MARCOUILLER Magog, Quebec	Director
DAVID A. THOMPSON Horseheads, New York	Director
ANDRE TREMBLAY Outremont, Quebec	Director
MICHAEL UNGER Woodbridge, Ontario	Director
KIMBERLEY ANN OKELL Quebec City, Quebec	Secretary and Legal Counsel

The address of each of our executive officers, senior managers and directors is c/o EXFO Electro-Optical Engineering Inc., 465 Godin Avenue, Vanier, Quebec, Canada. The following is a brief biography of each of our executive officers, senior managers and directors.

GERMAIN LAMONDE is one of our founders. Germain Lamonde has been our Chairman of the Board, President and Chief Executive Officer since our inception in 1985. Mr. Lamonde holds a bachelor's degree in Physics Engineering from Ecole Polytechnique, University of Montreal in Canada and a master's degree in Optics from Laval University in Canada.

PIERRE PLAMONDON has been our Vice-President, Finance and Chief Financial Officer since January 1996 and was a director from December 1999 to May 2000. Prior to joining us, Mr. Plamondon served as senior manager for Price Waterhouse, now PricewaterhouseCoopers LLP, from September 1981 to December 1995 in Canada and France. Mr. Plamondon holds a bachelor's degree in Business Administration and a license in Accounting, both from Laval

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University in Canada. Mr. Plamondon has been a member of the Canadian Institute of Chartered Accountants since 1983.

MARIO LAROSE was appointed Vice-President, Marketing on June 7, 2000. Prior to joining us, Mr. Larose was Interim General Manager with C-MAC Corporation, a manufacturer of microelectronic products, from September 1999 to January 2000. Prior to the acquisition by C-MAC of L.G. Technologies Ltee, Mr. Larose held the position of Vice-President, Marketing and Sales with L.G. Technologies Ltee, a sub-contract electronic manufacturer from January 1998 to September 1999. Prior to that, Mr. Larose was Vice-President, Engineering with Unican Security Systems Limited, a public security systems manufacturer, from August 1995 to December 1997. Prior to joining Unican, Mr. Larose held various positions with Northern Telecom, now Nortel Networks Limited, a provider of

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telephony, data, wireless and wire-line solutions for the Internet. Mr. Larose is President and a shareholder of LAMA2 inc., a private management consulting company. Mr. Larose holds a bachelor's degree in Applied Sciences, Engineering Physics from Ecole Polytechnique, University of Montreal in Canada and a master's in Business Administration from Universite du Quebec a Montreal in Canada.

STEPHEN BULL was appointed our Vice-President, Research and Development in December 1999. He joined us in July 1995 and held the positions of Assistant Director-Engineering from September 1997 to December 1999 and Group Leader (Engineering Management) from July 1995 to September 1997. From June 1990 to March 1995, Mr. Bull held the position of General Manager and Managing Director for Space Research Corporation, a military engineering company in Belgium. Mr. Bull holds a bachelor's degree in Electrical Engineering from Laval University in Canada.

JEAN-FRANCOIS BOULET joined us in March 2000 as Vice-President, Human Resources. Mr. Boulet was formerly employed by Societe de portefeuille du Groupe Desjardins -- Assurances Generales since 1996 where he had been successively Senior Vice-President, Human Resources and Senior Vice-President, Human Resources and Corporate Communications. From 1992 to 1996, Mr. Boulet held different senior management positions related to human resources and organizational development for Inglis Limited, a leading manufacturer of home appliances. Mr. Boulet holds a bachelor's degree in Industrial Relations from Laval University in Canada.

BRUCE BONINI has been our Vice-President, North American Sales since December 1998. Prior to joining us, Mr. Bonini held the position of Vice-President Sales-Eastern Region for Wandel & Golterman, now Wavetek Wandel & Golterman, a company specializing in communications test solutions, from September 1997 to December 1998. Mr. Bonini was successively Sales Director and Vice-President of Sales for Digital Lightwave Inc., a synchronous optical network test equipment manufacturer, from August 1996 to January 1997. From August 1987 to August 1996, Mr. Bonini held different sales and senior management positions for Laser Precision Corporation, an optical test equipment manufacturer. Following the acquisition of Laser Precision by GN Nettest, Mr. Bonini was named Global Vice-President of Sales for GN Nettest/Fiber-Optics Division. Mr. Bonini holds a bachelor's degree in Business Administration (industrial marketing) from Western Michigan University in the United States.

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JUAN-FELIPE GONZALEZ has been our Vice-President, International Sales since September 1998. From January 1997 to September 1998, he was our International Sales Director and, from September 1993 to January 1997, our Sales Manager for Latin America and the Caribbean. Prior to joining us in September 1993, Mr. Gonzalez was Marketing and Sales Director at Reyde, Barcelona, a plastics technical product corporation in Spain. Mr. Gonzalez holds a bachelor's degree in Industrial Chemistry from Complutense University of Madrid in Spain and a master's degree in Business Administration from the School of Industrial Organization in Spain.

GREGORY SCHINN was appointed our Chief Technology Officer in November 1999, after simultaneously holding the positions of Scientific Director and Head of the Research Group since joining us in April 1996. Prior to joining us, Dr. Schinn led the research and development team responsible for optical amplifier and fiber laser development at MPB Technologies, Inc., a diversified technology company, in Montreal from 1990 to 1996. Dr. Schinn holds a bachelor's degree in Engineering Science and a master's degree in Aerospace Engineering from the University of Toronto. He also holds a Ph.D. in Physics from the University of Colorado at Boulder and has spent two years as a post-doctoral research

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associate at the University of Virginia. Dr. Schinn has been published in numerous scientific journals and he has served on the technical organizing committees of several international scientific conferences. He is currently the Director of the Division of Applied Physics of the Canadian Association of Physicists.

PIERRE MARCOUILLER has served as our director since May 2000. Mr. Marcouiller is Chairman of the Board and Chief Executive Officer of Camoplast Inc., a supplier of components to the recreational and motorized vehicle and automotive parts markets. He is the founder and has been sole shareholder of Nexcap Inc., an investment company in the manufacturing sector, since December 1996. Mr. Marcouiller worked with Venmar Ventilation Inc., a private ventilation equipment manufacturer, from January 1983 to December 1996. Mr. Marcouiller was the controlling shareholder of Venmar from 1991 to 1996 and held the position of President and General Manager of Venmar from December 1986 to December 1996. Mr. Marcouiller is also a director of Heroux-Devtek Inc., a publicly traded company that manufactures aerospace and industrial turbines, and holds directorships in other privately held companies. Mr. Marcouiller holds a bachelor's degree in Business Administration from Universite du Quebec a Trois-Rivieres in Canada and a Master in Business Administration from Sherbrooke University in Canada.

DAVID A. THOMPSON has served as our director since June 2000. He has held various positions with Corning Inc., a manufacturer of optical fiber and other products for the telecommunications, television and other communications-related industries, since 1976. Mr. Thompson was the Director -- Technology and Strategy of Corning's Components Business-Photonic Technologies since March 1995, after which he acted as Director, Operations and Project Management for the Optical Physics Technology Directorate and in February 2001, he was named Division Vice President Strategy and Innovation. Mr. Thompson holds a bachelor's degree in Chemistry from the Ohio State University, in the United States, and a doctorate in Inorganic Chemistry from the University of Michigan, in the United States.

ANDRE TREMBLAY has served as our director since May 2000. He has been President and Chief Executive Officer of Microcell Telecommunications Inc., a wireless telecommunications

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provider, since May 1995. Mr. Tremblay has been a member of the board of directors of Microcell since November 1995. In addition, Mr. Tremblay is a member of the executive committee and a member of the board of directors of Telesystem Ltd. and, since 1992, Executive Vice-President of Telesystem Ltd. Prior to joining Telesystem Ltd., a privately-held holding company, Mr. Tremblay was a tax partner and member of the management committee of Raymond, Chabot, Martin, Pare, a Canadian accounting firm. Mr. Tremblay is also a member of the Boards of Directors of Telesystem International Wireless Inc., a global mobile communications company; Boomerang Tracking Inc., a publicly traded company that assembles, markets and distributes a cellular-based asset tracking system; and SignalGene Inc., a genomics-based drug discovery company. Mr. Tremblay holds a bachelor's degree in Business Administration and a license in Accounting from Laval University in Canada, as well as a master's degree in taxation from Sherbrooke University in Canada. He also completed the Advanced Management Program offered by the Harvard Business School in the United States.

MICHAEL UNGER has served as our director since May 2000. He worked with Nortel Networks Limited, now Nortel Networks Corporation, from 1962 to 2000. Mr. Unger's most recent position was President of Nortel's Optical Networks Business Unit, a position he held from May 1998 to April 2000. Prior to this appointment, Mr. Unger was Nortel's Group Vice-President, Transport Networks from March 1990 to May 1998. Mr. Unger also serves on the board of Tundra Semiconductor

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Corporation a publicly traded company with its shares listed on The Toronto Stock Exchange that designs, develops and markets networking and network access technology for use by communications infrastructure equipment companies. He is also a member of the boards of a number of privately-held companies active in the areas of photonic and optical components, optical network systems and solutions for cable operators and other communications service providers. Mr. Unger holds a bachelor's degree in Science from Concordia University in Canada.

KIMBERLEY ANN OKELL has been our in-house legal counsel since February 2000 and our Secretary since May 2000. Prior to joining us, Ms. Okell was Vice-President Legal Affairs and Secretary with Groupe Equiconcept Inc. from October 1999 to February 2000 and Director of Legal Services and Secretary with Informission Group Inc., now nurun Inc., an information technology company, from December 1997 to October 1999. Prior to that, Ms. Okell was an associate with the law firm McCarthy Tetrault from August 1994 to December 1997. Ms. Okell has been a member of the Quebec Bar since September 1993. Ms. Okell holds a bachelor's degree in Civil Law from Laval University in Canada, a bachelor's degree in Common Law from The University of Western Ontario in Canada and an Honors bachelor of Arts degree from York University in Canada.

TERM OF EXECUTIVE OFFICERS

Executive officers are appointed annually by the board of directors and serve until their successors are appointed and qualified or until earlier resignation or removal.

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B. COMPENSATION

DIRECTOR COMPENSATION

In the financial year terminated August 31, 2001, our directors who are not officers or employees received annual compensation of C\$18,000 comprised of cash, the equivalent value of our subordinate voting shares under our directors' compensation plan or options to purchase some of our subordinate voting shares under our stock option plan. Directors who are also committee members received additional annual compensation of C\$3,000 per committee and committee chairpersons received C\$5,000 annually comprised of cash, the equivalent value of our subordinate voting shares under our directors' compensation plan or options to purchase some of our subordinate voting shares under our stock option plan. Fees of C\$1,000 (US\$655) for each meeting of the Board of Directors or of a Committee attended by them in person and fees of C\$500 (US\$327) if such participation was made by telephone were also paid. All directors will be reimbursed for traveling and other expenses incurred in connection with attendance at meetings.

As partial remuneration for the financial year ended August 31, 2001, a total of 20,359 options were granted under our Stock Option Plan in October 2001 to directors who are not employees.

For the financial year commencing September 1, 2001, the annual compensation of directors who are not officers or employees was increased to C\$25,000 payable by way of cash, the equivalent value of our subordinate voting shares under our director's compensation plan or options to purchase some of our subordinate voting shares under our stock option plan. In addition, such directors each received 12,500 options under our stock option plan as partial compensation for the financial year commencing September 1, 2001.

EXECUTIVE COMPENSATION

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The table below shows certain compensation information for Mr. Germain Lamonde, the President and Chief Executive Officer of the Corporation, and the four other most highly compensated executive officers of the Corporation and its subsidiaries during the financial year ended August 31, 2001 (collectively, the "Named Executive Officers"). This information includes the US dollar value of base salaries, bonus awards and long term incentive plan payments, the number of options granted, and certain other compensation, if any, whether paid or deferred.

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SUMMARY COMPENSATION TABLE

NAME AND PRINCIPAL POSITION	FINANCIAL YEAR	SALARY (US\$)	BONUS (1) (US\$)	OTHER ANNUAL COMPENSATION (US\$)	SECUR UND OPTION
Germain Lamonde, President and Chief Executive Officer	2001	180,044	99,024	-	5,0
	2000	134,932	63,566	-	25,4
Bruce Bonini, Vice-President, North American Sales	2001	272,678 (4)	33,450	-	82,7
	2000	309,801	20,000	-	3,9
Juan-Felipe Gonzalez, Vice-President, International Sales	2001	204,781 (5)	129,629 (8)	-	45,6
	2000	153,502	15,879	-	6,9
David J. Farrell, President, Burleigh Instruments, Inc.	2001	184,500 (6)	16,326 (9)	-	40,0
William S. Gornall, Vice-President of Technology, Burleigh Instruments, Inc.	2001	135,000 (7)	11,874 (9)	-	30,0

(1) A portion of the bonus amounts is paid in cash in the year for which they are awarded and the balance is paid in cash in the year following the financial year for which they are awarded.

(2) Indicates the number of Subordinate Voting Shares underlying the options granted under the Stock Option Plan during the financial year indicated.

(3) Indicates the amount contributed by the Corporation during the financial year indicated to the Deferred Profit Sharing Plan or the 401K plans, as applicable, for the benefit of the Named Executive Officer. Mr. Lamonde is not eligible to participate in the Deferred Profit Sharing Plan and Mr. Gonzalez did not participate.

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- (4) This amount includes an amount of US\$28,654 paid as a retroactive adjustment to salary for the financial year ended August 31, 2000.
- (5) This amount includes an amount of US\$4,935 paid as a retroactive adjustment to salary for the financial year ended August 31, 2000.
- (6) This amount represents Mr. Farrell's base annual salary. Since he joined the Corporation on December 20, 2000, the base salary paid to him for the financial year ended August 31, 2001 amounted to US\$134,097.
- (7) This amount represents Mr. Gornall's base annual salary. Since he joined the Corporation on December 20, 2000, the base salary paid to him for the financial year ended August 31, 2001 amounted to US\$99,193.
- (8) This amount includes an amount of US\$2,771 paid as a retroactive adjustment to bonus for the financial year ended August 31, 2000.
- (9) These are the amounts paid or payable for the financial year ended August 31, 2001 to Messrs Farrell and Gornall, as applicable, since December 20, 2000, the date that they joined the Corporation.

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The following table indicates additional information on the options granted to our Named Executive Officers during the 2001 fiscal year.

NAME	SECURITIES UNDER OPTIONS GRANTED (1) (#)	PERCENTAGE OF NET TOTAL OF OPTIONS GRANTED TO EMPLOYEES IN FINANCIAL YEAR (%)	EXERCISE OR BASE PRICE (2) (US\$/ SECURITY)	MARKET VALUE OF SECURITIES UNDERLYING OPTIONS ON THE DATE OF GRANT (US\$/SECURITY) (3)
Germain Lamonde	5,080	0.28 %	\$22.25	\$23.56
Bruce Bonini	20,000	1.10 %	\$45.94	\$48.19
	30,000	1.67 %	\$34.07	\$36.88
	32,780	1.82 %	\$22.25	\$23.56
Juan-Felipe Gonzalez	15,000	0.83 %	\$45.94	\$48.19
	15,000	0.83 %	\$34.07	\$36.88
	15,630	0.87 %	\$22.25	\$23.56
David J. Farrell	40,000	2.22 %	\$22.62	\$19.69
William S. Gornall	30,000	1.67 %	\$22.62	\$19.69

(1) Underlying securities: Subordinate Voting Shares.

(2) The exercise price of options granted is determined based on the highest of the closing prices of the Subordinate Voting Shares on The Toronto Stock

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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 on the grant date to convert the NASDAQ National Market closing price to Canadian dollars, as required.

- (3) Based on the closing price on the NASDAQ National Market on the date of the grant.

EMPLOYMENT AGREEMENTS

We have an employment agreement with Germain Lamonde. The agreement provides for Mr. Lamonde's employment as President and Chief Executive Officer at a base salary applicable from September 1, 2000 to August 31, 2001 of C\$275,000 (approximately \$180,044) per year. In addition, a bonus of C\$137,500 (approximately \$90,022) will be payable if performance-based objectives are met. If performance objectives are exceeded, such bonus will be greater in a proportional amount. The agreement is for an indeterminate period and the salary is reviewed annually. In the event of the termination of Mr. Lamonde's employment other than for cause, Mr. Lamonde will be entitled to severance payments (in no case exceeding 24 months of remuneration) and the vesting of all stock options. In addition, in the event that Mr. Lamonde's employment is terminated following a merger or an acquisition by a third party of substantially all of our assets or of the majority of our share capital or if Mr. Lamonde voluntarily resigns, he will be entitled to the vesting of all stock options.

We also have employment agreements with Mr. Bruce Bonini and Mr. Juan-Felipe Gonzalez, and Burleigh has employment agreements with David J. Farrell and William S. Gornall.

The agreement with Mr. Bonini provides for Mr. Bonini's employment as Vice-President, North American Sales at a base salary of \$145,000, plus commissions of \$100,000 if sales objectives are met, for the period from September 1, 2000 to August 31, 2001. If sales objectives are exceeded, commissions will be greater. The agreement is for an indeterminate period and

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salary is reviewed annually. In addition, bonuses totaling \$39,000 will be payable if various performance-based objectives are met. If performance objectives are exceeded, such bonus will be greater in a proportional amount. In the event Mr. Bonini's employment terminates for any reason whatsoever and he is unable to accept new employment due to his non-competition obligations to us, Mr. Bonini may receive compensation for a period of 18 months following the date of termination in amounts varying from 5% to 125% of his base monthly salary at the time of termination depending on the cause of the termination.

The agreement with Mr. Gonzalez provides for Mr. Gonzalez's employment as Vice-President International Sales at a base salary of \$110,000, plus commissions on sales of \$72,540, for the period from September 1, 2000 to August 31, 2001. If sales objectives are exceeded, commissions will be greater. Upon Mr. Gonzalez's move to Singapore, effective March 1, 2001, the agreement provides that the annual base salary is \$120,753 to take into account cost of living differences. The agreement is for an indeterminate period and salary is reviewed annually. In addition, bonuses totaling \$140,500 will be payable if various performance-based objectives are met. If performance objectives are exceeded, such bonus will be greater in a proportional amount. In addition, Mr. Gonzalez shall be paid a bonus of C\$750,000 if he has not voluntarily resigned or been dismissed with cause prior to September 2003. In the event Mr. Gonzalez's employment terminates for any reason whatsoever and he is unable to accept new employment due to his non-competition obligations to us, Mr. Gonzalez

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may receive compensation for a period of 18 months following the date of termination in amounts varying from 5% to 50% of his base monthly salary at the time of termination depending on the cause of the termination.

The agreement between Burleigh and Mr. Farrell provides for Mr. Farrell's employment as President of Burleigh at an annual base salary of \$184,500. In addition, a bonus of \$16,326 was payable based on Burleigh's performance for the financial year ended August 31, 2001. The agreement is for an indeterminate period and salary is reviewed annually. In the event of termination of Mr. Farrell's employment other than for cause, Mr. Farrell will be entitled to severance payments equivalent to 6 months of remuneration. In the event of Mr. Farrell's termination due to a merger or acquisition by a third party of substantially all of Burleigh's assets or of the majority of its share capital, Mr. Farrell shall be entitled to severance benefits ranging from 6 to 12 months of remuneration, based on his length of service with Burleigh since such merger or acquisition.

The agreement between Burleigh and Mr. Gornall provides for Mr. Gornall's employment as Vice-President of Technology of Burleigh at an annual base salary of \$135,000. In addition, a bonus of \$11,874 was payable based on Burleigh's performance for the financial year ended August 31, 2001. The agreement is for an indeterminate period and salary is reviewed annually. In the event of termination of Mr. Gornall's employment other than for cause, Mr. Gornall will be entitled to severance payments equivalent to 6 months of remuneration. In the event of Mr. Gornall's termination due to a merger or acquisition by a third party of substantially all of Burleigh's assets or of the majority of its share capital, Mr. Gornall shall be entitled to severance benefits ranging from 6 to 12 months of remuneration, based on his length of service with Burleigh since such merger or acquisition.

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STOCK OPTION PLAN

We have a stock option plan for our directors, executive officers, employees and consultants and those of our subsidiaries as determined by our board of directors, to attract and retain competent directors, executive officers, employees and consultants motivated to work toward ensuring our success and to encourage them to acquire our shares.

All of the options that will be granted under the plan must be exercised within a maximum period of ten years following the grant date of the options or they will be forfeited. The board of directors will designate the recipients of options and determine the number of subordinate voting shares covered by each of these options, the date of vesting of each option, the exercise price of each option, the expiry date and any other conditions relating to these options, in each case in accordance with the applicable legislation of the securities regulatory authorities. The price at which the subordinate voting shares may be purchased under the plan will not be lower than the highest of the closing prices of the subordinate voting shares on the stock exchanges where the subordinate voting shares are listed at the date preceding the date of grant.

The maximum number of subordinate voting shares that is issuable under the plan may not exceed 4,470,961 shares, which represents 7.3 % of our issued and outstanding share capital as at December 31, 2001. The maximum number of subordinate voting shares that may be granted to any individual may not exceed 5% of the outstanding subordinate voting shares. The board of directors may accelerate the vesting of any or all outstanding options of any or all options upon the occurrence of a change of control.

The aggregate number of subordinate voting shares covered by options

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granted during the financial year ended August 31, 2001 was 1,804,497 (net of cancelled options due to employment terminations) at a weighted average exercise price of \$29.00 (C\$44.29) per subordinate voting share. At the end of the financial year ended August 31, 2001, there were 2,414,231 subordinate voting shares covered by options granted and outstanding pursuant to the stock option plan. Following these grants, and net of cancelled options for departures, as of August 31, 2001, there were 2,056,730 options available for future grants under the plan. Since August 31, 2001 we have made the following grants to directors and employees: September 1, 2001: 60,980 options, October 10, 2001: 506,259 options, November 2, 2001: 250,000 options and December 3, 2001: 42,437 options.

Except for certain options granted to non-employee directors of the Corporation, options vest on a cumulative basis at a rate of 25 % annually commencing on the first anniversary date of their grant and may be exercised in whole or in part once vested. Some options granted to non-employee directors vest on the first anniversary date of their grant and may be exercised in whole or in part once vested.

In the financial year ended August 31, 2000 we had commenced a process to obtain approval for the re-pricing of options granted to employees and consultants on September 1, 2000, on September 13, 2000 and on October 11, 2000, in the respective amounts of 122,908, 313,835 and 75,000 to purchase the same amounts of subordinate voting shares at the price of

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C\$83.66, C\$68.17 and C\$51.25 respectively. Prior to obtaining shareholder approval and final approval from NASDAQ and The Toronto Stock Exchange, we learned that such re-pricing would have future negative tax implications for a large number of our employees. Management therefore withdrew its request for shareholder approval and aborted the re-pricing process.

SHARE PLAN

In September 1998, we established a stock purchase plan for officers, directors and key employees as amended in April 2000. A total of 707,264 subordinate voting shares were issued and fully paid under the 1998 Stock Purchase Plan, having a weighted average cash consideration of C\$0.98 per share. The plan provides that all shares issued under the plan are restricted as to sale and transferability for a minimum period of five years upon the date of acquisition.

On April 3, 2000, we adopted a new share plan that replaced the 1998 Stock Purchase Plan. No additional shares will be issued under the new share plan. The new share plan established restrictions on the rights of the holders of subordinate voting shares who hold those shares as a result of the conversion of the Class "F" shares issued under the 1998 Stock Purchase Plan. The new share plan also requires the subordinate voting shares to be held in trust by a trustee until August 31, 2004, except for 256,017 subordinate voting shares that will be released between October 21, 2003 and January 20, 2004. The new share plan also provides for the earlier release of shares in the event that the employment of a holder of shares is terminated or upon the occurrence of a change of control. The new share plan does not permit any transfer, except within the trust to a registered retirement savings plan or a registered retirement income fund or to a trustee in bankruptcy. The new share plan also established the conditions pursuant to which the shares of a shareholder are to be sold by the trustee on the public market. As of August 31, 2001, 663,265 subordinate voting shares were being held in trust under the new share plan.

RESTRICTED STOCK AWARD PLAN

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The EXFO Electrical-Optical Engineering Restricted Stock Award Plan (the "Plan") was established to provide a means through which employees of Burleigh can be granted awards of restricted shares ("Restricted Shares") of our subordinate voting shares to promote retention and foster identity of interest between our stockholders and employees of Burleigh.

The effective date of the Plan is December 20, 2000. The expiration date of the Plan is the business day next following the final grant of Restricted Shares under the Plan. However, the administration of the Plan shall continue until all awards of Restricted Shares have been forfeited or settled. The aggregate number of shares subject to the Plan is 360,000. Grants of Restricted Shares are to be made in accordance with a pre-determined schedule. The Plan is administered by the committee that is designated to administer our Stock Option Plan.

Awards of Restricted Shares are subject to forfeiture and restrictions on transfer until the Restricted Shares become vested at which point a stock certificate will be issued to a participant with respect to the number of vested shares, which are then freely transferable. Restricted Shares become vested, subject to a participant's continued employment with the Company or its

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affiliates, on each of the first four anniversaries of the date of grant of an award of Restricted Shares. On December 20, 2001, we issued an aggregate of 83,657 subordinate voting shares in accordance with the vesting schedule under the Plan.

Upon a participant's termination of employment with us, or any of our affiliates due to the participant's death, disability or retirement on or after age 60, the participant's award of restricted shares becomes fully vested and is no longer subject to forfeiture. However, the transfer restrictions remain in place until the occurrence of the vesting dates originally contemplated by the award.

Upon the voluntary resignation of a participant, the termination of a participant's employment for cause, the termination of a participant who is not designated a member of Burleigh's "Management Team" without cause prior to a change in control of EXFO or a termination without cause of a participant who is designated a member of Burleigh's Management Team that is initiated by Burleigh prior to a change in control of EXFO, the unvested portion of the participant's award of Restricted Shares will be forfeited.

Upon the termination without cause of a participant who is designated a member of Burleigh's Management Team that is initiated by us or a termination of a participant's employment without cause following a change in control of EXFO, a participant's award of Restricted Stock will become fully vested and all restrictions will lapse.

In the event of a change in control, the committee administering the Plan may in its discretion remove restrictions on Restricted Shares or provide for the cancellation of awards in exchange for payment in respect of the Restricted Shares subject to an award.

STOCK APPRECIATION RIGHTS PLAN

On August 4, 2001, the Corporation established a Stock Appreciation Rights Plan ("SAR Plan") for the benefit of certain employees residing in countries where the granting of options under the Stock Option Plan is not feasible in the opinion of the Corporation. The Board has full and complete authority to interpret the SAR Plan and to establish the rules and regulations

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applying to it and to make all other determinations it deems necessary or useful for the administration of the SAR Plan.

Under the SAR Plan, eligible employees are entitled to receive a cash amount equivalent to the difference between the market price of the subordinate voting shares on the date of exercise and the exercise price determined on the date of grant. No subordinate voting shares are issuable under the SAR Plan.

The Board of Directors has delegated to Management the task of designating the recipients of stock appreciation rights, the date of vesting, the expiry date and other conditions. Under the terms of the SAR Plan, the exercise price of the stock appreciation rights may not be lower than the highest of the closing prices of the subordinate voting shares on The Toronto Stock Exchange and on 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 on the grant

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date to convert the NASDAQ National Market closing price to Canadian dollars. Stock appreciation rights are non-transferable.

The stock appreciation rights vest over a four-year period, with 25% vesting annually commencing on the first anniversary date of the date of grant. Once vested, stock appreciation rights may be exercised between the second and the fifteenth business day following each release of the Corporation's quarterly financial results. All of the stock appreciation rights that are granted under the SAR Plan may be exercised within a maximum period of 10 years following the date of their grant. Any stock appreciation rights granted under the SAR Plan will lapse immediately upon the termination of the relationship with the Corporation or one of its subsidiaries for a good and sufficient cause or at the date on which an employee resigns or leaves his employment with the Corporation or one of its subsidiaries (or within 30 days if the holder is dismissed without cause). In the event of retirement or disability, any stock appreciation right held by an employee lapses 30 days after the date of any such disability or retirement. In the event of death, any stock appreciation right lapses 6 months after the date of death.

As of December 31, 2001, 22,400 SAR's had been granted.

DEFERRED PROFIT SHARING PLAN

Under the plan, we contribute an amount equal to 1% of each employee's gross salary to that employee's individual deferred profit sharing plan to the extent that such employee contributes at least 2% of his or her gross salary to his or her individual tax-deferred registered retirement savings plan. In the year ended August 31, 2001, the aggregate amount of contributions under the plan was \$419,000 (C\$642,000).

401(K) PLANS

We maintain 401(k) plans for eligible United States resident employees of our subsidiaries. Employees become eligible to participate in the 401(k) plans on the first day of the month following the completion of three months of continuous service. Employees may elect to defer their current compensation up to the lesser of 1% of eligible compensation or the statutorily prescribed annual limit and have the deferral contributed to the 401(k) plans. The 401(k) plans permit, but do not require, us to make additional matching contributions to the 401(k) plans 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. In the year ended August 31,

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2001, we made an aggregate of \$285,000 in matching contributions to the 401(k) plans. Contributions by employees or by us to the 401(k) plans and income earned on plan contributions are generally not taxable to the employees until withdrawn and contributions by us are generally deductible by us when made. At the direction of each participant, the trustees of the 401(k) plans invest the assets of the 401(k) plans in selected investment options.

INDEMNIFICATION OF DIRECTORS AND EXECUTIVE OFFICERS AND LIMITATION OF LIABILITY

Our by-laws require us, subject to the limitations provided by law, to indemnify our present or former directors and officers or any persons who act or acted at our request as directors or officers of a body corporate of which we are or were a shareholder and for all costs,

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losses, charges and expenses that arose or may arise by reason of their status as directors or officers of EXFO or such body corporate. A policy of directors' and officers' liability insurance is maintained by us which insures our directors and officers and those of our subsidiaries against liability incurred by, arising from or against them for certain of their acts, errors or omissions.

C. BOARD PRACTICES

BOARD OF DIRECTORS

Our directors are elected at the annual meeting of shareholders for one-year terms and serve until their successors are elected or appointed, unless they resign or are removed earlier. Our articles of incorporation provide for a board of directors of a minimum of three and a maximum of 12 directors. Our board presently consists of five directors. Under the CANADA BUSINESS CORPORATIONS ACT, twenty-five percent of the directors and of the members of any committee of the board of directors must be resident Canadians. We have no arrangements with any of our directors providing for the payment of benefits upon their termination of service as director.

COMMITTEES OF THE BOARD OF DIRECTORS

Our board of directors has established an audit committee and a human resources committee.

Our audit committee will recommend a firm to be appointed as independent auditors to audit financial statements and to perform services related to the audit, review the scope and results of the audit with the independent auditors, review with management and the independent auditors our annual operating results and consider the adequacy of the internal accounting procedures and the effect of the procedures relating to the auditors' independence. The audit committee is composed of three independent directors: Andre Tremblay, Michael Unger and Pierre Marcouiller. The chairperson of the audit committee is Andre Tremblay.

Our human resources committee will evaluate, review and supervise our procedures with regards to human resources and will assess the performance of our executive officers and the chief executive officer. This committee will also review annually the remuneration of the directors and will recommend to the board of directors general remuneration policies regarding salaries, bonuses and other forms of remuneration for our directors, executive officers and employees as a whole. In addition, the human resources committee will monitor the board's corporate governance practices and generally review the functioning of the board and the powers, mandates and performance of the committees. Finally, the human resources committee will review our organizational structure annually and the

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development and maintenance of a succession plan. The human resources committee is composed of three independent directors: David A. Thompson, Michael Unger and Pierre Marcouiller. The chairperson of the human resources committee is Michael Unger.

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D. EMPLOYEES

We have fostered a corporate culture where growth and change are strongly encouraged. In fact, employees are constantly evolving with the rapid pace of technology to meet new challenges and realities. We believe that we possess a good cross-section of experience and youth to handle these inevitable changes in the industry. The average age of our employees is around 33 years old.

As of December 31, 2001, we had 928 employees primarily based in Quebec, Canada, with 171 employees based outside of Canada. As of December 31, 2001, we employed 1,099 full-time employees. Three hundred and thirty-seven are involved in research and development, 354 in manufacturing, 198 in sales and marketing, 127 in general administrative positions and 83 in communications and customer support. Over the summer of 2001, we were forced to lay off a total of 245 employees as part of our efforts to reduce costs in response to a general slowdown in the telecommunications industry. In December 2001, we announced further layoffs totaling 10 % of our global workforce. Notwithstanding these layoffs, during the 12-month period ended December 31, 2001, we added 136 employees. We have agreements with almost all of our employees covering confidentiality and non-competition. Only manufacturing employees are represented by a collective bargaining agreement, which expires in 2004. We have never experienced a work stoppage. We believe that relations with our employees are good.

E. SHARE OWNERSHIP

The following table presents information regarding the beneficial ownership of our share capital as of December 31, 2001 by our directors, our Chief Executive Officer and our four highest compensated executive officers; and all of our directors and executive officers as a group.

Each multiple voting share is convertible at the option of the holder into one subordinate voting share. Holders of our subordinate voting shares are entitled to one vote per share and holders of our multiple voting shares are entitled to ten votes per share.

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NAME	MULTIPLE VOTING SHARES BENEFICIALLY OWNED (1)		SUBORDINATE VOTING SHARES BENEFICIALLY OWNED (1)	
	NUMBER	PERCENT	NUMBER	PERCENT

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Germain Lamonde (2).....	37,900,000	100	6,351	*
Juan Felipe Gonzalez.....	--	--	60,677	*
Bruce Bonini.....	--	--	68,299	*
David J. Farrell.....			768,549	3.17
William S. Gornall.....	--	--	450,171	1.88
Pierre Marcouiller.....	--	--	3,500	*
David A. Thompson.....	--	--	2,600	*
Andre Tremblay (3).....	--	--	7,500	*
Michael Unger.....	--	--	500	*
TOTAL.....	37,900,000	100	1,368,147	5.69

* Less than 1%.

- (1) Beneficial ownership is determined in accordance with the rules of the SEC and generally includes voting or investment power with respect to securities. Options that are currently exercisable are deemed to be outstanding and to be beneficially owned by the person holding such options for the purpose of computing the percentage ownership of such person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person.
- (2) The number of shares held by Germain Lamonde includes 1,900,000 multiple voting shares held of record by Fiducie Germain Lamonde and 36,000,000 multiple voting shares held of record by G. Lamonde Investissements Financiers inc.
- (3) The number of subordinate voting shares held of record by Andre Tremblay includes 6,650 subordinate voting shares held of record by 9044-6451 Quebec Inc. and 350 subordinate voting shares held of record by 9089-3082 Quebec Inc., companies controlled by Mr. Tremblay.

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The following table presents information regarding stock options held as of December 31, 2001 by our directors, our Chief Executive Officer and our four highest compensated executive officers.

NAME	SECURITIES UNDER OPTIONS GRANTED (1) (#)	EXERCISE PRICE (2) (US\$/SECURITY)	EX
Germain Lamonde.....	25,402	\$26.00	Ju
	5,080	\$22.25	Jan
	70,000	\$9.13	Oct
	70,000		
Juan Felipe Gonzalez.....	6,900	\$26.00	Ju
	15,000	\$45.94	Sept
	15,000	\$34.07	Oct
	15,630	\$22.25	Jan
	15,000	\$9.13	Oct

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Bruce Bonini.....	3,900	\$26.00	Ju
	20,000	\$45.94	Sept
	30,000	\$34.07	Oct
	32,780	\$22.25	Jan
	15,000	\$9.13	Oct
David J. Farrell.....	40,000	\$22.62	Dece
	10,000	\$9.13	Oct
William S. Gornall.....	30,000	\$22.62	Dece
	5,000	\$9.13	Oct
Pierre Marcouiller.....	2,000	\$26.00	Ju
	400	\$22.25	Jan
	17,966	\$9.13	Oct
David A. Thompson.....	2,000	\$26.00	Ju
	400	\$22.25	Jan
	15,334	\$9.13	Oct
Andre Tremblay.....	2,000	\$26.00	Ju
	400	\$22.25	Jan
	17,291	\$9.13	Oct
Michael Unger.....	2,000	\$26.00	Ju
	400	\$22.25	Jan
	18,168	\$9.13	Oct

-
- (1) Underlying securities: subordinate voting shares
- (2) The exercise price of options granted is determined based on 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 on the grant date to convert the NASDAQ National Market closing price to Canadian dollars, as required.

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ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. MAJOR SHAREHOLDERS

The following table presents information regarding the beneficial ownership of our share capital as of December 31, 2001 by persons or groups of affiliated persons known by us to own more than 5% of our voting shares.

NAME	MULTIPLE VOTING SHARES BENEFICIALLY OWNED (1)		SUBORDINATE VOTING SHARES BENEFICIALLY OWNED (1)		TOT
	NUMBER	PERCENT	NUMBER	PERCENT	
-----	-----	-----	-----	-----	-----

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Germain Lamonde (2)	37,900,000	100 %	6,351	*
Fiducie Germain Lamonde (3)	1,900,000	5 %	Nil	Nil
G. Lamonde Investissements Financiers inc. (4)	36,000,000	95 %	Nil	Nil

 * Less than 1%

- (1) Beneficial ownership is determined in accordance with the rules of the SEC and generally includes voting or investment power with respect to securities. Options that are currently exercisable are deemed to be outstanding and to be beneficially owned by the person holding such options for the purpose of computing the percentage ownership of such person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person.
- (2) The number of shares held by Germain Lamonde includes 1,900,000 multiple voting shares held of record by Fiducie Germain Lamonde and 36,000,000 multiple voting shares held of record by G. Lamonde Investissements Financiers inc.
- (3) Fiducie Germain Lamonde is a family trust for the benefit of Mr. Lamonde and members of his family.
- (4) G. Lamonde Investissements Financiers inc. is a company controlled by Mr. Lamonde.

Each multiple voting share is convertible at the option of the holder into one subordinate voting share. Holders of our subordinate voting shares are entitled to one vote per share and holders of our multiple voting shares are entitled to ten votes per share.

Unless otherwise indicated, the address of each person who beneficially owns 5% or more of our subordinate voting shares or multiple voting shares is c/o EXFO Electro-Optical Engineering Inc., 465 Godin Avenue, Vanier, Quebec, Canada.

As of December 31, 2001, approximately 57.48% of our subordinate voting shares were held in bearer form and the remainder (10,003,174 subordinate voting shares) were held by 279 record holders. As of December 31, 2001, we believe approximately 46.62% of our outstanding subordinate voting shares were held in the United States.

B. RELATED PARTY TRANSACTIONS

INDEBTEDNESS OF DIRECTORS, EXECUTIVE OFFICERS AND EMPLOYEES

We have guaranteed the repayment of loans granted to employees by a financial institution for the purchase of our Class "F" shares that were converted into subordinate voting shares immediately prior to our initial public offering. As of August 31, 2001, the total principal

amount guaranteed by us is C\$130,899 (approximately \$85,700) and \$56,200. We

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have outstanding loans to some of our employees up to \$8,840 to finance the acquisition of our Class "F" shares. These loans are to be reimbursed no later than five years from the date of the loans. These loans accrue interest at prime rate and are secured by a pledge of the employees' shares to us.

Except as disclosed in this section, none of our directors, executive officers, associates or affiliates had any material interest in any transaction with us during the past three years or in any proposed transaction which has materially affected or could materially affect us.

LEASES

We have entered into lease agreements with 9080-9823 Quebec inc., a company controlled by Mr. Germain Lamonde, for the manufacturing facilities located at 436 Nolin Street and the executive and administrative offices located at 465 Godin Avenue in Vanier, Quebec. These leases were renewed in December 2001, with all terms and conditions remaining the same. The table below sets forth the leased space and annual rent:

LOCATION	SQUARE FOOTAGE	ANNUAL RENT	EXPIRY DATE
436 Nolin	43,000	C\$220,820	November 30, 2006
465 Godin	24,000	C\$144,000	November 30, 2006

Based on third-party valuations of the property values, we believe these lease agreements are at prevailing market terms.

REGISTRATION RIGHTS AGREEMENTS

REGISTRATION RIGHTS AGREEMENT WITH MR. LAMONDE

In July 2000, we entered into a registration rights agreement with Germain Lamonde, under which Mr. Lamonde and entities affiliated with him were granted demand registration rights in the United States in respect of the subordinate voting shares, including the subordinate voting shares issued upon conversion of the multiple voting shares held by him or entities affiliated with him. With respect to the demand registration rights of Mr. Lamonde, subject to minimum dollar amounts, Mr. Lamonde may make a demand once every 12 consecutive month period. Mr. Lamonde also has an unlimited number of piggyback registration rights in respect of the subordinate voting shares issued upon conversion of the multiple voting shares held by him or entities affiliated with him. The piggyback registration rights generally will allow Mr. Lamonde to include all or a portion of the subordinate voting shares issuable upon conversion of the multiple voting shares under any registration statement filed by us.

We will pay all expenses, other than underwriting discounts and commissions and taxes, in connection with the exercise of any demand registration rights or piggyback registration rights. We also will agree to indemnify any sellers and underwriters against some liabilities, including liabilities arising under applicable securities laws. Mr. Lamonde agreed not to exercise his registration rights without the prior written consent of Merrill Lynch on behalf of the underwriters of the initial public offering for a period of 180 days following June 29, 2000.

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REGISTRATION RIGHTS AGREEMENT WITH BURLEIGH SHAREHOLDERS

In December 2000 in connection with the acquisition of Burleigh, we issued registration rights to the former shareholders of Burleigh. In July 2001, we fulfilled our obligations to the former shareholders of Burleigh by filing a registration statement on Form F-3 relating to the resale of the subordinate voting shares held by the former shareholders of Burleigh. The Burleigh shareholders also have an unlimited number of piggyback registration rights in respect of their subordinate voting shares. The piggyback registration rights generally will allow the Burleigh shareholders to include all or a portion of their subordinate voting shares under any registration statement filed by us. The piggyback registration rights cease to apply on June 1, 2002.

We will pay all expenses, other than underwriting commissions or discounts, taxes and fees and expenses of counsel and advisors to the Burleigh shareholders, in connection with the preparation and filing of any of the foregoing registration statements. We also agreed to indemnify any sellers and underwriters against some liabilities, including liabilities arising under applicable securities laws, incurred in connection with the registration statement on Form F-3.

REGISTRATION RIGHTS AGREEMENT WITH AVANTAS SHAREHOLDERS

In November 2001, in connection with the acquisition of EXFO Protocol (formerly Avantas Networks Corporation), we issued registration rights to the former shareholders of EXFO Protocol. We agreed to file a registration statement on Form F-3 or Form F-10 in the United States prior to February 28, 2002 in order to register the resale of the shares issued to the former shareholders of EXFO Protocol.

We will pay all expenses, other than underwriting commissions or discounts, taxes and fees and expenses of counsel and advisors to the EXFO Protocol shareholders, in connection with the preparation and filing of any of the foregoing registration statements. We also agreed to indemnify any sellers against some liabilities, including liabilities arising under applicable securities laws, incurred in connection with any of the foregoing registration statements.

ITEM 8. FINANCIAL INFORMATION

Consolidated financial statements: pages F-1 to F-44

Valuation and qualifying accounts are as follows (in thousands of US dollars):

	YEARS ENDED NOVEMBER 30,		
	1999	2000	2001
Allowance for doubtful accounts			
Balance - Beginning of year	\$ 26	\$ 30	\$ 149
Addition charged to earnings	12	147	1,134
Write off of uncollectible accounts	(8)	(41)	(184)
Reversal of collectible accounts	-	(3)	(268)
Foreign currency translation adjustment	-	16	62
Balance - End of year	\$ 30	\$ 149	\$ 893

LEGAL PROCEEDINGS

A description of legal proceedings is set forth in Item 4 of this annual report.

DIVIDEND POLICY

We do not currently anticipate paying dividends for at least the three next years. Our current intention is to reinvest our earnings in our business long-term growth. Any future determination by us to pay dividends will be at the discretion of our board of directors and in accordance with the terms and conditions of any outstanding indebtedness and will depend on our financial condition, results of operations, capital requirements and such other functions as our board of directors considers relevant.

ITEM 9. THE OFFER AND LISTING

Not Applicable, except for Item 9A (4) and Item 9C.

Our subordinate voting shares have been quoted on the NASDAQ National Market under the symbol "EXFO" and listed on The Toronto Stock Exchange under the symbol "EXF" since our initial public offering on June 29, 2000. Prior to that time, there was no public market for our subordinate voting shares. The following table sets forth, for the periods indicated, the high and low closing sales prices per subordinate voting share as reported on the NASDAQ National Market and The Toronto Stock Exchange.

On January 16, 2002, the last reported sale price for our subordinate voting shares on the NASDAQ National Market was \$10.32 per share and the last reported sale price for our subordinate voting shares on The Toronto Stock Exchange was C\$16.55 per share.

PERIOD	NASDAQ			TSE
	HIGH	LOW		HIGH
	-----			-----
June 29, 2000 to August 31, 2000	92.50	26.00		134.00
September 1, 2000 to August 31, 2001	57.75	11.80		85.00
2001 1st Quarter	57.75	19.19		85.00
2001 2nd Quarter	50.44	17.63		76.00
2001 3rd Quarter	39.16	21.69		60.50
2001 4th Quarter	30.53	11.80		46.50
2002 1st Quarter	15.00	9.00		23.80
2001 July	16.55	14.13		25.10
2001 August	16.76	11.80		25.75
2001 September	11.71	9.00		18.59
2001 October	12.36	8.51		19.50
2001 November	15.00	10.60		23.80
2001 December	14.00	10.96		22.10

ITEM 10. ADDITIONAL INFORMATION

A. SHARE CAPITAL

Not Applicable

B. MEMORANDUM AND ARTICLES OF ASSOCIATION

Incorporated by reference to our registration statement on Form F-1 (Reg. No. 333-38956).

C. MATERIAL CONTRACTS

Except as otherwise disclosed in this annual report and our financial statements and notes included elsewhere in this annual report, we have no other material contracts.

D. EXCHANGE CONTROLS

Subject to the following paragraph, there is no law or governmental decree or regulation in Canada that restricts the export or import of capital, or affects the remittance of dividends, interest or other payments to non-resident holders of our subordinate voting shares, other than withholding tax requirements.

There is no limitation imposed by Canadian law or by our articles of incorporation or our other charter documents on the right of a non-resident to hold or vote subordinate voting shares, other than as provided by the INVESTMENT CANADA ACT, the NORTH AMERICAN FREE TRADE AGREEMENT IMPLEMENTATION ACT (Canada) and the WORLD TRADE ORGANIZATION AGREEMENT IMPLEMENTATION ACT. The INVESTMENT CANADA ACT requires notification and, in certain cases, advance review and approval by the Government of Canada of an investment to establish a new Canadian business by a non-Canadian or of the acquisition by a "non-Canadian" of "control" of a "Canadian business", all as defined in the INVESTMENT CANADA ACT. Generally, the threshold for review will be higher in monetary terms for a member of the World Trade Organization or North American Free Trade Agreement.

E. TAXATION

UNITED STATES TAXATION

The information set forth below under the caption "United States Taxation" is a summary of the material U.S. federal income tax consequences of the ownership and disposition of subordinate voting shares by a U.S. Holder, as defined below. These discussions are not a complete analysis or listing of all of the possible tax consequences of such transactions and do not address all tax considerations that may be relevant to particular holders in light of their personal circumstances or to persons that are subject to special tax rules. In particular, the information set forth under the caption "United States Taxation" deals only with U.S. Holders that will hold subordinate voting shares as capital assets within the meaning of the Internal

Revenue Code of 1986, as amended, and who do not at any time own individually, nor are treated as owning 10% or more of the total combined voting power of all

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classes of our stock entitled to vote. In addition, this description of U.S. tax consequences does not address the tax treatment of special classes of U.S. Holders, such as banks, tax-exempt entities, insurance companies, persons holding subordinate voting shares as part of a hedging or conversion transaction or as part of a "straddle," U.S. expatriates, persons subject to the alternative minimum tax, dealers or traders in securities or currencies and holders whose "functional currency" is not the U.S. dollar. This summary does not address estate and gift tax consequences or tax consequences under any foreign, state or local laws other than as provided in the section entitled "Canadian Federal Income Tax Considerations" provided below.

As used in this section, the term "U.S. Holder" means:

- (a) an individual citizen or resident of the United States;
- (b) a corporation created or organized under the laws of the United States or any state thereof including the District of Columbia;
- (c) an estate the income of which is subject to United States federal income taxation regardless of its source;
- (d) a trust if a court within the United States is able to exercise primary jurisdiction over its administration and one or more U.S. persons have authority to control all substantial decisions of the trust; or
- (e) a partnership to the extent the interests therein are owned by any of the persons described in clauses (a), (b), (c) or (d) above.

Holders of subordinate voting shares who are not U.S. Holders, sometimes referred to as "Non-U.S. Holders", should also consult their own tax advisors, particularly as to the applicability of any tax treaty.

The following discussion is based upon:

- o the Internal Revenue Code;
- o U.S. judicial decisions;
- o administrative pronouncements;
- o existing and proposed Treasury regulations; and
- o the Canada-- U.S. Income Tax Treaty.

Any of the above is subject to change, possibly with retroactive effect. We have not requested, and will not request, a ruling from the U.S. Internal Revenue Service with respect to any of the U.S. federal income tax consequences described below, and as a result, there can be no assurance that the U.S. Internal Revenue Service will not disagree with or challenge any of the conclusions we have reached and describe here.

HOLDERS OF SUBORDINATE VOTING SHARES ARE URGED TO CONSULT THEIR TAX ADVISORS AS TO THE PARTICULAR CONSEQUENCES TO THEM UNDER U.S. FEDERAL, STATE, LOCAL AND APPLICABLE FOREIGN TAX LAWS OF THE ACQUISITION, OWNERSHIP AND DISPOSITION OF SUBORDINATE VOTING SHARES.

DIVIDENDS

Subject to the discussion of passive foreign investment companies below, the gross amount of any distribution paid by us to a U.S. Holder will generally be subject to U.S. federal income tax as foreign source dividend income to the extent paid out of our current or accumulated earnings and profits, as determined under U.S. federal income tax principles. The amount of any distribution of property other than cash will be the fair market value of such property on the date of the distribution. Dividends received by a U.S. Holder will not be eligible for the dividends received deduction allowed to

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corporations. To the extent that an amount received by a U.S. Holder exceeds such holder's allocable share of our current and accumulated earnings and profits, such excess will be applied first to reduce such U.S. Holder's tax basis in his subordinate voting shares, thereby increasing the amount of gain or decreasing the amount of loss recognized on a subsequent disposition of the subordinate voting shares. Then, to the extent such distribution exceeds such U.S. Holder's tax basis, it will be treated as capital gain. We do not currently maintain calculations of our earnings and profits for U.S. federal income tax purposes.

The gross amount of distributions paid in Canadian dollars, or any successor or other foreign currency, will be included in the income of such U.S. Holder in a dollar amount calculated by reference to the spot exchange rate in effect on the day the distributions are paid regardless of whether the payment is in fact converted into U.S. dollars. If the Canadian dollars, or any successor or other foreign currency, are converted into U.S. dollars on the date of the payment, the U.S. Holder should not be required to recognize any foreign currency gain or loss with respect to the receipt of Canadian dollars as distributions. If, instead, the Canadian dollars are converted at a later date, any currency gains or losses resulting from the conversion of the Canadian dollars will be treated as U.S. source ordinary income or loss. Any amounts recognized as dividends will generally constitute foreign source "passive income" or, in the case of certain U.S. Holders, "financial services income" for U.S. foreign tax credit purposes. A U.S. Holder will have a basis in any Canadian dollars distributed equal to their dollar value on the payment date.

A Non-U.S. Holder of subordinate voting shares generally will not be subject to U.S. federal income or withholding tax on dividends received on subordinate voting shares unless such income is effectively connected with the conduct by such Non-U.S. Holder of a trade or business in the United States.

SALE OR EXCHANGE

A U.S. Holder's initial tax basis in the subordinate voting shares will generally be cost to the holder. A U.S. Holder's adjusted tax basis in the subordinate voting shares will generally be the same as cost, but may differ for various reasons including the receipt by such holder of a distribution that was not made up wholly of earnings and profits as described above under the heading "Dividends." Subject to the discussion of passive foreign investment companies below, gain or loss realized by a U.S. Holder on the sale or other disposition of subordinate voting shares will be subject to U.S. federal income taxation as capital gain or loss in an amount equal to the difference between the U.S. Holder's adjusted tax basis in the subordinate voting shares

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and the amount realized on the disposition. In the case of a non-corporate U.S. Holder, the federal tax rate applicable to capital gains will depend upon:

- o the holder's holding period for the subordinate voting shares, with a preferential rate available for subordinate voting shares held for more than one year; and
- o the holder's marginal tax rate for ordinary income.

Any gain realized will generally be treated as U.S. source gain and loss realized by a U.S. Holder generally also will be treated as from sources within the United States.

The ability of a U.S. Holder to utilize foreign taxes as a credit to offset U.S. taxes is subject to complex limitations and conditions. The consequences of the separate limitation calculation will depend upon the nature

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and sources of each U.S. Holder's income and the deductions allocable thereto. Alternatively, a U.S. Holder may elect to claim all foreign taxes paid as an itemized deduction in lieu of claiming a foreign tax credit. A deduction does not reduce U.S. tax on a dollar-for-dollar basis like a tax credit, but the availability of the deduction is not subject to the same conditions and limitations applicable to foreign tax credits.

If a U.S. Holder receives any foreign currency on the sale of subordinate voting shares, such U.S. Holder may recognize ordinary income or loss as a result of currency fluctuations between the date of the sale of subordinate voting shares and the date the sale proceeds are converted into U.S. dollars.

A Non-U.S. Holder of subordinate voting shares generally will not be subject to U.S. federal income or withholding tax on any gain realized on the sale or exchange of such subordinate voting shares unless:

- o such gain is effectively connected with the conduct by such Non-U.S. Holder of a trade or business in the United States; or
- o in the case of any gain realized by an individual Non-U.S. Holder, such Non-U.S. Holder is present in the United States for 183 days or more in the taxable year of such sale and certain other conditions are met.

Personal Holding Company

We could be classified as a personal holding company for U.S. federal income tax purposes if both of the following tests are satisfied:

- o if at any time during the last half of our taxable year, five or fewer individuals own or are deemed to own more than 50% of the total value of our shares; and
- o we receive 60% or more of our U.S. related gross income from specified passive sources, such as royalty payments.

A personal holding company is taxed on a portion of its undistributed U.S. source income, including specific types of foreign source income which are connected with the conduct of a U.S. trade or business, to the extent this income is not distributed to shareholders. We do not

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believe we are a personal holding company presently and we do not expect to become one. However, we can not assure you that we will not qualify as a personal holding company in the future.

FOREIGN PERSONAL HOLDING COMPANY

We could be classified as a foreign personal holding company if in any taxable year both of the following tests are satisfied:

- o five or fewer individuals who are United States citizens or residents own or are deemed to own more than 50% of the total voting power of all classes of our shares entitled to vote or the total value of our shares; and
- o at least 60%, 50% in some cases, of our gross income, as adjusted, consists of "foreign personal holding company income", which generally includes passive income such as dividends, interests, gains from the sale or exchange of shares or securities, rent and royalties.

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If we are classified as a foreign personal holding company and if you hold shares in us, you may have to include in your gross income as a dividend your pro rata portion of our undistributed foreign personal holding company income. If you dispose of your shares prior to such date, you will not be subject to tax under these rules. We do not believe we are a foreign personal holding company presently and we do not expect to become one. However, we can not assure you that we will not qualify as a foreign personal holding company in the future.

PASSIVE FOREIGN INVESTMENT COMPANY

We believe that our subordinate voting shares should not currently be treated as stock of a passive foreign investment company for United States federal income tax purposes, but this conclusion is a factual determination made annually and thus may be subject to change based on future operations and composition and valuation of our assets. In general, we will be a passive foreign investment company with respect to a U.S. Holder if, for any taxable year in which the U.S. Holder holds our subordinate voting shares, either:

- o at least 75% of our gross income for the taxable year is passive income; or
- o at least 50% of the average value of our assets is attributable to assets that produce or are held for the production of passive income.

For this purpose, passive income includes income such as:

- o dividends;
- o interest;
- o rents or royalties, other than certain rents or royalties derived from the active conduct of trade or business;
- o annuities; or
- o gains from assets that produce passive income.

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If a foreign corporation owns at least 25% by value of the stock of another corporation, the foreign corporation is treated for purposes of the passive foreign investment company tests as owning its proportionate share of the assets of the other corporation and as receiving directly its proportionate share of the other corporation's income.

If we are treated as a passive foreign investment company, a U.S. Holder that did not make a qualified electing fund election or, if available, a mark-to-market election, as described below, would be subject to special rules with respect to:

- o any gain realized on the sale or other disposition of subordinate voting shares; and
- o any "excess distribution" by us to the U.S. Holder.

Generally, "excess distributions" are any distributions to the U.S. Holder in respect of the subordinate voting shares during a single taxable year that are greater than 125% of the average annual distributions received by the U.S. Holder in respect of the subordinate voting shares during the three preceding taxable years or, if shorter, the U.S. Holder's holding period for the subordinate voting shares.

Under the passive foreign investment company rules,

- o the gain or excess distribution would be allocated ratably over

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- the U.S. Holder's holding period for the subordinate voting shares;
- o the amount allocated to the taxable year in which the gain or excess distribution was realized would be taxable as ordinary income;
- o the amount allocated to each prior year, with certain exceptions, would be subject to tax at the highest tax rate in effect for that year; and
- o the interest charge generally applicable to underpayments of tax would be imposed in respect of the tax attributable to each such year.

A U.S. Holder owning actually or constructively "marketable stock" of a passive foreign investment company may be able to avoid the imposition of the passive foreign investment company tax rules described above by making a mark-to-market election. Generally, pursuant to this election, such holder would include in ordinary income, for each taxable year during which such stock is held, an amount equal to the increase in value of the stock, which increase will be determined by reference to the value of such stock at the end of the current taxable year compared with their value as of the end of the prior taxable year. Holders desiring to make the mark-to-market election should consult their tax advisors with respect to the application and effect of making such election.

In the case of a U.S. Holder who does not make a mark-to-market election, the special passive foreign investment company tax rules described above will not apply to such U.S. Holder if the U.S. Holder makes an election to have us treated as a qualified electing fund and we provide certain required information to holders. For a U.S. Holder to make a qualified electing fund election, we would have to satisfy certain reporting requirements. We have not determined whether we will undertake the necessary measures to be able to satisfy such requirements in the event that we were treated as a passive foreign investment company.

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A U.S. Holder that makes a qualified electing fund election will be currently taxable on its pro rata share of our ordinary earnings and net capital gain, at ordinary income and capital gains rates, respectively, for each of our taxable years, regardless of whether or not distributions were received. The U.S. Holder's basis in the subordinate voting shares will be increased to reflect taxed but undistributed income. Distributions of income that had previously been taxed will result in a corresponding reduction of basis in the subordinate voting shares and will not be taxed again as a distribution to the U.S. Holder. U.S. Holders desiring to make a qualified electing fund election should consult their tax advisors with respect to the advisability of making such election.

UNITED STATES BACKUP WITHHOLDING AND INFORMATION REPORTING

A U.S. Holder will generally be subject to information reporting with respect to dividends paid on, or proceeds of the sale or other disposition of, our subordinate voting shares, unless the U.S. Holder is a corporation or comes within certain other categories of exempt recipients. A U.S. Holder that is not an exempt recipient will generally be subject to backup withholding with respect to the proceeds from the sale or the disposition of, or with respect to dividends on, subordinate voting shares unless the U.S. Holder provides a taxpayer identification number and otherwise complies with applicable requirements of the backup withholding rules. Any amount withheld under these rules will be creditable against the U.S. Holder's U.S. federal income tax liability or refundable to the extent that it exceeds such liability. A U.S. Holder who does not provide a correct taxpayer identification number may be

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subject to penalties imposed by the United States Internal Revenue Service.

Non-U.S. Holders will generally be subject to information reporting and possible backup withholding with respect to the proceeds of the sale or other disposition of subordinate voting shares effected within the United States, unless the holder certifies to its foreign status or otherwise establishes an exemption if the broker does not have actual knowledge that the holder is a U.S. holder. Payments of dividends on or proceeds from the sale of subordinate voting shares within the United States by a payor within the United States to a non-exempt U.S. or Non-U.S. Holder will be subject to backup withholding if such holder fails to provide appropriate certification. In the case of such payments by a payor within the United States to a foreign partnership other than a foreign partnership that qualifies as a "withholding foreign partnership" within the meaning of such Treasury regulations, the partners of such partnership will be required to provide the certification discussed above in order to establish an exemption from backup withholding tax and information reporting requirements.

CANADIAN FEDERAL INCOME TAX CONSIDERATIONS

The following is a summary of the material Canadian federal income tax considerations generally applicable to a U.S. person who holds subordinate voting shares and who, for the purposes of the INCOME TAX ACT (Canada), or the ITA, and the CANADA-UNITED STATES INCOME TAX CONVENTION (1980), or the Convention, as applicable and at all relevant times:

- o is resident in the United States and not resident in Canada,
- o holds the subordinate voting shares as capital property,

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- o does not have a "permanent establishment" or "fixed base" in Canada, as defined in the Convention; and
- o deals at arm's length with us. Special rules, which are not discussed below, may apply to "financial institutions", as defined in the ITA, and to non-resident insurers carrying on an insurance business in Canada and elsewhere.

This discussion is based on the current provisions of the ITA and the Convention and on the regulations promulgated under the ITA, all specific proposals to amend the ITA or the regulations promulgated under the ITA announced by or on behalf of the Canadian Minister of Finance prior to the date of this annual report and the current published administrative practices of the Canada Customs and Revenue Agency, or the Agency. It does not otherwise take into account or anticipate any changes in law or administrative practice nor any income tax laws or considerations of any province or territory of Canada or any jurisdiction other than Canada, which may differ from the Canadian federal income tax consequences described in this document.

Under the ITA and the Convention, dividends paid or credited, or deemed to be paid or credited, on the subordinate voting shares to a U.S. person who owns less than 10% of the voting shares will be subject to Canadian withholding tax at the rate of 15% of the gross amount of those dividends or deemed dividends. If a U.S. person is a corporation and owns 10% or more of the voting shares, the rate is reduced from 15% to 5%. As described above and subject to specified limitations, a U.S. person may be entitled to credit against U.S. federal income tax liability for the amount of tax withheld by Canada.

Under the Convention, dividends paid to specified religious, scientific, charitable and similar tax exempt organizations and specified organizations that are resident and exempt from tax in the United States and that have complied with specified administrative procedures are exempt from this

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Canadian withholding tax.

A capital gain realized by a U.S. person on a disposition or deemed disposition of the subordinate voting shares will not be subject to tax under the ITA unless the subordinate voting shares constitute taxable Canadian property within the meaning of the ITA at the time of the disposition or deemed disposition. In general, the subordinate voting shares will not be "taxable Canadian property" to a U.S. person if they are listed on a prescribed stock exchange, which includes The Toronto Stock Exchange, unless, at any time within the five-year period immediately preceding the dispositions, the U.S. person, persons with whom the U.S. person did not deal at arm's length, or the U.S. person together with those persons, owned or had an interest in or a right to acquire more than 25% of any class or series of our shares.

If the subordinate voting shares are taxable Canadian property to a U.S. person, any capital gain realized on a disposition or deemed disposition of those subordinate voting shares will generally be exempt from tax under the ITA by virtue of the Convention if the value of the subordinate voting shares at the time of the disposition or deemed disposition is not derived principally from real property, as defined by the Convention, situated in Canada. The determination as to whether Canadian tax would be applicable on a disposition or deemed

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disposition of the subordinate voting shares must be made at the time of the disposition or deemed disposition.

HOLDERS OF SUBORDINATE VOTING SHARES ARE URGED TO CONSULT THEIR OWN TAX ADVISORS TO DETERMINE THE PARTICULAR TAX CONSEQUENCES TO THEM, INCLUDING THE APPLICATION AND EFFECT OF ANY STATE, LOCAL OR FOREIGN INCOME AND OTHER TAX LAWS, OF THE ACQUISITION, OWNERSHIP AND DISPOSITION OF SUBORDINATE VOTING SHARES.

F. DIVIDENDS AND PAYING AGENTS

Not Applicable

G. STATEMENT BY EXPERTS

Not Applicable

H. DOCUMENTS ON DISPLAY

Any statement in this annual report about any of our contracts or other documents is not necessarily complete. If the contract or document is filed as an exhibit to the registration statement, the contract or document is deemed to modify the description contained in this annual report. You must review the exhibits themselves for a complete description of the contract or document.

You may review a copy of our filings with the SEC, including exhibits and schedules filed with it, at the SEC's public reference facilities in Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549 and at the regional offices of the SEC located at 233 Broadway, New York, New York 10279 and at the Northwestern Atrium Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. You may also obtain copies of such materials from the Public Reference Section of the SEC, Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. You may call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. The SEC maintains a Web site ([HTTP://WWW.SEC.GOV](http://www.sec.gov)) that contains reports, proxy and information statements and other information regarding registrants that file

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electronically with the SEC . Although we make many of our filings with the SEC electronically as a foreign private issuer, we are not obligated to do so.

You may read and copy any reports, statements or other information that we file with the SEC at the addresses indicated above and you may also access them electronically at the Web site set forth above. These SEC filings are also available to the public from commercial document retrieval services.

WE ARE REQUIRED TO FILE REPORTS AND OTHER INFORMATION WITH THE SEC UNDER THE SECURITIES EXCHANGE ACT OF 1934. REPORTS AND OTHER INFORMATION FILED BY US WITH THE SEC MAY BE INSPECTED AND COPIED AT THE SEC'S PUBLIC REFERENCE FACILITIES DESCRIBED ABOVE. AS A FOREIGN PRIVATE ISSUER, WE ARE EXEMPT FROM THE RULES UNDER THE EXCHANGE ACT PRESCRIBING THE FURNISHING AND CONTENT OF PROXY STATEMENTS AND OUR OFFICERS, DIRECTORS AND PRINCIPAL SHAREHOLDERS ARE EXEMPT FROM THE REPORTING AND SHORT-SWING PROFIT RECOVERY PROVISIONS CONTAINED IN SECTION 16 OF THE EXCHANGE ACT. UNDER THE EXCHANGE ACT, AS A FOREIGN PRIVATE ISSUER, WE ARE NOT REQUIRED TO PUBLISH FINANCIAL STATEMENTS AS FREQUENTLY OR AS PROMPTLY AS UNITED STATES COMPANIES.

I. SUBSIDIARY INFORMATION

See Item 4.C. of this annual report.

ITEM 11. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK

CURRENCY RISK

We are exposed to currency risk as a result of our export sales of products manufactured in Canada, substantially all of which are denominated in US dollars. Our exposure to foreign exchange rate fluctuations is partially hedged by operating expenses and the portion of our raw materials purchased in US dollars. In addition, we frequently enter into forward exchange contracts to sell US dollars at fixed forward rates in exchange for Canadian dollars. We enter into such contracts to manage the risk of exchange rate fluctuations between the Canadian and US dollars on cash flows related to anticipated future revenue streams and firmly committed future sales transactions denominated in US dollars. We do not enter into forward exchange contracts for trading purposes.

The following table summarizes the forward exchange contracts in effect as at August 31, 2001, classified by expected transaction dates, none of which exceed two years. The table below presents the notional amounts of such contracts (in thousands of US dollars) along with the weighted average contractual forward rates under such contracts. The notional amounts of such contracts are used to calculate the contractual payments to be exchanged under these contracts.

	YEARS ENDING AUGUST 31,	
	----- 2002 -----	2003 -----
Forward exchange contracts to sell US dollars in exchange for Canadian dollars		
Contractual amounts.....	\$ 15,200	\$ 1,800

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Weighted average contractual exchange rates..... 1.4969 1.5184

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FAIR VALUE

The fair value of these contracts as at August 31, 2001, based on the prevailing exchange rate at that date of \$1.00 = C\$1.5477, amounted to C\$26,3 million compared to a contractual value of C\$25,5 million, resulting in a deferred unrealized loss of C\$825,000 (approximately \$533,000).

INTEREST RATE RISK

We are exposed to the impact of interest rate changes and changes in the market values of our available-for-sale securities. We do not use derivative financial instruments for our available-for-sale securities. Our available-for-sale securities consist of debt instruments issued by high-credit quality financial institutions and corporations and units of a low-risk mutual fund.

The debt instruments bear interest at fixed rate and may have their fair market value adversely impacted due to a rise in interest rate. However, due to their very short-term maturity, we consider this risk to be insignificant.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES.

Not Applicable

PART II.

ITEM 13. DEFAULTS, DIVIDENDS ARREARAGES AND DELINQUENCIES

Not Applicable

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Not Applicable

ITEM 15. [RESERVED]

ITEM 16. [RESERVED]

PART III.

ITEM 17. FINANCIAL STATEMENTS

Not Applicable.

ITEM 18. FINANCIAL STATEMENTS

See pages F-1 to F-44

ITEM 19. EXHIBITS

NUMBER	EXHIBIT
1.1	Amended Articles of Incorporation of EXFO (incorporated by reference to Exhibit 3.1 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
1.2	By-laws of EXFO (incorporated by reference to Exhibit 3.2 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
1.3	Amended and Restated Articles of Incorporation of EXFO (incorporated by reference to Exhibit 1.3 of EXFO's annual report on Form 20-F dated January 18, 2001).
2.1	Form of Subordinate Voting Share Certificate (incorporated by reference to Exhibit 4.1 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
2.2	Form of Registration Rights Agreement between EXFO and Germain Lamonde dated July 6, 2000) (incorporated by reference to Exhibit 10.13 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
3.1	Form of Trust Agreement among EXFO, Germain Lamonde, GEXFO Investissements Technologiques inc., Fiducie Germain Lamonde and G. Lamonde Investissements Financiers inc. (incorporated by reference to Exhibit 4.2 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
4.1	Agreement of Merger and Plan of Reorganization, dated as of November 4, 2000, by and among EXFO, EXFO Sub, Inc., Burleigh Instruments, Inc., Robert G. Klimasewki, William G. May, Jr., David J. Farrell and William S. Gornall (incorporated by reference to Exhibit 4.1 of EXFO's annual report on Form 20-F dated January 18, 2001)
4.2	Amendment No.1 to Agreement of Merger and Plan of Agreement, dated as of December 20, 2000, by and among EXFO, EXFO Sub, Inc., Burleigh Instruments, Inc., Robert G. Klimasewski, William G. May, Jr., David J. Farrell and William S. Gornall (incorporated by reference to Exhibit 4.2 of EXFO's annual report on Form 20-F dated January 18, 2001).
4.3	Agreement of Merger, dated as of August 20, 2001, by and among EXFO, Buyer Sub, and Avantas Networks Corporation and Shareholders of Avantas Networks corporation.
4.4	Amendment No. 1 dated as of November 1, 2002 to Agreement of Merger, dated as of August 20, 2001, by and among EXFO, 3905268 Canada Inc., Avantas Networks Corporation and Shareholders of Avantas Networks.
4.5	Offer to purchase shares of Nortech Fibronic Inc., dated February 6, 2000 among EXFO, Claude Adrien Noel, 9086-9314

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- Quebec inc., Michel Bedard, Christine Bergeron and Societe en Commandite Capidem Quebec Enr. and Certificate of Closing, dated February 7, 2000 among the same parties (including summary in English) (incorporated by reference to Exhibit 10.2 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.6 Share Purchase Agreement, dated as of March 5, 2001, among EXFO Electro-Optical Engineering, Inc., John Kennedy, Glenn Harvey and EFOS Corporation (incorporated by reference to Exhibit 4.1 of EXFO's Registration Statement on Form F-3, File No. 333-65122).
- 4.7 Amendment Number One, dated as of March 15, 2001, to Share Purchase Agreement, dated as of March 5, 2001, among EXFO Electro-Optical Engineering, Inc., John Kennedy, Glenn Harvey and EFOS Corporation. (incorporated by reference to Exhibit 4.2 of EXFO's Registration Statement on Form F-3, File No. 333-65122).
- 4.8 Share Purchase Agreement, dated as of November 2, 2001 between JDS Uniphase Inc. and 3905268 Canada Inc.
- 4.9 Intellectual Property Assignment and Sale Agreement between EFOS Inc., EXFO Electro-Optical Engineering, Inc., John Kennedy, Glenn Harvey and EFOS Corporation. (incorporated by reference to Exhibit 4.3 of EXFO's Registration Statement on Form F-3, File No. 333-65122).
- 4.10 Offer to acquire a building, dated February 23, 2000, between EXFO and Groupe Mirabau inc. and as accepted by Groupe Mirabau inc. on February 24, 2000 (including summary in English) (incorporated by reference to Exhibit 10.3 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.11 Lease Agreement, dated December 1, 1996, between EXFO and GEXFO Investissements Technologiques inc., as assigned to 9080-9823 Quebec inc. on September 1, 1999 (including summary in English) (incorporated by reference to Exhibit 10.4 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.12 Lease Agreement, dated March 1, 1996, between EXFO and GEXFO Investissements Technologiques inc., as assigned to 9080-9823 Quebec inc. on September 1, 1999 (including summary in English) (incorporated by reference to Exhibit 10.5 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.13 Lease renewal of the existing leases between 9080-9823 Quebec inc. and EXFO, dated November 30, 2001.
- 4.14 Loan Agreement between EXFO and GEXFO Investissements Technologiques inc., dated May 11, 1993, as assigned to 9080-9823 Quebec inc. on September 1, 1999 (including summary in English) (incorporated by reference to Exhibit 10.9 of EXFO's Registration Statement on Form F-1, File No. 333-38956).

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- 4.15 Resolution of the board of directors of EXFO, dated September 1, 1999, authorizing EXFO to acquire GEXFO Distribution Internationale inc. from GEXFO Investissements Technologiques inc. (including summary in English) (incorporated by reference to Exhibit 10.10 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.16 Form of Promissory Note of EXFO issued to GEXFO Investissements Technologiques inc. dated June 27, 2000) (incorporated by reference to Exhibit 10.12 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.17 Credit Agreement, dated July 6, 1995, among EXFO, National Bank of Canada and Banque Nationale de Paris(Canada), as amended on December 22, 1999 and on March 28, 2000 (including summary in English) (incorporated by reference to Exhibit 10.1 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.18 Term Loan Offer, dated March 28, 2000, among EXFO and National Bank of Canada as accepted by EXFO on April 3, 2000 (including summary in English) (incorporated by reference to Exhibit 10.11 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.119 Sale Agreement, dated September 1, 1999, between EXFO and GEXFO Investissements Technologiques inc. (including summary in English) (incorporated by reference to Exhibit 10.14 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.120 Purchase Agreement to acquire a building dated June 7, 2000, between EXFO and Groupe Mirabau inc. (incorporated by reference to Exhibit 10.16 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.21 Employment Agreement of Germain Lamonde dated May 29, 2000 (incorporated by reference to Exhibit 10.15 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.22 Employment Agreement of Mario Larose dated as of May 30, 2000. (incorporated by reference to Exhibit 4.15 of EXFO's annual report on Form 20-F dated January 18, 2001)
- 4.23 First Amending Agreement to Employment Agreement of Mario Larose dated as of September 1, 2000. (incorporated by reference to Exhibit. 4.16 of EXFO's annual report on Form 20-F dated January 18, 2001)
- 4.24 Employment Agreement of Bruce Bonini dated as of September 1, 2000.
- 4.25 Employment Agreement of Juan-Felipe Gonzalez dated as of September 1, 2000.
- 4.26 Employment Agreement of David J. Farrell dated as of December 20, 2000.
- 4.27 Employment Agreement of William S. Gornall dated as of December 20, 2000.
- 4.28 Deferred Profit Sharing Plan, dated September 1, 1998

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(incorporated by reference to Exhibit 10.6 of EXFO's Registration Statement on Form F-1, File No. 333-38956).

- 4.29 Stock Option Plan, dated May 25, 2000 (incorporated by Reference to Exhibit 10.7 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.30 Share Plan, dated April 3, 2000 (incorporated by reference to Exhibit 10.8 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.31 Directors' Compensation Plan (incorporated by reference to Exhibit 10.17 of EXFO's Registration Statement on Form F-1, File No. 333-38956).
- 4.32 Restricted Stock Award Plan, dated December 20, 2000 (incorporated by reference to Exhibit 4.21 of EXFO's annual report on Form 20-F dated January 18, 2001).
- 8.1 Subsidiaries of EXFO.

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20 -F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

EXFO ELECTRO-OPTICAL ENGINEERING INC.

By: /s/ Germain Lamonde

Name: Germain Lamonde

Title: Chairman of the Board, President
and Chief Executive Officer

Date: January 17, 2002.

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AUDITORS' REPORT

TO THE SHAREHOLDERS OF
EXFO ELECTRO-OPTICAL ENGINEERING INC.

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We have audited the consolidated balance sheets of EXFO ELECTRO-OPTICAL ENGINEERING INC. as at August 31, 2000 and 2001 and the consolidated statements of earnings, retained earnings (deficit) and contributed surplus and cash flows for each of the years in the three-year period ended August 31, 2001. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian and United States generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at August 31, 2000 and 2001 and the results of its operations and its cash flows for each of the years in the three-year period ended August 31, 2001 in accordance with Canadian generally accepted accounting principles.

In addition, in our opinion, the financial statement schedule on the variation in the allowance for doubtful accounts included in Form 20-F presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

/S/ PRICEWATERHOUSECOOPERS LLP

CHARTERED ACCOUNTANTS

Quebec, Quebec, Canada
September 21, 2001

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EXFO ELECTRO-OPTICAL ENGINEERING INC. CONSOLIDATED STATEMENTS OF EARNINGS

(in thousands of US dollars)

	AS AT AUGUST 31,	
	2000	2001
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 729	\$ 7,729
Short-term investments (notes 7 and 18)	162,659	66,861
Accounts receivable (notes 7 and 18)		
Trade	18,272	24,531

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Other	2,790	3,660
Income taxes receivable (note 7)	284	--
Inventories (notes 4 and 7)	18,868	44,345
Prepaid expenses	1,023	1,265
Future income taxes (note 15)	995	1,423
	-----	-----
	205,620	149,814
PROPERTY, PLANT AND EQUIPMENT (notes 5 and 7)	8,694	27,140
INTANGIBLE ASSETS AND GOODWILL (notes 6 and 7)	2,320	264,242
FUTURE INCOME TAXES (note 15)	3,089	1,381
	-----	-----
	\$ 219,723	\$ 442,577
	=====	=====
LIABILITIES		
CURRENT LIABILITIES		
Bank advances (note 7)	\$ 10	\$ --
Accounts payable and accrued liabilities (note 8)	10,353	16,180
Income taxes payable	--	2,623
Mandatorily redeemable preferred shares (note 9)	543	--
Deferred revenue	395	616
Current portion of long-term debt	152	106
	-----	-----
	11,453	19,525
DEFERRED REVENUE	151	--
DEFERRED GRANTS (note 13)	1,109	1,002
LONG-TERM DEBT (note 10)	16	664
FUTURE INCOME TAXES (note 15)	--	6,581
	-----	-----
	12,729	27,772
	-----	-----
COMMITMENTS (note 11)		
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (note 12)	198,459	429,995
CONTRIBUTED SURPLUS	--	1,457
CUMULATIVE TRANSLATION ADJUSTMENT	1,555	(8,333)
RETAINED EARNINGS (DEFICIT)	6,980	(8,314)
	-----	-----
	206,994	414,805
	-----	-----
	\$ 219,723	\$ 442,577
	=====	=====

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ON BEHALF OF THE BOARD

/s/ GERMAIN LAMONDE

/s/ ANDRE TREMBLAY

 GERMAIN LAMONDE
 Chairman, President and CEO

 ANDRE TREMBLAY
 Chairman, Audit Committee

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

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EXFO ELECTRO-OPTICAL ENGINEERING INC. CONSOLIDATED BALANCE SHEET

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

	YEARS ENDED	
	1999	
	-----	-----
SALES (note 16)	\$ 42,166	\$
COST OF SALES	14,998	
	-----	-----
GROSS MARGIN	27,168	
	-----	-----
OPERATING EXPENSES		
Selling and administrative	13,279	
Net research and development (note 13)	4,315	
Amortization of property, plant and equipment	857	
Amortization of intangible assets	41	
Non-recurring expenses (note 14)	--	
	-----	-----
TOTAL OPERATING EXPENSES	18,492	
	-----	-----
EARNINGS FROM OPERATIONS	8,676	
Interest income, net	136	
Foreign exchange gain (loss)	(506)	
	-----	-----
EARNINGS BEFORE INCOME TAXES AND AMORTIZATION OF GOODWILL	8,306	
INCOME TAXES (note 15)	2,492	
	-----	-----
EARNINGS BEFORE AMORTIZATION OF GOODWILL	5,814	
AMORTIZATION OF GOODWILL	--	
	-----	-----

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NET EARNINGS (LOSS) FOR THE YEAR	\$ 5,814	\$
	=====	=====
BASIC AND DILUTED EARNINGS (LOSS) PER SHARE		
Earnings before amortization of goodwill	\$ 0.14	\$
Net earnings (loss)	\$ 0.14	\$
BASIC WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING (000'S)	38,001	
DILUTED WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING (000'S) (note 17)	38,001	

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

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EXFO ELECTRO-OPTICAL ENGINEERING INC.
CONSOLIDATED BALANCE SHEET

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

RETAINED EARNINGS (DEFICIT)	YEARS ENDED AUGUST 31,		
	1999	2000	2001
	-----	-----	-----
BALANCE - BEGINNING OF YEAR	\$ 12,044	\$ 14,592	\$ 6,980
ADD			
Net earnings (loss) for the year	5,814	9,924	(15,294)
	-----	-----	-----
	17,858	24,516	(8,314)
	-----	-----	-----
DEDUCT			
Dividends			
Class A shares	2,926	17,216	--
Class C share (note 3)	340	--	--
Class F shares	--	320	--
	-----	-----	-----
	3,266	17,536	--
	-----	-----	-----
BALANCE - END OF YEAR	\$ 14,592	\$ 6,980	\$ (8,314)
	=====	=====	=====
DIVIDENDS PER SHARE			
Class A shares	\$ 0.08	\$ 0.45	\$ --
Class C share	\$ 340	\$ --	\$ --
Class F shares	\$ --	\$ 0.45	\$ --

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CONTRIBUTED SURPLUS

	YEARS ENDED AUGUST 31,		
	1999	2000	2001
BALANCE - BEGINNING OF YEAR	\$ --	\$ --	\$ --
ADD			
Premium on resale of share capital	--	--	1,457
BALANCE - END OF YEAR	\$ --	\$ --	\$ 1,457

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

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EXFO ELECTRO-OPTICAL ENGINEERING INC.
CONSOLIDATED BALANCE SHEET

(in thousands of US dollars)

	YEARS ENDED	
	1999	2000
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings (loss) for the year	\$ 5,814	\$ 9,114
Add (deduct) items not affecting cash and cash equivalents		
Amortization of discount on short-term investments	--	--
Amortization of property, plant and equipment	857	1,114
Amortization of intangible assets	41	1,114
Foreign exchange gains on disposal of short-term investments	--	--
Non-recurring expenses	--	--
Future income taxes	(42)	--
Amortization of goodwill	--	--
Change in non-cash operating working capital items		
Accounts receivable	(3,875)	(10,114)
Income taxes receivable	(381)	2,114
Inventories	(1,259)	(10,114)
Prepaid expenses	(205)	--
Accounts payable and accrued liabilities	1,965	3,114
Income taxes payable	(115)	--
Deferred revenue	327	--
Deferred grants	533	--
	3,660	(4,114)
CASH FLOWS FROM FINANCING ACTIVITIES		

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Bank advances	(136)	
Repayment of mandatorily redeemable preferred shares	--	
Repayment of loan from a company under common control	--	(1
Repayment of long-term debt	(20)	
Issuance of share capital	86	209
Resale of share capital	--	
Redemption of share capital	--	
Share issue expenses	--	(16
Dividends paid	(3,215)	(17
	-----	-----
	(3,285)	172
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to short-term investments	(33)	(519
Proceeds from disposal of short-term investments	--	359
Additions to property, plant and equipment and intangible assets	(1,181)	(7
Business combinations (note 3)	--	(2
	-----	-----
	(1,214)	(169
	-----	-----
CHANGE IN CASH AND CASH EQUIVALENTS	(839)	
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	--	
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	1,262	
	-----	-----
CASH AND CASH EQUIVALENTS- END OF YEAR	\$ 423	\$
	=====	=====
SUPPLEMENTARY INFORMATION		
Interest paid	\$ (148)	\$
Interest received	\$ 98	\$
Income taxes paid	\$ (2,801)	\$ (3

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

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EXFO ELECTRO-OPTICAL ENGINEERING INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

1 INCORPORATION AND NATURE OF ACTIVITIES

The company, incorporated in 1985 under the Canada Business Corporations Act, designs, manufactures and markets a full line of fiber-optic test, measurement and automation solutions for the telecommunications industry to measure the physical characteristics of optical fiber and related hardware and to automate manufacturing processes. The company derives substantially all of its revenue from customers located in the United States, Canada, Europe, Asia and South America. The company's customers

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consist primarily of telecommunications carriers, optical component and system manufacturers, as well as research and development laboratories.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES BASIS OF PRESENTATION

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada. These principles conform, in all material respects, with accounting principles generally accepted in the United States, except as described in note 19. The principal accounting policies of the company, which have been consistently applied, are summarized as follows:

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 disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting year. Actual results could differ from those estimates.

CONSOLIDATION

These consolidated financial statements include the accounts of the company and its domestic and international subsidiaries. Intercompany accounts and transactions have been eliminated.

REPORTING CURRENCY

The consolidated financial statements of the company were presented in Canadian dollars up to August 31, 1999. Effective September 1, 1999, the US dollar has been adopted as the reporting currency. The functional currency continues to be the Canadian dollar. The financial statements for the year ended August 31, 1999 are presented in US dollars in accordance with a translation of convenience method using the representative exchange rate as at August 31, 1999 of US\$1.00 = Cdn\$1.4958. The translated amount for monetary and

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

non-monetary items as at August 31, 1999 became the historical basis for those items in subsequent years.

The financial statements as at August 31, 2000 and 2001 and for the years then ended have been translated using the current rate method. Under this method, the financial statements are translated into the reporting currency as follows: assets and liabilities are translated at the exchange rate in effect at the date of the balance sheet and revenues and expenses are translated at the average exchange rate for the year. All gains and losses resulting from the translation of the financial statements into the reporting currency are included in the cumulative translation adjustment

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in shareholders' equity.

FOREIGN CURRENCY TRANSLATION

Foreign currency transactions

Transactions denominated in currencies other than the functional currency are translated into the functional currency as follows: monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date and revenues and expenses are translated at the average rate for the year. Non-monetary assets and liabilities are translated at historical rates. Gains and losses arising from such translation are reflected in the statements of earnings.

Foreign subsidiaries

The financial statements of integrated foreign operations are remeasured into the functional currency using the temporal method. Under this method, monetary assets and liabilities are remeasured at the exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are remeasured at historical rates. Revenues and expenses are remeasured at the average rate for the year. Gains and losses resulting from remeasurement are reflected in the statements of earnings.

The financial statements of self-sustaining operations with a functional currency other than the US dollar are remeasured into the functional currency using the current rate method. Under this method, assets and liabilities are remeasured at the exchange rates in effect at the balance sheet date and revenues and expenses are remeasured at the average rate for the year. Gains and losses resulting from remeasurement are reflected in the cumulative translation adjustment in shareholders' equity.

Forward exchange contracts

The company enters into forward exchange contracts in order to hedge against potential exchange rate fluctuations on cash flows related to anticipated future revenue streams denominated in foreign currencies. Unrealized gains and losses on these forward exchange contracts are deferred and recognized upon settlement of the related transactions.

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Accordingly, cash flows resulting from forward exchange contract settlements are classified as cash flows from operating activities along with the corresponding cash flows being hedged.

In 2000, the company entered into forward exchange contracts to sell Canadian dollars in exchange for US dollars. These contracts, which were speculative in nature, were carried on at fair value as at August 31, 2000. The unrealized loss on these contracts as at August 31, 2000 has been included in earnings for that year. As at August 31, 2001, the company does not hold such forward exchange contracts.

CASH AND CASH EQUIVALENTS

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Cash and cash equivalents consist of cash on hand and balances with banks and all highly liquid short-term investments with original maturities of three months or less.

SHORT-TERM INVESTMENTS

Short-term investments are valued at the lower of cost and market value. Cost is composed of acquisition cost plus amortization of discount or less amortization of premium.

INVENTORIES

Inventories are valued at the lower of cost and net realizable value. The cost of raw materials and work in progress is determined using the first-in, first-out method. The cost of finished goods is determined using the average cost method.

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 their estimated useful lives as follows:

	TERM
Buildings	15 and 25 years
Equipment	2 to 7 years
Leasehold improvements	Remaining lease term including lease renewal option

The carrying value of property, plant and equipment is evaluated for impairment whenever significant events occur which may indicate an impairment in value, based upon a comparison of the carrying value to the net recoverable amount.

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EXFO ELECTRO-OPTICAL ENGINEERING 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 include the cost of acquired in process research and development, core technology, work force and trademark, net of accumulated amortization. Intangible assets are amortized on a straight-line basis over their estimated useful lives ranging from five to eight months for in process research and development, of five years for core technology, of one year for work force and of two years for trademark.

Goodwill, which represents the excess of the purchase price of acquired businesses over the estimated fair value of net identifiable assets acquired, is amortized on a straight-line basis over the estimated useful life of five years.

Intangible assets and goodwill are reviewed for impairment when events or circumstances indicate that costs may not be recoverable. Impairment exists when the carrying value of the asset is greater than the pre-tax

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undiscounted future cash flows expected to be provided by the asset. The amount of impairment loss, if any, is the excess of the carrying value over the estimated pre-tax undiscounted future cash flows. Intangible assets and goodwill are written down for any permanent impairment in value of the unamortized portion. As at August 31, 2001, there are no events or circumstances indicating that the carrying value may not be recoverable.

REVENUE RECOGNITION

For products where the software is incidental, the company recognizes revenue when the products are delivered, with provisions made for estimated returns, warranties and support obligations.

For products where software is not incidental, the revenues are separated into two categories, product and customer support revenues based upon vendor-specific objective evidence of fair value. The product revenues for these sales are recognized when the products are delivered with provisions made for estimated returns and warranties. The customer support revenues are deferred and recognized ratably over the years of the support arrangement, except where provided within one year of delivery, costs of providing this support are insignificant and accrued at the time of delivery and no upgrades of software are provided.

ADVERTISING COSTS

Advertising costs are expensed as incurred.

GOVERNMENT GRANTS

Government grants are accrued as a receivable when there is reasonable assurance that the company has complied and will continue to comply with all the conditions related to the

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

grant. 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 asset. Grants related to job creation and training programs for extended periods are deferred and amortized on a straight-line basis over the minimum period for which the created job must be maintained or training provided.

RESEARCH AND DEVELOPMENT EXPENSES

All expenses related to development activities, which do not meet generally accepted criteria for deferral, and research are expensed as incurred, net of related tax credits and government grants. Development expenses which meet generally accepted criteria for deferral are capitalized, net of related tax credits and government grants, and amortized against earnings over the estimated period of benefit.

As at August 31, 2001, the company had not deferred any development costs.

INCOME TAXES

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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 using enacted income tax rates expected to be in effect for the years in which the differences are expected to reverse.

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 (LOSS) PER SHARE

During the year, the company adopted the Canadian Institute of Chartered Accountants (CICA) section 3500 "Earnings per Share", which requires the use of the treasury stock method in calculating diluted earnings per share and to apply the concept of contingently issuable shares. This standard has been applied retroactively and did not result in any material change to previously reported basic and diluted earnings per share.

Basic earnings (loss) and dividends per share are determined using the weighted average number of common shares outstanding during the year, as adjusted for the effects of reorganizations of share capital in prior years.

Diluted earnings (loss) per share are determined using the weighted average number of common shares outstanding during the year, plus the effects of dilutive potential common shares outstanding during the year. This method requires that diluted earnings (loss) per share be calculated, using the treasury stock method, as if all potential common shares had

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

been exercised at the later of the beginning of the year or the date of issuance, as the case may be, and that the funds obtained thereby be used to purchase common shares of the company at the average fair value of the common shares during the year.

STOCK-BASED COMPENSATION PLANS

The company maintains stock-based compensation plans, which are described in note 12. Under accounting principles generally accepted in Canada, no compensation cost is recognized when stocks, stock options or stock awards are issued to plan participants. Any consideration received from plan participants upon the purchase of stock or the exercise of stock options or stock awards is credited to share capital. Cash amounts paid upon the exercise of stock appreciation rights are charged to earnings.

NEW ACCOUNTING STANDARDS

On August 1, 2001, the CICA issued section 1581 "Business combinations", which supersedes section 1580, and issued section 3062 "Goodwill and Other Intangible Assets". Section 1581 requires business combinations initiated

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after June 30, 2001 or business combinations accounted for by the purchase method with a date of acquisition after June 30, 2001 to be accounted for using the purchase method of accounting. This section also broadens criteria for recording intangible assets separately from goodwill. Upon the adoption of section 3062, recorded goodwill and intangible assets will be evaluated against those new criteria and may result in certain intangible assets being reclassified into goodwill or, alternatively, amounts initially recorded as goodwill being separately identified and recognized apart from goodwill as intangible assets. Section 3062 requires the use of a non-amortization approach to account for purchased goodwill and indefinite-lived intangibles. Under non-amortization approach, goodwill and indefinite-lived intangibles will not be amortized, but instead they will be reviewed for impairment and written down and charged to earnings only in the periods in which the recorded value of goodwill and indefinite-lived intangibles exceeds their fair value. This section will be adopted on September 1, 2002.

The impact of adopting section 3062 will allow the company to use the non-amortization approach for goodwill and will reduce annual goodwill amortization by approximately \$50,000,000. Moreover, the company will implement a new goodwill impairment methodology and any potential initial impairment losses on goodwill determined by this methodology will be charged to deficit. Any subsequent impairment losses on goodwill will be charged to earnings in the period in which it is incurred.

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

3 BUSINESS COMBINATIONS

BUSINESS COMBINATIONS DURING 2001

BURLEIGH INSTRUMENTS, INC.

On December 20, 2000, the company acquired a 100% interest in Burleigh Instruments, Inc. ("Burleigh"), a U.S. company which manufactures precision scientific instruments used in basic and applied research, engineering and production test applications in a variety of fields, in exchange for a total consideration valued at US\$189,270,000, including acquisition-related costs of US\$2,461,000.

The consideration paid consisted of US\$42,461,000 in cash and the issuance of 6,488,816 subordinate voting shares for an amount of US\$146,809,000.

Furthermore, as part of this acquisition, the company established a restricted stock award plan for employees of Burleigh (note 12). This plan provides that in the event of an employee's departure, shares to be issued to this employee under the plan will be issued to Burleigh's former shareholders. In such circumstances, this issuance of shares will be recorded as additional goodwill.

EFOS INC. (RENAMED EXFO PHOTONIC SOLUTIONS INC.)

On March 15, 2001, the company acquired a 100% interest in EXFO Photonic Solutions Inc. ("EXFO Photonic"), a Canadian company specializing in

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precision light-based adhesive spot curing technologies as well as curing process control for the global optical component manufacturing market. This acquisition was settled for a total consideration valued at US\$110,146,000, including acquisition-related costs of US\$194,000. The consideration paid consisted of US\$25,194,000 in cash and the issuance of 3,700,000 subordinate voting shares for an amount of US\$84,952,000.

These acquisitions have been accounted for using the purchase method and consequently, the net earnings of Burleigh and EXFO Photonic have been included in the consolidated statement of earnings of the company from the date of acquisition of these subsidiaries, being December 20, 2000 for Burleigh and March 15, 2001 for EXFO Photonic.

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EXFO ELECTRO-OPTICAL ENGINEERING 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, has been allocated based on the estimated fair value of net assets at the dates of acquisition as follows:

	BURLEIGH	EXFO PHOTONIC
	-----	-----
Assets acquired		
Current assets	\$ 7,092	\$ 9,195
Property, plant and equipment	4,457	1,054
In process research and development	1,800	972
Core technology	24,000	25,324
Work force	1,250	907
Trademark	-	421
Liabilities assumed	(9,068)	(7,169)
Future income taxes	(8,342)	(983)
	-----	-----
Net identifiable assets acquired	21,189	29,721
Goodwill	168,081	80,425
	-----	-----
Purchase price	189,270	110,146
Less: Subordinate voting shares issued	146,809	84,952
	-----	-----
Cash paid	\$ 42,461	\$ 25,194
	=====	=====

The fair value allocated to intangible assets acquired from Burleigh and EXFO Photonic was based upon independent valuations performed in

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conjunction with these acquisitions.

The existing technology that has reached technological feasibility was classified as core technology.

Acquired in process research and development represents the existing technology that has not reached technological feasibility and has no future alternative use.

The fair value of subordinate voting shares issued as part of these business combinations was determined based on the market price of the shares over a reasonable period of time before and after the dates of acquisition of the subsidiaries.

VANGUARD TECHNICAL SOLUTIONS, INC.

On March 16, 2001, the company, through one of its subsidiaries, Burleigh Automation Inc., acquired substantially all the assets of Vanguard Technical Solutions, Inc., a U.S. company

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

specializing in the design and manufacturing of ultra-precision assembly equipment for sensitive process and critical assembly challenges on the production floor. This acquisition, which was settled for a total cash consideration of US\$600,000 allocated to property and equipment, has been accounted for using the purchase method.

BUSINESS COMBINATIONS DURING 2000

NORTECH FIBRONIC INC.

On February 4, 2000, the company acquired a 100% interest in Nortech Fibronic Inc. ("Nortech"), a Canadian company specializing in fiber-optic testing and temperature sensing, in exchange for total consideration valued at US\$2,799,000. The consideration paid consisted of US\$2,108,000 in cash, the issuance of 800,000 Class G shares which were mandatorily redeemable, for cash or subordinate voting shares at the option of the company, for an amount of US\$553,000 (note 9), and a non-interest-bearing debenture in the amount of US\$138,000 (note 10).

This acquisition has been accounted for using the purchase method. The estimated fair value of assets and liabilities acquired amounted to US\$2,488,000 and US\$2,231,000 respectively, resulting in goodwill of US\$2,542,000 related to the telecommunication core business.

The net earnings of Nortech have been included in the consolidated statement of earnings of the company from the date of acquisition, being February 4, 2000.

The mandatorily redeemable preferred shares were settled during the year for US\$354,000, resulting in a purchase price adjustment of US\$189,000 (note 9), which has been applied against goodwill.

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GAP OPTIQUE S.A.

On June 1, 2000, the company acquired the 85% interest in GAP Optique S.A. held by its parent company for a cash consideration of US\$16,000. The carrying value of the net assets of GAP Optique S.A. was US\$19,000 as at December 31, 1999. Since the exchange occurred between entities under common control, the exchange has been accounted for in a manner similar to a pooling of interests. The assets, liabilities and shareholders' equity of the company and GAP Optique S.A. have been combined using their respective carrying amounts, and financial statements of prior years have been restated as if the companies had always been combined.

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EXFO ELECTRO-OPTICAL ENGINEERING INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

BUSINESS COMBINATION DURING 1999

GEXFO DISTRIBUTION INTERNATIONALE INC.

On September 1, 1998, the company acquired, from its parent company, all the issued and outstanding shares of GEXFO Distribution Internationale Inc. in exchange for 1 Class C share of the company, which was redeemed at a price of US\$340,000. This holding company had two wholly-owned subsidiaries, EXFO America Inc. and EXFO Europe S.A.R.L., which market the company's products for the American and European markets.

Since the exchange was between entities under common control, the exchange has been accounted for in a manner similar to a pooling of interests. The assets, liabilities and shareholders' equity of the company and these companies have been combined using their respective carrying amounts, and financial statements of prior years have been restated as if the companies had always been combined.

4 INVENTORIES

	AS AT AUGUST 31,	
	2000	2001
	-----	-----
Raw materials	\$ 12,057	\$ 29,891
Work in progress	2,910	3,507
Finished goods	3,901	10,947
	-----	-----
	\$ 18,868	\$ 44,345
	=====	=====

5 PROPERTY, PLANT AND EQUIPMENT

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AS AT AUGUST 31, 2000

	COST	ACCUMULATED AMORTIZATION	NET
Land	\$ 299	\$ -	\$ 299
Building	3,442	32	3,410
Equipment	8,451	4,158	4,293
Leasehold improvements	1,373	681	792
	-----	-----	-----
	\$ 13,565	\$ 4,871	\$ 8,694

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EXFO ELECTRO-OPTICAL ENGINEERING 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, 2001

	COST	ACCUMULATED AMORTIZATION	NET
Land	\$ 2,735	\$ -	\$ 2,735
Buildings	9,077	326	8,751
Equipment	23,906	9,286	14,620
Leasehold improvements	2,390	1,356	1,034
	-----	-----	-----
	\$ 38,108	\$ 10,968	\$ 27,140
	=====	=====	=====

6 INTANGIBLE ASSETS AND GOODWILL

	AS AT AUGUST 31, 2000	AS AT AUGUST 31,	
	NET	COST	ACCUMULATED AMORTIZATION
In process research and development	\$ -	\$ 2,769	2,769
Core technology	-	49,483	5,678
Work force	-	2,155	1,281
Other assets	68	637	246

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	-----	-----	-----
	68	55,044	9,974
Goodwill	2,252	250,497	31,325
	-----	-----	-----
	\$ 2,320	\$ 305,541	\$ 41,299
	=====	=====	=====

7 CREDIT FACILITIES

The company has available credit facilities under lines of credit which provide for advances of up to Cdn\$13,000,000 (US\$8,400,000) and up to US\$3,000,000. These facilities, which are renewable annually, bear interest at prime rate (prime rate in 2000). Accounts receivable, inventories and all tangible and intangible assets of the company have been pledged as security against these facilities. Amounts of Cdn\$15,000 (US\$10,000) and nil were drawn against these facilities as at August 31, 2000 and 2001, respectively.

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EXFO ELECTRO-OPTICAL ENGINEERING INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

8 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	AS AT AUGUST 31,	
	-----	-----
	2000	2001
	-----	-----
Trade	\$ 6,847	\$ 7,732
Salaries and social benefits	1,698	3,917
Commissions	966	1,307
Non-recurring expenses (note 14)	-	1,230
Warranty	392	901
Other	450	1,093
	-----	-----
	\$ 10,353	\$ 16,180
	=====	=====

9 MANDATORILY REDEEMABLE PREFERRED SHARES

Authorized - unlimited as to number, without par value Preferred, non-voting, ranking in priority to subordinate and multiple voting shares, each series ranking pari passu with the preferred shares of every other series, issuable in one or more series Preferred Series 1, non-voting, redeemed on November 30, 2000.

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On February 7, 2000, the company filed articles of amendment pursuant to which the Class G shares were created.

Prior to June 29, 2000, the company's authorized mandatorily redeemable preferred shares consisted of Class B, C, E and G shares.

On June 29, 2000, the company filed articles of amendment pursuant to which preferred shares issuable in series and preferred shares Series 1 were created, the 800,000 issued and outstanding Class G shares were converted into 800,000 preferred shares Series 1 and Class B, C, E and G shares were cancelled.

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EXFO ELECTRO-OPTICAL ENGINEERING 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 the preferred share activity since August 31, 1998:

		CLASS C SHARE		
		NUMBER	AMOUNT	
Balance as at August 31, 1998		-	\$ -	19,0
Business combination (note 3)		1	340	
Redemption		(1)	(340)	
Conversion of Class E shares into Class A shares (note 12)		-	-	(19,0
		-----	-----	-----
Balance as at August 31, 1999, 2000 and 2001		-	\$ -	=====
		=====	=====	=====
		CLASS G SHARE		
		NUMBER	AMOUNT	
Balance as at August 31, 1998 and 1999		-	\$ -	
Business combination (note 3)		800,000	555	
Conversion of Class G shares into preferred shares Series 1		(800,000)	(555)	8
Foreign currency translation adjustment		-	-	
		-----	-----	-----
Balance as at August 31, 2000		-	-	8
Redemption		-	-	(8
Purchase price adjustment				

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(note 3)	-	-
	-----	-----
Balance as at August 31, 2001	-	\$ -
	=====	=====

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EXFO ELECTRO-OPTICAL ENGINEERING INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

10 LONG-TERM DEBT

	AS AT AUGUST 31,	
	2000	2001
	-----	-----
Loans collateralized by equipment, bearing interest at 9.6%, repayable in monthly instalments of \$13,000 including principal and interest, maturing in 2008	\$ -	\$ 754
Unsecured non-interest-bearing debenture, repaid during the year (note 3)	136	-
Unsecured non-interest-bearing loan repayable through July 2002	32	16
	-----	-----
	168	770
Less: Current portion	152	106
	-----	-----
	\$ 16	\$ 664
	=====	=====

As at August 31, 2001, minimum principal repayments required in each of the next five years are \$106,000 in 2002, \$100,000 in 2003, \$110,000 in 2004, \$122,000 in 2005 and \$134,000 in 2006.

11 COMMITMENTS

The company has entered into operating leases for its premises, which expire at various dates through to 2007. Minimum rentals payable under these operating leases amount to \$3,170,000 as at August 31, 2001.

For the years ended August 31, 1999, 2000 and 2001, rental expense amounted to \$344,000, \$579,000 and \$1,580,000, respectively.

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12 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 ten 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

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EXFO ELECTRO-OPTICAL ENGINEERING INC.
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(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

Prior to June 29, 2000, the company's authorized share capital consisted of Class A, D and F shares.

On September 2, 1998, the company filed articles of amendment pursuant to which the Class A shares were split on a 190,000-to-one basis. Pursuant to articles of amendment dated September 3, 1998, the 100 issued and outstanding Class E shares (note 9) were converted into Class A shares on a 190,000-to-one basis. All references to numbers of shares and per share amounts have been restated in order to reflect the share split and conversion noted above.

On June 29, 2000, the company filed articles of amendment pursuant to which subordinate and multiple voting shares were created, the 38,000,000 issued and outstanding Class A shares were converted into 38,000,000 multiple voting shares, the 707,264 issued and outstanding Class F shares were converted into 707,264 subordinate voting shares and the Class A, D and F shares were cancelled.

The following tables summarize the share capital activity since August 31, 1998:

	CLASS A SHARES		C
	NUMBER	AMOUNT	
Balance as at August 31, 1998	19,000,000	\$ 1	
Conversion of Class E shares into Class A shares (note 9)	19,000,000	--	
Issued for cash under stock purchase plan	--	--	197,
	-----	-----	----
Balance as at August 31, 1999	38,000,000	\$ 1	197,
Issued for cash under stock purchase plan	--	--	509,
Conversion of Class F shares into			

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subordinate voting shares	--	--	(707,
Conversion of Class A shares into multiple voting shares	(38,000,000)	(1)	
Balance as at August 31, 2000 and 2001	=====	\$ =====	=====

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EXFO ELECTRO-OPTICAL ENGINEERING INC.
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(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

	MULTIPLE VOTING SHARES		SUBORDINATE VOTING SHARES	
	NUMBER	AMOUNT	NUMBER	AMOUNT
Balance as at August 31, 1998 and 1999	-	\$ -	-	\$ -
Conversion of Class F shares into subordinate voting shares	-	-	707,264	
Conversion of Class A shares into multiple voting shares	38,000,000	1	-	
Issued pursuant to the initial public offering	-	-	8,050,000	209,
Share issue expenses, net of related income taxes of \$5,425,000	-	-	-	(11,
	-----	-----	-----	-----
Balance as at August 31, 2000	38,000,000	1	8,757,264	198,
Business combinations (note 3)	-	-	10,188,816	231,
Conversion of multiple voting shares into subordinate voting shares	(100,000)	-	100,000	
Redemption	-	-	(43,999)	
Resale	-	-	43,999	
Share issue expenses, net of related income taxes of \$106,000	-	-	-	(
	-----	-----	-----	-----
Balance as at August 31, 2001	37,900,000	\$ 1	19,046,080	\$ 429,
	=====	=====	=====	=====

STOCK PURCHASE PLAN

The company's stock purchase plan terminated at the time of the initial public offering, being June 29, 2000. In accordance with that plan,

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officers, directors and key employees could purchase Class F shares up to a maximum of 5% of all participating, issued and outstanding shares of the company. The purchase price of shares under that plan was determined as a multiple of the company's equity as at the end of the preceding fiscal year. Shares issued under that plan are restricted as to sale and transferability for a period of at least five years from the date of acquisition. Prior to its initial public offering, the company issued 707,264 Class F shares in exchange for a weighted average cash consideration of Cdn\$0.98 (US\$0.68) per share. As at August 31, 2001, the company has guaranteed the repayment of third party loans totalling Cdn\$218,000 (US\$141,000) obtained by certain employees with respect to the purchase of Class F shares.

STOCK OPTION PLAN

In May, 2000, the company established a stock option plan for directors, executive officers, employees and consultants and those of the company's subsidiaries, as determined by the Board of Directors.

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The maximum number of subordinate voting shares issuable under the plan cannot exceed 4,470,961 shares. The maximum number of subordinate voting shares that may be granted to any individual cannot exceed 5% of the number of outstanding subordinate voting shares. The exercise price is the market price of the common shares on the date of grant. Options granted under the plan generally expire ten years from the date of grant. Options granted under the plan generally vest over a four-year period, with 25% vesting on an annual basis commencing on the first anniversary of the date of grant. Up to October 10, 2000, the number of options which ultimately would become exercisable in any given year, and in aggregate, was dependent on the degree to which the company's financial performance objectives were met. Nevertheless, on October 10, 2000, the Board of Directors of the company amended the vesting terms for options granted pursuant to the option plan to remove the financial performance criterion. Accordingly, options granted vest over the four-year period. The Board of Directors may accelerate the vesting of any or all outstanding options upon the occurrence of a change of control.

The following table summarizes the stock option activity since May 2000:

	YEARS ENDED AUGUST 31,		
	2000		
	NUMBER	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER
Outstanding - Beginning of year	-	\$ -	609,734
Granted	609,734	26	2,153,352
Forfeited	-	-	(348,855)

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Outstanding - End of year	609,734	\$ 26	2,414,231
Exercisable - End of year	-	\$ -	510,244

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

The following table summarizes information about stock options as at August 31, 2001:

EXERCISE PRICE	OPTIONS OUTSTANDING AS AT AUGUST 31, 2001		OPTIONS EXERCISABLE AS AT AUGUST 31, 2001
	NUMBER	WEIGHTED AVERAGE CONTRACTUAL LIFE REMAINING	NUMBER
\$19.19 to \$29.99	1,965,551	9.3 years	510,244
\$30.00 to \$39.99	72,500	9.1 years	-
\$40.00 to \$49.99	282,550	9 years	-
\$50.00 to \$56.75	93,630	9 years	-
	2,414,231	9.2 years	510,244

RESTRICTED STOCK AWARD PLAN

On December 20, 2000, the company established a restricted stock award plan for employees of Burleigh. A total of 359,781 stock awards entitle employees to receive an equal aggregate number of subordinate voting shares at a purchase price of nil. Stock awards granted under the plan vest over a four-year period, with 25% vesting on an annual basis commencing on the first anniversary of the date of grant. The plan will expire on December 20, 2004.

As at August 31, 2001, none of the 359,781 outstanding stock awards were exercisable.

STOCK APPRECIATION RIGHT PLAN

On August 4, 2001, the company established a stock appreciation right plan for certain of its employees. Under that plan, eligible employees are

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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 ten years from the date of grant.

Stock appreciation rights generally vest over a four-year period, with 25% vesting on an annual basis commencing on the first anniversary of the date of grant.

During the year, the company granted 22,400 stock appreciation rights with a weighted average exercise price of US\$29.72 and none of them were exercisable as at August 31, 2001.

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Considering the market price of the common shares of US\$12.09 as at August 31, 2001, no compensation expense has been recorded in 2001 under that plan.

13 OTHER DISCLOSURES

NET RESEARCH AND DEVELOPMENT EXPENSES

Net research and development expenses comprise the following:

	YEARS ENDED AUGUST 31,		
	1999	2000	2001
	-----	-----	-----
Gross research and development expenses	\$ 6,390	\$ 9,374	\$ 17,601
Research and development tax credits	(1,935)	(2,436)	(3,369)
Government grants	(140)	(536)	(631)
	-----	-----	-----
	\$ 4,315	\$ 6,402	\$ 13,601
	=====	=====	=====

OTHER GRANTS AND TAX CREDITS

During 1998, the company entered into an agreement with the Quebec Minister of Industry, Commerce, Science and Technology (the "Minister"). Pursuant to this agreement, the Minister agreed to contribute, in the form of grants, up to a maximum of Cdn\$600,000 (US\$388,000) towards interest costs incurred over the period from January 1, 1998 through December 31, 2002. In addition, the Minister agreed to provide grants up to a maximum of Cdn\$2,220,000 (US\$1,434,000) over the period from January 1, 1998 through December 31, 2002, payable based on the number of full-time jobs

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created during the period.

The above grants are subject to the condition that the company maintains its Canadian principal place of business within the Province of Quebec until at least December 31, 2002 and that jobs created pursuant to the agreement be maintained for a period of at least five years from the date of creation. Should these conditions not be met by the company, the Minister may enforce various recourse options, which include suspension or cancellation of the agreement or requiring the repayment of amounts received by the company. During the period from January 1, 1998 to August 31, 2001, the company recognized a total of Cdn\$2,820,000 (US\$1,822,000) under this program, of which Cdn\$1,505,000 (US\$972,000) has been credited to earnings with the balance of Cdn\$1,315,000 (US\$850,000) having been included in deferred grants in the balance sheet.

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Furthermore, in 1999, the company entered into another agreement with the Minister. Pursuant to this agreement, the Minister agreed to provide grants up to a maximum of Cdn\$3,756,000 (US\$2,427,000) over the period from February 1998 to June 2002, payable based on the number of jobs created and certain specific training expenses related to such jobs. The above grant is subject to the condition that 361 jobs be created pursuant to the agreement and that the new employees continue to participate in the specific training program for a period of at least ten consecutive months. Should these conditions not be met by the company, the Minister may enforce various recourse, which include suspension or cancellation of the agreement or requiring the repayment of amounts received by the company. Since 1998, the company has recognized a total of Cdn\$2,552,000 (US\$1,649,000) under this program, of which Cdn\$2,317,000 (US\$1,497,000) has been credited to earnings with the balance of Cdn\$235,000 (US\$152,000) having been included in deferred grants in the balance sheet.

Should any repayments of amounts received pursuant to these agreements be required, such repayments will be charged to earnings as the amounts of any repayments become known.

Finally, since 2000, companies operating in the Quebec City area are eligible for a refundable tax credit granted by the government of the Province of Quebec. This credit is earned on the increase of production and marketing salaries incurred in the Quebec City area at a rate of 40%. Since 2000, the company has recognized a total of Cdn\$3,387,000 (US\$2,188,000) under this program which has been credited to earnings.

The reduction in the company's work force described in note 14 had no effect on amounts recognized under these programs.

Following is a summary of the classification of these and certain other grants and tax credits (government grants) in the statements of earnings.

Interest income for the years ended August 31, 1999, 2000 and 2001 is net

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of related government grants of \$126,000, \$196,000 and \$15,000, respectively.

Cost of sales for the years ended August 31, 1999, 2000 and 2001 is net of government grants of \$33,000, \$915,000 and \$1,742,000, respectively.

Selling and administrative expenses for the years ended August 31, 1999, 2000 and 2001 are net of government grants of \$21,000, \$386,000 and \$260,000, respectively.

Research and development expenses for the years ended August 31, 1999, 2000 and 2001 are net of government grants of \$140,000, \$536,000 and \$631,000, respectively.

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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:

- o Deferred profit sharing plan

The company maintains a plan for eligible Canadian resident employees, that requires the company to contribute an amount equal to 1% of an employee's gross salary, provided that the employee has contributed at least 2% of gross salary to a tax-deferred registered retirement savings plan. Contributions to this plan during the years ended August 31, 1999, 2000 and 2001 amounted to Cdn\$156,000 (US\$104,000), Cdn\$202,000 (US\$137,000) and Cdn\$642,000 (US\$419,000), respectively.

- o 401K plans

The company maintains 401K plans for eligible U.S. resident employees. Under these plans, the company may elect to contribute an amount of up to 50% of the first 6% of an employee's current compensation, subject to certain legislated maximum contribution limits. During the years ended August 31, 1999, 2000 and 2001, the company recorded contributions totalling \$21,000, \$23,000 and \$285,000, respectively.

14 NON-RECURRING EXPENSES

During 2001, the company implemented a structured plan to reduce costs and increase efficiency.

Under that plan, the company recorded non-recurring expenses of \$3,288,000, including \$844,000 in severance expenses for the 245 employees who were terminated, \$1,476,000 for unused assets and \$968,000 for future payments on exit leased facilities. These expenses are recorded as non-recurring expenses in the statement of earnings. As at August 31,

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2001, the accrued liabilities related to this structured plan are \$1,230,000, including \$372,000 for severance expenses and \$858,000 for future payments on exit leased facilities.

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EXFO ELECTRO-OPTICAL ENGINEERING INC.
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(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

15 INCOME TAXES

The reconciliation of the income tax provision calculated using the combined Canadian federal and provincial statutory income tax rate to the provision for income taxes per the financial statements is as follows:

	YEARS ENDED AUGUST 31,		
	1999	2000	2001
	-----	-----	-----
Income taxes at combined Canadian federal and provincial statutory tax rate (38% in 1999 and 2000 and 37% in 2001)	\$ 3,156	\$ 5,897	\$ 8,855
Increase (decrease) due to:			
Manufacturing and processing deduction	(519)	(645)	(1,201)
Non-taxable income	-	-	(144)
Non-deductible expenses	40	57	274
Higher rate on interest income	-	133	480
Lower rate on foreign exchange gain	-	-	(283)
Difference between combined Canadian federal and provincial statutory tax rate and foreign subsidiaries statutory tax rates	-	-	60
Effect of consolidation of subsidiaries	-	-	(276)
Tax deductions	-	-	(136)
Other	(185)	(144)	159
Change in valuation allowance	-	-	362
	-----	-----	-----
	\$ 2,492	\$ 5,298	\$ 8,150
	=====	=====	=====
Income taxes consist of the following:			
Current	\$ 2,534	\$ 5,331	\$ 9,929
Future	(42)	(33)	(1,779)
	-----	-----	-----
	\$ 2,492	\$ 5,298	\$ 8,150
	=====	=====	=====

EXFO ELECTRO-OPTICAL ENGINEERING INC.
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(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

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

	AS AT AUGUST 31,	
	2000	2001
Future tax assets		
Property, plant and equipment and intangible assets	\$ -	\$ 107
Provisions and accruals	266	1,208
Government grants	-	247
Deferred revenue	175	198
Share issue expenses	4,358	3,128
Non-recurring expenses	-	930
Research and development expenses	94	86
Losses carried forward	105	272
Other	(6)	39
	4,992	6,215
Valuation allowance	-	(362)
	\$ 4,992	\$ 5,853
Future tax liabilities		
Property, plant and equipment and intangible assets	\$ (419)	\$ (8,640)
Research and development tax credits	(474)	(680)
Government grants	(15)	(310)
	(908)	(9,630)
Future tax assets (liabilities), net	\$ 4,084	\$ (3,777)

As at August 31, 2001, a company's subsidiary has accumulated losses for income tax purposes of approximately \$902,000 and research and development expenses of approximately \$961,000 at the provincial level for which a valuation allowance of \$362,000 has been established. These losses can be carried forward against the subsidiary's future years' taxable income until 2008. These accumulated research and development expenses can be carried forward indefinitely against the subsidiary's future years' provincial taxable income.

EXFO ELECTRO-OPTICAL ENGINEERING INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

16 SEGMENT INFORMATION

Management has organized the company under one operating segment, that being the development, manufacture and marketing of fiber-optic test, measurement and automation solutions.

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

	YEARS ENDED AUGUST 31,		
	1999	2000	2001
United States	\$ 20,755	\$ 36,139	\$ 72,604
Canada	2,973	8,006	12,531
Europe	8,721	14,503	30,568
Asia	3,199	6,486	19,059
South America	2,271	2,221	5,838
Other	4,247	4,284	5,413
	\$ 42,166	\$ 71,639	\$ 146,013
	=====	=====	=====

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

During all years presented above, there were no customers from which 10% or more of total sales were derived.

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

	AS AT AUGUST 31,	
	2000	2001
United States	\$ -	\$ 171,450
Canada	11,014	119,932
	\$ 11,014	\$ 291,382
	=====	=====

Long-lived assets consist of property, plant and equipment, intangible assets and goodwill.

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17 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 used in the diluted earnings per share calculations:

	YEARS ENDED AUGUST 31,		
	1999	2000	2001
Basic weighted average number of shares outstanding (000's)	38,001	39,951	53,014
Conversion of preferred shares Series I	-	26	-
Exercise of stock options	-	109	-
Diluted weighted average number of shares outstanding (000's)	38,001	40,086	53,014

UNAUDITED SUPPLEMENTARY PER SHARE INFORMATION

The following supplementary per share information is calculated from net earnings before the amortization of goodwill of \$31,076,000 (\$297,000 in 2000 and nil in 1999), the after-tax effect of amortization of intangible assets of \$6,513,000 (\$31,000 in 2000 and \$28,700 in 1999) and the after-tax effect of non-recurring expenses of \$2,168,000 (nil in 2000 and 1999). The unaudited supplementary information may not be comparable to similarly titled measures reported by other companies because it is non-GAAP information.

	YEARS ENDED AUGUST 31,		
	1999	2000	2001
Net earnings before amortization of goodwill and after-tax effect of amortization of intangible assets and non-recurring expenses	\$ 5,843	\$ 10,252	\$ 24,4
Basic and diluted per share net earnings before amortization of goodwill and after-tax effect of amortization of intangible assets and non-recurring expenses	\$ 0.14	\$ 0.26	\$ 0.

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18 FINANCIAL INSTRUMENTS

SHORT-TERM INVESTMENTS

Short-term investments consist of the following:

	AS AT AUGUST 31,	
	2000	2001
	-----	-----
Mutual fund denominated in Canadian dollars	\$ -	\$ 14
Commercial paper denominated in Canadian dollars, bearing interest at annual rates of 5.77% to 5.98% in 2000 and 4.35% to 4.60% in 2001, maturing on different dates between November 2000 and February 2001 in 2000 and September 2001 and November 2001 in 2001	41,872	52
Commercial paper denominated in US dollars, bearing interest at annual rates of 6.51% to 6.79%, matured in 2001	120,787	
	-----	-----
	\$ 162,659	\$ 66
	=====	=====

FAIR VALUE

Cash and cash equivalents, accounts receivable, bank advances, accounts payable and accrued liabilities and long-term debt are financial instruments whose fair values approximate their carrying values.

The fair value of short-term investments, determined based on market value, amounted to \$162,719,000 and \$66,861,000 as at August 31, 2000 and 2001, respectively.

CREDIT RISK

Financial instruments which potentially subject the company to credit risk consist principally of cash and cash equivalents, short-term investments, accounts receivable and forward exchange contracts. The company's short-term investments consist of debt instruments issued by high-credit quality financial institutions and corporations and units of a low-risk mutual fund. The company's cash and cash equivalents 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 remote.

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Due to the North American, European, Asian and South American distribution of the company's customers, there is no particular concentration of credit risk. 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 \$149,000 and \$893,000 as at August 31, 2000 and 2001, respectively.

INTEREST RATE RISK

As at August 31, 2001, the company's exposure to interest rate risk is summarized as follows:

Cash and cash equivalents	Non-interest bearing
Short-term investments	As described above
Accounts receivable	Non-interest bearing
Bank advances	Prime rate
Accounts payable and accrued liabilities	Non-interest bearing
Long-term debt	As described in note 10

FORWARD EXCHANGE CONTRACTS

The company is exposed to currency risks as a result of its export sales of products manufactured in Canada, substantially all of which are denominated in US dollars. These risks are partially hedged by forward exchange contracts and certain operating expenses. As at August 31, 2000 and 2001, the company held contracts to sell US dollars at various forward rates, which are summarized as follows:

	CONTRACTUAL AMOUNTS	WEIGHTED AVERA
	-----	-----
As at August 31, 2000		
September 2000 to August 2001	\$ 5,400	
September 2001 to April 2002	1,200	
As at August 31, 2001		
September 2001 to August 2002	\$ 15,200	
September 2002 to February 2003	1,800	

As at August 31, 2000 and 2001, these contracts resulted in deferred unrealized losses of US\$45,000 and US\$533,000, respectively, which have not been reflected in the statements of earnings.

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As at August 31, 2000, the company held forward exchange contracts to buy US dollars at various forward rates, which are summarized as follows:

	CONTRACTUAL AMOUNTS	WEIGHTED AVERA
	-----	-----
Maturing between November 2000 and January 2001	\$ 40,500	

As at August 31, 2000, these contracts resulted in an unrealized loss of US\$24,000 which has been reflected in the statement of earnings for that year.

19 UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

As a registrant with the Securities and Exchange Commission in the United States, the company is required to reconcile its financial results for significant differences between generally accepted accounting principles as applied in Canada (Canadian GAAP) and those applied in the United States (U.S. GAAP).

Additional significant disclosures required under U.S. GAAP have also been provided in the accompanying financial statements and notes. The following summarizes the significant differences between Canadian and U.S. GAAP and other required disclosures under U.S. GAAP not already disclosed in the accompanying financial statements.

RECONCILIATION OF NET EARNINGS (LOSS) TO CONFORM WITH U.S. GAAP

The following summary sets out the significant differences to the company's reported net earnings (loss) and net earnings (loss) per share which would be made to conform with U.S. GAAP:

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

	YEARS ENDED AUGUST 31	
	1999	2000
Net earnings (loss) for the year in accordance with Canadian GAAP	\$ 5,814	\$ 9,924
Non-cash stock-based compensation costs related to stock option plan	a) -	(1,464)
Non-cash stock-based compensation costs related to stock purchase plan	a) (10)	(538)
Non-cash stock-based compensation costs related to restricted stock award plan	a) -	-
Change in reporting currency	b) (44)	-
Unrealized gains on forward exchange contracts	c) 208	-
Future income taxes on forward exchange contracts	c) (67)	-
Future income taxes on acquired in process research and development	d) -	-
Amortization of goodwill	d) -	-
Net earnings (loss) for the year in accordance with U.S. GAAP	5,901	7,922
Other comprehensive income (loss)		
Foreign currency translation adjustments	b) 606	1,555
Unrealized holding gains on available-for-sale securities, net of related future income taxes	e) 36	37
Reclassification of holding gains on available-for-sale securities included in net earnings (loss), net of related future income taxes	e) -	(36)
Comprehensive income (loss)	6,543	\$ 9,478
Basic and diluted net earnings (loss) per share in accordance with U.S. GAAP	f) \$ 0.15	\$ 0.20

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As a result of the aforementioned adjustments to net earnings (loss), significant differences with respect to shareholders' equity under U.S. GAAP are as follows:

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SHARE CAPITAL

	AS AT AUGUST 31,	
	1999	2000
	-----	-----
Share capital in accordance with Canadian GAAP	\$ 87	\$ 198,459
Stock-based compensation costs related to stock purchase plan		
Current year	45	2,647
Cumulative effect of prior years	-	45
Shares issued upon business combinations	-	-
	-----	-----
Share capital in accordance with U.S. GAAP	\$ 132	\$ 201,151
	=====	=====

DEFERRED STOCK-BASED COMPENSATION COSTS

	AS AT AUGUST 31,	
	1999	2000
	-----	-----
Deferred stock-based compensation costs in accordance with Canadian GAAP	\$ 87	\$ 198,459
Stock-based compensation costs related to stock-based compensation plans		
Current year	(45)	(21,396)
Cumulative effect of prior years	-	(35)
Amortization for the year	10	2,002
Reduction of stock-based compensation costs	-	-
	-----	-----
Deferred stock-based compensation costs in accordance with U.S. GAAP	\$ (35)	\$ (19,429)
	=====	=====

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EXFO ELECTRO-OPTICAL ENGINEERING INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

OTHER CAPITAL

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	AS AT AUGUST 31,	
	1999	2000
	-----	-----
Other capital in accordance with Canadian GAAP	\$ -	\$ -
Stock-based compensation costs related to		
stock-based compensation plans		
Current year	-	18,749
Cumulative effect of prior years	-	-
Reduction of stock-based compensation costs	-	-
	-----	-----
Other capital in accordance with U.S. GAAP	\$ -	\$ 18,749
	=====	=====

RETAINED EARNINGS (DEFICIT)

	AS AT AUGUST 31,	
	1999	2000
	-----	-----
Retained earnings (deficit) in accordance with		
Canadian GAAP	\$ 14,592	\$ 6,980
Stock-based compensation costs related to		
stock-based compensation plans		
Current year	(10)	(2,002)
Cumulative effect of prior years	-	(10)
Unrealized gains on forward exchange contracts,		
net of related future income taxes		
Current year	-	-
Future income taxes on acquired in process research		
and development		
Current year	-	-
Amortization of goodwill		
Current year	-	-
Change in reporting currency		
Current year		
Net earnings	(44)	-
Dividends	24	-
Cumulative effect of prior years	1,036	1,016
	-----	-----
Retained earnings (deficit) in accordance		
with U.S. GAAP	\$ 15,598	\$ 5,984
	=====	=====

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ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

		AS AT AUGUST 31,	
		1999	2000
		-----	-----
Foreign currency translation adjustments	b)		
Balance - Beginning of year		\$ (1,622)	\$ (1,016)
Change during the year		606	1,555
		-----	-----
Balance - End of year		(1,016)	539
		-----	-----
Unrealized holding gains on available-for-sale securities, net of future income taxes	e)		
Balance - Beginning of year		-	36
Unrealized gains arising during the year, net of related future income taxes		36	37
Reclassification adjustment for amounts included in net earnings (loss), net of related future income taxes		-	(36)
		-----	-----
Balance - End of year		36	37
		-----	-----
Accumulated other comprehensive income (loss)		\$ (980)	\$ 576
		=====	=====

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EXFO ELECTRO-OPTICAL ENGINEERING INC.
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(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

BALANCE SHEETS

The following table summarizes the significant differences in balance sheet items between Canadian GAAP and U.S. GAAP:

AS AT AUGUST 31, 2000		AS AT AUGUST 31, 2000
AS REPORTED	U.S. GAAP	AS REPORTED
-----	-----	-----

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Goodwill	d)			
Cost		\$ 2,549	\$ 2,549	\$ 250,497
Accumulated amortization		(297)	(297)	(31,125)
		-----	-----	-----
		\$ 2,252	\$ 2,252	\$ 219,172
		=====	=====	=====
Shareholders' equity				
Share capital	a), d)			
	g),	\$ 198,459	\$ 201,151	\$ 429,995
Contributed surplus		-	-	1,457
Cumulative translation adjustment	b)	1,555	-	(8,333)
Deferred stock-based compensation costs	a), g)	-	(19,429)	-
Other capital	a)	-	18,749	-
Retained earnings (deficit)	a), b)			
	c), d)	6,980	5,984	(8,314)
Accumulated other comprehensive income (loss)	b), e)	-	576	-
		-----	-----	-----
		\$ 206,994	\$ 207,031	\$ 414,805
		=====	=====	=====

STATEMENTS OF CASH FLOWS

For the years ended August 31, 1999, 2000 and 2001, there are no significant differences between the statements of cash flows under Canadian GAAP as compared to U.S. GAAP.

RECONCILIATION ITEMS

A) ACCOUNTING FOR STOCK-BASED COMPENSATION

To conform with U.S. GAAP, the company measures stock-based compensation costs using the intrinsic value method (APB 25 "Accounting for Stock Issued to Employees").

Stock purchase plan

Under APB 25, compensation cost related to the stock purchase plan is measured as the difference between the fair value of the purchased stock and the purchase price paid by

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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plan participants. Compensation cost is amortized to expense over a period of five years, being the restriction period. This plan terminated at the time of the Initial Public Offering on June 29,

2000.

During the years ended August 31, 1999 and 2000, the weighted average fair value per share under the stock purchase plan amounted to \$0.68 and \$10.80, respectively. The fair value per share since inception of the plan to June 29, 2000 ranged between \$0.68 and \$18.00.

Stock option plan

In accordance with APB 25, the company's stock option plan was considered to be a variable plan until October 10, 2000. As a result of the amendment to the stock option plan described in note 12, the performance criterion was removed and the number of shares to be issued under the plan was fixed. Aggregate compensation cost for the period from the date of grant to August 31, 2001 amounts to \$2,418,000. Accordingly, the current year reflects a net reduction of the compensation cost and deferred compensation cost previously recognized of \$467,000 and \$14,544,000, respectively. Compensation cost under this plan is measured as the difference between the fair value of the underlying stock at the date of grant and the exercise price of the option. Compensation cost is amortized to expense over the estimated vesting period up to a maximum of four years.

Restricted stock award plan

Under APB 25, compensation cost related to the restricted stock award plan is measured as the difference between the fair value of the underlying stock at the date of grant and the exercise price which is nil. Compensation cost is amortized to expense over the estimated vesting period up to a maximum of four years, being the acquisition period.

Under Canadian GAAP, no compensation cost is recognized for these stock-based compensation plans.

B) CHANGE IN REPORTING CURRENCY

As mentioned in note 2, on September 1, 1999, the company adopted the US dollar as its reporting currency. Under U.S. GAAP, the financial statements, including prior years, are translated according to the current rate method. Under Canadian GAAP, at the time of change in reporting currency, the historical financial statements are presented using a translation of convenience.

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Under Canadian GAAP, the statement of earnings for the year ended August 31, 1999 was translated into US dollars using an exchange rate of US\$1.00 = Cdn\$1.4958. Under U.S. GAAP, revenues and expenses would be translated at exchange rates prevailing at the respective transaction dates. Average exchange rate for the year ended August 31, 1999 was US\$1.00 = Cdn\$1.5068. The exchange rate as at August 31, 1999 was US\$1.00 = Cdn\$1.4958.

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C) FORWARD EXCHANGE CONTRACTS

On September 1, 2000, the company prospectively adopted Statement of Financial Accounting Standard No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133) and its amendments (SFAS 138), which requires all derivatives to be carried on the balance sheet at fair value. The forward exchange contracts used by the company have not qualified for hedging accounting treatment during the year ended August 31, 2001 and accordingly, changes in the fair value of the derivatives have been charged to earnings during the year.

Prior to the adoption of SFAS 133, forward exchange contracts held by the company were accounted for in accordance with SFAS 52 under U.S. GAAP. Accordingly, certain of the forward exchange contracts held for hedging and other purposes in 1998 and 1999, for which the underlying transactions were not firmly committed, did not qualify for hedge accounting. Consequently, unrealized gains or losses on these contracts at each balance sheet date were reflected in earnings for the corresponding year.

Under Canadian GAAP, the company's forward exchange contracts held for the purpose of hedging anticipated sales qualified for hedge accounting and any unrealized gains or losses were deferred and recognized in the statement of earnings upon settlement of the related transactions.

D) BUSINESS COMBINATIONS

Under U.S. GAAP, the value of shares issued upon a business combination should be determined based on the market price of the shares over a reasonable period of time before and after the companies have reached an agreement on the purchase price, the significant terms of the agreement are known and the proposed transaction is announced.

Consequently, the measurement dates of the acquisitions of Burleigh and EXFO Photonic occurred on December 14, 2000 and March 6, 2001, respectively, the dates on which all significant terms of the agreements were known. The average market price of the shares a few days before and after those dates was \$31.09 and \$25.84, respectively. Considering the number of shares issued upon those acquisitions, the total consideration for U.S. GAAP purposes amounts to \$244,198,000 (\$189,270,000 under Canadian

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

GAAP) for Burleigh and \$120,802,000 (\$110,146,000 under Canadian GAAP) for EXFO Photonic, thus increasing share capital and goodwill under U.S. GAAP.

Furthermore, under U.S. GAAP, in process research and development acquired in a business combination is written off at the time of

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acquisition and no future income taxes are recognized on this asset in the purchase price allocation process. Under Canadian GAAP, in process research and development acquired in a business combination is capitalized and amortized over its estimated useful life. Future income taxes are recognized on the acquisition date on that asset in the purchase price allocation process. As at August 31, 2001, in process research and development recorded under Canadian GAAP was fully amortized.

E) SHORT-TERM INVESTMENTS

Under U.S. GAAP, the short-term investments would be classified as "available-for-sale" securities. Consequently, these securities would be carried at fair value, with any unrealized holding gains or losses at each balance sheet date being reflected in other comprehensive income (loss) on a net-of-tax basis. Under Canadian GAAP, short-term investments are carried at the lower of cost and market value and cost is composed of acquisition cost plus amortization of discount or less amortization of premium.

F) EARNINGS (LOSS) PER SHARE

Under U.S. GAAP, the presentation of per share figures for earnings before amortization of goodwill and of any other unaudited supplementary per share non-GAAP information is not permitted. In addition, under U.S. GAAP, amortization of goodwill would be included in the computation of earnings from operations.

G) SHARE CAPITAL

Under Canadian GAAP, restricted shares reacquired from employees under the stock purchase plan are treated as arm's length repurchases of shares whereas under U.S. GAAP, the reacquisition of shares would be accounted for as a forfeiture by the employee, resulting in any difference between the amount originally credited to share capital and the remaining deferred compensation cost being credited to compensation expense in the current period. The subsequent resale of the shares would be treated as an issuance of shares for the proceeds received.

H) NEW ACCOUNTING STANDARDS

On June 15, 2001, the Financial Accounting Standards Board issued SFAS 143, "Accounting for Asset Retirement Obligation", which is effective for fiscal years beginning on or after June 15, 2002. This standard requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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incurred if a reasonable estimate of fair value can be made. The company has not yet assessed the impact of the adoption of this new standard.

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On July 20, 2001, the Financial Accounting Standards Board issued SFAS 141, "Business Combinations" and SFAS 142, "Goodwill and Other Intangible Assets". SFAS 141 requires business combinations initiated after June 30, 2001 or business combinations accounted for by the purchase method with a date of acquisition after June 30, 2001 to be accounted for using the purchase method of accounting. This section also broadens criteria for recording intangible assets separately from goodwill. Upon the adoption of SFAS 142, recorded goodwill and intangible assets will be evaluated against those new criteria and may result in certain intangible assets being reclassified into goodwill, or alternatively, amounts initially recorded as goodwill being separately identified and recognized apart from goodwill as intangible assets. SFAS 142 requires the use of a non-amortization approach to account for purchased goodwill and indefinite-lived intangibles. Under non-amortization approach, goodwill and indefinite-lived intangibles will not be amortized, but instead would be reviewed for impairment and written down and charged to earnings only in the periods in which the recorded value of goodwill and indefinite-lived intangibles exceeds their fair value. This section will be adopted on September 1, 2002.

The impact of adopting SFAS 142 will allow the company to use the non-amortization approach for goodwill and will reduce annual goodwill amortization by approximately \$63,000,000. Moreover, the company will implement a new goodwill impairment methodology and any potential initial impairment losses on goodwill determined by this methodology will be charged to earnings.

UNAUDITED PRO FORMA INFORMATION ON BUSINESS COMBINATIONS

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

The following unaudited pro forma information reflects the results of operations as if the 2001 acquisitions had been completed on September 1, 2000 and 1999, the 2000 acquisitions had been completed on September 1, 1999 and 1998, and the 1999 acquisition had been completed on September 1, 1998.

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.

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EXFO ELECTRO-OPTICAL ENGINEERING 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,		
1999	2000	2001
-----	-----	-----

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Sales	\$ 44,948	\$ 107,262	\$ 165
Net earnings (loss)	\$ 5,689	(71,143)	\$ (56)
Basic and diluted net earnings (loss) per share	\$ 0.14	\$ (1.42)	\$ (

ACCOUNTING FOR STOCK-BASED COMPENSATION

Under U.S. GAAP, the company has elected to measure compensation cost related to grants of stock options and stock awards using the intrinsic value method of accounting. In this instance, however, under SFAS 123, Accounting for Stock-Based Compensation, the company is required to make pro forma disclosures of net earnings (loss), basic and diluted net earnings (loss) per share as if the fair value based method of accounting had been applied.

The fair value of options or awards granted was estimated using the Black-Scholes options pricing model with the following weighted average assumptions:

	YEARS ENDED AUGUST 31,	
	2000	2001
Risk-free interest rate	6.04%	5.36%
Expected volatility	75%	75%
Dividend yield	Nil	Nil
Weighted average expected life	32 months	33 months

The Black-Scholes options valuation model was developed for use in estimating the fair value of traded options and awards which have no vesting restrictions, and are fully transferable. In addition, option and award valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the company's employee stock options and stock awards have characteristics significantly different from those of traded options and awards, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options and stock awards.

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EXFO ELECTRO-OPTICAL ENGINEERING INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

If the fair value based method had been used to account for stock-based compensation costs related to stock options and stock awards issued to employees, directors and executive officers, the net earnings (loss) and related net earnings (loss) per share figures under U.S. GAAP would be as follows:

YEARS ENDED AUGUST 31,

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	----- 2000 -----	2001 -----
Pro forma net earnings (loss) for the year	\$ 8,939	\$ (39,109)
Pro forma basic and diluted net earnings (loss) per share	\$ 0.22	\$ (0.74)

20 SUBSEQUENT EVENT

ACQUISITION OF AVANTAS NETWORKS CORPORATION

On August 20, 2001, the company entered into an agreement to acquire a 100% interest in Avantas Networks Corporation, a Canadian company specializing in fiber-optic protocol testing. This acquisition is expected to be settled for a total consideration of approximately US\$95,625,000, less cash acquired of US\$28,000,000. The consideration paid will consist of US\$36,000,000 in cash and the issuance of approximately 4,400,000 subordinate voting shares. The fair value of subordinate voting shares to be issued was determined based on the market price of the shares over a reasonable period of time before and after the terms of the acquisition were agreed to and announced. This acquisition will be accounted for using the purchase method according to the new CICA section 1581. The goodwill resulting from this acquisition will not be amortized according to CICA section 3062 but will be subject to an impairment test.

This acquisition is expected to be closed in the first quarter of 2002.