EXFO INC.
Form 20-F
November 27, 2018

UNITED STATES
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, 2018; or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________; or

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report

Commission File No. 0-30895

EXFO INC.
(Exact name of Registrant as specified in its charter)

Not Applicable
(Translation of Registrant's name into English)

Canada
(Jurisdiction of incorporation or organization)

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

Benoit Ringuette, (418) 683-0211, benoit.ringuette@exfo.com, (418) 683-9839, 400 Godin Avenue, Quebec, Quebec, G1M 2K2, Canada
(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

Title of each class	Name of each exchange on which registered
Subordinate Voting Shares without par value	NASDAQ
Subordinate Voting Shares without par value	TSX

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

None
(Title of Class)

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

None
(Title of Class)

As of August 31, 2018, the registrant had 23,472,995 Subordinate Voting Shares outstanding and 31,643,000 Multiple Voting Shares outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

If this report is an annual report or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934.

Yes No

Indicate by check mark whether the registrant (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 the registrant 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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See definition of "large accelerated filer", "accelerated filer" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer
		Emerging growth company

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP	International Financial Reporting Standards as issued by the International Accounting Standards Board	Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

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If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b 2 of the Exchange Act).

Yes No

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DISCLOSURE REGARDING FORWARD-LOOKING INFORMATION

This Annual Report contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995, and we intend that such forward-looking statements be subject to the safe harbors created thereby. Forward-looking statements are statements other than historical information or statements of current condition. Words such as may, expect, believe, plan, anticipate, intend, could, estimate, continue, or similar expressions or the negative of such expressions are intended to identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events and circumstances are considered forward-looking statements. They are not guarantees of future performance and involve risks and uncertainties. Actual results may differ materially from those in forward-looking statements due to various factors including, but not limited to, macroeconomic uncertainty, including trade wars; our ability to successfully integrate businesses that we acquire; capital spending and network deployment levels in the telecommunications industry (including our ability to quickly adapt cost structures to anticipated levels of business and our ability to manage inventory levels with market demand); future economic, competitive, financial and market conditions; consolidation in the global telecommunications test, service assurance and analytics solutions markets and increased competition among vendors; capacity to adapt our future product offering to future technological changes; limited visibility with regard to the timing and nature of customer orders; delay in revenue recognition due to longer sales cycles for complex systems involving customers' acceptance; fluctuating exchange rates; concentration of sales; timely release and market acceptance of our new products and other upcoming products; our ability to successfully expand international operations and to conduct business internationally; and the retention of key technical and management personnel. Assumptions relating to the foregoing involve judgments and risks, all of which are difficult or impossible to predict and many of which are beyond our control. Other risk factors that may affect our future performance and operations are detailed in this Annual Report. We believe that the expectations reflected in the forward-looking statements are reasonable based on information currently available to us, but we cannot assure that the expectations will prove to have been correct. Accordingly, you should not place undue reliance on these forward-looking statements. These statements speak only as of the date of this document. Unless required by law or applicable regulations, we undertake no obligation to revise or update any of them to reflect events or circumstances that occur after the date of this document.

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

PART I.

Item 1. Identity of Directors, Senior Management and Advisers

Not Applicable.

Item 2. Offer Statistics and Expected Timetable

Not Applicable.

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Item 3. Key Information
A. Selected Financial Data

The consolidated statements of earnings data for the years ended August 31, 2016, 2017 and 2018 and the consolidated balance sheets data as at August 31, 2017 and 2018 have been derived from our audited consolidated financial statements that are included elsewhere in this Annual Report on Form 20-F. Consolidated statement of earnings data for the years ended August 31, 2014 and 2015 and consolidated balance sheets data as at August 31, 2014, 2015 and 2016 have been derived from our audited consolidated financial statements not included in this Annual Report on Form 20-F.

Consolidated financial statements from which the selected financial data has been derived, have been prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB).

The selected financial data should be read in conjunction with "Item 5. Operating and Financial Review and Prospects" and our audited consolidated financial statements and the related notes thereto, included in this Annual Report on Form 20-F.

	Years ended August 31,				
	2018	2017	2016	2015	2014
	(in thousands of US dollars, except share and per share data)				
Consolidated Statements of Earnings Data:					
Sales	$269,546	$243,301	$232,583	$222,089	$230,806
Cost of sales (1)	105,004	94,329	87,066	85,039	86,836
Selling and administrative (2)	98,794	86,256	82,169	82,200	86,429
Net research and development	57,154	47,168	42,687	44,003	44,846
Depreciation of property, plant and equipment	5,444	3,902	3,814	4,835	4,995
Amortization of intangible assets	10,327	3,289	1,172	2,883	4,398
Changes in fair value of cash contingent consideration	(670)	(383)			
Interest and other (income) expense	1,378	303	(828)	(155)	(326)
Foreign exchange (gain) loss	(1,309)	978	(161)	(7,212)	(1,634)
Unusual charge (2)				603	720
Share in net loss of an associate	2,080				
Gain on deemed disposal of the investment in an associate	(2,080)				
Earnings (loss) before income taxes	(6,576)	7,459	16,664	9,893	4,542
Income taxes	5,678	6,608	7,764	5,036	4,286
Net earnings (loss) for the year	(12,254)	851	8,900	4,857	256
Net loss for the year attributable to non-controlling interest	(352)				
Net earnings (loss) for the year attributable to parent interest	$(11,902)	$851	$8,900	$4,857	$256
Basic net earnings (loss) attributable to parent interest per share	$(0.22)	$0.02	$0.17	$0.09	$0.00
Diluted net earnings (loss) attributable to parent interest per share	$(0.22)	$0.02	$0.16	$0.08	$0.00
Basic weighted average number of shares used in per share calculations (000's)	54,998	54,423	53,863	56,804	60,329

Diluted weighted average number of shares used in per share calculations (000's)	54,998	55,555	54,669	57,457	61,015
Other Consolidated Statements of Earnings Data:					
Gross research and development	$65,243	$53,124	$47,875	$50,148	$52,423
Net research and development	$57,154	$47,168	$42,687	$44,003	$44,846

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	As at August 31,				
	2018	2017	2016	2015	2014
	(in thousands of US dollars)				
Consolidated Balance Sheets Data:					
Cash	$12,758	$38,435	$43,208	$25,864	$54,121
Short-term investments	2,282	775	4,087	1,487	5,726
Total assets	284,544	259,241	237,793	217,478	276,948
Long-term debt (excluding current portion)	5,907				
Share capital	91,937	90,411	85,516	86,045	111,491
Shareholders' equity	$177,921	$196,790	$181,401	$169,227	$230,287

(1) The cost of sales is exclusive of depreciation and amortization, shown separately.
(2) Selling and administrative is exclusive of unusual charge, shown separately, which represents bad debt expenses.

B. Capitalization and Indebtedness

Not Applicable.

C. Reasons for the Offer and Use of Proceeds

Not Applicable.

D. Risk Factors

Our business may be adversely affected by unfavorable general economic and market conditions.

Our business is subject to general global and regional economic conditions, particularly those in the communications test, monitoring and analytics markets. In the past, our operating results were adversely affected by unfavorable economic conditions and reduced or delayed capital spending in the Americas, Europe, Middle East and Africa (EMEA) as well as Asia-Pacific regions.

Global and regional economic conditions continue to be volatile and uncertain. If global and/or regional economic and market conditions, or economic conditions in key markets, remain uncertain or deteriorate, we may experience material adverse effects on our business. Unfavorable and/or uncertain economic and market conditions may result in lower capital spending or delayed spending by our customers on network test, monitoring and analytics solutions and, therefore, demand for our products could decline and adversely impact our revenue. Adverse economic and/or market conditions could also result in, among other things:

- difficulty in forecasting, budgeting and planning due to the uncertain spending plans of current or prospective customers;
- increased competition for fewer network projects and sales opportunities;
- increased pricing pressure that may adversely affect revenue and gross margin;
- higher cost structure compared to revenue level;
- increased risk of charges related to excess and obsolete inventories, write-offs of deferred tax assets and tax credits, and impairment of intangible assets and goodwill;

- customers' financial difficulties and increased difficulty in collecting accounts receivable;
- additional restructuring costs; and
- increased protectionism or international trade barriers.

These effects, as well as other unforeseeable effects, are difficult to forecast and mitigate. As a result, we may experience material adverse effects on our business, operating results, financial condition, and stock price.

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Fluctuations in the exchange rates between the Canadian dollar, US dollar, euro, British Pound and other currencies may adversely affect our revenues and operating results.

Our functional currency is the Canadian dollar, but we report our results in US dollars. As a result, any increase in the value of the US dollar versus the Canadian dollar, euro and British Pound could adversely affect our revenues because we generate a certain percentage of our sales in Canadian dollars, euros and British Pounds but we report them in US dollars in our financial statements.

We are also exposed to a currency risk in terms of operating results for any fluctuation in the exchange rate between the Canadian dollar, on one hand, and the US dollar, euro, British Pound and other currencies on the other. In fact, the majority of our revenues are denominated in US dollars, euros and British Pounds, but a significant portion of our cost of sales, operating expenses and capital expenditures are denominated in Canadian dollars, US dollars, euros and other currencies such as British Pounds, Rupees (India) and Renminbis (China). Even though we partially manage our exposure to currency risks with forward exchange contracts (by selling US dollars for Canadian dollars and US dollars for Indian Rupees) and even though some of our operating expenses are denominated in currencies other than the Canadian dollar, namely the US dollar, euro and British Pound, we remain exposed to fluctuations in the exchange rates between the Canadian dollar, on one hand, and the US dollar, euro and other currencies on the other. Any increase in the value of the Canadian dollar relative to the US dollar and other currencies, or any unfavorable variance between the value of the Canadian dollar and the contractual rates of our US-Canadian dollar forward exchange contracts, could result in increased expenses reported in US dollars or foreign exchange losses and have a material adverse effect on our operating results.

Foreign exchange rate fluctuations also flow through statement of earnings line items, since a significant portion of our cost of sales and operating expenses are denominated in Canadian dollars, euros, British Pounds and Indian rupees, and we report our results in US dollars. Any decrease in the value of the US dollar relative to the Canadian dollar and other currencies, could have a material adverse effect on our operating results and provide competitive advantages to our competitors.

We must continue to overcome significant competition in our targeted industries in order to keep or gain market share and achieve our growth strategy.

The market for our business activity namely designing, manufacturing, marketing and selling test, monitoring and analytics solutions for communications service providers, data center, cloud and web-scale operators as well as network equipment manufacturers is rapidly evolving and is marked by intense competition, consolidation and technical innovation. We anticipate the pace of change to remain high or even accelerate for our targeted markets in the future. We might see the emergence of new competitors or the consolidation of current competitors, as the markets for communications test, monitoring and analytics solutions evolve in response to technical innovations and economic conditions.

Main competitors in the test equipment environment include global suppliers like Anritsu Corporation, Fortive Corporation (Fluke Networks), and Viavi Solutions, as well as other players such as AFL Noyes, Deviser Instruments, Keysight (IXIA), Kingfisher International, Shineway Tech, Spirent Communications plc, VeEX Inc., and Yokogawa Electric Corporation. On the monitoring and analytics side, we mainly compete against Accedian Networks, Anritsu Corporation, Empirix, Keysight (IXIA), Netrounds, NetScout Systems, Inc., Polystar, Radcom, Spirent Communications plc, and Viavi Solutions.

Some competitors have greater financial, technical and/or marketing resources than us. Consequently, they may be able to devote greater resources to the development, marketing, manufacturing, selling and support of their products in order to capture market share.

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Competitors also may be better positioned than us to capture market share or to acquire companies and new technologies that would potentially displace our products or render them obsolete. We cannot predict whether current or future competitors will develop or market products that offer higher performance, more features, or are more cost-effective than our current or future products. To remain competitive and achieve our growth strategy, we must develop products internally or purchase technologies through acquisitions that offer higher performance and more functionality, in current and new sectors, so that we can increase our market share. Our failure to do so may harm our business, results of operations and financial condition.

We may not be able to make the acquisitions or strategic alliances needed for the development of our business and, if we do make such acquisitions or strategic alliances, we may not be able to successfully integrate the acquired businesses, products, technologies and personnel or realize the expected benefits of strategic alliances.

We intend to carefully seek businesses through acquisitions and alliances, whose products and technologies are complementary to ours, or which will enable us to expand our markets and/or our market share. For example, we made two acquisitions in fiscal 2018, namely Yenista Optics and Astellia. However, we may not be able to make beneficial transactions or a sufficient number of them in the future to meet our strategic goals. Our competitors may be in a better position to acquire the same businesses, products and technologies that we want to acquire. Our fluctuating stock price, cash position, or ability to raise capital or issue debt on favorable terms at the time of an acquisition may also affect our ability to complete such an acquisition. Acquisitions or alliances could also distract management's attention from our day-to-day business and operations. In the event of any future acquisition or strategic alliance, we could, among other things:

- issue shares that would dilute individual shareholder percentage ownership;
- incur additional debt, be subject to additional debt covenants, and incur additional interest expense;
- assume liabilities and commitments;
- incur significant expenses related to acquisition costs;
- incur significant expenses related to amortization of additional intangible assets;
- incur significant impairment losses of goodwill and intangible assets related to such acquisitions; and
- incur losses from operations.

In the event we complete acquisitions or sign strategic alliances, we may be unable to successfully integrate acquired companies or realize the expected benefits of alliances. Integration risks include, among other things:

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

Ultimately, the failure to make acquisitions or strategic alliances, or the inability to effectively integrate acquisitions and realize the expected benefits of alliances, could disrupt our overall business and harm our financial condition.

If we fail to adapt appropriately to the challenges associated with operating internationally, the expected growth of our business may be impeded, and our operating results may be affected.

For the fiscal year ended August 31, 2018, customers outside of Canada accounted for 93.2% of our sales.
Our international sales will be limited if we cannot establish and maintain relationships with international distributors, set up additional foreign operations, expand international sales channel management, hire additional personnel, develop relationships with international communications service providers, web-scale operators and network equipment manufacturers, and operate adequate after-sales support internationally.

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Even if we are able to successfully operate and expand 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, among other things:

- challenges in staffing and managing foreign operations due to the limited number of qualified candidates, employment laws and business practices in foreign countries, any of which could increase the cost and reduce the efficiency of operating in foreign countries;
- fluctuations among currencies;
- our inability to comply with import/export, environmental and other trade compliance regulations of the countries in which we do business, together with unexpected changes in such regulations, including the recently signed United States, Mexico and Canada Agreement (formerly NAFTA) and bilateral trade agreements between countries;
- measures to ensure that we design, implement and maintain adequate and effective controls over our financial processes and reporting in the future;
- failure to adhere to laws, regulations and contractual obligations relating to customer contracts in various countries;
- difficulties in establishing and enforcing our intellectual property rights;
- inability to maintain a competitive list of distributors for indirect sales;
- tariffs and other trade barriers;
- economic instability in foreign markets, including Britain's decision to exit the European Union and the impact this choice may have on doing business in Europe;
- wars, acts of terrorism and political unrest;
- language and cultural barriers;
- lack of integration of foreign operations;
- potential foreign and domestic tax consequences;
- 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;
- longer accounts receivable payment cycles and possible difficulties in collecting payments which may increase our operating costs and hurt our financial performance; and
- failure to meet certification requirements.

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

Our reliance on software development resources in India and manufacturing personnel in China may expose us to unanticipated costs or liabilities.

In addition to research and development centers in Quebec City, Canada, Montreal, Canada, Oulu, Finland, Rennes, France, Lannion, France and Valencia, Spain, we maintain a software development center in Pune, India. We also manufacture products at our wholly-owned production facility in Shenzhen, China.

Over the years, we have significantly increased our software development and manufacturing activities in India and China, respectively. There is no assurance that our reliance on software development resources in India and manufacturing personnel in China will enable us to maintain our cost structure at current levels, achieve additional cost savings, or generate greater resource efficiency. Furthermore, our software development and manufacturing efforts abroad involve significant risks in addition to the ones disclosed in other risk factors:

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difficulty in hiring and retaining appropriate engineering and manufacturing resources due to intense competition for such resources and resulting wage inflation;
- exposure to misappropriation of intellectual property and proprietary information;
- heightened exposure to changes in the economic, regulatory, security, and political conditions of these countries;

- fluctuations in currency exchange rates;
- changes in tax laws and regulations in India and China, including transfer pricing policies;
- cash management and repatriation of profit; and
- high inflation rates which could increase our operating costs and render these operations too expensive.

If we are unable to adapt to current and future changes in technology or if we are unable to introduce new and enhanced products on a timely basis, our products may become obsolete, which could prevent us from achieving our growth strategy and adversely affect our operating results.

The markets that we serve are characterized by rapidly evolving technology and industry standards that result in frequent new product introductions. For example, we are gradually transforming ourselves from a supplier of dedicated test instruments into a supplier of software-intensive monitoring and analytics solutions to meet the emerging needs of communications service providers, who are seeking to virtualize their networks in preparation for the 5G mobility cycle. While we are devoting substantial resources to meet these needs, this trend may result in lower demand for our hardware test equipment. Additionally, barriers to entry are generally lower for such software-based solutions, which may lead to increased competition for our products and services. Any failure by us to anticipate or respond to new technological developments, customer requirements or evolving standards could cause us to incur significant impairment losses of goodwill and/or losses from operations. Consequently, this could have a material adverse effect on our business, results of operations and financial condition. The development of proprietary technology entails significant technical and business risks and requires substantial expenditures and lead times. The success of our new product introductions will depend on several factors, including, among other things, our ability to:

- properly identify and anticipate customer needs;
- innovate and develop new products on a timely basis;
- gain timely market acceptance for new products;
- manufacture and deliver our new products on time, in sufficient volume and with adequate quality;
- price our products competitively;
- continue investing in our research and development programs;
- anticipate competitors' announcements of new products; and
- successfully transform the company into an end-to-end monitoring and analytics supplier.

Failure to do the above could be exploited by our competitors. If we lose market share due to lapses in our product development, our business would suffer.

We have faced pricing pressure on our existing products and expect this pressure will continue. If we do not continue to lower our manufacturing costs or introduce new products with higher margins, our gross margin may decrease, and our operating results may be adversely affected.

Increased competition in the communications test, monitoring and analytics markets, along with consolidation among competitors and customers, will likely result in ongoing downward pressure on average selling prices. For example, some of our customers have been subject to consolidation and could obtain products from a vendor other than us or demand more favorable terms and conditions from us. This, in turn, may negatively affect our gross margin. In addition, some customers may merge with or acquire our competitors and discontinue their relationships with us. Pricing pressure can result from a number of factors such as, among other things:

- increased competition for business;
- reduced demand;
- limited number of potential customers;

- competition from companies with lower production costs, including companies operating in lower-cost environments;
- introduction of new products by competitors;

- greater economies of scale for higher-volume competitors;
- large customers, who buy in high volumes, can exert substantial negotiating leverage over us; and
- resale of used equipment.

As pricing pressure will likely continue to affect our existing products, we may have to increase the number of units sold to maintain our existing sales levels. If we are unable to increase our sales levels, lower our manufacturing costs, or introduce new products with higher margins, our gross margin may decline, and our operating results may suffer.

Our products may have unforeseen defects, offer substandard technical specifications or fail to deliver the key features that customers want, all of which could harm our reputation, impede market acceptance of our products and negatively impact our business, results of operations and financial condition.

Given their complexity, our products may contain undetected software or hardware defects, inaccurate calibration or compatibility problems, or regulatory compliance issues, particularly when they are first introduced or when new versions are released. Our new products could also be substandard in terms of technical specifications or fail to deliver the key features that customers want. There can be no assurance that, despite our testing and diligent efforts, defects will not be found in new products after they have been fully deployed and operated under peak stress conditions, or that customized products will meet customer sign-off acceptance requirements. If we are unable to fix defects or other problems or meet customized requirements, we could experience, among other things:

- costly repairs;
- additional development and support costs;
- product returns or recalls;
- sales cancellations;
- damage to our brand reputation;
- loss of customers, failure to attract new customers or achieve market acceptance;
- diversion of development and engineering resources;
- legal actions by our customers, including claims for consequential damages and loss of profits; and
- 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, results of operations and financial condition.

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, with which we attempt to prevent others from using the innovations that are central to our existing and future products. As of August 31, 2018, our records indicate that we held the following portfolio of utility patents: 94 active granted US patents, 107 granted or validated patents in countries of the European Union and 48 patents in other jurisdictions. In addition, we have 27 utility patent applications (including provisional applications) pending in the US, 18 patent applications at the European Patent Office and 22 applications in other countries. The expiration dates of our active issued patents range from 2019 to 2036, with no significant active patent expiring in the near future.

Our records also indicate that, as of August 31, 2018, we held 31 active granted design patents, as well as 4 pending design patent applications, in the United States, Europe, China and other jurisdictions.

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.

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We may have to engage in litigation, formal opposition proceedings, or the like to defend our patents and other intellectual property rights or to determine the validity or scope of the proprietary rights of others. Such litigation and opposition proceedings can be time-consuming and expensive, regardless of whether we win or lose.

The process of seeking patent protection can be long and expensive and we cannot be certain that any currently pending or future application will actually result in issued patents, or that, even if a patent is issued in a particular jurisdiction, it will not be subsequently invalidated at the patent office as a result of a third-party-initiated opposition procedure. Moreover, we cannot be certain that an issued patent will be of sufficient scope or strength to provide meaningful protection or commercial advantage to us.

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 rendered ineffective 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 jurisdictions 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.

Our intellectual property rights, particularly our existing or future patents, may be invalidated, circumvented, challenged or required to be licensed to others.

Our intellectual property rights are important assets for us. Various events outside of our control pose a threat to our intellectual property rights, as well as to our products, services and technologies. For example, effective intellectual property protection may not be available in every country in which our products and services are distributed. Also, the efforts we have undertaken to protect our proprietary rights may not be sufficient or effective.

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 or are unable to protect our technology, thereby enabling others to copy or use it, we will be less able to differentiate our products and our sales may decline.

Others may claim that our products infringe upon their intellectual property rights, or they may infringe our intellectual property, and we may expend significant resources enforcing or defending our rights or suffer competitive injury.

Litigation regarding intellectual property rights is common in the technology industry and 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. Conversely, we may be required to spend significant resources to monitor and enforce our intellectual property rights.

Non-practicing entities (NPEs – also informally known as "patent trolls") are increasingly asserting patent claims against companies working in the Information and Communications Technology domain. Because their entire business model is predicated upon undertaking legal action to extract licensing and/or royalty fees from legitimate "practicing" entities, such as EXFO, they often initiate such litigation even if the purported relevance of their patent claims may be questionable. Consequently, we may be obliged to reach a negotiated monetary settlement or embark upon costly legal proceedings if an NPE asserts such claims against us.

More generally, we could incur substantial costs in defending ourselves and our customers against infringement claims asserted by any third party (including notably competitors), or in bringing infringement claims against others. 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 an infringement claim, 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.

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Our use of open source software in our products could adversely affect our ability to sell our products and subject us to possible litigation.

Some of our products contain software licensed to us by third-party authors under "open source" licenses. If our proprietary commercial software were to incorporate open source software, we might, under the terms of certain open source licenses, be required to license that combined software as well as release the source code of the combined software to third parties. This could allow third parties to use our proprietary software at no charge, could enable our competitors to create similar products with lower development effort and time, and ultimately could result in a loss of product sales and lower revenues for us.

We also could be subject to suits by parties claiming infringement of intellectual property rights in what we believe to be licensed open source software. Moreover, we cannot assure you that our internal processes for controlling our use of open source software in our products will be effective. If we are held to have breached the terms of an open source software license, we could be required to seek licenses from third parties to continue offering our products, to re-engineer our products, to discontinue the sale of our products if re-engineering could not be accomplished in a timely manner, to allow third parties to use our products at no charge under the terms of that open source software license, or to make generally available, in source code form, our proprietary software, any of which could adversely affect our business, operating results, and financial condition.

Our quarterly revenues and 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 significant fluctuations may occur in the future. Given that orders for our monitoring and analytics solutions vary in size and complexity and in certain instances require customer acceptance before revenue recognition occurs, our sales may fluctuate significantly on a quarterly basis. This risk has been amplified with the closing of the Astellia acquisition in February 2018. As well, many of our deals involve lengthy sales cycles, contract negotiations, professional services, as well as extensive product testing, installation, laboratory or network certification, including network-specific or region-specific processes. In addition, our sales and operating results generally depend on the volume and timing of the orders we receive from customers as well as our ability to fulfill received orders.

On the other hand, our cost of sales and operating expenses, which include manufacturing overhead costs, selling and administrative, research and development, as well as depreciation and amortization expenses, are relatively fixed in the short term. If we sell fewer products than anticipated, if there is a delay in the launch of new products, or if prices for our products decline, we may not be able to quickly reduce our cost of sales and operating expenses in response to lower sales. Factors that could affect the amount and timing of our sales and cause quarterly fluctuations in our revenue and operating results include, among other things:

- length of the sales cycle for certain products, especially those that are higher priced and more complex;
- sales cycle prolonged by lengthy customer acceptance;
- timing of product launches and market acceptance of our new products as well as those of our competitors;
- our ability to sustain product volumes and high levels of quality across all product lines;
- timing of shipments for large orders;
- effect of seasonality on sales and bookings; and
- losing key accounts and not successfully developing new ones.

Our sales and operating results could also be volatile due to a number of factors, some of which we have little or no control over, including, without limitation:

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- fluctuating demand for test, monitoring and analytics solutions;
- changes in the capital spending and operating budgets of our customers, which may cause seasonal or other fluctuations in product mix, volume, timing and number of orders we receive from our customers;
- order cancellations or rescheduled delivery dates;
- pricing changes by our competitors or suppliers;
- insufficient or excess inventory;
- variations in the mix between higher and lower-margin products and services;
- customer bankruptcies and difficulties in collecting accounts receivable;
- restructuring and impairment charges;
- foreign exchange rate fluctuations;
- general economic conditions, including a slowdown or recession;
- distorted effective tax rate due to non-taxable/deductible elements and unrecognized deferred tax assets; and
- effects of recent acquisitions of businesses.

We may in the future choose to reduce prices, increase spending, or modify our product portfolio in response to actions by competitors or in an effort to pursue new market opportunities. These actions may also adversely affect our business and operating results and may cause our quarterly results to be lower than the results of previous quarters. 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.

We depend on short-term arrangements with a single supplier or a limited number of suppliers for some 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 single supplier or a limited number of suppliers for several parts used to manufacture our products for which alternative sources may not be readily available. In addition, all of our orders are placed through individual purchase orders and, therefore, our suppliers may stop supplying parts to us at any time. Our reliance on a single source or limited number of suppliers could result in increased costs, delivery problems, reduced control over product pricing and quality and could require us to stockpile critical parts. Financial difficulties of suppliers could also affect our ability to obtain necessary parts in a timely manner. Any interruption or delay in the supply of any of these parts could significantly harm our ability to meet scheduled product deliveries to our customers and cause us to lose sales. Furthermore, the process of qualifying a new manufacturer for complex parts designed to our specifications, such as our optical, electronic and mechanical parts, is lengthy and would consume a substantial amount of time from our technical personnel and management. If we were required to change a supplier in a short period of time, our business would be disrupted. In addition, we may be unsuccessful in identifying a new supplier capable of meeting and willing to meet our needs on acceptable terms. Consolidation involving suppliers could further reduce the number of alternatives available to us and increase the cost of parts, which would make our products less competitive and result in lower margins.

Our failure to maintain an effective system of internal control over financial reporting means that we may not be able to accurately report our financial information or prevent fraud, which could harm our operating results and cause investors to lose confidence in our reported financial information.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

We devote significant resources and time to comply with the requirements of the Sarbanes-Oxley Act of 2002. Our efforts to comply with the annual internal control reporting requirement for each fiscal year depends on the effectiveness of our financial reporting as well as data systems and controls throughout our company and operating subsidiaries. We cannot be certain that these measures will ensure that we design, implement and maintain adequate controls over our financial processes and reporting in the future. Our failure to implement newly required or improved controls or adapt our controls, or difficulties encountered in their operation, or difficulties in the assimilation of acquired businesses into our control system, can harm our operating results, or prevent us from meeting our financial reporting obligations or result in a restatement of previously disclosed financial statements. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on our share price and our access to capital.

We require employees and managers who are knowledgeable about the specialized nature of our business. If we are unable to attract and retain sufficient numbers of highly skilled technical, sales, marketing, senior management and other personnel, our operations and financial results will suffer.

Due to the specialized nature of our business, we are highly dependent on the continued service of and on our ability to attract qualified engineering, sales, marketing, senior management and other personnel. If we are unable to attract and retain such qualified personnel, it could have a material adverse effect on our business, results of operations and financial condition.

We must also provide significant training for our employees due to the highly specialized nature of the communications test, monitoring and analytics markets. The knowledge base of our current personnel may be inadequate, or 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 international business development, product management, sales, engineering and operations – may be difficult to find. Once trained, our employees may leave the organization or be hired by our competitors and reveal highly sensitive information to them.

We may become involved in various lawsuits and legal proceedings that may substantially increase our costs and harm our business.

We may from time to time become involved in various lawsuits and legal proceedings. Litigation is subject to inherent uncertainties and an adverse result may arise from time to time that 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.

In addition, the failure of our products to perform to customer 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, but this may not be sufficient to cover all potential liability.

We may also face other types of claims by third parties in relation to the conduct of our business. A successful claim against us for an amount exceeding our policy limits would force us to use our own resources to pay the claim, which could result in a reduction of our cash available for other uses, increase our expenses and have a negative effect on our business, results of operations and financial condition.

If we suffer loss to our factories or facilities, our operations could be seriously harmed.

Our factories and facilities may be subject to catastrophic losses due to fire, vandalism, terrorism or other natural or man-made disasters. We do not have redundant multiple-site capacity and if any of our facilities or factories were to experience a catastrophic loss, it would disrupt our operations, delay production, shipments and revenue and result in large expenses, thereby harming our results of operations.

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Unexpected declines in our research and development and other tax credits and grants may have an adverse effect on our business.

Our operating results reflect substantial benefits from programs sponsored by governments for the support of research and development activities conducted in Canada, France, and Finland. In fiscal 2018, our R&D tax credits and grants, as a percentage of gross R&D expenses, increased year-over-year with the acquisitions of France-based Astellia (seven-month contribution) and Yenista Optics (11-month contribution). Altogether, research and development tax credits and grants represented 12.4% of our gross research and development expenses for the year ended August 31, 2018.

If changes in laws or government policies terminate or adversely modify the Canadian, French or Finnish government programs, under which we receive our research and development and other 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 and other expenses will materially increase or we may decrease our research and development activities.

In addition, to the extent that we may increase our research and development activities in India, or potentially acquire new companies, our increased R&D activities may not be eligible for these programs. If we were required to decrease our research and development activities or were unable to benefit from other tax credits and grants, this could have a material adverse effect on our business, results of operations and financial condition.

Changes in our effective tax rate or adverse outcomes resulting from tax audits, including international inter-company transfer price audits, may have an adverse impact on our results.

As an international corporation, we are subject to taxation in the various jurisdictions in which we conduct business. Significant judgment is required in the determination of our worldwide provision for income taxes and this determination requires the interpretation and application of complex tax laws and regulations. Our global effective tax rate may be adversely impacted by the level of earnings, by changes in the mix of earnings/losses among companies and countries which may have different statutory tax rates, by the write-off of our deferred tax assets, by the intercompany transfer price used and by changes in tax rules and regulations. We are also subject to income tax and transfer pricing audits in the respective jurisdictions in which we conduct business. We regularly assess the likelihood of adverse outcomes resulting from these audits and review the adequacy of our provisions for income taxes. There can be no assurance that the outcomes of these tax audits will not result in liabilities in excess of our provisions, which could have an adverse impact on our results and financial condition.

Our current principal stockholder has effective control over our company.

As of November 1, 2018, Germain Lamonde, our Executive Chairman of the Board, held 94.11% of the voting rights in our stock. By virtue of his stock ownership, Mr. Lamonde has effective control over all matters submitted to our stockholders, including the election of our Directors, and exercises significant control over our policies and affairs. Such concentration of voting power could have the effect of delaying, deterring or preventing a change in control or other business combinations that might otherwise be beneficial to our stockholders and may harm the market price of our shares.

If we complete major acquisitions of complementary businesses, products or technologies, 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 and new product offerings as well as competing technology and market developments. As a result, we may not be able to generate sufficient cash flows from our operations to meet additional working capital requirements, support additional capital expenditures or take advantage of acquisition opportunities. As at August 31, 2018, we held $15.0 million in cash and short-term investments, while total debt and bank loan reached $19.5 million. We also had revolving credit facilities of $52.7 million available to us as at August 31, 2018.

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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, access to credit facilities, our operating performance, as well as current debt level. 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 new investors could obtain terms more favorable than previous investors. If we raise funds through debt financing, we could incur significant borrowing costs and be required to meet restrictive debt covenants. If we are unable to raise additional funds when needed or at terms satisfactory to us, our ability to operate and grow our business could be impeded.

We continue to realign our cost structure to current and anticipated future market conditions.

We implemented restructuring plans in fiscal 2018 and 2017 to realign our cost structure to current and anticipated future market conditions. Delays in the implementation of anticipated workforce reductions in highly regulated locations outside of Canada and the US could materially impair our ability to achieve expected cost reductions or may disrupt our business. We may also fail to meet operational targets due to the loss of key employees. In addition, the anticipated cost savings and other benefits that we hope to achieve from these actions are based on many estimates and assumptions. These estimates and assumptions are subject to significant economic, competitive and other uncertainties, some of which are beyond our control. If these estimates and assumptions are incorrect, if we experience delays, or if other unforeseen events occur, our business and results of operations could be adversely affected.

We have outstanding indebtedness and may incur additional indebtedness in the future, which could adversely affect our financial condition, liquidity and results of operations.

We currently have outstanding indebtedness as well as availability to incur additional indebtedness under revolving credit facilities. We may borrow additional amounts in the future and use the proceeds from any future borrowing for general corporate purposes, future acquisitions, capital expenditures, expansion of our business or repurchases of our outstanding subordinate voting shares. Our incurrence of this debt, and increases in our aggregate levels of debt, may adversely affect our operating results and financial condition by, among other things:

- requiring a portion of our cash flows from operations to make interest payments on this debt;
- increasing our vulnerability to general adverse economic and industry conditions;
- reducing cash flows available to fund capital expenditures and other corporate purposes and to grow our business; and
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry.

Our current revolving credit facilities and bank loan imposes restrictions on us, including restrictions on our ability to create liens on our assets and the ability of our subsidiaries to incur indebtedness, and requires us to maintain compliance with specified financial ratios. Our ability to comply with these ratios may be affected by events beyond our control If we breach any of the covenants and do not obtain a waiver from the lenders, then, subject to applicable cure periods, our outstanding indebtedness could be declared immediately due and payable.

Our business and operations would suffer in the event of a failure of our information technology infrastructure.

We rely upon the capacity, efficiency and security of our information technology hardware and software infrastructures and those from third parties, as well as our ability to expand and update these infrastructures, in response to our evolving needs. Any failure to manage, expand, update or secure our information technology infrastructures or any failure in the operation of these infrastructures could harm our business.

Our information systems and third-party systems may be vulnerable to damages from computer viruses, natural disasters, unauthorized access, theft of information and other similar disruptions. Any system failure, accident or security breach could result in disruptions to our operations. To the extent that any disruption, security breach or cyber-attack results in a loss or damage to our data, or inappropriate disclosure of confidential information, it could harm our business. In addition, these events may force us to devote more money and resources in order to protect ourselves against damages caused by these disruptions or security breaches in the future.

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The enactment of new privacy laws and regulations in the jurisdictions in which we do business could require significant company resources or limit the way our customers can use our products.
The enactment of new federal, provincial, or foreign data privacy laws and regulations could prevent customers from taking advantage of all the features or capabilities of our products which, in turn, could reduce demand for certain of our products. In addition, changes in international privacy laws have required an adjustment to some of our internal processes and significant resources in the past, and future changes could require similar efforts and resources with regard to compliance. The adoption of or changes to any such data privacy laws and regulations could affect demand for our products, increase the cost of selling our products and divert time and attention of our management, all of which could have a material and adverse effect on our financial condition and results of operations. For example, the European Union (EU) data protection law, the General Data Protection Regulation (GDPR), which became effective in May 2018, is wide-ranging in scope. To adapt to these new requirements, we have invested resources necessary to enhance our policies and controls across our business units and services, relating to how we collect and use personal data from customers and employees and how vendors handle personal data we provide to them. We will also evaluate the potential impact of the Canadian "Digital Privacy Act" and the "People's Republic of China Network Security Law" that were implemented on November 1, 2018, and June 1, 2017, respectively, as well as that of the "California Consumer Privacy Act" coming into effect on January 1, 2020. Going forward, we expect that the international transfer of personal data will present ongoing compliance challenges and complicate our business transactions as we negotiate and implement suitable arrangements with international customers as well as international and domestic vendors.

Compliance with SEC rules relating to "conflict minerals" may require us and our suppliers to incur substantial expense and may result in disclosure by us that certain minerals used in components and/or products we contract to manufacture may contain such "conflict minerals".

The SEC adopted disclosure requirements under Section 1502 of the Dodd-Frank Act, regarding the source of certain conflict minerals for issuers for which such conflict minerals are necessary to the functionality or production of a product manufactured, or contracted to be manufactured, by that issuer, which are mined from the Democratic Republic of Congo ("DRC") and adjoining countries. The metals covered by the rules include tin, tantalum, tungsten and gold, commonly referred to as "3TG." Because we use components which contain tin, tantalum, tungsten or gold, the SEC rules require us to conduct a reasonable country of origin inquiry to determine if we know or have reason to believe any of the minerals used in the production process may have originated from the DRC or an adjoining country (collectively referred to as "covered countries") and, depending on the results of such inquiry, to perform further supply chain due diligence on the source and chain of custody of those minerals to determine if they originated in one of the covered countries and, if so, whether they financed or benefited armed groups in the covered countries. Our material sourcing is broad based and multi-tiered, and we may not be able to easily verify the origins for all metals used in our products. As a result, the costs of the aforementioned diligence efforts by us and by our suppliers could be significant. In addition, disclosures by us mandated by the rules which are perceived by the market to be "negative" may cause customers to refuse to purchase our products. We are unable to assess the cost of continuing compliance with this rule, and there can be no assurance that the cost will not have an adverse effect on our business, financial condition or results of operations.

If we are held liable for the violation of the applicable anti-bribery laws, it could have a material adverse effect on our business.

We are subject to the applicable anti-bribery laws in countries we do business, which generally prohibit companies, their subsidiaries, their affiliates and their intermediaries from making improper payments to government officials for the purpose of obtaining or retaining business or otherwise obtaining favorable treatment. The anti-bribery laws generally apply to companies, individual directors, officers, employees and agents. Under the applicable anti-bribery laws, companies may be held liable for actions taken by agents, local partners or representatives. If we or our intermediaries fail to comply with the requirements of the applicable anti-corruption laws, governmental authorities in the U.S., in Canada or other countries could seek to impose civil and/or criminal penalties, which could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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Our stock price is volatile.

Our stock price has experienced substantial volatility in the past and may remain volatile in the future. Volatility in our stock price can arise from a number of factors discussed in this "Risk Factors" section. Our stock price will fluctuate based on our financial performance and growth expectations. It can also be affected by public announcements from our competitors and our customers in the communications industry. In addition, turmoil in credit markets and in the broader economy can contribute to share price and volume fluctuations in global stock markets. During fiscal 2018, our closing stock price on NASDAQ ranged from a high of $4.70 per share to a low of $3.20 per share. These aforementioned factors, including volatility often unrelated to the operating performance of our company, may materially affect our stock price in the future.

Item 4. Information on the Company

A. History and Development of the Company

Our legal name and commercial name is EXFO Inc. / EXFO inc. Our head office is located at 400 Godin Avenue, Quebec, Quebec, Canada, G1M 2K2 and our main telephone number is (418) 683-0211. Our e-mail address is info@EXFO.com and our website is www.EXFO.com. Information on our website is not incorporated by reference in this Annual Report. Our agent for service in the United States is CT Corporation System, 111 Eighth Avenue, 13th Floor, New York, New York 10011. Our Transfer Agent and Registrar is AST Trust Company (Canada) (AST), 2001 Robert-Bourassa Blvd., Suite 1600, Montreal, Quebec, Canada, H3A 2A6. This Annual Report contains trademarks and registered trademarks of us and other companies.

We were incorporated in Canada 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 legal and corporate names and our share capital.

Since we are using this Form 20-F as an annual report, we have provided herein the information required pursuant to Item 4A(4) for the period beginning as at September 1, 2017 until the date of this Annual Report. For information responsive to this Item 4A(4) for prior periods, please refer to our previously filed Annual Reports on Form 20-F. Information in our previously filed Annual Reports on Form 20-F is not incorporated by reference in this Annual Report.

On September 8, 2017, we acquired a 33.1% interest in Astellia, a publicly traded company on the NYSE Euronext Paris stock exchange. Astellia is a provider of network and subscriber intelligence-enabling mobile operators to drive service quality, maximize operational efficiency, reduce churn and increase revenue. Its vendor-independent, real-time monitoring and troubleshooting solution is used to optimize networks end-to-end from radio to core. The purchase price amounted to €10 per share for a total cash consideration of €8.6 million (US$10.3 million).

On October 10, 2017, we reached an agreement with Astellia to acquire Astellia's remaining shares, at a share price of €10, for a total consideration of €17.3 million (US$21.4 million) by way of a public tender offer. The public offering opened on December 15, 2017 and closed on January 26, 2018.

On December 21 and 22, 2017, we acquired additional interests of 6.0% and 1.2% respectively in Astellia at a purchase price of €10 per share for a total cash consideration of €1.9 million (US$2.2 million), which brought our investment in Astellia to 40.3%.

On January 26, 2018, upon the closing of the public tender offer, we acquired an additional interest of 48.1% in Astellia at a purchase price of €10 per share for a total cash consideration of €12.5 million (US$15.5 million), which brought our investment in Astellia to 88.4%, and provided us with control over Astellia.

We re-opened the public tender offer to acquire the remaining shares of Astellia from February 9, 2018 to February 22, 2018. During that period, we acquired an additional interest of 8.9% in Astellia at a purchase price of €10 per share for a total cash consideration of €2.3 million (US$2.8 million), which brought our investment in Astellia to 97.3%.

Finally, on February 28, 2018, we entered into a squeeze-out process to acquire the remaining 2.7% interest in Astellia at a share price of €10, for a total consideration of €0.7 million (US$0.8 million). The binding terms of the squeeze-out process gave us control over Astellia's remaining shares as at February 28, 2018 and consequently, as of that date we controlled 100% of Astellia's shares.

The fair value of the total consideration for all shares of Astellia amounted to €25.9 million (US$32.1 million) and consisted of €21.1 million (US$26.2 million), net of Astellia's cash of €4.8 million (US$5.9 million) at the date of acquisition of control.

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On October 2, 2017, we acquired all issued and outstanding shares of Yenista Optics S.A.S., renamed EXFO Optics Inc. (EXFO Optics), a privately held company located in France and a supplier of advanced optical test equipment for the research and development and manufacturing markets. The acquisition-date fair value of the total consideration amounted to €9.4 million (US$11.1 million) and consisted of €8.1 million (US$9.5 million) in cash, net of EXFO Optics' cash of €1.3 million (US$1.5 million) at the acquisition date.

On October 25, 2017, we modified certain credit facilities whereby existing lines of credit that provided advances up to CA$4.8 million (US$3.7 million) and up to US$6.0 million for operating purposes were cancelled and replaced with a credit facility of CA$28.9 million (US$22.2 million) mainly for the acquisition of the remaining shares of Astellia under the public tender offer.

In addition, on December 21, 2017, we cancelled and replaced this renewed credit facility (that provided advances up to CA$28.9 million (US$22.2 million)), with new revolving credit facilities of up to CA$70.0 million (US$53.6 million) and US$9.0 million. These modified credit facilities were used to finance a portion of the acquisition of Astellia's remaining shares and are used to finance working capital and for other general corporate purposes. As at August 31, 2018, an amount of $11.8 million was drawn from these credit facilities for bank loan and credit facilities.

On August 21, 2018, we announced a restructuring plan to accelerate the integration of our newly acquired monitoring and analytics technologies from Astellia and simplify our cost structure and optimize resources as we converge toward fewer sites and reduce our workforce.

In September 2018, as part of our fiscal 2018 restructuring plan and the shutdown of our operations in Toronto, Canada, we entered into a binding agreement to sell one of our buildings for net proceeds of $3.3 million. The transfer of ownership is expected to occur in the second quarter of fiscal 2019 and will result in a pre-tax gain of $1.9 million that will be recorded in our consolidated statement of earnings for that quarter.

B. Business Overview

We provide communications service providers (CSPs) as well as data center, cloud and web-scale operators with test, monitoring and analytics solutions to ensure the smooth deployment, maintenance and management of next-generation networks. We have also forged strong relationships with network equipment manufacturers (NEMs) to develop deep expertise that migrates from the lab to the field and beyond. We believe that our key differentiation comes from combining intelligent, automated and cloud-based test and monitoring solutions with real-time analytics to deliver superior network performance, service reliability and subscriber insights. We are number one in optical testing in terms of global market share and are among the top five suppliers of monitoring and analytics solutions for the communications industry worldwide.

We believe that our unique blend of hardware equipment, software and services accelerates digital transformations related to fixed and mobile network deployments. More specifically, we target high-growth market opportunities that enable customers to increase bandwidth capacity and improve quality of experience on network infrastructures: 5G and Internet of Things (IoT), 4G/LTE (long-term evolution), wireless backhaul, small cells and distributed antenna systems (DAS), 400G and 100G network upgrades as well as fiber-to-the-home (FTTH)/fiber-to-the-curb (FTTC)/fiber-to-the-node (FTTN) deployments.

We were founded in 1985 in Quebec City, Canada. Our original products were focused on the needs of installers and operators of fiber-optic networks. Customers use these field-portable test solutions for the installation, maintenance and troubleshooting of optical networks. Over the past several years, we have enhanced our competitive position in the communications test, monitoring and analytics markets through acquisitions of transport and datacom, copper/xDSL and wireless test companies, an IP service assurance business, an analytics software company, radio frequency (RF) test technologies for fiber-based radio access networks (RANs), automated network topology discovery software, optical test equipment for lab and research applications, as well as performance analysis solutions for mobile networks and subscriber experience.

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We launched seven major products in fiscal 2018. New product introductions included a compact 400G test solution for network equipment manufacturers, carrier labs and data centers. We also introduced SkyRAN, a remote access monitoring solution for fiber-based fronthaul networks. Developed in collaboration with tier-1 mobile network operators, SkyRAN provides real-time, on-demand testing and 24/7 monitoring of optical networks and the radio frequency spectrum. Other key product introductions included EX1, a multipurpose test solution for validating bandwidth speeds up to full line rate Gigabit Ethernet and for monitoring quality of experience at customer premises; an optical spectrum analyzer delivering in-service optical signal-to-noise ratio (OSNR) measurements for high-speed networks; and an automated network troubleshooting solution that links performance measurements to network topology to deliver service degradation diagnosis.

Industry Background

Favorable market conditions prevailed in fiscal 2018 as CSPs deployed fiber deeper in their networks and at higher speeds to address growing Internet usage, proliferation of smart phones and tablets, and explosion in videos services. As a result, the 100G optical investment cycle progressed throughout metropolitan networks and data centers, while 400G made its way into labs. With the advent of new technologies like 5G wireless and Internet of Things (IoT), CSPs also continued to upgrade their fronthaul and backhaul networks to support the ultra-high speeds and low-latency requirements of tomorrow's network infrastructures. On the other hand, spending on virtualized networks remained muted as CSPs grappled with the complex architectures required to manage hybrid networks, both physical and virtualized.

These market drivers within the communications industry in 2018 were affected by consolidation issues among large CSPs and protectionist government policies in the United States, slowing growth in the Asia-Pacific region, especially China, and a mixed economic environment in Europe, Middle East and Africa (EMEA).

Growth Strategy

Our long-term goal is to become the global leader in the communications test, monitoring and analytics markets. We believe that digital transformations are taking place throughout the communications industry to cope with surging bandwidth demand and the need to better monetize networks. Consequently, CSPs, webscale companies and NEMs are making considerable investments to modernize network infrastructures.

Our growth strategy focuses on internal investments and acquisitions in four key technology areas: fiber, the Cloud, network virtualization and 5G.

First, fiber is being deployed everywhere, supporting 1G data transmission rates in the home, 100G in Metro links and data centers, and 400G in lab environments. As the market leader in optical and high-speed transport testing, EXFO will continue to leverage the 100G investment cycle. We also believe we are well positioned for the next wave of customer spending with a commercially available 400G test solution and high-end optical instruments from the Yenista Optics acquisition.

Second, the Cloud. EXFO is helping webscale companies deliver reliable cloud services with a dedicated test offering for inside and outside their data centers. For interconnecting data centers, our 100G test solutions ensure smooth fiber deployments and quality of service. Inside data centers, solutions like our automated multifiber inspection probe are significantly improving efficiency and reducing operating expenses.

Third, network virtualization. As telecom networks are gradually becoming virtualized to increase service agility and reduce costs, EXFO has taken the lead to enable a virtualized world. We have designed virtual verifiers that are released on generic, white-label servers alongside virtual network functions. We also acquired real-time network topology discovery technology from Ontology Systems in 2017 to complement our active monitoring offering. Ontology Systems' software uses semantic searches to build real-time views of network services and their related elements. This mapping is essential for automated root cause analysis, especially because networks can change on the fly in a virtualized environment.

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Finally, 5G represents the next technology milestone for mobile networks. CSPs are investing heavily in fiber, fronthaul, and backhaul network initiatives to get prepared for 5G mobility. In fiscal 2017, we acquired from Absolute Analysis optical RF technology for testing fiber-based mobile networks. These solutions are critical for analyzing RF interference issues in fiber to the antenna, distributed antenna systems, remote radio heads and baseband units that support 4G/LTE and upcoming 5G networks.

In 2018, we acquired Astellia, a leading provider of network and subscriber intelligence for mobile operators. We believe this strategic acquisition bolsters our product and services offering with passive wireless monitoring, rich subscriber analytics and professional services. Equally important, it provides us with a strong foothold with global mobile operators, who are investing in high-speed, low-latency 5G wireless infrastructures.

Customers

Customers on a global basis use our test, monitoring and analytics solutions to enable their networks to perform optimally during their complete life cycles: research, development, manufacturing, installation, maintenance and monitoring.

We initially developed test equipment for wireline CSPs and, to a lesser extent, component vendors and network equipment manufacturers, but over the years we have expanded our offering to wireless CSPs, cable television companies, data center, cloud and web-scale operators, public utilities, private network operators, third-party installers, equipment rental companies, large enterprises and laboratory researchers.

In fiscal 2018, our top customer accounted for 9.1% of our sales and our top three customers represented 15.9%. In comparison, our top customer accounted for 10.1% of sales and our top three customers represented 18.4% in 2017, while our top customer accounted for 7.1% of sales and our top three customers represented 15.6% in 2016.

Products

We offer an extensive range of wireline and wireless test, monitoring and analytics solutions for the global communications industry. We believe our success has been largely predicated on our core expertise in developing test equipment for optical networks. Over the years, we have completed acquisitions in adjacent markets including copper, wireless and optical RF testing, monitoring, real-time network topology discovery and analytics.

We believe the competitive advantages of our products include a high degree of innovation, modularity (especially wireline products) and ease of use. Ultimately, we believe our products enable NEMs, CSPs as well as data center, cloud and web-scale operators to design, deploy, troubleshoot and monitor wireline and wireless networks, and also help customers reduce their operating expenses.

Products for Communications Service Providers (CSPs)

Wireline Test Equipment

We provide an extensive range of portable test solutions that are mainly used by CSPs to install, turn up and maintain their optical and copper-based communications networks. These products are available as handheld test instruments, portable platforms with related modules, and as rack-mounted chassis with related modules. We also offer fiber monitoring solutions, which leverage OTDR (optical time domain reflectometry) technology, to enable customers to identify bends or breaks in their optical networks 24 hours per day, seven days per week.

Our handheld instruments are durable, compact and easy to use. They include dedicated testers like power meters or they can be multi-function units that carry out several different measurements.

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Our field-test platforms, namely the FTB-1 Pro Platform, FTB-1 Platform, FTB-2 Pro Platform, FTB-4 Pro Platform and FTB-500 Platform, are at the core of our wireline product portfolio. Our FTB-1 Pro, designed for frontline technicians in the field, is a single-slot, modular platform dedicated to carry out optical, Ethernet and multiservice tests simply and efficiently. It differentiates itself through ultra-strong processing power and rich features like a multi-touch, high-resolution widescreen display. The FTB-1 Platform does not possess the same processing power or rich feature set of the FTB-1 Pro, but it is suitable for optical, copper, Ethernet and multiservice testing applications.

Our FTB-2 Pro offers the power and scalability of a multi-technology, high-performance unit, but in a smaller form factor. The FTB-2 Pro Platform can host two single-slot test modules, such as an OTDR (optical time domain reflectometer), automated optical loss test set (OLTS) with a variety of fiber inspection probes (FIPs), and Ethernet tester that can characterize transmission rates up to 100 Gbit/s.

The FTB-4 Pro, the latest addition to our platform family, supports as many as four modules for tests in high-speed networks, data centers and R&D labs. It provides field technicians with a combination of 400 Gbit/s commissioning, turn-up and troubleshooting tools on a single platform for both transport and advanced dispersion testing.

Our FTB-500 platform is available in two configurations for various high-end tasks with transmission rates up to 100 Gbit/s. The four-slot model of the FTB-500 is designed for datacom testing, OTDR analysis, optical loss, Ethernet and multiservice transport (SONET/SDH/OTN) testing. The eight-slot model is a high-performance, multiple-protocol unit that allows users to combine next-generation SONET/SDH functions with Ethernet, Fibre Channel and optical-layer testing capabilities. It can handle dispersion characterization (PMD and CD), as well as DWDM/ROADM testing with optical spectrum analysis, and a variety of FIPs.

All five portable platforms support USB, mobile, Wi-Fi, and Bluetooth connectivity capabilities to efficiently manage testing and reporting operations in the field. These PC-centric, open-ended platforms, combined with cloud-based software applications, can be transformed into a fully connected test environment that allows CSPs to automate complex, labor-intensive tasks like fiber-to-the-antenna (FTTA), distributed antenna system (DAS) and small cell deployments. Leveraging platform connectivity, customers can also keep track of their entire test fleet, manage software updates and schedule calibration procedures. All test data can be stored in a central database and used as a point of reference against future measurements within our cloud-based solution. Consequently, this enhanced test environment enables customers to increase productivity and reduce operating expenses.

Wireless Test Equipment

We provide 2G, 3G and 4G/LTE network simulators for CSP labs. EXFO's network simulators emulate real-world, large-scale network traffic and end-user behavior in a laboratory environment in order to predict network behavior, uncover faults and optimize networks before wireless networks and services are deployed. Typical tests include wireless node (EPC, IMS) functional and network load testing.

In addition, we provide optical radio frequency (RF) test equipment for analyzing RF interference issues in fiber to the antenna, distributed antenna systems, remote radio heads and baseband units that support 4G/LTE and upcoming 5G networks.

Monitoring and Analytics Systems

We provide a comprehensive portfolio of monitoring solutions, both active and passive, for wireline and wireless CSPs offering full visibility of the network, service and subscriber levels.

On the active monitoring side, the EXFO Worx System is a hardware and software solution that delivers real-time, end-to-end quality of service (QoS) and quality of experience (QoE) service monitoring for next-generation IP networks. Built around a distributed architecture, we believe the EXFO Worx System enables the successful launch and ongoing profitable operation of Ethernet/IP-based voice, video and data networks and services across wireline and wireless networks.

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We have also transformed our active monitoring portfolio to address the growing need for virtualized solutions. The EXFO Worx solution offers a variety of software-based probes, enabling the interworking with virtualized network architectures and functions.

We believe a competitive advantage of EXFO's active monitoring solution is the ability to implement SLA (service level agreement) monitoring and assure any IP service, over any network, to any endpoint—all from the same open and extensible platform. Key capabilities include:

· Layer 2-7 service performance monitoring and analysis for business and residential services;
· mobile backhaul and metro Ethernet service activation and assurance;
· IP/MPLS core monitoring and analysis;
· IP video service assurance;
· advanced data correlation and analysis engine with comprehensive northbound APIs;
· advanced analytics and reports; and
· custom solutions and back-office integration services.

The EXFO Worx System offers a multi-play capability such that customers can leverage one, several or all of the aforementioned capabilities on a single platform, which we believe delivers significant savings in capital and operating expenditures.

Our active monitoring solution is complemented by Ontology Systems' network topology discovery software for automated root cause analysis and network inventory applications (physical, virtual and hybrid).

Following the acquisition of Astellia in February 2018, EXFO also offers a passive monitoring, analytics and troubleshooting solution for multi-technology mobile networks (2G, 3G, 4G). The EXFO-Astellia Nova solution provides mobile network operators with capabilities to detect, correlate, analyze, report, geolocate and troubleshoot issues related to network performance, handset behavior and service usage. It is fully virtualized and integrates rich information from call traces, probes, CRM, billing, etc., to make the most of big data.

The EXFO-Astellia Nova solution improves customer experience and mobile operators' business performance, optimizes end-to-end service quality, and provides the required insights to enhance subscriber experience. It meets the requirements of network operations, service operations, customer care and marketing teams. Key strengths of this solution include:

· Geolocation capabilities;
· Vendor independence;
· Data agnostic (call traces, probe data, third party);
· End-to-end, from radio to core;
· Big data based; and
· Fully virtualized.

To allow customers to get the most out of their monitoring and analytics investments, our experts work hands-on with them through value-added services that include quality assurance and performance audits as well as business consulting and customization. We also provide additional services such as training, project management and 24/7 customer support.

EXFO intends to combine EXFO, Ontology and Astellia's products into a unified solution to bring a unique value proposition to its customers.

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Products for Network Equipment Manufacturers (NEMs)

Wireline Test Equipment

Our network equipment manufacturer (NEM) solutions, mainly built around our LTB-8 Rackmount Platform, are available as test modules or stand-alone benchtop instruments.

Our highly scalable LTB-8 platform, which can host as many as eight 100G test modules, was introduced in 2016 to address the numerous requirements that NEMs demand from their multiservice transport and datacom network equipment. Lab users can carry out tests for a variety of technologies including Ethernet, OTN, Fibre Channel and SONET/SDH. Optical tests can also be carried out via power meters, variable attenuators and switches. Remote control of one or several LTB-8 platforms is available via a proprietary web-based interface. In March 2017, we introduced a 400G test solution for the LTB-8 platform that is dedicated to the lab and manufacturing markets.

Following the acquisition of Yenista Optics in October 2017, we offer advanced optical test equipment for the R&D and manufacturing markets. This high-end product portfolio includes benchtop optical spectrum analyzers, tunable lasers, tunable filters and passive optical component test systems for network equipment manufacturers and optical component vendors.

Wireless Test Equipment

We provide 2G, 3G and 4G/LTE network simulators for the NEMs market. EXFO's network simulators emulate real-world, large-scale network traffic and end-user behavior in a laboratory environment in order to predict network behavior, uncover faults and optimize networks before wireless networks and services are deployed. Typical tests include regression and load testing.

We also offer intelligence tools for police, armed forces and other governmental organizations to help fight organized crime and terrorists.

Research and Development

Our global R&D operations fall under the management of a vice-president. We maintain R&D centers in Quebec City, Canada, Montreal, Canada, Oulu, Finland, Pune, India, Lannion, France, Rennes, France, Valencia, Spain, and London, UK. Gross research and development expenditures totaled $65.2 million in fiscal 2018 compared to $53.1 million in 2017 and $47.9 million in 2016.

In line with our strategic imperative to increase R&D synergies and efficiencies, we consolidated activities in Toronto, Canada and Chelmsford, US at primary R&D centers within the company. These two centers were closed down in October 2018.

We believe that our future success largely depends on our ability to introduce new solutions and product enhancements to our core technologies. Through market-oriented product portfolio review processes, we ensure that our investments in research and development are aligned with market opportunities and customers' needs. This process enables us to maximize our returns on R&D investments by focusing our resources on prioritized projects. Product portfolio review meetings, which occur two times per year, enable us to select the right 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. 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 significantly changed.

Product development projects, once they are underway, are managed through a structured process known as the stage-gate approach combined with an Agile methodology. The stage-gate approach is based on a systematic review of a project's progress at various stages of its lifecycle. The following are the key review stages of the stage-gate approach:

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- market study and research feasibility;
- product definition;
- development feasibility;
- development;
- qualification; and
- 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 new product development is synchronized with other internal departments and external industry events.

The Agile methodology allows for software development to be done in small increments with constant validation with lead customers. Efficient execution is done through collaborative teams called SCRUM team, ensuring that each increment is fully tested and validated.

Sales

We sell our wireline and wireless test, monitoring and analytics solutions through direct and indirect sales channels in the Americas (US, Canada, Central and South America), Europe, Middle East and Africa (EMEA) and Asia-Pacific regions.

In the Americas, we use a hybrid model, combining key account management with direct and indirect sales coverage. We typically use key account managers to serve large customers that generate high sales volumes or might potentially represent high sales volumes in the future. These key account managers are supplemented by regional sales managers, sales engineers, sales representatives and distributors in the US as well as Central and South American metropolitan areas, and regional sales managers and sales engineers in Canada.

We opt for a direct sales approach when selling higher-end, highly technical products to sophisticated buyers. Sales of low- to medium-level complexity products to less stringent technical buyers are usually done through a manufacturer representative organization or distributors supported by regional sales managers. Our main sales offices in the Americas are located in Richardson, Texas, Quebec City, Canada and Mexico D.F., Mexico. They are supplemented by a regional presence in cities across the US, Central and South America, as well as Canada.

On the international front, we have a direct sales force covering strategic accounts in EMEA and Asia-Pacific and distribution partners for smaller customers from lower revenue-generating regions.

Our sales network in EMEA is supported by a main office and service center in Chandler's Ford, Hampshire, UK, which serves as headquarters of our European sales operations and also provides repair, calibration and technical support services for our EMEA customers. We also have additional sales offices in multiple countries across EMEA to serve and support our various customers and distribution partners.

As for Asia-Pacific, our regional headquarters are based in Singapore, while our main sales offices for mainland China are located in Beijing, Shenzhen and Shanghai. In addition, we have other sales offices in strategic locations around the Asia-Pacific region to support our customers and distribution partners.

We rely on a network of distributors worldwide to work with us in supporting mostly our international sales and to participate in a large number of international events. We believe that the local presence and cultural attributes of our distributors allow us to better serve our global markets.

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Our sales team is led by our chief executive officer (CEO), who is supported by a vice-president responsible for each major geographic region: Americas, EMEA and Asia-Pacific. These sales executives, in turn, are backed by regional sales directors that lead a widely distributed team acting as key account managers, regional sales managers, sales engineers and application engineers. Our sales people are located throughout major metropolitan areas around the world. This group of sales professionals has on average more than 15 years of experience in the fields of telecommunications, fiber optics, or test and monitoring. Within each major geographic region, we have sales staff dedicated to wireline and wireless test, monitoring and analytics customers.

We also have an in-house Customer Service Group to meet the needs of existing and new customers. This group is 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.

Sales to customers in the Americas represented 50% of our sales in fiscal 2018, while sales to customers in EMEA and Asia-Pacific accounted for 32% and 18% of our sales, respectively. In comparison, the Americas, EMEA and Asia-Pacific accounted for 55%, 26% and 19% of our sales in 2017, respectively, and 55%, 25% and 20% in 2016, respectively.

Product Management

All product management duties fall under the leadership of our CEO, who is supported by two vice-presidents responsible for test and measurement as well as service assurance, systems and services. Each product management executive, in turn, is backed by directors and/or product managers who have various degrees in engineering, science and business administration. Directors and product managers are responsible for all aspects of our telecom marketing program including product strategy, new product introductions, definition of new features and functions, pricing, product launches and advertising campaigns. We follow up our marketing initiatives by attending industry trade shows. Furthermore, we have a customer relationship management (CRM) system to compile market and customer information including forecasts, opportunities, leads and competitive data. We use this information to make strategic business decisions.

Marketing/Communications

Likewise, all marketing and communications activities fall under the leadership of our CEO. Our marketing-communications team, which mainly consists of a director, group managers, project managers, marketing writers, translators and graphic artists, supports our product management team by producing marketing and corporate documentation in-house. Literature includes specification sheets, application notes, product catalogues, advertising copy and an electronic corporate newsletter. This Marketing-Communications team also provides the sales tools required by our worldwide sales force like webinars and for updating the marketing contents of our website. In addition, it is responsible for engaging with key industry analysts and media as well as for field marketing, campaign management and digital marketing activities.

Global Services

EXFO's Global Services operation provides customers with a broad array of support and services worldwide. This team has in-house staff in North America, Europe, and Asia. It also provides local support in specific countries through select partners. Such a strategy enables EXFO to have a global reach while maintaining strong local ties.

This team's objective is to ensure customer satisfaction through a flawless business experience and to achieve our long-term mission by providing internal and customer-facing services. Specifically, it fulfills its mission by offering:

- Sales Support – Leverage the effectiveness of our sales force by providing pre-sales and demo support, as well as guiding customers in purchasing the correct equipment for their respective applications, issuing quotations, and promoting our extended warranty service and support program;
- Order Management – Accurately process customer orders from entry through fulfillment and delivery, and manage order changes;

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- Customer Service – Serve as a primary interface for inbound and outbound customer communication. Provide customers with one central point of contact and work with the customer from purchasing equipment to helping them arrange for service, if necessary;
- Technical Support – Provide post-sales technical support to Test & Measurement product end-users, by providing software fixes and upgrades, troubleshooting malfunction or wrong usage of equipment and suggesting ways to improve equipment productivity and performance;
- Field Support – Provide expert technical support and deliver product service worldwide. Support our Worldwide Service Centers and directly manage the Service Partner Program. Where applicable, furnish installation and on-site servicing for more complex equipment and applications;
- Systems Services – Provide pre-sale, delivery, post-sale technical support, and systems actualization of customer's network monitoring and converged service assurance systems;
- Education Services – Aggregate expertise, develop material, and deliver free and fee-based training;
- Professional Services – Provide value-added solution services for our test and system customers.

Manufacturing

Our manufacturing operations consist mainly of material planning, supply-chain management, sub-assembly, final assembly and test, software loading, calibration, quality control, shipping, billing and customs management. Most of our manufacturing activities, which occupy a total of 125,000 square feet, take place at our facility compound in Quebec City, Canada, Shenzhen, China, and Lannion, France, but we also have facilities in Rennes, France and Oulu, Finland, for product configuration, software loading, quality control and shipping of monitoring systems. All our manufacturing operations fall under the supervision of a vice-president.

Our Quebec City, Canada, operations mainly produce low-volume, high-complexity telecom products. It has maintained ISO 9001 certification since 1994 and first obtained TL 9000 certification in July 2012. Our manufacturing plant in Shenzhen, China, which started operations in September 2007, is responsible for the production of high-volume, low-complexity telecom products. Our Shenzhen plant, which follows the same corporate quality standards, was first certified ISO 9001 in January 2009 and also obtained TL 9000 certification in July 2012.

All of our products meet required industry standards, and some of our products address additional voluntary standards, such as those set by Telcordia, IEC, IETF, ETSI and other bodies that issue industry standards. During manufacturing, each product has a specific quality control plan, with rigorous checkpoints, to ensure product conformity. Various tasks in the quality assurance process include quality control, conformity testing, product documentation, product improvement, regulatory compliance, metrology and calibration.

Our manufacturing operations include the following responsibilities:

- Production. From production planning to product shipment, our production department is responsible for manufacturing high-quality products on time. Factories are organized in work cells; each cell consists of specialized technicians with equipment and has full responsibility over a product family. Technicians are cross-trained and versatile enough, so that they can carry out specific functions in more than one cell. This allows shorter lead times by alleviating bottlenecks.

- Manufacturing and Test Engineering. 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, and the quality control and regulatory compliance process.

Quality control represents a key element in our manufacturing operations. Quality is assured through product testing at numerous stages in the manufacturing process to ensure that our products meet both stringent industry and customer performance requirements.

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- Supply-Chain Management. This department is responsible for sales forecasting, raw material procurement, material-cost reduction and vendor performance management. Our products consist of optical, electronic and mechanical parts, which are purchased from suppliers around the world. Approximately one-third of our parts are manufactured to our specifications. Materials represent the largest portion of our cost of goods. Our performance is tightly linked to vendor performance, requiring greater emphasis on this critical aspect of our business.

Our manufacturing operations are subject to environmental laws in various jurisdictions around the world. As the world undergoes climate changes, environmental and biodiversity issues have become critical to our society. We obtained ISO 14001 certification in October 2013 and, therefore, started continuous improvement in reducing our environmental footprint.

Sources and Availability of Raw Materials

We use various suppliers to provide parts for the manufacture and support of multiple product lines. Although our intent is to establish at least two sources of supply for materials whenever possible, we obtain several parts from single or limited source supply arrangements. We may not be able to procure these parts from alternative sources at acceptable prices within a reasonable time; therefore, the loss or interruption of such arrangements could have an impact on our ability to deliver certain products on a timely basis. See Item 3D of this Annual Report under "Risk Factors" We depend on short-term arrangements with a single supplier or a limited number of suppliers for some 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 will continue to mitigate the risk of production interruptions and shortages of parts by: (1) carrying safety stock of critical components, (2) monitoring the delivery performance of our suppliers, (3) selecting and qualifying alternative sources of supplies for key parts whenever possible, and (4) promptly assessing potential effects of worldwide natural disasters.

Seasonality

Historically, we have been subject to seasonality mainly in our second quarter (December, January and February) due to the Christmas holidays and delays in approval of CSP spending budgets for the new calendar year. These two factors can have negative effects on our bookings in our second quarter, but they are mitigated by the renewal of annual maintenance contracts and sometimes calendar year-end spending on the part of CSPs. We are increasingly subject to seasonality in the fourth quarter (June, July and August) because bookings activity tends to slow down during the summer months, especially in Europe. The acquisition of Astellia could also render us more vulnerable to seasonality in the summer, since its sales are largely concentrated in Europe, Middle East and Africa (EMEA). These seasonal effects do not apply consistently and do not always correlate to our financial results. Accordingly, they should not be considered as reliable indicators of future revenue or results of operations.

Competition

The communications test, monitoring and analytics markets are highly competitive and subject to rapid change because of technological developments and market conditions. 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:

- level of technical compliance and alignment to use-case;
- product performance and reliability;

- solution's contribution to productivity;
- price and quality of products;
- level of technological innovation;
- product lead times;

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· breadth of product offerings;
· ease of use;
· brand-name recognition;
· customer service and technical support;
· strength of sales and distribution relationships; and
· financial stability of supplier.

Main competitors in the test equipment environment include global suppliers like Anritsu Corporation, Fortive Corporation (Fluke Networks), and Viavi Solutions, as well as other players such as AFL Noyes, Deviser Instruments, Keysight (IXIA), Kingfisher International, Shineway Tech, Spirent Communications plc, VeEX Inc., and Yokogawa Electric Corporation. On the monitoring and analytics side, we mainly compete against Accedian Networks, Anritsu Corporation, Empirix, Keysight (IXIA), Netrounds, NetScout Systems, Inc., Polystar, Radcom, Spirent Communications plc, and Viavi Solutions. See Item 3D of this Annual Report under "Risk Factors We must continue to overcome significant competition in our targeted industries in order to keep or gain market share and achieve our growth strategy."

Employees

As at November 1, 2018, we had 1,803 full-time employees compared to 1,577 and 1,551 for the same periods in 2017 and 2016, respectively. Our workforce as of November 1, 2018 included 353 employees in manufacturing, 620 employees in research and development, and 830 employees in sales and marketing as well as general and administrative functions.

Our future performance depends, to a significant degree, on our continued ability to attract and retain highly skilled and qualified technical, sales and marketing, and senior management personnel. The majority of our employees are not represented by a labor union with the exception of our manufacturing personnel in Quebec City, Canada, R&D and Service employees in Valencia and Madrid, Spain, and R&D and Service employees in Rennes, France. We consider relations with our employees to be good. See Item 3D of this Annual Report under "Risk Factors We require employees and managers who are knowledgeable about the specialized nature of our business. If we are unable to attract and retain sufficient numbers of highly skilled technical, sales, marketing, senior management and other personnel, our operations and financial results will suffer".

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 some agencies of the U.S. federal government, including the Federal Communications Commission (FCC), the Food and Drug Administration (FDA) and the Occupational Safety and Health Administration (OSHA). Under the FCC's regulations, our products must comply with certain electromagnetic interference (EMI) requirements to insure they do not generate electromagnetic noise which could possibly cause undesirable operation, as well as affect other surrounding devices. Additionally, some of our products must comply with the FDA's non-medical performance standards and related rules concerning light-emitting products, such as lasers. The FDA's regulations applicable to our products are intended to promote safety by limiting human exposure to harmful non-iodizing radiation. Similarly, our products must comply with safety standards adopted by OSHA.

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Similar regulations apply in other countries. For example, in Canada our products must comply with the applicable standards adopted by the Standards Council of Canada (SCC). These include product safety standards developed in collaboration with the Canadian Standards Association as well as EMI requirements adopted by Innovation, Science and Economic Development Canada. Countries in the European Union require product compliance as dictated by the applicable directives, which are required to apply the CE marking on the product. This includes testing to ensure compliance with harmonized European Norm (EN) standards for product safety, EMC and Wireless products requirements and RoHS.

To address the issue of environmental compliance, the European Union has mandated the Restriction of the Use of Certain Hazardous Substances or "RoHS" Directive (2011/65/EU), which applies to all products included within the scope of WEEE directive. Mandatory product compliance includes the ban of certain substances within specified concentrations, unless formally exempted by the directive. To ensure compliance to this directive, a formal restricted substance control (RSC) program was implemented for our products included within the scope of WEEE. This program ensures the design, procurement and manufacturing of affected products prevents the inclusion of the banned substances as specified by the RoHS directive.

Other significant types of regulations not described in this Annual Report also may apply, depending upon the relevant product and country of destination.

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. as well as other foreign (utility) patent applications to protect technology, inventions and improvements important to the development of our business. We also rely on a combination of design patents, copyright, trademark, trade secret rights, licensing and confidentiality agreements.

Our intellectual property and proprietary technology are important to the continued success of our business. Were we to inadequately protect our intellectual property and proprietary technology, our competitive position might be significantly impaired. There also remains a risk that our intellectual property rights, particularly our existing or future patents might be invalidated, circumvented, challenged or required to be licensed to others. Furthermore, others may claim that our products infringe upon their intellectual property rights, or they may infringe our intellectual property, and we may expend significant resources enforcing or defending our rights or suffer competitive injury.

Our success and ability to compete depend to a significant extent on our proprietary technology, with which we attempt to prevent others from using the innovations that are central to our existing and future products. As of August 31, 2018, our records indicate that we held the following portfolio of utility patents: 94 active granted US patents, 107 granted or validated patents in countries of the European Union and 48 patents in other jurisdictions. In addition, we have 27 utility patent applications (including provisional applications) pending in the US, 18 patent applications at the European Patent Office and 22 applications in other countries. The expiration dates of our active issued patents range from 2019 to 2036, with no significant active patent expiring in the near future.

Our records also indicate that, as of August 31, 2018, we held 31 active granted design patents, as well as 4 pending design patent applications, in the United States, Europe, China and other jurisdictions.

We consider six of our inventions to be material. These inventions are protected by granted patents and/or pending patent applications and can be described as follows:

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a method and apparatus for improved characterization of loss-inducing "events" along an optical fiber using an Optical Time Domain Reflectometer (OTDR). By a judicious combination of OTDR data corresponding to different optical-pulse durations, the location and loss characteristics of an event can be quantified with much better accuracy and/or more rapidly than via conventional approaches;

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- a method for determining the optical signal-to-noise ratio on polarization-multiplexed signals used in high-bandwidth DWDM optical networks by employing an optical spectrum analyzer. It employs a reference trace acquired with one channel being turned off;
- a method and apparatus to determine the theoretical and practical data rates for a cable under test. This invention uses a single test device to predict the performance of a pair of ADSL (Asymmetric Digital Subscriber Line) modems, and in case of problems, analyze the cause of the modems' failure to synchronize;
- a scalable system for monitoring network elements, for which only a non-redundant subset of the identified network information is stored, thereby enabling monitoring of a much larger group of network elements than is possible with conventional memory-constrained monitoring systems. Furthermore, this system employs a multi-threaded architecture that dynamically spawns an array of multi-technology monitoring sub-systems. The user can leverage data from a multitude of sources and define a sequence of activities based on templates in order to accomplish a given task;
- a method for actively analyzing a data packet delivery path to provide diagnostics and root cause analysis of network delivery path issues;
- a communication methodology used to perform independent bi-directional protocol testing over a connection or connectionless network between two test instruments, wherein the transfer mechanism of status and intermediate test results during an active test and the transmission of the final results to one of the instruments enables the user to perform a bidirectional single-ended test.

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 under 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. However, these efforts afford only limited protection.

Disclosure pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012

Under Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012, which added section 13(r) of the Securities Exchange Act of 1934, as amended ("the Exchange Act"), public reporting issuers are required to disclose whether they or any of their affiliates knowingly engaged in certain activities, transactions, or dealings relating to Iran or certain designated individuals or entities.

From February 2018, EXFO Solutions (formerly Astellia), a recently acquired subsidiary of EXFO organized and existing under the laws of France, engaged in transactions involving the sale of passive monitoring and troubleshooting solutions and associated services to end users in Iran. EXFO Solutions (formerly Astellia) sold the equipment for end use by Iranian mobile network operators, Mobile Communications Company of Iran ("MCCI") and MTN Irancell. Although it is difficult to evaluate with any reasonable degree of certainty, we have concluded that we cannot exclude the possibility that MCCI or MTN Irancell is owned or controlled, directly or indirectly, by the government of Iran.

Gross revenues reported by EXFO Solutions (formerly Astellia) in connection with these transactions were approximately US$2.24 million; estimated net result from these transactions was nominal.

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Prior to its acquisition by EXFO, EXFO Solutions (formerly Astellia), through a subsidiary located in Lebanon, employed four (4) employees delivering services in Iran, a practice that was continued after the acquisition through the end of October 2018. These activities complied in all material respects with applicable sanction laws and regulations; however, they were inconsistent with EXFO's internal policies. EXFO discovered this activity during the pre-acquisition due diligence of EXFO Solutions (formerly Astellia) and has conducted a comprehensive internal investigation and review. As a result of this investigation and review, EXFO has implemented additional compliance procedures designed to prevent future violations of its internal policy and is currently in the process of withdrawing from any direct activities, transactions, or dealings relating to Iran or certain designated individuals or entities and will no longer have employees providing services in Iran. In addition, EXFO revised its internal policies to allow indirect support and maintenance of EXFO Solutions' systems deployed at MCCI and MTN Irancell through a non-related third-party based outside Iran to honor EXFO Solutions' (formerly Astellia) prior engagement with existing customers in compliance with applicable export controls, sanctions and other laws, rules and regulation. The withdrawal process was completed on November 4, 2018 and support services through a non-related third party was established at that date.

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C. Organizational Structure

As of November 1, 2018, the following chart presents our corporate structure, the jurisdiction of incorporation of our subsidiaries and the percentage of shares (which is also the percentage of voting power) that we hold in those subsidiaries.

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D. Property, Plant and Equipment

Our head offices are located in Quebec City, Province of Quebec, Canada where we occupy two buildings. These buildings house our executive and administrative offices, research and development facilities and production facilities. We also have offices in Montreal, Province of Quebec, Canada, in Valencia, Spain (Astellia Telecom Spain SL), in Richardson, Texas, United States (EXFO America Inc.), in Pune, India (EXFO Electro-Optical Engineering India Private Ltd.), in Chandler's Ford, Hampshire, United Kingdom (EXFO Europe Limited), in Lannion, France (EXFO Optics SAS), in Oulu, Finland (EXFO Oy), in Rennes, France (EXFO Solutions SAS), in Shenzhen, China (EXFO Telecom Equipment (Shenzhen) Co. Ltd.) and in London, United Kingdom (Ontology-Partners Limited).

In addition, we maintain sales offices and/or have regional sales managers located in Australia, China, Czech Republic, France, Germany, Great Britain, India, Japan, Lebanon, Mexico, Morocco, Singapore, Spain, Sweden, United Arab Emirates and the United States.

The following table sets forth information with respect to the main facilities that we occupy as at November 1, 2018.

Location	Use of Space	Square Footage	% of Utilization	Type of Interest
436 Nolin Street Quebec (Quebec) G1M 1E7	Occupied for manufacturing of products	44,000	95%	Owned
400 Godin Avenue Quebec (Quebec) G1M 2K2	Occupied for research and development, customer services, repair/calibration services, manufacturing, management and administration	129,000 (1)	95%	Owned
2500 Alfred-Nobel Montreal (Quebec) H4S 2C3	Occupied for research and development, management and administration	75,000	70%	Owned
2500 Alfred-Nobel Montreal (Quebec) H4S 2C3	Leased to third parties	23,736	100%	Owned
2500 Alfred-Nobel Montreal (Quebec) H4S 2C3	Available for rent	26,264	0%	Owned
160 Drumlin Circle Concord (Ontario) L4K 3E5	Unoccupied, for sale	23,500	0%	Owned

Ronda Narciso Monturiol 6 Oficina 110B, 111B, 112B and 113B, Parque Technologico Paterna, Valencia 46980 Spain	Occupied for research and development and customer services	10,398	100%	Leased
Offices No 602, 603, 604, 701 and 702, Tower S-4 Cybercity Magarpatta, Hadapsar Pune 411 013 India	Occupied for research and development	33,981	85%	Owned

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Location	Use of Space	Square Footage	% of Utilization	Type of Interest
Offices No 102 Tower S-4 Cybercity Magarpatta, Hadapsar Pune 411 013 India	Leased to a third party	5,979	100%	Owned
Winchester House School Lane Chandlers Ford, Eastleigh Hampshire SO53 4DG United Kingdom	Occupied for European customer service, repair/calibration services, sales management and administration	13,000	85%	Leased
4 rue de Louis de Broglie Lannion 22300 France	Occupied for research and development, manufacturing, management and administration	24,800	50%	Leased
Elektroniikkatie 2 FI-90590 Oulu Finland	Occupied for research and development, manufacturing, management and administration	13,380	100%	Leased
250 Apollo Drive Chelmsford, MA 01824 United States	Unoccupied	25,400	0%	Leased
ZAC Airlande 2, rue Jacqueline Auriol CS 69123 Saint-Jacques-de-la-Lande 35091 Rennes Cedex 9 France	Occupied for research and development, customer services, manufacturing, management and administration	50,235	90%	Leased
F1 to F3, No. 71-3, Xintian Avenue, Xintian Community Fuhai Subdistrict, Bao'an District Shenzhen, Guangdong 518103 China	Occupied for manufacturing of products, repair/calibration services	64,000	90%	Leased

Phoenix Yard 65-69 Kings Cross Road London WC1X 9LW United Kingdom	Occupied for research and development, management and administration	2,423	100%	Leased

(1) Including the warehouse space. Premises without the warehouse are approximately 115,000 square feet.

Item 4A. Unresolved Staff Comments

Not applicable.

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Item 5. Operating and Financial Review and Prospects

This discussion and analysis contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995, and we intend that such forward-looking statements be subject to the safe harbors created thereby. Forward-looking statements are statements other than historical information or statements of current condition. Words such as may, expect, believe, plan, anticipate, intend, could, estimate, continue, or similar expressions or the negative of such expressions are intended to identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events and circumstances are considered forward-looking statements. They are not guarantees of future performance and involve risks and uncertainties. Actual results may differ materially from those in forward-looking statements due to various factors including, but not limited to, macroeconomic uncertainty, including trade wars; our ability to successfully integrate businesses that we acquire; capital spending and network deployment levels in the telecommunications industry (including our ability to quickly adapt cost structures to anticipated levels of business and our ability to manage inventory levels with market demand); future economic, competitive, financial and market conditions; consolidation in the global communications test, monitoring and analytics solutions markets and increased competition among vendors; capacity to adapt our future product offering to future technological changes; limited visibility with regard to the timing and nature of customer orders; delay in revenue recognition due to longer sales cycles for complex systems involving customers' acceptance; fluctuating exchange rates; concentration of sales; timely release and market acceptance of our new products and other upcoming products; our ability to successfully expand international operations and to conduct business internationally; and the retention of key technical and management personnel. Assumptions relating to the foregoing involve judgments and risks, all of which are difficult or impossible to predict and many of which are beyond our control. Other risk factors that may affect our future performance and operations are detailed in our Annual Report, on Form 20-F, and our other filings with the U.S. Securities and Exchange Commission and the Canadian securities commissions. We believe that the expectations reflected in the forward-looking statements are reasonable based on information currently available to us, but we cannot assure you that the expectations will prove to have been correct. Accordingly, you should not place undue reliance on these forward-looking statements. These statements speak only as of the date of this document. Unless required by law or applicable regulations, we undertake no obligation to revise or update any of them to reflect events or circumstances that occur after the date of this document. This discussion and analysis should be read in conjunction with the consolidated financial statements.

The following discussion and analysis of financial condition and results of operations is dated November 27, 2018.

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

COMPANY OVERVIEW

We are a leading provider of test, monitoring and analytics solutions for fixed and mobile communications service providers (CSPs), web-scale operators and network equipment manufacturers (NEMs) in the global communications industry. Our broad portfolio of intelligent hardware and software solutions enable network transformations related to fiber, 5G and 4G/LTE, virtualization and big data analytics. Ultimately, customers rely on our solutions to increase network capacity and improve quality of experience for end-users, while driving operational efficiencies.

Our success has been largely predicated on our core expertise in developing test equipment for fixed networks. These solutions are available as handheld test instruments, portable platforms with related modules, and as rack-mounted chassis with related modules. Our PC-centric, open-ended platforms, combined with cloud-based software applications, can be transformed into a fully connected test environment that allows CSPs to automate complex, labor-intensive tasks like fiber-to-the-antenna (FTTA), distributed antenna system (DAS) and small cell deployments. Leveraging platform connectivity, CSPs can also keep track of their entire test fleet, manage software updates and schedule calibration procedures. All test data can be stored in a central database and used as a point of reference against future measurements. Consequently, this enhanced test environment enables customers to increase productivity and reduce operating expenses.

Over the years, we have expanded our product portfolio into fiber monitoring, IP (Internet protocol) service assurance as well as testing of 2G, 3G, 4G/LTE and soon 5G mobile networks. Our fiber monitoring solution leverages EXFO's expertise and market leadership in optical time domain reflectometry (OTDR) by using this technology as remote test units (RTUs) to monitor an optical plant 24 hours per day, seven days per week. As such, this fiber monitoring solution proactively detects any fiber degradation or locates any fiber cut to optimize quality of service along long-haul, metro and access networks. Our IP service assurance solution is a probe-based hardware and software offering that delivers quality-of-service visibility as well as real-time service monitoring and verification of next-generation IP networks. We have enriched our IP service assurance offering, which can also be virtualized, with infrastructure performance management tools, analytics software and network topology discovery solutions via technology acquisitions.

Following the acquisition of Astellia S.A. in January 2018, EXFO offers monitoring solutions for multi-technology mobile networks (2G, 3G, 4G). The EXFO-Astellia portfolio provides mobile CSPs with capabilities to detect, correlate, analyze, report, geolocate and troubleshoot issues related to network performance, handset behavior and service usage. These solutions can be fully virtualized and combined with information from call traces, third-party probes, CRM, billing, etc., to optimize a big data framework. EXFO intends to integrate fiber monitoring, IP service assurance, as well as mobile network monitoring and analytics solutions into a unified platform to bring a unique value proposition to customers.

Our mobile portfolio also consists of network simulators and optical radio frequency (RF) test solutions. Our network simulators simulate real-world, large-scale network traffic and end-user behavior in a laboratory environment to predict network behavior, uncover faults and optimize networks before mobile networks and services are deployed. Our optical RF test solutions are dedicated to turning up and troubleshooting fiber-based mobile networks. These solutions are critical for locating and analyzing RF interference issues in FTTA, DAS, remote radio heads and baseband units that support 4G/LTE and upcoming 5G networks.

The competitive advantages of our products include a high degree of innovation, modularity (especially wireline products) and ease of use. Our products enable NEMs, CSPs and web-scale operators to design, deploy, troubleshoot and monitor fixed and mobile networks and, in the process, help them reduce the cost of operating their networks.

We have a staff of approximately 1,900 people in 25 countries, supporting more than 2,000 customers around the world. We operate four main manufacturing sites, which are located in Quebec City, Canada, Shenzhen, China, Rennes, France, and Oulu, Finland. We also have five main research and development expertise centers in Montreal, Quebec City, Rennes, Oulu and London, supported by a software development center in India.

We launched seven major solutions in fiscal 2018. New product introductions included a compact 400G test solution for network equipment manufacturers, carrier labs and data centers. EXFO also introduced SkyRAN, a remote access monitoring solution for fiber-based fronthaul networks. Developed in collaboration with tier-1 mobile network operators, SkyRAN provides real-time, on-demand testing and 24/7 monitoring of optical networks and the radio frequency spectrum. Other key product introductions included EX1, a multipurpose test solution for validating bandwidth speeds up to full line rate Gigabit Ethernet and for monitoring quality of experience at customer premises; an optical spectrum analyzer delivering in-service optical signal-to-noise ratio (OSNR) measurements for high-speed networks; and an automated network troubleshooting solution that links performance measurements to network topology to deliver service degradation diagnosis.

Our sales, which include a seven-month contribution from newly acquired Astellia S.A. (Astellia), increased 10.8% to $269.5 million in fiscal 2018 compared to $243.3 million in 2017. Bookings (purchase orders received from customers), which include a seven-month contribution from Astellia, increased 6.3% to $267.7 million in fiscal 2018, for a book-to-bill ratio of 0.99, from $251.8 million in 2017. In fiscal 2018, Astellia sales and bookings amounted respectively to $16.4 million (including $2.1 million for the acquisition-related deferred revenue fair value adjustment) and $16.5 million.

Net loss attributable to the parent interest amounted to $11.9 million, or $0.22 per share, in fiscal 2018, compared to net earnings of $0.9 million, or $0.02 per diluted share in fiscal 2017. Net loss attributable to the parent interest in fiscal 2018 included net expenses totaling $17.1 million, comprising $9.4 million in after-tax amortization of intangible assets, $1.7 million in stock-based compensation costs, $3.4 million in after-tax restructuring charges, $2.1 million for the acquisition-related deferred revenue fair value adjustment, $0.7 million in positive change in the fair value of the cash contingent consideration, $2.5 million in after-tax acquisition-related costs, and a foreign exchange gain of $1.3 million. Net earnings attributable to the parent interest in fiscal 2017 included net expenses totaling $10.6 million, comprising $2.7 million in after-tax amortization of intangible assets, $1.4 million in stock-based compensation costs, $4.8 million in after-tax restructuring charges, $0.4 million in positive change in the fair value of the cash contingent consideration, $1.1 million in after-tax acquisition-related costs, and a foreign exchange loss of $1.0 million.

Net loss attributable to the parent interest in fiscal 2018 included $12.9 million for the net loss of newly acquired Astellia, which included $5.1 million in after-tax amortization of acquired intangible assets. Excluding Astellia's net loss, our net earnings attributable to the parent interest would have amounted to $1.0 million, or $0.02 per diluted in fiscal 2018.

Adjusted EBITDA (net loss attributable to the parent interest before interest, income taxes, depreciation and amortization, stock-based compensation costs, restructuring charges, acquisition-related deferred revenue fair value adjustment, change in fair value of cash contingent consideration, share in net loss of an associate, gain on the deemed disposal of the investment in an associate, and foreign exchange gain or loss) amounted to $17.2 million, or 6.4% of sales, in fiscal 2018, compared to $22.0 million, or 9.1% of sales in 2017. In fiscal 2018, Astellia negatively impacted adjusted EBITDA by $5.1 million. Adjusted EBITDA is a non-IFRS measure. See page 56 of this document for a complete reconciliation of adjusted EBITDA to IFRS net loss attributable to the parent interest.

On September 8, 2017, we acquired a 33.1% interest in Astellia, a publicly traded company on the NYSE Euronext Paris stock exchange. Astellia is a provider of network and subscriber intelligence enabling mobile operators to drive service quality, maximize operational efficiency, reduce churn and increase revenue. Its vendor-independent, real-time monitoring and troubleshooting solution is used to optimize networks end-to-end from radio to core. The purchase price amounted to €10 per share for a total cash consideration of €8.6 million (US$10.3 million).

On October 10, 2017, we reached an agreement with Astellia to acquire Astellia's remaining shares, at a share price of €10, for a total consideration of €17.3 million (US$21.4 million) by way of a public tender offer. The public offering opened on December 15, 2017 and closed on January 26, 2018.

On December 21 and 22, 2017, we acquired additional interests of 6.0% and 1.2% respectively in Astellia at a purchase price of €10 per share for a total cash consideration of €1.9 million (US$2.2 million), which brought our investment in Astellia to 40.3%.

On January 26, 2018, upon the closing of the public tender offer, we acquired an additional interest of 48.1% in Astellia at a purchase price of €10 per share for a total cash consideration of €12.5 million (US$15.5 million), which brought our investment in Astellia to 88.4%, and provided us with control over Astellia.

We re-opened the public tender offer to acquire the remaining shares of Astellia from February 9, 2018 to February 22, 2018. During that period, we acquired an additional interest of 8.9% in Astellia at a purchase price of €10 per share for a total cash consideration of €2.3 million (US$2.8 million), which brought our investment in Astellia to 97.3%.

Finally, on February 28, 2018, we entered into a squeeze-out process to acquire the remaining 2.7% interest in Astellia at a share price of €10, for a total consideration of €0.7 million (US$0.8 million). The binding terms of the squeeze-out process gave us control over Astellia's remaining shares as at February 28, 2018 and consequently, as of that date we controlled 100% of Astellia's shares.

The fair value of the total consideration for all shares of Astellia amounted to €25.9 million (US$32.1 million) and consisted of €21.1 million (US$26.2 million), net of Astellia's cash of €4.8 million (US$5.9 million) at the date of acquisition of control.

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From September 8, 2017 to January 25, 2018, the investment in Astellia provided us with significant influence over Astellia, and it was therefore accounted for under the equity method as required by IAS 28, "Investments in Associates and Joint Ventures". Under this method, on initial recognition this investment was recognized at cost, and the carrying amount decreased to recognize our share of the net loss of Astellia after the acquisition date. Included in the consolidated statement of earnings for fiscal 2018 is an equity loss pick-up of $2.1 million.

Upon the acquisition of an additional 48.1% interest in Astellia on January 26, 2018 (the "acquisition date"), the acquisition has been considered a business combination, and the acquisition was accounted for by applying the acquisition method as required by IFRS 3, "Business Combinations", and the requirements of IFRS 10, "Consolidated Financial Statements". Consequently, the fair value of the total consideration transferred was allocated to the assets acquired and liabilities assumed based on management's estimate of their fair value as at the acquisition date. The results of operations of the acquired business have been included in the consolidated financial statements of the company since January 26, 2018. The company recognized the non-controlling interest in Astellia at fair value. At the acquisition date, the carrying value of the 40.3% interest in Astellia held prior to the business combination was re-measured at fair value, that is, €10 per share, and was deemed to have been disposed of on that date. This re-measurement resulted in a gain of $2.1 million that was accounted for in the consolidated statement of earnings for fiscal 2018. In addition, upon the successive acquisitions of the non-controlling interest in February 2018, we recorded a gain in the amount of $0.4 million in shareholders' equity, representing the excess of the carrying value of the non-controlling interest and the purchase price paid.

On October 2, 2017, we acquired all issued and outstanding shares of Yenista Optics S.A.S., renamed EXFO Optics Inc. (EXFO Optics), a privately held company located in France and a supplier of advanced optical test equipment for the research and development and manufacturing markets. The acquisition-date fair value of the total consideration amounted to €9.4 million (US$11.1 million) and consisted of €8.1 million (US$9.5 million) in cash, net of EXFO Optics' cash of €1.3 million (US$1.5 million) at the acquisition date. This acquisition was accounted for by applying the acquisition method as required by IFRS 3, "Business Combinations", and the requirements of IFRS 10, "Consolidated Financial Statements"; consequently, the fair value of the total consideration transferred was allocated to the assets acquired and liabilities assumed based on management's estimate of their fair value as at the acquisition date. The results of operations of the acquired business have been included in our consolidated financial statements since October 2, 2017, being the date of acquisition.

On October 25, 2017, we modified certain credit facilities whereby existing lines of credit that provided advances up to CA$4.8 million (US$3.7 million) and up to US$6.0 million for operating purposes were cancelled and replaced with a credit facility of CA$28.9 million (US$22.2 million) mainly for the acquisition of the remaining shares of Astellia under the public tender offer.

In addition, on December 21, 2017, we cancelled and replaced this renewed credit facility (that provided advances up to CA$28.9 million (US$22.2 million)), with new revolving credit facilities of up to CA$70.0 million (US$53.6 million) and US$9.0 million. These modified credit facilities were used to finance a portion of the acquisition of Astellia's remaining shares and are used to finance working capital and for other general corporate purposes. As at August 31, 2018, an amount of $11.8 million was drawn from these credit facilities for bank loan and credit facilities.

On August 21, 2018, we announced a restructuring plan to accelerate the integration of our newly acquired monitoring and analytics technologies from Astellia and simplify our cost structure and optimize resources as we converge toward fewer sites and reduce our workforce.

This plan will result in pre-tax expenses of approximately $8 million, mainly for severance expenses, costs for remaining non-cancellable operating leases, write-off of research and development income tax credits and impairment of long-lived assets, net of related income taxes. During the fourth quarter of fiscal 2018, we recorded severance expenses of $2.1 million, costs for remaining non-cancelable operating lease of $1.1 million, write-off of research and development income tax credits of $1.2 million and impairment of long-lived assets of $0.2 million, net of related income taxes of $1.2 million, for total after-tax restructuring charges of $3.4 million. The remainder of the restructuring charges, which mainly comprise severance expenses, will be recorded in the first half of fiscal 2019.

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In September 2018, as part of our fiscal 2018 restructuring plan and the shutdown of our operations in Toronto, Canada, we entered into a binding agreement to sell one of our buildings for net proceeds of $3.3 million. The transfer of ownership is expected to occur in the second quarter of fiscal 2019 and will result in a pre-tax gain of $1.9 million that will be recorded in our consolidated statement of earnings for that quarter.

Sales

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

In fiscal 2016 and 2018, no customer accounted for more than 10% of our sales, with our top customer representing 7.1% and 9.1% of our sales respectively. In fiscal 2017, our top customer represented 10.1% of our sales.

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

Cost of Sales

The cost of sales includes raw materials, salaries and related expenses for direct and indirect manufacturing personnel and professional services, as well as overhead costs. Excess, obsolete and scrapped materials are also included in the cost of sales. However, the cost of sales is presented exclusive of depreciation and amortization, which are shown separately in the consolidated statements of earnings.

Operating Expenses

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

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

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

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RESULTS OF OPERATIONS
(in thousands of US dollars, except per share data, and as a percentage of sales for the years indicated)

Consolidated statement of earnings data [1]:	2018	2017	2016	2018	2017	2016
Sales	$269,546	$243,301	$232,583	100.0%	100.0%	100.0%
Cost of sales [2]	105,004	94,329	87,066	39.0	38.8	37.4
Selling and administrative	98,794	86,256	82,169	36.7	35.5	35.3
Net research and development	57,154	47,168	42,687	21.2	19.4	18.4
Depreciation of property, plant and equipment	5,444	3,902	3,814	2.0	1.6	1.6
Amortization of intangible assets	10,327	3,289	1,172	3.8	1.4	0.5
Change in fair value of cash contingent consideration	(670)	(383)	–	(0.3)	(0.2)	–
Interest and other (income) expense	1,378	303	(828)	0.5	0.1	(0.4)
Foreign exchange (gain) loss	(1,309)	978	(161)	(0.5)	0.4	–
Share in net loss of an associate	2,080	–	–	0.8	–	–
Gain on deemed disposal of the investment in an associate	(2,080)	–	–	(0.8)	–	–
Earnings (loss) before income taxes	(6,576)	7,459	16,664	(2.4)	3.0	7.2
Income taxes	5,678	6,608	7,764	2.1	2.7	3.4
Net earnings (loss) for the year	(12,254)	851	8,900	(4.5)	0.3	3.8
Net loss for the year attributable to non-controlling interest	(352)	–	–	(0.1)	–	–
Net earnings (loss) for the year attributable to the parent interest [3]	$(11,902)	$851	$8,900	(4.4)%	0.3%	3.8%
Basic net earnings (loss) attributable to the parent interest per share	$(0.22)	$0.02	$0.17			
Diluted net earnings (loss) attributable to the parent interest per share	$(0.22)	$0.02	$0.16			
Other selected information:						
Gross margin before depreciation and amortization [4]	$164,542	$148,972	$145,517	61.0%	61.2%	62.6%
Research and development data:						
Gross research and development	$65,243	$53,124	$47,875	24.2%	21.8%	20.6%
Net research and development	$57,154	$47,168	$42,687	21.2%	19.4%	18.4%
Restructuring charges included in:						
Cost of sales	$517	$1,697	$–	0.2%	0.7%	–%
Selling and administrative expenses	$673	$1,150	$–	0.2%	0.5%	–%
Net research and development expenses	$3,219	$2,232	$–	1.2%	0.9%	–%
Adjusted EBITDA [4,5,6]	$17,198	$22,041	$22,039	6.4%	9.1%	9.5%

Consolidated balance sheet data [1]:

Total assets	$282,623	$259,241	$237,793

(1) Consolidated statement of earnings and balance sheet data has been derived from our consolidated financial statements prepared according with IFRS, as issued by the IASB, except for non-IFRS measures [4].

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

(3) Includes net loss of Astellia of $12.9 million or 4.8% of sales in fiscal 2018 (nil in 2016 and 2017).

(4) Refer to page 56 for non-IFRS measures.

(5) Astellia negatively impacted the adjusted EBITDA by $5.1 million or 1.9% of sales in fiscal 2018 (nil in 2016 and 2017).

(6) Includes acquisition-related costs of $2.2 million or 0.8% of sales in fiscal 2018 and $1.1 million or 0.4% of sales in 2017 (nil in 2016).

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RESULTS OF OPERATIONS

Sales and Bookings

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

Sales

	Years ended August 31,		
	2018	2017	2016
Physical-layer product line	$172,912	$161,864	$151,910
Protocol-layer product line	95,759	81,905	83,324
	268,671	243,769	235,234
Foreign exchange gains (losses) on forward exchange contracts	875	(468)	(2,651)
Total sales	$269,546	$243,301	$232,583

Bookings

	Years ended August 31,		
	2018	2017	2016
Physical-layer product line	$172,094	$165,886	$155,320
Protocol-layer product line	94,724	86,348	87,631
	266,818	252,234	242,951
Foreign exchange gains (losses) on forward exchange contracts	875	(468)	(2,651)
Total bookings	$267,693	$251,766	$240,300

Sales by geographic region

The following table summarizes sales by geographic region:

	Years ended August 31,		
	2018	2017	2016
Americas	50 %	55 %	55 %
Europe, Middle-East and Africa (EMEA)	32	26	25
Asia-Pacific (APAC)	18	19	20
	100 %	100 %	100 %

Fiscal 2018 vs. 2017

In fiscal 2018, our sales increased 10.8% to $269.5 million, compared to $243.3 million in 2017, while our bookings increased 6.3% year-over-year to $267.7 million in 2018 from $251.8 million in 2017, for a book-to-bill ratio of 0.99.

Sales

In fiscal 2018, the increase in total sales year-over-year comes from our physical-layer product line, the positive effect of our recent acquisitions of Astellia (seven-month contribution) and EXFO Optics (eleven-month contribution), as well as the positive currency impact. In fiscal 2018, total sales included $16.4 million from newly acquired Astellia. Otherwise, in fiscal 2018, excluding the positive effect of the recent acquisitions and the positive currency impact, our total sales would have been flat year-over-year, since the year-over-year increase in sales of our physical-layer product line was offset by the decrease of our protocol-layer product line.

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In fiscal 2018, sales of our physical-layer product line (optical and copper testing) increased 6.8% year-over-year mainly due to the recent acquisition of EXFO Optics and the positive currency impact. In addition, we reported increased sales in the EMEA region, where we experienced higher sales for our copper-testing solutions and our network quality fiber-monitoring systems (NQMS) (a subgroup within our physical-layer product line) amongst other, as well as increased sales in the Americas for our optical product line, and increased in sales in the APAC region where we also experienced higher sales for our NQMS. Sales of copper-testing solutions and NQMS are characterized by large intermittent orders from customers.

Sales of our protocol-layer product line increased 16.9% year-over-year in fiscal 2018, due to the positive effect of the recent acquisition of Astellia, which contributed $16.4 million in sales, as well as the positive currency impact. Otherwise, sales of our protocol-layer product line decreased in all regions year-over-year mainly due to the streamlining of our passive monitoring product line in the second half of fiscal 2017, as well as the year-over-year decrease in sales of our legacy active monitoring product line.

Bookings

In fiscal 2018, the 6.3% increase in total bookings year-over-year comes from the positive effect of our recent acquisitions of Astellia (seven-month contribution), EXFO Optics (eleven-month contribution) and Ontology (full contribution in 2018 versus six-month contribution in 2017), a solid performance of our NQMS worldwide, as well as the positive currency impact, offset in part by lower bookings from our Transport and Datacom and passive monitoring product lines. In fiscal 2018, total bookings included $16.5 million from newly acquired Astellia.

In fiscal 2018, bookings of our physical-layer product line increased 3.7% year-over-year, due to higher bookings for our NQMS worldwide, the positive effect of the recent acquisition of EXFO Optics, as well as the positive currency impact year-over-year. Otherwise, bookings decreased year-over-year in APAC for both our optical (mainly in China due to delayed investments from NEMs as they prepare for 5G investments) and copper-access product lines, as well as in the Americas for our copper-access product line. Bookings of copper-testing solutions and NQMS are characterized by large intermittent orders from customers.

Bookings of our protocol-layer product line increased 9.7% year-over-year in fiscal 2018, due to the positive effect of the recent acquisitions of Astellia, which contributed $16.5 million in bookings, as well as the positive currency impact. Otherwise, bookings of our protocol-layer product line decreased year-over-year in the APAC region for our Transport and Datacom product line (a subgroup within our protocol-layer product line), which had delivered strong bookings in fiscal 2017 in this region. In addition, bookings of our protocol-layer product line decreased year-over-year in the EMEA region, mainly due to the streamlining of our passive-monitoring product line in the second half of fiscal 2017. Otherwise, despite streamlining of our passive-monitoring product line in 2017, bookings of our protocol-layer product line slightly increased year-over-year in the Americas, which offset in part the decrease in the EMEA and APAC regions.

As we gradually evolve from a supplier of dedicated test instruments to a supplier of end-to-end system-based solutions, our quarterly sales and bookings are becoming increasingly subject to quarterly fluctuations, as we are managing more complex, multimillion-dollar deals that have prolonged sales and revenue recognition cycles related to our protocol-layer products. This has been amplified with the recent acquisitions of Astellia and Ontology.

Fiscal 2017 vs. 2016

In fiscal 2017, our sales increased 4.6% to $243.3 million, compared to $232.6 million in 2016, while our bookings increased 4.8% year-over-year to $251.8 million in 2017 from $240.3 million in 2016, for a book-to-bill ratio of 1.03.

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Sales

In fiscal 2017, we made progress in sales (6.6%) for our physical-layer product line, mainly in the Americas, compared to 2016, mostly due to our leadership position in portable optical testing, a 100G investment cycle among CSPs in this region, and growing business with web-scale operators for their data center interconnects. In addition, in fiscal 2017, we benefited to some extent from calendar year-end budget spending on the part of some CSPs in the Americas, versus a nominal amount in 2016. To a lesser extent, sales of our physical-layer product line increased in EMEA despite the negative currency impact year-over-year, which had to some extent a negative impact on our sales and bookings to this region in 2017 compared to 2016. In the APAC region, sales of our physical-layer product line decreased year-over-year in fiscal 2017, especially in China, mainly due to delayed investments from NEMs.

In fiscal 2017, sales of our protocol-layer product line decreased 1.7% year-over-year, mainly in the Americas, despite the positive impact of newly acquired Absolute. In fiscal 2016, we also had recognized a large order from a North American Tier-1 network operator for our EXFO Xtract solution, and we did not close any such large order in fiscal 2017. In addition, the streamlining of our passive monitoring product line in fiscal 2017 had a negative impact on our sales in 2017 compared to 2016. Furthermore, in fiscal 2016, our Transport and Datacom product line (a subgroup within our protocol-layer product line) benefited, to a greater extent, from the 100G investment cycle, especially in the United States, compared to 2017. Otherwise, sales of our protocol-layer product line increased in the EMEA year-over-year, mainly due to the positive impact of recently acquired Ontology, despite the negative currency impact year-over-year. Sales of our protocol-layer product line were flat overall in APAC year-over-year in fiscal 2017.

Finally, in fiscal 2017, we reported lower losses on our forward exchange contracts, which had a $2.2 million positive impact on our total sales year-over-year.

Bookings

In fiscal 2017, we reported a year-over-year increase in total bookings, which mainly comes from the Americas for our physical-layer product line and from the EMEA for our protocol-layer product line, despite negative currency impacts.

In fiscal 2017, our physical-layer product line reported a significant year-over-year increase in bookings in the Americas as we benefited from heightened penetration of mobile network operators for their fronthaul and backhaul networks, increased traction with fixed network operators for their 100G long-haul and metro links and growing business with web-scale operators for their data center interconnects. In addition, as mentioned earlier, in fiscal 2017, we benefited to some extent from calendar year-end budget spending on the part of some CSPs in the Americas, versus a nominal amount in 2016. Otherwise, bookings for our physical-layer product line were flat in the EMEA and APAC year-over-year. The EMEA was to some extent negatively impacted by the decrease in the average value of the British pound and the euro compared to the US dollar year-over-year. In APAC, bookings were negatively impacted by the decrease in bookings in China, mainly due to delayed investments from NEMs, offset by traction gained in the rest of APAC.

Our protocol-layer product lines reported a decrease in total bookings in fiscal 2017 compared to 2016 (-1.5%). Most of the decrease comes from the Americas, despite the positive impact our newly acquired Absolute and Ontology businesses, as our Transport and Datacom product line (a subgroup within our protocol-layer product line) did not reach the same level of orders from the 100G investment cycle, especially in the United States compared to 2016. In addition, in 2016, we received a large order from a North American Tier 1 network operator for our EXFO Xtract solution, and we did not close any such large order in 2017. Otherwise, we made progress in bookings in the EMEA thanks to the recent acquisition of Ontology. In addition, in fiscal 2017, bookings in APAC slightly increased year-over-year. Finally, the streamlining of our passive monitoring product line in fiscal 2017 negatively impacted the bookings of our protocol-layer product line compared to 2016.

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GROSS MARGIN BEFORE DEPRECIATION AND AMORTIZATION
(non-IFRS measure – refer to page 56 of this document)

Gross margin before depreciation and amortization amounted to 61.0%, 61.2% and 62.6% of sales in fiscal 2018, 2017 and 2016 respectively.

Fiscal 2018 vs. 2017

In fiscal 2018, gross margin before depreciation and amortization included a negative impact of 0.3% of sales for the acquisition-related deferred revenue fair value adjustment from the acquisition of Astellia (nil in 2017).

In fiscal 2018, gross margin before depreciation and amortization included $0.5 million, or 0.2% of sales in restructuring charges for severance expenses, compared to $1.7 million or 0.7% of sales in 2017.

However, in fiscal 2018, we recorded in our sales foreign exchange gains on our forward exchange contracts, compared to foreign exchange losses in 2017, which contributed to an increase of 0.2% in gross margin before depreciation and amortization year-over-year.

Excluding these items, gross margin before depreciation and amortization would have amounted to 61.3% of sales in fiscal 2018, compared to 61.9% of sales in 2017, slightly lower (0.6%) year-over-year.

In fiscal 2018, newly acquired Astellia, a subgroup within our protocol-product line, delivered lower margins than our typical average margin, and we recorded slightly higher write-offs (excluding those in restructuring expenses) compared to 2017, which had a negative impact on our gross margin before depreciation and amortization year-over-year.

Fiscal 2017 vs. 2016

In fiscal 2017, gross margin before depreciation and amortization included $1.7 million or 0.7% of sales in restructuring charges for severance expenses and inventory writeoffs. Excluding those charges, gross margin before depreciation and amortization would have amounted to 61.9% of sales in fiscal 2017, slightly lower (0.7%) compared to 2016.

In fiscal 2017, our gross margin before depreciation and amortization (excluding the impact of our restructuring charges) was unfavorably affected by product mix within both product lines compared to 2016. In particular, in fiscal 2016, we recognized a large order with a Tier-1 network operator for our EXFO Xtract solution, which had a positive impact on our gross margin before depreciation and amortization during that year as this product delivers strong margins. We did not have any such high-margin deals this year. In addition, in fiscal 2017, our physical-layer product line represented a larger portion of our sales year-over-year, and this product line delivers lower margins than our protocol-layer product line (protocol-layer products have a richer software content), which had a negative impact on our gross margin before depreciation and amortization year-over-year.

However, in fiscal 2017, we recorded in our sales lower foreign exchange losses on our forward exchange contracts, compared to 2016, which contributed to increasing our gross margin before depreciation and amortization by 0.3% year-over-year.

In addition, in fiscal 2017, we recorded lower inventory writeoffs compared to 2016, which contributed to increase our gross margin before depreciation and amortization by an additional 0.2% year-over-year.

SELLING AND ADMINISTRATIVE EXPENSES

Selling and administrative expenses amounted to $98.8 million, $86.3 million and $82.2 million for fiscal 2018, 2017 and 2016 respectively. As a percentage of sales, selling and administrative expenses amounted to 36.7%, 35.5% and 35.3% for fiscal 2018, 2017 and 2016 respectively.

Fiscal 2018 vs. 2017

In fiscal 2018, our selling and administrative expenses increased $12.5 million year-over-year, mainly due to additional expenses following the acquisitions of Astellia (seven-month contribution), EXFO Optics (eleven-month contribution) and Ontology (full contribution in 2018 versus six-month contribution in 2017), inflation, salary increases, as well as increased acquisition-related costs of $1.1 million following the recent business acquisitions. In addition, in fiscal 2018, the decrease in the average value of the US dollar compared to other currencies had a negative impact on our selling and administrative expenses year-over-year.

However, in fiscal 2018, selling and administrative expenses included $0.7 million in restructuring charges compared to $1.2 million in 2017. In addition, the positive impact of our 2017 restructuring plan reduced our selling and administrative expenses year-over-year in fiscal 2018.

Excluding restructuring charges and acquisition-related costs for business combinations, our selling and administrative expenses would have represented 35.7% of sales, 1.1% higher compared to 34.6% of sales in 2017, due to the impact of the recent acquisitions and the negative currency impact.

Fiscal 2017 vs. 2016

In fiscal 2017, our selling and administrative expenses increased $4.1 million year-over-year due to restructuring charges of $1.2 million, additional expenses following the acquisitions of Absolute and Ontology and to support the growth of our business, inflation, salary increases, as well as acquisition-related costs of $1.1 million following the recent business acquisitions.

Excluding restructuring charges and acquisition-related costs for business combinations, which represent 0.9% of sales, our selling and administrative expenses would have represented 34.6% of sales, lower compared to 35.3% of sales in 2016.

RESEARCH AND DEVELOPMENT EXPENSES

Gross research and development expenses

Gross research and development expenses totaled $65.2 million, $53.1 million and $47.9 million for fiscal 2018, 2017 and 2016 respectively. As a percentage of sales, gross research and development expenses amounted to 24.2%, 21.8% and 20.6% for fiscal 2018, 2017 and 2016 respectively, while net research and development expenses accounted for 21.2%, 19.4% and 18.4% of sales for these respective years.

Fiscal 2018 vs. 2017

In fiscal 2018, our gross research and development expenses increased $12.1 million year-over-year, mainly due to additional expenses following the acquisitions of Astellia (seven-month contribution), EXFO Optics (eleven-month contribution) and Ontology (full contribution in 2018 versus six-month contribution in 2017), as well as inflation and salary increases.

In addition, in fiscal 2018, our gross research and development expenses included $3.2 million in restructuring charges compared to $2.2 million in 2017.

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Finally, in fiscal 2018, the decrease in the average value of the US dollar compared to other currencies had a negative impact on our gross research and development expenses year-over-year.

However, our gross research and development expenses decreased year-over-year due to the positive impact of our 2017 recent restructuring plan.

Excluding restructuring charges, which represent 1.2% of sales in fiscal 2018 compared to 0.9% of sales in 2017, our gross research and development expenses would have represented 23.0% of sales in 2018, 2.1% higher compared to 20.9% of sales in 2017, due to the impact of the recent acquisitions and the negative currency impact.

Fiscal 2017 vs. 2016

In fiscal 2017, our gross research and development expenses increased $5.2 million year-over-year due to restructuring charges of $2.2 million, additional expenses following the acquisitions of Absolute and Ontology and to support the growth of our business, inflation, salary increases, as well as a shift in the mix and timing of research and development projects, compared to 2016.

Excluding restructuring charges, which represent 0.9% of sales, our gross research and development expenses would have represented 20.9% of sales, almost flat compared to 20.6% of sales in 2016.

Tax Credits and Grants

We are entitled to tax credits for eligible research and development activities conducted in Canada and France.

Tax credits and grants for research and development activities were $8.1 million, $6.0 million and $5.2 million for fiscal 2018, 2017 and 2016 respectively. As a percentage of gross research and development expenses, tax credits and grants reached 12.4%, 11.2% and 10.8% for fiscal 2018, 2017 and 2016 respectively.

Fiscal 2018 vs. 2017

The increase in our tax credits and grants in fiscal 2018, compared to 2017, mainly comes from newly acquired Astellia (seven-month contribution) and EXFO Optics (eleven-month contribution) that are entitled to tax credits and grants on research and development activities carried out in France. This also explains the increase in tax credits and grants as a percentage of gross research and development expenses year-over-year.

Fiscal 2017 vs. 2016

The increase in our tax credits and grants in fiscal 2017, compared to 2016, mainly results from the increase in our gross research and development expenses year-over-year.

In fiscal 2017, the increase in tax credits and grants as a percentage of gross research and development expenses, compared to 2016, mainly comes from the shift in the mix of eligible projects.

DEPRECIATION OF PROPERTY, PLANT AND EQUIPMENT

Depreciation of property, plant and equipment totaled $5.4 million, $3.9 million and $3.8 million for fiscal 2018, 2017 and 2016 respectively.

In fiscal 2018, the year-over-year increase in our depreciation expense, compared to 2017, is due to the acquisitions of Astellia (seven-month contribution), EXFO Optics (eleven-month contribution) and Ontology (full contribution in 2018 compared to six-month contribution in 2017) as well as the decrease in the average value of the US dollar compared to other currencies year-over-year.

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AMORTIZATION OF INTANGIBLE ASSETS

In conjunction with the business combinations we completed, we recorded intangible assets primarily consisting of core technologies and customer relationships. In addition, intangible assets include software and brand names. These intangible assets resulted in amortization expenses of $10.3 million, $3.3 million and $1.2 million for fiscal 2018, 2017 and 2016 respectively.

Fiscal 2018 vs. 2017

The increase in our amortization expense in fiscal 2018, compared to 2017, is due to the acquisitions of Astellia (seven-month contribution), EXFO Optics (eleven-month contribution) and Ontology (full contribution in 2018 compared to six-month contribution in 2017), as well as the decrease in the average value of the US dollar compared to other currencies year-over-year.

Fiscal 2017 vs. 2016

The increase in our amortization expense in fiscal 2017, compared to 2016, was due to the acquisitions of Absolute (ten-month contribution in 2017) and Ontology (six-month contribution).

FOREIGN EXCHANGE GAIN (LOSS)

Foreign exchange gains and losses are mainly the result of the translation of operating activities denominated in currencies other than our functional currency, which is the Canadian dollar. A portion of our foreign exchange gains or losses results from the translation of cash balances and deferred income taxes denominated in US dollars. We manage our exposure to currency risk in part with forward exchange contracts. In addition, some of our entities' operating activities are denominated in US dollars, euros and British pounds, which further hedges this risk. However, we remain exposed to a currency risk; namely, any increase in the value of the Canadian dollar compared to the US dollar would have a negative impact on our operating results.

We reported a foreign exchange gain of $1.3 million in fiscal 2018 compared to a loss of $1.0 million in 2017 and a gain of $0.2 million in 2016.

Fiscal 2018

In fiscal 2018, the period-end value of the Canadian dollar decreased versus the US dollar, compared to the previous year-end, which resulted in a foreign exchange gain of $1.3 million during that year. The period-end value of the Canadian dollar decreased 4.0% versus the US dollar to CA$1.3055 = US$1.00 in fiscal 2018, compared to CA$1.2536 = US$1.00 at the end of the previous year. In fiscal 2018, the average value of the Canadian dollar versus the US dollar was CA$1.2768 = US$1.00.

Fiscal 2017

In fiscal 2017, the period-end value of the Canadian dollar increased versus the US dollar compared to the previous year-end, which resulted in a foreign exchange loss of $1.0 million during the year. The period-end value of the Canadian dollar increased 4.6% versus the US dollar to CA$1.2536 = US$1.00 in fiscal 2017 compared to CA$1.3116 = US$1.00 at the end of the previous year. In fiscal 2017, the average value of the Canadian dollar versus the US dollar was CA$1.3212 = US$1.00.

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Fiscal 2016

In fiscal 2016, we witnessed some volatility in the value of the Canadian dollar as it fluctuated compared to the US dollar, which overall resulted in a foreign exchange gain of $0.2 million during that period. The period-end value of the Canadian dollar slightly increased 0.3% versus the US dollar to CA$1.3116 = US$1.00 in fiscal 2016 compared to CA$1.3157 = US$1.00 at the end of the previous year. In fiscal 2016, the average value of the Canadian dollar versus the US dollar was CA$1.3278 = US$1.00.

Foreign exchange rate fluctuations also flow through the P&L line items as portions of our sales are dominated in Canadian dollars and euros and significant portions of our cost of sales and operating items are denominated in Canadian dollars, euros, Indian rupees and British pounds, and we report our results in US dollars. In fiscal 2018, the decrease in the average value of the US dollar compared to the Canadian dollar, the euro and the British pound year-over-year, resulted in a negative impact on our financial results. The average value of the US dollar decreased 3.4%, 8.0% and 6.1% respectively year-over-year, compared to the Canadian dollar, the euro and the British pound.

INCOME TAXES

In fiscal 2018, we reported income tax expenses of $5.7 million on a loss before income taxes of $6.6 million, compared to income tax expenses of $6.6 million on earnings before income taxes of $7.5 million in 2017 and income tax expenses of $7.8 million on earnings before income taxes of $16.7 million in 2016.

On December 22, 2017, the US tax reform ("Tax Cuts and Jobs Act") was substantively enacted and reduced the maximum corporate income tax rate from 35% to 21%, effective January 1, 2018. Based on our estimate of deferred tax assets expected to be used in fiscal 2018 and beyond against taxable income in the United States, we recorded a deferred income tax expense of $1.5 million in the consolidated statement of earnings for fiscal 2018 to account for the effect of this new substantively enacted tax rate.

Excluding this one-time income tax expense in fiscal 2018, our distorted tax rates for all periods mainly resulted from the fact that we did not recognize deferred income tax assets for some of our subsidiaries at loss and acquisition-related costs for business combinations are non-deductible for tax purposes. In addition, we had some other non-deductible losses and expenses, such as stock-based compensation costs. However, a significant portion of our foreign exchange gain was a result of the translation of the financial statements of our foreign subsidiaries from their local currency to the functional currency and was therefore non-taxable. Otherwise, our effective tax rate would have been closer to the combined Canadian and provincial statutory tax rate of 27% for this year.

Please refer to note 20 to our consolidated financial statements for a full reconciliation of our income tax provision.

LIQUIDITY AND CAPITAL RESOURCES

Cash Requirements and Capital Resources

As at August 31, 2018, cash and short-term investments totaled $15.0 million, while our working capital was at $32.3 million. Our cash and short-term investments decreased $24.2 million in fiscal 2018, compared to 2017.

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The following table summarizes the decrease of cash and short-term investments in fiscal 2018 in thousands of US dollars:

Cash flows provided by operating activities	$14,370
Bank loan	11,061
Acquisition of Astellia (including non-controlling interest)	(25,767)
Acquisition of EXFO Optics	(9,540)
Acquisition of Ontology (contingent consideration)	(480)
Purchases of capital assets	(10,452)
Repayment of long-term debt and other liabilities	(3,137)
Unrealized foreign exchange loss on cash and short-term investments	(225)
	$(24,170)

The unrealized foreign exchange loss resulted from the translation, in US dollars, of our Canadian-dollar-denominated cash and short-term investments and was included in accumulated other comprehensive income in the consolidated balance sheet.

Our short-term investments consist of debt instruments issued by high-credit quality corporations; therefore, we consider the risk of non-performance of these financial instruments to be limited. These debt instruments are not expected to be affected by a significant liquidity risk. For the purpose of managing our cash position, we have established a cash management policy, which we follow and monitor on a regular basis.

We believe that our cash balances and short-term investments totaling $15.0 million, combined with our available revolving credit facilities of up to $52.7 million, will be sufficient to meet our liquidity and capital requirements for the foreseeable future, including any possible working capital requirements from our new acquisitions. In addition to these assets and credit facilities, we have unused available lines of credit of $25.1 million for foreign currency exposure related to forward exchange contracts. However, possible operating losses, additional restructuring costs and/or possible investments in or acquisitions of complementary businesses, products or technologies may require additional financing. There can be no assurance that additional debt or equity financing will be available when required or, if available, that it can be secured on satisfactory terms.

Sources and Uses of Cash

We finance our operations and meet our capital expenditure requirements through a combination of cash flows from operating activities, the use of our cash and short-term investments, borrowing under our existing credit facilities as well as the issuance of subordinate voting shares.

Operating activities

Cash flows provided by operating activities were $14.4 million in fiscal 2018, compared to $12.9 million in 2017 and $24.4 million in 2016.

Fiscal 2018 vs. 2017

Cash flows provided by operating activities in fiscal 2018 were attributable to net earnings after items not affecting cash of $8.4 million, and the positive net change in non-cash operating items of $6.0 million; this was mainly due to the positive effect on cash of the decrease of $7.3 million in our accounts receivable due to the timing of receipts and sales during the year, and the increase of $1.0 million in our accounts payable and accrued liabilities and provisions due to timing of purchases and payments during the year. These positive effects on cash were offset in part by the negative effect on cash of the $1.0 million increase in our inventories to meet future demand and the negative effect on cash of the $1.3 million increase in our other assets due to the timing of payments during the year.

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Fiscal 2017 vs. 2016

Cash flows provided by operating activities in fiscal 2017 were attributable to net earnings after items not affecting cash of $13.0 million, slightly offset by the negative net change in non-cash operating items of $0.1 million; this was mainly due to the positive effect on cash of the decrease of $4.0 million in our accounts receivable due to the timing of receipts and sales during the year and by the positive effect on cash of the decrease of $0.9 million in our inventories due to improved inventory turns during the year; these positive effects on cash were more than offset by the negative effect on cash of the $2.4 million increase in our income tax and tax credits recoverable due to tax credits earned during the year not yet recovered, the negative effect on cash of the increase of $0.9 million in our prepaid expenses due to timing of payments during the year, and by the negative effect on cash of the decrease of $1.7 million in our accounts payable, accrued liabilities and provisions due to timing of purchases and payments during the year.

Investing activities

Cash flows used by investing activities amounted to $43.9 million in fiscal 2018, compared to $16.5 million in 2017 and $7.0 million in 2016.

Fiscal 2018

In fiscal 2018, we made cash payments of $10.5 million and $32.1 million respectively for the purchase of capital assets and the acquisitions of EXFO Optics and Astellia. In addition, we acquired (net of disposal) $1.3 million worth of short-term investments during the year.

Fiscal 2017

In fiscal 2017, we made cash payments of $12.8 million and $7.2 million respectively for the acquisitions of Absolute and Ontology and the purchase of capital assets. Otherwise, we disposed (net of acquisitions) of $3.5 million worth of short-term investments.

Fiscal 2016

In fiscal 2016, we paid $4.4 million for the purchase of capital assets, and we acquired (net of disposal) $2.6 million worth of short-term investments.

Financing activities

Cash flows provided by financing activities amounted to $4.3 million in fiscal 2018, compared to cash flows used of $1.5 million in 2017 and $1.6 million in 2016.

Fiscal 2018

In fiscal 2018, our bank loan increased by $11.1 million, but we repaid $3.1 million of our long-term debt and other liabilities and paid $3.7 million for the purchase of the non-controlling interest in Astellia.

Fiscal 2017

In fiscal 2017, we repaid the long-term debt of $1.5 million assumed as part of the acquisition of Ontology.

Fiscal 2016

In fiscal 2016, we redeemed share capital under our share repurchase program for a cash consideration of $1.6 million.

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Contractual obligations

We are committed under the terms of contractual obligations which have various expiration dates, primarily for the rental of premises and equipment, licensing of intellectual property and long-term debt. The following table summarizes our contractual obligations, on an undiscounted basis, as at August 31, 2018 in thousands of US dollars:

	Long-term debt	Operating leases	Licensing agreements	Total
No later than one year	$ 2,921	$ 3,365	$ 1,492	$7,778
Later than one year and no later than five years	5,745	9,519	1,982	17,246
Later than five years	162	502		664
	$ 8,828	$ 13,386	$ 3,474	$25,688

In addition, on August 31, 2018, we had letters of guarantee amounting to $1.7 million for our own selling and purchasing requirements, which were reserved from our lines of credit; these letters of guarantee expire at various dates through fiscal 2022.

FORWARD EXCHANGE CONTRACTS

We are exposed to currency risk as a result of our export sales of products manufactured in Canada, China, France and Finland, the majority of which are denominated in US dollars and euros. In addition, we are exposed to currency risk as a result of our research and development activities in India (Indian rupees). These risks are partially hedged by forward exchange contracts. Forward exchange contracts, which are designated as cash flow hedging instruments, qualify for hedge accounting.

As at August 31, 2018, we held forward exchange contracts to sell US dollars for Canadian dollars and Indian rupees at various forward rates, which are summarized as follows:

US dollars – Canadian dollars

Expiry dates	Contractual amounts	Weighted average contractual forward rates
September 2018 to August 2019	$26,400,000	1.3029
September 2019 to August 2020	15,700,000	1.2756
September 2020 to May 2021	3,700,000	1.2703
Total	$45,800,000	1.2909

US dollars – Indian rupees

Expiry dates	Contractual amounts	Weighted average contractual

		forward rates
September 2018 to May 2019	$4,600,000	67.68

The carrying amount of forward exchange contracts is equal to fair value, which is based on the amount at which they could be settled based on estimated current market rates. The fair value of forward exchange contracts amounted to net gains of $2.3 million and net losses of $0.5 million as at August 31, 2017 and 2018 respectively. The US dollar – Canadian dollar year-end exchange rate was CA$1.3055 = US$1.00 as at August 31, 2018.

SHARE CAPITAL

As at November 12, 2018, EXFO had 31,643,000 multiple voting shares outstanding, entitling to 10 votes each and 23,590,515 subordinate voting shares outstanding. The multiple voting shares and the subordinate voting shares are unlimited as to number and without par value.

OFF-BALANCE SHEET ARRANGEMENTS

As at August 31, 2018, our off-balance sheet arrangements consisted of letters of guarantee amounting to $1.7 million for our own selling and purchasing requirements, which were reserved from our lines of credit; these letters of guarantee expire at various dates through fiscal 2022.

STRUCTURED ENTITIES

As at August 31, 2018, we did not have interests in any structured entities.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with IFRS requires us to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and the disclosures of contingent assets and liabilities at the date of the financial statements. On an ongoing basis, we evaluate these estimates and assumptions, including those related to the fair value of assets and liabilities acquired in business combinations, the fair value of financial instruments, the allowance for doubtful accounts receivable, the amount of tax credits recoverable, the provision for excess and obsolete inventories, the estimated useful lives of capital assets, the valuation of long-lived assets, the impairment of goodwill, the recoverable amount of deferred income tax assets, the amount of certain accrued liabilities, provisions and deferred revenue as well as stock-based compensation costs. We base our estimates and assumptions on historical experience and on other factors that we believe to be reasonable under the circumstances.

Critical Judgments in Applying Accounting Policies

(a) Determination of functional currency

We operate in multiple countries and generate revenue and incur expenses in several currencies, namely the Canadian dollar, the US dollar, the euro, the British pound, the Indian rupee and the CNY (Chinese currency). The determination of the functional currency of EXFO and its subsidiaries may require significant judgment.
In determining the functional currency of EXFO and its subsidiaries, we take into account primary, secondary and tertiary indicators. When indicators are mixed, and the functional currency is not obvious, we use our judgment to determine the functional currency.

(b) Determination of cash generating units and allocation of goodwill

For the purpose of impairment testing, goodwill must be allocated to each cash-generating unit (CGU) or group of CGUs that are expected to benefit from the synergies of the business combination. Initial allocation and possible reallocation of goodwill to a CGU or a group of CGUs requires judgment.

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Critical Estimates and Assumptions

(a) Inventories

We state our inventories at the lower of cost, determined on an average cost basis and net realizable value, and we provide reserves for excess and obsolete inventories. We determine our reserves for excess and obsolete inventories based on the quantities on hand at the reporting dates compared to foreseeable needs, taking into account changes in demand, technology or market. It is possible that additional inventory reserves may occur if future sales are less than our forecasts or if there is a significant shift in product mix compared to our forecasts, which could adversely affect our results.

(b) Income taxes

We are subject to income tax laws and regulations in several jurisdictions. Under these laws and regulations, uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. We maintain provisions for uncertain tax positions that we believe appropriately reflect our risk based on our interpretation of laws and regulations. In addition, we make reasonable estimates and assumptions to determine the amount of deferred tax assets that can be recognized in our consolidated financial statements, based upon the likely timing and level of anticipated future taxable income together with tax planning strategies. The ultimate realization of our deferred income tax assets is dependent upon the generation of sufficient future taxable income during the periods in which those assets are expected to be realized.

(c) Tax credits recoverable

Tax credits are recorded provided that there is reasonable assurance that we have complied and will comply with all the conditions related to the tax credits and that the tax credits will be received. The ultimate recovery of our Canadian non-refundable tax credits is dependent upon the generation of sufficient future taxable income during the tax credits carry-forward periods. We have made reasonable estimates and assumptions to determine the amount of non-refundable tax credits that can be recognized in our consolidated financial statements, based upon the likely timing and level of anticipated future taxable income together with tax planning strategies.

As at August 31, 2018, our Canadian non-refundable research and development tax credits recognized in the consolidated balance sheet amounted to $40.0 million. To recover these non-refundable research and development tax credits, we need to generate approximately $267 million (CA$348 million) in pre-tax earnings at the Canadian federal level. To generate $267 million in pre-tax earnings at the Canadian federal level over the estimated recovery period of 15 years, we must generate a pre-tax earnings compound annual growth rate of 2%, which we believe is probable. Our non-refundable research and development tax credits can be carried forward over a twenty-year period.

(d) Impairment of non-financial assets

Impairment exists when the carrying value of an asset or group of assets (cash generating unit (CGU)) exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use. The fair value less costs of disposal calculation for our CGUs is based on a market approach that relies on input from implicit valuation multiples and recent transactions for comparable assets or businesses, within the same industry. We apply judgment in making adjustments for factors such as size, risk profile or profitability and also consider EXFO's value derived from its market capitalization considering a control premium based on comparable situations. Depending on the market evidence available, we, from time to time, may further supplement this market approach with an income approach that considers discounted cash flows to determine fair value less costs of disposal, as well as the nature and magnitude of research and development activities carried out by the CGU.

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In the fourth quarter of fiscal 2018, we performed our annual goodwill impairment test for all CGUs.

For the purposes of the impairment test, goodwill has been allocated to the lowest level within the company at which it is monitored by management to make business decisions, which are the following CGUs:

EXFO CGU	$13,185,000
Brix CGU	13,327,000
Ontology CGU	7,471,000
Yenista CGU	3,562,000
Astellia CGU	2,347,000
Total	$39,892,000

In performing the goodwill impairment review of our CGUs, we determined the recoverable amount of goodwill based on fair value less costs of disposal. In estimating the recoverable amount of our CGUs, we used a market approach, which is based on sales multiples, within the range of 1.7 to 3.4 times sales, for comparable businesses with similar operations within the same industry over the past year. We applied judgment in making certain adjustments for factors such as size, risk profile or profitability of the comparable businesses, when compared to our CGU. In addition, for the Brix CGU, we used a liquidation approach based on the level of research and development expenses incurred over the last three years.

As at August 31, 2018, the recoverable amount for all CGUs exceeded their carrying value.

(e) Purchase price allocation in business combinations

The fair value of the total consideration transferred in business combinations (purchase price) must be allocated based on the estimated fair value of acquired net assets at the date of acquisition. Allocating the purchase price requires management to make estimates and judgments to determine assets acquired and liabilities assumed, useful lives of certain long-lived assets and the respective fair value of assets acquired, and liabilities assumed; this may require the use of unobservable inputs, including management's expectations of future revenue growth, operating costs and profit margins as well as discount rates.

i) Growth rates

The assumptions used are based on acquired companies' historical growth, expectations of future revenue growth, expected synergies as well as industry and market trends.

ii) Discount rate

We use a discount rate to calculate the present value of estimated future cash flows, which represents our weighted average cost of capital (WACC).

NEW IFRS PRONOUNCEMENTS NOT YET ADOPTED

Financial Instruments

The final version of IFRS 9, "Financial Instruments", was issued in July 2014 and will replace IAS 39, "Financial Instruments: Recognition and Measurement". IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of its financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. Requirements relating to hedge accounting, representing a new hedge accounting model, have also been added to IFRS 9. The new standard is effective for annual periods beginning on or after January 1, 2018 and must be applied retrospectively. We will adopt this new standard on September 1, 2018, and its adoption will not have a significant impact on our consolidated financial statements.

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Revenue from Contracts with Customers

IFRS 15, "Revenue from Contracts with Customers", was issued in May 2014. The objective of this new standard is to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability. This new standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. This new standard is effective for annual periods beginning on or after January 1, 2018. We will adopt this new standard on September 1, 2018 using the modified retrospective method, with the cumulative effect of the initial application of the standard recognized as an adjustment to the opening balance of retained earnings as at the date of initial application. We will apply this standard retrospectively only to contracts that are not completed at the date of initial application.

We performed an assessment to identify significant areas of impact between our current accounting treatment under IAS 18, "Revenue" and the new requirements of IFRS 15. Based on the assessment, we concluded that the main areas of impact relate to the allocation of the transaction price to the various performance obligations under the contracts, the timing of revenue recognition for sales arrangement that contain customer acceptance clauses, and the sale of licenses that provide customers with the "right to use" our intellectual property.

We performed a quantitative analysis of the main areas of impact as of September 1, 2018, and we do not expect the new standard to materially impact our consolidated financial statements.

Leases

IFRS 16, "Leases", was issued in January 2016. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, that is the customer (lessee) and the supplier (lessor). IFRS 16 will supersede IAS 17, "Leases", and related Interpretations. This new standard is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted if IFRS 15, "Revenue from Contracts with Customers", is also applied. We have not yet assessed the impact that the new standard will have on our consolidated financial statements.

Foreign Currency Transactions and Advance Consideration

IFRIC 22, "Foreign Currency Transactions and Advance Consideration", was issued in December 2016. IFRIC 22 addresses how to determine the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) and on the derecognition of a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration in a foreign currency. IFRIC 22 is effective for annual periods beginning on or after January 1, 2018. Early adoption is permitted. We will adopt this interpretation on September 1, 2018 and its adoption will not have a material impact on our consolidated financial statements.

Uncertainty over Income Tax Treatments

IFRIC 23, "Uncertainty over Income Tax Treatments", was issued in June 2017. IFRIC 23 provides guidance on how to value uncertain income tax positions based on the probability of whether the relevant tax authorities will accept the company's tax treatments. A company is to assume that a taxation authority with the right to examine any amounts reported to it will examine those amounts and will have full knowledge of all relevant information when doing so. IFRIC 23 is effective for annual periods beginning on or after January 1, 2019. We will adopt this interpretation on September 1, 2019 and are currently assessing the impact that it will have on our consolidated financial statements.

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INTERNAL CONTROL

The Chief Executive Officer and the Chief Financial Officer have limited the scope of their design of disclosure controls and procedures and internal control over financial reporting to exclude controls, policies and procedures of the EXFO Optics and Astellia business acquisitions, which were completed on October 2, 2017 and January 26, 2018 respectively.

Refer to note 3 to our consolidated financial statements for fiscal 2018, for summary financial information about these business acquisitions.

NON-IFRS MEASURES

We provide non-IFRS measures (gross margin before depreciation and amortization and adjusted EBITDA) as supplemental information regarding our operational performance. Gross margin before depreciation and amortization represents sales, less cost of sales, excluding depreciation and amortization. Adjusted EBITDA represent net earnings (loss) attributable to the parent interest before interest, income taxes, depreciation and amortization, stock-based compensation costs, restructuring charges, acquisition-related deferred revenue fair value adjustment, change in fair value of cash contingent consideration, share in net loss of an associate, gain on the deemed disposal of the investment in an associate, and foreign exchange gain or loss.

These non-IFRS measures eliminate the effect on our IFRS results of non-cash and/or non-operating statement of earnings elements, as well as elements subject to significant volatility such as foreign exchange gain or loss. We use these measures for evaluating our historical and prospective financial performance, as well as our performance relative to our competitors. These non-IFRS measures are also used by financial analysts that evaluate and compare our performance against that of our competitors and industry players in our sector.

Finally, these measures help us plan and forecast future periods as well as make operational and strategic decisions. We believe that providing this information to our investors, in addition to the IFRS measures, allows them to see the company's results through the eyes of management, and to better understand our historical and future financial performance. More importantly, it enables the comparison of our performance on a relatively similar basis against that of other public and private companies in our industry worldwide.

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

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The following table summarizes the reconciliation of adjusted EBITDA to IFRS net earnings (loss) attributable to the parent interest, in thousands of US dollars:

	Years ended August 31,		
	2018	2017	2016
IFRS net earnings (loss) attributable to the parent interest for the year	$(11,902)	$851	$8,900
Add (deduct):			
Depreciation of property, plant and equipment	5,444	3,902	3,814
Amortization of intangible assets	10,327	3,289	1,172
Interest and other (income) expense	1,378	303	(828)
Income taxes	5,678	6,608	7,764
Stock-based compensation costs	1,748	1,414	1,378
Restructuring charges	4,409	5,079	–
Change in fair value of cash contingent consideration	(670)	(383)	–
Acquisition-related deferred revenue fair value adjustment	2,095	–	–
Share in net loss of an associate	2,080	–	–
Gain on deemed disposal of the investment in an associate	(2,080)	–	–
Foreign exchange (gain) loss	(1,309)	978	(161)
Adjusted EBITDA for the year (1)(2)	$17,198	$22,041	$22,039
Adjusted EBITDA in percentage of total sales	6.4 %	9.1 %	9.5 %

(1) Astellia negatively impacted adjusted EBITDA by $5.1 million in fiscal 2018 (nil in 2017).
(2) Include acquisition-related costs of $1.1 million and $2.2 million in fiscal 2017 and 2018 respectively.

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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 November 1, 2018.

Name and Municipality of Residence	Position with EXFO
ABDELKRIM BENAMAR Le Raincy, France	Vice-President, Service Assurance, Systems and Services
STEPHEN BULL Quebec City, Quebec	Vice- President, Research and Development
STÉPHANE CHABOT Quebec City, Quebec	Vice President, Test and Measurement
FRANÇOIS CÔTÉ Montreal, Quebec	Independent Director
LUC GAGNON St-Augustin-de-Desmaures, Quebec	Vice President, Manufacturing Operations and Customer Service
GERMAIN LAMONDE St-Augustin-de-Desmaures, Quebec	Executive Chairman of the Board
JULIE LAMONTAGNE Laval, Quebec	Vice-President, Human Resources
ANGELA LOGOTHETIS Bath, United Kingdom	Independent Director
CLAUDIO MAZZUCA LaSalle, Quebec	Vice President, Partnerships and Strategic Alliance
PHILIPPE MORIN Senneville, Quebec	Chief Executive Officer
PIERRE PLAMONDON Quebec City, Quebec	Chief Financial Officer and Vice President, Finance
BENOIT RINGUETTE Boischatel, Quebec	General Counsel and Corporate Secretary
MICHAEL SCHEPPKE Singapore, Singapore	Vice President, Sales — Asia-Pacific

CLAUDE SÉGUIN Westmount, Quebec	Independent Director
WILLEM JAN TE NIET Harfsen, Netherlands	Vice President, Sales — Europe Middle East and Africa
RANDY E. TORNES Frisco, Texas	Independent Director
DANA YEARIAN Lake Forest, Illinois	Vice President, Sales — Americas

The address of each of our executive officers, senior managers and Directors is c/o EXFO Inc., 400 Godin Avenue, Quebec, Quebec, Canada, G1M 2K2. The following is a brief biography of each of our executive officers, senior managers and Directors.

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Abdelkrim Benamar was appointed EXFO's Vice President of Service Assurance, Systems and Services Division in May 2018, following the Astellia acquisition. In this role, Mr. Benamar is responsible for the overall product and services portfolio for monitoring and analytics. He brings over 25 years of experience in the telecom industry with proven leadership, business transformation and change management skills. Before joining EXFO, Mr. Benamar successively held the positions of COO (July 2015) and CEO (June 2016) of Astellia. He previously held several executive roles at Alcatel-Lucent including Vice President EMEA, CEO Alcatel-Lucent International, and Vice President Global Head of Financial Analysis and Risk Assessment. He has also worked for leading telecom companies such as Ericsson Group (2000–2007), Motorola (1996–2000) and Alcatel Mobile Phones, in areas such as R&D, Communications & Public Affairs, and Strategy and Sales. Mr. Benamar holds an engineering degree from Telecom SudParis (formerly known as Institut National des Télécommunications) and a PhD in electrical engineering from Université Paris-Sud.

Stephen Bull joined EXFO in 1995 as an Engineering Manager (project management) for the Advanced Optics group. From September 1997 to December 1999, he held the position of Assistant Director of Engineering responsible for all software development. Mr. Bull was then appointed EXFO's Vice President of Research and Development in December 1999. Today, he manages a department that includes more than 760 engineers and technicians spread across over three continents and nine locations. He is responsible for EXFO's product development initiatives and oversees the Project Management Office and related processes. Prior to joining EXFO, Mr. Bull was General Manager and Managing Director at Space Research Corporation, a military engineering company in Belgium, from June 1986 to March 1990, then at Taurus, an IT consulting firm, from 1990 to 1995. He is currently the President of the Institut de développement de produits (an institute dedicated to the advancement of product development practices) and a member of the Product Development Management Association (PDMA). He speaks regularly at conferences on product development. Mr. Bull holds a bachelor's degree in electrical engineering from Université Laval in Quebec City, and is a PDMA-certified New Product Development Professional.

Stéphane Chabot first joined EXFO as a Product Line Manager in 1998 and was promoted to Product Line Manager – Network Service Provider Market in 2001. As Vice President, Test and Measurement, Mr. Chabot is responsible for the Optical and Access and Platform product lines. Prior to this appointment, he was Director of EXFO's Optical Business Unit, a position he had held since 2006. In this role, Mr. Chabot led the main team developing EXFO's worldwide optical business and strategy, developing and maintaining the product family roadmap and vision, developing and controlling annual marketing, ensuring go-to-market plans, developing new markets, providing key market watch and competitive updates, analyzing product line performance and metrics, providing periodic benchmarking, and developing partnerships/OEMs/acquisitions within the product line family. Mr. Chabot was highly successful as Director of the Optical Business Unit, doubling its annual revenues to more than $120 million and increasing EXFO's global share of the portable optical solutions market to 38 percent. His leadership has been instrumental in many key applications with global reach, such as fiber-to-the-home. Prior to his employment at EXFO, Mr. Chabot was a telecommunications officer in the Canadian Armed Forces from 1992 to 1998. Mr. Chabot holds a bachelor's degree in space science from the Royal Military College of Canada, and a diploma in business administration from Université Laval in Quebec City.

François Côté was appointed a member of our Board of Directors in January 2015. Mr. Côté is a director as a full-time occupation, for corporations in the public, private and non-profit sectors, bringing his expertise in strategy, M&A, governance and passion for growth. Mr. Côté held a variety of executive positions at Bell Canada prior to becoming President and Chief Executive Officer of Emergis. Following the acquisition of Emergis by TELUS in January 2008, he was appointed President of TELUS Quebec, TELUS Health and TELUS Ventures. In this role, Mr. Côté was responsible for broadening TELUS Quebec's presence and driving the company's national health strategy through timely investments in information technology and innovative wireless solutions. Mr. Côté holds a bachelor's degree in Industrial Relations from Laval University. In 2007, he was named Entrepreneur of the Year by Ernst & Young, in the

Corporate Restructuring category for the province of Quebec. Mr. Côté serves on the boards of Alithya, Aspire Food Group, the Fondation Martin Matte and Purkinje, a Montréal health IT growth company as lead Director. Mr. Côté serves on the Advisor Committee of Groupe Morneau and is also acting as an advisor to different companies' CEO's.

Luc Gagnon was appointed Vice President, Manufacturing Operations in May 2003 and, in May 2007, he also took on the role of Vice President of Global Services. He oversees the smooth operation of all manufacturing activities including purchasing, product engineering, quality assurance, planning, manufacturing engineering, product configuration, transportation and customs, and material resources. In addition, Mr. Gagnon must ensure that there is an ongoing and efficient relationship between the manufacturing process and the end customer. He also held the position of Production Director from 2000 to 2003. Before joining EXFO, Mr. Gagnon held similar roles in several other high-technology companies. He worked for Mendes from 1999 to 2000, for C-MAC from 1997 to 1999, for STERIS from 1993 to 1997 and for Mitel from 1985 to 1993. Mr. Gagnon holds a bachelor's degree in electrical engineering and master's degree in engineering, both from the Université de Sherbrooke.

Germain Lamonde, founder of EXFO, is Executive Chairman of the Board and served as the company's Chief Executive Officer (CEO) for over 30 years. During his tenure as CEO, Mr. Lamonde grew the company from the ground up, turning it into a global leader in the communications test, monitoring and analytics market and the world's #1 fiber/highspeed testing company, with customers in over one hundred countries. Today as Executive Chairman, Mr. Lamonde leads EXFO's acquisitions strategy and is actively involved in defining the company's growth and investment strategies, strategic direction and corporate governance policies. Mr. Lamonde has served on the board of directors of several public and private organizations, fulfilled numerous speaking engagements, and received several industry awards for his leadership, innovation and global development. Mr. Lamonde presently serves on the Board of QG100 and was recently appointed Chairman of the Quebec Digital Transformation Council and Chairman of ENCQOR the Canada–Quebec-Ontario partnership focused on research and innovation in the field of 5G/IoT innovation. Mr. Lamonde holds a bachelor's degree in engineering physics from Université de Montréal's school of engineering (Polytechnique Montréal) and a master's degree in optics from Université Laval in Québec City. He is a graduate of the Ivey Executive Program at Western University in London, Ontario, and a Fellow of the Canadian Academy of Engineering.

Julie Lamontagne was appointed Vice President, Human Resources (HR) in November 2017. She is responsible for overseeing EXFO's global HR activities, including talent management, talent acquisition, performance management, HR policies and governance, and executive compensation. Specifically, her role is to implement an HR vision and strategy to support EXFO's strategic plan. Before joining EXFO, Ms. Lamontagne held a similar position at Lumenpulse, which she joined in 2011. Previously, she was an Associate Director with Bell Canada for five years and HR Director for Brookfield LePage Johnson Controls for three years. Ms. Lamontagne has also held HR consultancy positions with Ceridian Canada and SIBN (a subsidiary of National Bank). Ms. Lamontagne holds a bachelor's degree in industrial relations from Université de Montréal as well as a Certified Human Resources Professional (CHRP) designation from Quebec's Ordre des conseillers en ressources humaines agréés.

Angela Logothetis has more than twenty-five (25) years of international experience in the telecommunications industry. She has been strategically engaged in the industry's major network transformations. Ms. Logothetis has an outstanding software pedigree having worked for market-leading software companies including Amdocs, Cramer, PricewaterhouseCoopers and Accenture as well as start-up software companies Clarity and Time Quantum Technology. She has held senior leadership positions in ANZ, APAC and EMEA and has held global responsibility for the past ten (10) years. Ms. Logothetis is the CTO for Amdocs Open Network. Amdocs is the market leader in customer experience software solutions and services for the world's largest communications, entertainment and media service providers. Ms. Logothetis has held several senior leadership positions at Amdocs including Head of OSS Product and Technology, Vice-President of OSS Product Management and Executive Site Lead for Amdocs Bath. She has chaired high-caliber software forums in Amdocs including the Divisional Leadership Team, the Technical Advisory Council, and has served as an executive on the Product Business Management Team and the Product Leadership Forum. Ms. Logothetis holds a Bachelor of Science degree, with first class honors, in Business Information Technology from the University of New South Wales, Australia. She completed dual majors in accountancy and information technology.

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Claudio Mazzuca was appointed Vice President, Strategic Partners in May 2018. Prior to this appointment, he had served as Vice President, Systems and Analytics since 2012 and director of EXFO's Transport and Datacom Business Unit since 2006. In this role, he was responsible for the development and execution of business and product strategy for the unit, which now is a leading player in the Ethernet and next-generation packet transport test market segments. Mr. Mazzuca began his career as a systems engineer for Nortel Networks, where he worked on the launch of the highly successful 10G High-Speed Transport and DWDM product line, and later on Nortel's Preside Network Management solution. He then moved to technology startup Hyperchip Systems as Senior Product Manager, focusing on the development of large-scale metro and core IP routers and switches, and associated OEM components. In 2004, Mr. Mazzuca joined EXFO's Transport and Datacom Business Unit as Product Line Manager for the next-generation SONET/SDH products, and in 2005, was promoted to Group Manager for the entire Transport and Datacom product line. Mr. Mazzuca holds a bachelor's degree in electrical engineering from Montreal's Concordia University and a master's degree in business from McGill University, also in Montreal.

Philippe Morin was appointed Chief Executive Officer (CEO) of EXFO in April 2017 and is responsible for the company's strategy and financial directions, goals and results. He has more than thirty (30) years of experience in the telecommunications industry and joined EXFO in November 2015 as Chief Operating Officer (COO) leading the company's global sales leadership, market development, and product strategy. Before joining EXFO, Mr. Morin was Senior Vice-President of Worldwide Sales and Field Operations at Ciena. He previously held senior leadership roles at Nortel Networks, including President of Metro Ethernet Networks and Vice-President and General Manager of Optical Networks. Philippe Morin holds a bachelor's degree in electrical engineering from Université Laval in Quebec City, Canada, and a master's degree in business (MBA) from McGill University in Montreal, Canada.

Pierre Plamondon was appointed Chief Financial Officer and Vice President, Finance of EXFO in January 1996. He is responsible for accounting, legal and IT services, as well as financial reporting and investor relations. Prior to joining EXFO, Mr. Plamondon served as Senior Manager for Price Waterhouse, now PricewaterhouseCoopers LLP, from September 1981 to December 1995, in Canada and France. Mr. Plamondon is a member of the Order of Chartered Professional Accountants of Quebec. Over the years, he has served on the boards of several organizations, including Urbanimmersive, a public company listed on the TSX Venture Exchange, as well as non-profits, such as the Fondation de l'Université Laval and SOVAR Inc. (Société de valorisation des applications de la recherche de l'Université Laval). Mr. Plamondon holds a bachelor's degree in business administration and a license in accounting, both from Université Laval in Quebec City.

Benoit Ringuette has been our in-house General Counsel and Corporate Secretary since April 2004. Prior to joining EXFO, Mr. Ringuette practiced mainly in commercial, corporate and securities law from 1998 to 2003 as an associate in the law firms of O'Brien, Flynn Rivard in Quebec City and Desjardins Ducharme Stein Monast in Quebec City. Mr. Ringuette has been a member of the Quebec Bar since 1998. Mr. Ringuette holds a bachelor's degree in Civil Law and a master's degree in Business Administration (MBA) from Laval University in Quebec City, Canada.

Michael Scheppke was appointed EXFO's Vice President, Sales – APAC in October 2016. He is responsible for managing telecom sales, both direct and indirect, and executing sales strategies across the Asia-Pacific (APAC) region. Mr. Scheppke developed his expertise working in the industry in both the USA and Asia. Following several years at HP and Agilent, he spent a significant part of his career at Ixia, where he held various senior roles. He has developed and executed the go-to-market strategy for their network monitoring business in APAC by successfully leading diverse sales teams, and expanding sales coverage with channel partners. Mr. Scheppke holds a bachelor of science degree in electrical engineering from the University of Florida.

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Claude Séguin was appointed a member of EXFO's Board of Directors in February 2013. He brings to EXFO nearly forty (40) years of corporate, financial, executive and provincial government experience gained through senior management positions in major corporations and government departments. Mr. Séguin was Special advisor to the Founder and Executive Chairman at CGI Group Inc., a global leader in information technology and business process services, until March 2018. He was, until November 2016, Senior Vice-President, Corporate Development and Strategic Investments. In this position, he was responsible for all merger and acquisition activities. Prior to joining CGI in 2003, he served as President of CDP Capital—Private Equity, and prior to this position, he served as Teleglobe Inc.'s Executive Vice-President, Finance and Chief Financial Officer, a position that he held from 1992 to 2000. Mr. Séguin also has extensive senior-level government experience, having served as Deputy Finance Minister of the Province of Quebec from 1987 to 1992, in addition to Assistant Deputy Finance Minister in prior years. Prior to that, he held senior positions at the Province of Quebec Treasury Board. Mr. Séguin is a member of the boards of HEC-Montréal, Centraide of Greater Montreal Foundation and was recently elected Chairman of the Fonds de solidarité FTQ, a $14B Labour Sponsored Investment Fund in Québec. Claude Séguin graduated from HEC-Montréal and earned a master's and a Ph.D. in public administration from Syracuse University in New York State. He also followed the Advanced Management Program at Harvard Business School.

Willem Jan te Niet was appointed Vice President, Sales – EMEA in August 2016. He is responsible for managing telecom sales, both direct and indirect, and executing sales strategies across Europe, the Middle East and Africa. Prior to joining EXFO, Mr. te Niet was on the senior management teams for global leaders such as Citrix Systems, Equinix, Ericsson-LG and Nortel. He brings considerable expertise in the areas of cloud, networking and big data mobile analytics. Mr. te Niet also has more than 20 years of experience in managing sales teams and implementing successful business development strategies with wireline and mobile operators. Mr. te Niet holds a master's degree in business administration from the University of Groningen.

Randy E. Tornes was appointed a member of EXFO's Board of Directors in February 2013. He brings to EXFO over thirty (30) years of telecommunications experience gained through senior management positions at leading network equipment manufacturers. Mr. Tornes is Vice-President, Client Partner for AT&T at Aricent, An Altran Company. Prior to joining Aricent, Mr. Tornes was Vice-President Strategic Alliances at Juniper Networks, a worldwide leader in high-performance networking and telecommunications equipment. Mr. Tornes has also worked as the Operating Area Leader for AT&T and responsible for all sales, service and support of Juniper products and services. Prior to joining Juniper Networks in May 2012, he spent two (2) years at Ericsson, where he was Vice-President Sales (AT&T account). Previous to that position, he worked for Nortel for twenty-six (26) years, holding various sales management positions, including Vice-President Sales, GSM Americas. Mr. Tornes also served as member of the Board of Governors at 3G Americas LLC. Randy E. Tornes holds a Bachelor of Science degree in business—organizational development and production and operations management, from the University of Colorado in Colorado Springs.

Dana Yearian was appointed EXFO's Vice President, Sales – Americas in March 2007. Prior to this appointment, Mr. Yearian held the position of Vice President, Telecom Sales, North America. He is responsible for managing telecom sales, both direct and indirect, and executing sales strategies across North, Central and South America. From 2005 to 2006, Mr. Yearian held senior executive sales positions in the service assurance division of Spirent Communications. In 2003, he founded The Katrixx Group, which provided consulting and contracting services to high tech companies. Before this, Mr. Yearian worked as Vice President of Sales at Acterna Corp. from 1991 to 2003, where he led both North American and international sales and support operations. Prior to working for Acterna, Mr. Yearian held various executive positions, namely at Toshiba America, Silicon Sensors (Advanced Photonix Inc.) and Impell Corporation (ABB Ltd.). Mr. Yearian holds a bachelor's degree in electrical engineering from the Illinois Institute of Technology in Chicago and has completed MBA course work at DePaul University, also in Chicago.

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. There are no family relations among directors and officers and no arrangements with third parties (customers, suppliers) pursuant to which they were appointed as officers or directors.

B. Compensation

COMPENSATION OF DIRECTORS AND EXECUTIVE OFFICERS

Compensation Discussion and Analysis

This Compensation Discussion and Analysis focuses primarily on: (i) significant elements of the Corporation's executive compensation program; (ii) principles on which the Corporation makes compensation decisions and determines the amount of each element of executive and director compensation; and (iii) an analysis of the material compensation decisions made by the Human Resources Committee for the financial year ended August 31, 2018.

The following is a discussion of the compensation arrangements with the Corporation's Executive Chairman, Chief Executive Officer ("CEO"), Chief Financial Officer ("CFO") and each of the two most highly compensated executive officers of the Corporation and its subsidiaries whose total compensation was, individually, more than CA$150,000 (collectively with the Executive Chairman, CEO and CFO, the "Named Executive Officers" or "NEOs"). The NEOs for the financial year ended August 31, 2018 were Mr. Germain Lamonde (Executive Chairman), Mr. Philippe Morin (CEO), Mr. Pierre Plamondon (CFO and Vice-President, Finance), Mr. Willem Jan te Niet (Vice-President, Sales — Europe Middle East and Africa) and Mr. Dana Yearian (Vice-President, Sales — Americas). Mr. Lamonde stepped down as CEO as of April 1, 2017 and was nominated Executive Chairman of the Corporation. Mr. Morin was promoted from Chief Operating Officer of the Corporation to CEO of the Corporation as of April 1, 2017.

Members of the Human Resources Committee

During the financial year ended August 31, 2018, the Human Resources Committee was composed of:

- Mr. François Côté (Chairman)
- Mr. Pierre-Paul Allard (until January 9, 2018)
- Ms. Angela Logothetis
- Mr. Claude Séguin
- Mr. Randy E. Tornes

None of these members were officers or employees, or former officers or employees of the Corporation or its subsidiaries. All of the members of the Human Resources Committee are considered "independent", as defined in applicable securities legislation and regulations. They each have experience in executive compensation either as a chief executive officer or a senior executive officer of a publicly-traded corporation. Mr. François Côté held a variety of executive positions, including president and chief executive officer, for approximately twenty (20) years. Mr. Côté also holds a Bachelor's degree in Industrial Relations. Ms. Angela Logothetis holds a Bachelor of Science degree, with first class honors, in Business Information Technology. She completed dual majors in accountancy and information technology. She has more than twenty-five (25) years of international experience in the telecommunications industry. Mr. Claude Séguin has held various senior management and executive positions in major corporations in the last forty (40) years. Mr. Randy E. Tornes has approximately thirty (30) years of management experience through senior sales management positions. Over the course of their careers, all members have been exposed at various degrees to the complexity of balancing efficient executive compensation strategies with the evolution of business requirements, having to manage directly or indirectly impacts and consequences of executive compensation decisions. The Board of Directors believes that the Human Resources Committee collectively has the knowledge, experience and background required to fulfill its mandate.

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Mandate of the Human Resources Committee

The Human Resources Committee of the Board of Directors is responsible for establishing the annual compensation and assessing the risks related thereto and overseeing the assessment of the performance of all the Corporation's executive officers, including the Executive Chairman and CEO. The Human Resources Committee also reviews and submits to the Board of Directors recommendations for the salary structure and the short-term and long-term incentive compensation programs for all employees of the Corporation. The Human Resources Committee also evaluates and makes recommendations to the Board of Directors regarding the compensation of directors, including the number of Deferred Share Units credited to the non-employee directors pursuant to the Deferred Share Unit Plan. The Human Resources Committee's goal is to develop and monitor executive compensation programs that are consistent with strategic business objectives and shareholders' interests. Though the Human Resources Committee is responsible for the review of employees' performance and approval of the identity of the employees that will receive Restricted Share Units or options to purchase shares of the Corporation, in accordance with policies established by the Board of Directors and the terms of the Long-Term Incentive Plan, these functions may be shared between the Board of Directors and the Human Resources Committee. During the period from September 1, 2017 to August 31, 2018, these functions have been shared by the Board of Directors and the Human Resources Committee but have mainly been performed by the Human Resources Committee.

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

From September 1, 2017 to November 1, 2018, the Human Resources Committee held five (5) meetings and at all of those meetings executive compensation was discussed. The Human Resources Committee meetings were attended by all the members of the Human Resources Committee. The following table outlines the main activities of the Human Resources Committee during the period from September 1, 2017 to November 1, 2018:

Meeting	Main Activities of the Human Resources Committee
October 11 & 12, 2017	Review of the Business Performance Measures results for the financial year ended August 31, 2017; Review of the Business Performance Measures for the financial year started September 1, 2017; Review of the Short-Term Incentive Plan results for the financial year ended August 31, 2017; Update on the Short-Term Incentive Plan for the financial year started September 1, 2017; Review of the proposed salary scales and salary increases for the year started September 1, 2017; Review of the compensation plans of executive officers for the financial year started September 1, 2017 being the Base Salary, the Short-Term Incentive Plan and the stock-based compensation delivered through the Long-Term Incentive Plan; Review and approval of the executive compensation section of the Management proxy circular for the financial year ended August 31, 2017;

Review and approval of the CEO and Executive Chairman objectives and compensation plan;

Key staffing update;

Annual Sales Force Achievement;

Annual Review of the Human Resources Committee Charter;

Review of the Risk Assessment of Executive Compensation;

Review and approval of the stock-based compensation for executive officers delivered through the Long-Term Incentive Plan for the financial year started September 1, 2017.

Meeting	Main Activities of the Human Resources Committee
January 9, 2018	Review of the Short-Term Incentive Plan results of some executive officers for the financial year ended August 31, 2017; Review and approval of the Short-Term Incentive Plan of some executive officers for the financial year started September 1, 2017, including the CEO and Executive Chairman; Review of the quarterly results under the Short-Term Incentive Plan for the financial year started September 1, 2017 and being part of the Short-Term Incentive Plan; Review and approval of the stock-based compensation for performing employees delivered through the Long-Term Incentive Plan for the financial year started September 1, 2017; Leadership program and Talent Management; Review of the Risk Assessment of Executive Compensation.
April 10, 2018	Review of the quarterly results under the Short-Term Incentive Plan for the financial year started September 1, 2017 and being part of the Short-Term Incentive Plan; Succession Planning; Review of the Key Human Resources Initiatives; Compensation Review; Review of the Talent Management and Leadership program.
July 10, 2018	Review of the quarterly results under the Short-Term Incentive Plan for the financial year started September 1, 2017 and being part of the Short-Term Incentive Plan; Global Compensation Review; Review of the Talent Management and Leadership program; Review of the Key Human Resources Initiatives.
	Review of the Business Performance Measures results for the financial year ended August 31, 2018; Review of the Business Performance Measures for the financial year started September 1, 2018;

Review of the Short-Term Incentive Plan results for the financial year ended August 31, 2018;

Review of the Short-Term Incentive Plan for the financial year started September 1, 2018;

Review of the proposed salary scales and salary increases for the year started September 1, 2018;

Review of the compensation plans of executive officers for the financial year started September 1, 2018 being the Base Salary, the Short-Term Incentive Plan and the stock-based compensation delivered through the Long-Term Incentive Plan;

Review and approval of the executive compensation section of the Management proxy circular for the financial year ended August 31, 2018;

Review and approval of the CEO and Executive Chairman objectives and compensation plan;

Review and approval of the stock-based compensation for executive officers delivered through the Long-Term Incentive Plan for the financial year started September 1, 2018;

Annual Sales Force Achievement;

Annual Review of the Human Resources Committee Charter;

Review of the Risk Assessment of Executive Compensation.

Compensation Plan Control – Compensation Consultant and Internal Review

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

For the financial year ended on August 31, 2018, the Human Resources Committee retained the services of Willis Towers Watson to evaluate the establishment of a performance share plan and Lee Hecht Harrison Knightsbridge in connection with outplacement services for an executive.

For the financial year that ended on August 31, 2017, the Human Resources Committee retained the services of Willis Towers Watson to evaluate the market competitiveness of the compensation package that is currently offered to the external members of its Board of Directors. The compensation elements covered by the analysis were: annual board retainer, committee chair and member retainers, board and committee meeting fees and stock-based compensation. Willis Towers Watson's work included assistance in benchmarking, assessing potential gaps between the market and the external Board members' compensation levels and proposing potential changes to ensure alignment with the market and with the Corporation's compensation policy. With a few exceptions, Willis Towers Watson used the same compensation group to benchmark the external members of the Board of Directors as it used to benchmark executive compensation (as further described below).

For the financial year that ended on August 31, 2017, the Human Resources Committee also retained the services of Willis Towers Watson to evaluate the market competitiveness of the compensation package that is currently offered to its Chief Executive Officer and its Executive Chairman. The compensation elements covered by the analysis were: base salary; target bonus; long-term incentive; perquisites and pension (hereinafter in this Annual Report referred to as the "Target Total Compensation"). Willis Towers Watson's work included assistance in benchmarking, assessing potential gaps between the market and the executives' compensation levels and proposing potential changes to ensure alignment with the market and with the Corporation's compensation policy.

In addition, internal pay equity studies are a key factor used by the Corporation to complete the compensation review process and indicate where necessary adjustments may be required. During the financial year ended August 31, 2018, this practice continued, and certain compensation adjustments were made as have been made in previous years.

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

For the financial years that ended on August 31, 2017 and 2018, the Corporation also retained the services of Willis Towers Watson, Mercer, Eckler, Aon, Great Place to Work, Lee Hecht Harrison Knightsbridge, RecrutXL Inc., and Xactly Corporation for services which were not related to executive compensation. The services provided by Willis Towers Watson concerned the access to benefits and compensation data and surveys for employees in Canada, United States and United Kingdom and review of last year's Annual Report. The services provided by Eckler related to pension plan analysis, retirement policy, governance and communication to employees. The services provided by Aon related to the access to compensation data and surveys for sales employees in various countries. The Corporation retained the services of Great Place to Work for culture audit services. The services provided by Lee Hecht Harrison Knightsbridge related to outplacement services. The Corporation consulted Mercer for assistance with compensation data for expatriate employees and assistance with the compliance of the Pay Equity Act established by the Government of Quebec, Canada. The Corporation consulted RecrutXL Inc. for assistance with employees' training. The Corporation consulted Xactly Corporation for the software improvement with respect to commission calculation. Fees for the services performed that are not related to executive compensation are not required to be approved by the Human Resources Committee.

The aggregate fees paid to Willis Towers Watson, Eckler, Aon, Great Place to Work, Lee Hecht Harrison Knightsbridge, Mercer, RecrutXL Inc. and Xactly Corporation for consulting services provided to the Human Resources Committee related to determining compensation for any of the Corporation's directors and executive officers and to the Corporation for all other services provided during the financial years ended August 31, 2017 and 2018 were as follows:

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Type of Fee	Financial 2017 Fees	Percentage of Financial 2017 Fees	Financial 2018 Fees	Percentage of Financial 2018 Fees
Executive Compensation – Related Fees	CA$25,107	10%	CA$5,736	7%
All Other Fees	CA$230,417	90%	CA$76,774	93%
Total	CA$255,524	100%	CA$82,510	100%

Benchmarking

For the purpose of assessing the competitiveness of the Target Total Compensation of senior executives, the Corporation considered compensation data from a comparator group including private and publicly-traded companies of comparable size and similar industry, operations in multiple countries and attracting similar profiles of employees, professionals and experts. The comparator group has been revised in 2016 with the guidance and advice from Willis Towers Watson.

- Canada executives: For the executives based in Canada, the Corporation used the following comparator group: 5N Plus Inc., ACCEO Solutions, AgJunction Inc, Atos IT Services and Solutions, Inc., Avigilon Corporation, Callian Technologies Ltd., Ciena, COM DEV International Ltd., Constellation Software inc., Evertz Technologies Ltd., GTECH, Open Text Corporation, Redline Communications Group Inc., Sandvine Corporation, Sierra Wireless Inc., Smart Technologies Inc., Vecima Networks Inc., Vidéotron Ltée and Wi-Lan Inc.

- United States executives: For the executives based in the United States, the Corporation used the following comparator group: AMETEK, Avangate, BMC Software, CDK Global, Communications Systems, Crown Castle, Intelsat, Itron, Keysight Technologies, Laird Technologies, MTS Systems, Plexus, SAS Institute, SunGard Data Systems, Teradata, TomTom, Total System Services, Truphone and Verint Systems.

- United Kingdom executives: For the executives based in the United Kingdom, the Corporation used the following comparator group: BAE Systems Applied Intelligence, COLT Telecom, Flextronics, Fujitsu, Irdeto, McCain Foods, PepsiCo, Premier Food Group, QinetiQ, Qualcomm, Rentokil Initial, Talk Talk Group and Viacom.

- Asia executives: For the executives based in Asia, the Corporation used a broader comparator group, based on general industry data: A.Menarini Asia-Pacific, Abbott Laboratories, AbbVie, Accenture, ACE Asia Pacific Services, ACE Insurance, ACE Life Insurance Company Ltd, ACR Capital Holdings, AIA Company, Aimia, Alcatel-Lucent, Amazon.com, ANZ Banking Group, ASML, AstraZeneca, Avanade, Aviva Ltd, AXA Insurance Singapore, AXA Life Insurance Singapore, Bank of New York Mellon, Baxter, Beckman Coulter, Becton Dickinson, BHP Billiton, Bio-Rad Laboratories, Biosensors, BT Global Services, Cerebos Pacific Limited, Chubb Pacific Underwriting, Cigna, CommScope, DHL, DHL Express, DHL GBS, DHL Global Forwarding, DHL Mail, DHL Supply Chain, Discovery Communications, Experian, Federal Insurance Company, Fujitsu, GE Energy, GE Healthcare, General Electric, Great Eastern Life Insurance, Hap Seng Consolidated, HSBC Holdings, IHS Global, IMI, Ingenico, Intel, Intercontinental

Hotels Group, International Flavors & Fragrances, ITT Corporation, Johnson & Johnson, Lexmark, Liberty Insurance, M1 Limited, Manulife, MasterCard, Merck KgaA, Microsoft, Molex, MSD International GMBH (Singapore Branch), National Australia Bank, NBC Universal, NCR, Overseas Assurance Corporation, Pfizer, Pramerica Financial Asia HQ, Proximus, Prudential Assurance Company, Prudential Services, QBE Insurance, Qualcomm, Reinsurance Group of America, RELX Group, Rio Tinto, Roche Pharmaceuticals, Sabre Holdings, Sealed Air, Smiths Group, Spirax Sarco, Standard Chartered Bank, StarHub, Starwood Hotels & Resorts, Straits Developments, Swiss Reinsurance International, Teva Pharmaceutical Industries, Thermo Fisher Scientific, Trayport, TUI, UBS, Unilever, United Overseas Bank, Verizon, Zurich Insurance Company and Zurich Life Insurance.

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To be considered in the comparator group, a company had to meet the following specific criteria:

a) Similar industry: Technology Hardware and Equipment, Telecommunications Equipment and Services or Software and Services; and