EXFO ELECTRO OPTICAL ENGINEERING INC
Form 20-F
November 29, 2005

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

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended August 31, 2005; or

[_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the transition period _____ 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.....

FOR THE TRANSITION PERIOD FROM SEPTEMBER 1, 2004 TO AUGUST 31, 2005

Commission File No. 0-30895

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

CANADA
(JURISDICTION OF INCORPORATION OR ORGANIZATION)

400 GODIN AVENUE
VANIER, QUEBEC G1M 2K2, CANADA
(418) 683-0211
(ADDRESS, INCLUDING ZIP CODE AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF
REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES)

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

None

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

Subordinate Voting Shares, no par value

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

None

As of November 1, 2005, the registrant had 30,672,617 Subordinate Voting
Shares outstanding.

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 [X] No [_]

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

Item 17 [ ] Item 18 [X]

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 [X]

DISCLOSURE REGARDING FORWARD-LOOKING INFORMATION

This annual report contains or incorporates by reference statements which constitute 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 that refer to expectations, projections or other characterizations of future events and circumstances. 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 those that are discussed under "Risk Factors" set forth in Item 3D of this annual report. Assumptions relating to forward-looking statements involve judgments and risks, all of which are difficult or impossible to predict and many of which are beyond our control. 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. We undertake no obligation to revise or update any of them to reflect events or circumstances that may occur after the date of this document.

PART I.

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not Applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

The consolidated statements of earnings data for the years ended August 31, 2001 and 2002 and the consolidated balance sheets data as at August 31, 2001, 2002 and 2003 are derived from our audited consolidated financial statements not included in this annual report. The consolidated statements of earnings data for each of the three years ended August 31, 2003, 2004 and 2005 and the consolidated balance sheets data as at August 31, 2004 and 2005 are derived from our audited consolidated financial statements that are included

elsewhere in this annual report.

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada ("Canadian GAAP") and significant differences in measurement and disclosure from generally accepted accounting principles in United States ("U.S. GAAP") are set out in note 21 to our consolidated financial statements included elsewhere in this annual report. The historical results below are not necessarily indicative of the results to be expected for any future periods.

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

	YEARS ENDED AUGUST 3			
	2005	2004	2003	
	(IN THOUSANDS OF US DOLLARS, EXCEPT DATA)			
CONSOLIDATED STATEMENTS OF EARNINGS DATA:				
AMOUNTS UNDER CANADIAN GAAP				
Sales	$ 97,216	$ 74,630	$ 61,930	$
Cost of sales (1)	44,059	34,556	36,197	
Gross margin	53,157	40,074	25,733	
Operating expenses				
Selling and administrative	31,782	25,890	26,991	
Net research and development	12,190	12,390	15,879	
Amortization of property, plant and equipment	4,256	4,935	5,210	
Amortization of intangible assets	4,836	5,080	5,676	
Impairment of long-lived assets and goodwill	--	620	7,427	
Restructuring and other charges	292	1,729	4,134	
Total operating expenses	53,356	50,644	65,317	
Earnings (loss) from operations	(199)	(10,570)	(39,584)	
Interest and other income	2,524	1,438	1,245	
Foreign exchange gain (loss)	(1,336)	(278)	(1,552)	
Earnings (loss) before income taxes and amortization and write-down of goodwill	989	(9,410)	(39,891)	
Income taxes	2,623	(986)	15,059	
Earnings (loss) before amortization and write-down of goodwill	(1,634)	(8,424)	(54,950)	
Amortization of goodwill	--	--	--	
Write-down of goodwill	--	--	--	
Net loss for the year	$ (1,634)	$ (8,424)	$ (54,950)	$

Basic and diluted net loss per share.....	$ (0.02)	$ (0.13)	$ (0.87)	$
Basic weighted average number of shares used in per share calculations (000's).....	68,526	66,020	62,852	
OTHER CONSOLIDATED STATEMENTS OF EARNINGS DATA:				
Gross research and development.....	$ 15,878	$ 15,668	$ 17,133	$
Net research and development.....	$ 12,190	$ 12,390	$ 15,879	$
AMOUNTS UNDER U.S. GAAP				
Net loss for the year.....	$ (2,920)	$ (9,571)	$ (48,201)	$
Basic and diluted net loss per share.....	$ (0.04)	$ (0.14)	$ (0.77)	$
Basic weighted average number of shares used in per share calculations (000's).....	68,526	66,020	62,852	

	AS AT AUGUST 31,			
	2005	2004	2003	
			(IN THOUSANDS OF US DOL	
CONSOLIDATED BALANCE SHEETS DATA:				
AMOUNTS UNDER CANADIAN GAAP				
Cash.....	$ 7,119	$ 5,159	$ 5,366	$
Short-term investments.....	104,883	83,969	52,010	
Working capital.....	135,288	115,141	76,659	
Total assets.....	190,957	172,791	146,254	
Long-term debt (excluding current portion)	198	332	453	
Share capital.....	521,875	521,733	492,452	
Shareholders' equity.....	$ 173,400	$ 157,327	$ 129,826	$
AMOUNTS UNDER U.S. GAAP				
Cash.....	$ 7,119	$ 5,159	$ 5,366	$
Short-term investments.....	104,883	83,969	52,010	
Working capital.....	138,225	117,116	78,225	
Total assets.....	182,852	164,758	138,020	
Long-term debt (excluding current portion)	198	332	453	
Share capital.....	597,664	596,309	565,291	
Shareholders' equity.....	$ 165,295	$ 149,294	$ 121,592	$

(1) The cost of sales is exclusive of amortization, shown below. Includes inventory write $4,121,000, $18,463,000 and nil for the years ended August 31, 2005, 2004, 2003, 2002 and and an unusual gain of $473,000 for the year ended August 31, 2003.

B. CAPITALIZATION AND INDEBTEDNESS

Not Applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not Applicable.

D. RISK FACTORS

WE MUST CONTINUE TO OVERCOME SIGNIFICANT COMPETITION IN OUR TARGETED INDUSTRIES IN ORDER TO GAIN MARKET SHARE AND ACHIEVE OUR GROWTH STRATEGY.

The market for our primary business activity - namely designing, manufacturing, selling and marketing telecommunications test and measurement equipment - is rapidly evolving and is marked by intense competition and technical innovation. Likewise, the market for our selected life sciences and

industrial solutions is very competitive. We anticipate the pace of change to remain high or even accelerate for our targeted industries in the future. We might see the emergence of new competitors or the consolidation of current competitors, as the markets for telecommunications test and measurement equipment as well as for life sciences and industrial solutions might evolve in response to technical innovations and economic conditions. Surpassing our key performance indicator of 15% sales growth in fiscal 2006 will largely depend on our ability to gain market share by increasing sales of current products to existing accounts, expanding into new accounts, introducing new products and product enhancements, and exploiting new market opportunities.

During the past year, the telecommunications test and measurement industry witnessed consolidation. Anritsu Corporation announced the acquisition of NetTest A/S in August 2005 and JDS Uniphase Corporation (JDSU) completed its acquisition of Acterna Corporation during the same month. Agilent Technologies Inc., meanwhile, announced it was divesting itself of its semiconductor division to refocus its efforts on test and measurement. With the exception of JDSU (which also sells optical components), these competitors are global test and measurement vendors who complement their broad range of products with telecommunications test and measurement equipment. Similarly, ANDO Corporation and Tektronix, Inc. are global test and measurement vendors who compete against us. Other competitors, such as Digital Lightwave Inc., IXIA and Sunrise Telecom Inc., compete against us in niche markets. Some competitors in both groups may 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.

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 increase our sales and develop cost-effective products and product enhancements 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.

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

Most of our sales are denominated in currencies other than the Canadian dollar (principally US dollars and Euros). However, a large portion of our operating expenses and capital expenditures are denominated in Canadian dollars. As a result, even though we manage to some extent our exposure to currency risk with forward exchange contracts and certain operating expenses denominated in currencies other than the Canadian dollar, we are exposed to fluctuations in the exchange rates between the Canadian dollar on the one hand and the US dollar and the Euro on the other. As of October 31, 2005, the Canadian dollar increased approximately 7.5% versus the US dollar and decreased 1.6% versus the Euro, compared to October 31, 2004. Any increase in the value of the Canadian dollar relative to other currencies, especially the US dollar, could have a material adverse effect on our operating results and provide strategic advantages to our competitors.

A CUSTOMER HAS ACCOUNTED FOR A HIGH PERCENTAGE OF OUR SALES IN THE PAST TWO YEARS, AND ANY ADVERSE FACTOR AFFECTING THIS CUSTOMER OR OUR RELATIONSHIP WITH THIS CUSTOMER COULD CAUSE OUR SALES TO DECREASE.

Although customer base has been well diversified on a historical basis, a Tier-1 carrier in the US accounted for 23.3% of our sales in fiscal 2005 and 13.8% in fiscal 2004. Even if this customer has a supply contract with us, it could change its purchasing practice, force us to renegotiate prices and is not obligated to purchase a specific amount of products from us or provide us with binding purchase forecasts for any period. In addition, our customers typically purchase our products under individual purchase orders and may cancel or defer purchases on short notice without significant penalties.

The loss of such a customer or the reduction, delay, or cancellation of orders from this customer or other significant customers could cause our sales and, therefore, net earnings to decline.

RECENT SIGNS OF MARKET STABILITY ARE NOT NECESSARILY INDICATIVE OF LONG-TERM GROWTH. IF MARKET CONDITIONS SIGNIFICANTLY DETERIORATE OR IF OPTICAL FIBER IS REPLACED BY ANOTHER MEDIUM AS THE PRIMARY SOLUTION FOR BANDWIDTH-INTENSIVE APPLICATIONS, DEMAND FOR OUR PRODUCTS MAY DECREASE, WHICH COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, RESULTS OF OPERATIONS AND FINANCIAL CONDITION.

Notwithstanding recent signs of market stability and generally increasing demand for our products, average selling prices may decline and revenue and profitability targets may be subject to uncertainty and variability. Any downturn in our markets or in general economic conditions, additional bankruptcies and decreased capital expenditures, or if optical fiber is replaced by a higher-performance medium, would result in a reduction in demand for our products as well as low visibility, and could harm our consolidated financial condition, results of operations, cash flows and stock price.

WE HAVE FACED PRICING PRESSURE ON OUR EXISTING PRODUCTS AND EXPECT THAT THIS PRESSURE WILL CONTINUE. IF WE DO NOT CONTROL OUR MANUFACTURING COSTS OR INTRODUCE NEW PRODUCTS WITH HIGHER MARGINS, OUR GROSS MARGINS MAY DECREASE AND OUR OPERATING RESULTS MAY BE ADVERSELY AFFECTED.

We continued implementing measures to protect our gross margin, which reached 54.7% of sales in fiscal 2005 compared to 53.7% in fiscal 2004, despite the negative impact of the exchange rate between US and Canadian currencies. However, increased competitiveness in the telecommunications test and measurement industry will likely result in continuing downward pressure on average selling prices, which may in turn negatively affect our gross margins. Pricing pressure can result from a number of factors such as:

- 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;
- Resale of used equipment; and
- Equipment sales resulting from manufacturing and rental company bankruptcies.

In addition, gross margins may also be negatively affected by increased costs of raw materials as well as obsolescence and excess costs,

product mix and under-absorption of fixed manufacturing costs.

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 margins may decline and our operating results may suffer.

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

As a result of 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. There can be no assurance that, despite our testing, defects will not be found in new products after they have been fully deployed and operated under peak stress conditions or that customized products meet customer sign-off acceptance requirements. If we are unable to fix defects or other problems or meet custom requirements, we could experience, among other things:

- Costly repairs;
- Product returns or recalls;
- 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.

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

We intend to carefully seek businesses, products and technologies that are complementary to ours or that will expand our markets. There can be no assurance that we will ultimately make any such acquisition. Our competitors may be in a better position to acquire the same businesses, products and technologies that we wish to acquire. In addition, our fluctuating stock price or our cash position at the time of an acquisition may affect our ability to complete such an acquisition.

We have made strategic acquisitions in the past and we intend to continue making acquisitions of businesses, products and technologies as part of our overall growth strategy. In the event of any future acquisition, we could:

- Issue shares that would dilute individual shareholder percentage ownership;
- Incur debt;
- Assume liabilities and commitments;
- 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.

These acquisitions also involve numerous risks, including:

- Risk of not realizing the expected benefits or synergies of such acquisition;
- Problems combining 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.

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

Mergers and acquisitions of high-technology businesses are inherently risky. For our past and future transactions to be successful, we must appropriately integrate the businesses, products, technologies and personnel already acquired – as well as those of any future acquisitions – with our own business, product portfolios and personnel in a manner that anticipates or responds to new technological developments and customer requirements on a timely basis. In addition, we must coordinate the operations and product portfolios of newly acquired companies with our own and manage all aspects of geographically dispersed operations. Integration requires the dedication of management resources, which may distract their attention from our day-to-day business and operations. If the integration process takes longer than expected

or if we fail to integrate the businesses, we may not be able to realize the benefits and synergies that we expect from these transactions and may be required to shut down, rationalize or exit such activities.

All of these factors could materially harm our business, results of operations 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. 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. Our operating expenses, which include research and development, selling and administrative, 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 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:

- Length of the product sales cycle for certain products, especially those that are higher priced and more complex;
- Timing of product launches and market acceptance of new products for us as well as 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 potential seasonality in sales; and
- Losing key accounts and not successfully develop new ones.

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

- Fluctuating demand for telecommunications test and measurement equipment as well as life sciences and industrial 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;
- Customer bankruptcies and difficulties in collecting accounts receivable;
- Restructuring and impairment charges; and
- General economic conditions.

In addition, we may in the future choose to reduce prices, increase spending, or modify our product portfolio in response to actions by competitors or as 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.

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 industries that we target are characterized by rapidly evolving technology and industry standards that result in frequent new product introductions. Any failure by us to anticipate or respond to new technological developments, customer requirements or evolving standards 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-time. The success of our new product introductions will depend on several factors, including our ability to:

- Properly identify customer needs;
- Innovate and develop new products;
- Gain timely market acceptance for new products;
- Manufacture and deliver our new products on time and in sufficient volume;
- Price our products competitively;
- Continue investing in our research and development program; and
- Anticipate competitors' announcements of new products.

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

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, 2005, customers outside of the United States and Canada accounted for 35.1% of our sales. Our international sales will be limited if we cannot establish relationships with international distributors, set up additional foreign operations, expand international sales channel management, hire additional personnel, develop relationships with international service providers and operate adequate after-sales support internationally. Even if we are able to successfully continue our international operations, we may not be able to maintain or increase international market demand for our products. Our international operations are subject to a number of risks, including:

- Challenges in staffing and managing foreign operations due to the limited number of qualified candidates, employment laws and practices in foreign countries, any of which could increase the cost and reduce the efficiency of operating in foreign countries;
- Our ability to comply with customs, import/export and other trade compliance regulations of the countries in which we do business, together with unexpected changes in such regulations;
- Difficulties in establishing and enforcing our intellectual property rights;
- Tariffs and other trade barriers;
- Economic instability in foreign markets;
- Wars, acts of terrorism and political unrest;
- Language and cultural barriers;
- Integration of foreign operations;
- Currency fluctuations;

- 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
- 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 have a significant negative effect on our future operating results.

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

Our products are designed to conform to the regulatory requirements of the countries in which they are marketed. In the event that technical regulations applicable in a given country are in any way changed - such as those prescribed by the European Union for the disposal of electrical and

electronic equipment (Waste Electrical and Electronic Equipment or WEEE) - we may be required to modify, redesign or recall some or all of our products in order to continue participating in that market. These changes may prove costly and time-consuming and could create technical advantages for products marketed by our competitors. We cannot assure that our products will continue to meet evolving standards in the future. In addition, failure to comply or delays in compliance with such regulatory requirements, or delays in receipt of certifications, could delay the introduction of new products or cause our existing products to become obsolete. We are also subject to environmental statutes and regulations. We might not be able to adopt our products in a timely matter to fully comply with all environmental requirements.

WE MAY MAKE MISJUDGMENTS IN OUR STRATEGIC PLANNING THAT COULD HAVE MATERIAL ADVERSE EFFECTS ON OUR BUSINESS, RESULTS OF OPERATIONS AND FINANCIAL CONDITION.

We devise an annual strategic business plan, which is prepared by management and approved by our Board of Directors. This strategic plan, reviewed by management on a regular basis, is mainly based on market research and analysis related to future market trends and demands. In our strategic plans, we have made, and will continue to make, judgments based on our analysis of future market trends and demands which may involve, for example, substantial investments by us in the development of new product lines or the diversification of our activities, either organically or through acquisitions.

WE HAVE ADOPTED MEASURES AND MAY ADOPT ADDITIONAL MEASURES THAT ALIGN OUR COST STRUCTURE TO EXISTING MARKET CONDITIONS. IF DEPRESSED MARKET CONDITIONS RETURN, IT COULD HAVE MATERIAL ADVERSE LONG-TERM EFFECTS ON OUR BUSINESS, RESULTS OF OPERATIONS AND FINANCIAL CONDITION.

We implemented a number of restructuring plans during the telecom downturn to re-align our cost structure to existing market conditions. Such plans and, if needed, subsequent plans could have material adverse, long-term effects on our business, results of operations and financial condition if we deplete our pool of highly qualified personnel or are unable to retain key

personnel; if we are unable to sustain sufficient research and development efforts for the launch of new products; if we are unable to meet the needs of our customers; if we are incapable of ramping up manufacturing when market conditions improve; and if we do not ensure a smooth transition in the consolidation of our operations. In addition, if we fail to adopt and implement adequate and pertinent measures on a timely basis to align our cost structure to further possibly declining market conditions, it could have a material adverse long-term effect on our business, results of operations and financial condition.

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

Some of our customers have experienced, or may experience, cash flow problems. Consequently, we may have customers who delay payments or may not be able to meet their financial commitments to us. Furthermore, they may not order as many products from us as originally forecasted or they may cancel their orders outright. The failure of customers to order products would result in decreased revenues for us. We attempt to reduce the possibility of large outstanding bills remaining unpaid by carrying out credit checks on customers and by having a diversified customer base. However, there is no assurance that such measures will reduce our exposure to customer credit risks. If customers

fail to meet their financial commitments to us, it could have a material adverse effect on our business, results of operations and financial condition.

AS OUR CUSTOMERS CONSOLIDATE, THEY MAY REDUCE OR HALT PURCHASES OF OUR PRODUCTS, WHICH WOULD HARM OUR SALES AND OPERATING RESULTS.

Consolidation in the telecommunications industry could reduce the number of customers to which our products are sold. 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, which would harm our sales and operating results. In addition, some customers may merge with or acquire our competitors and discontinue their relationships with us.

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

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

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

We depend on a limited number of suppliers for some of the parts used to manufacture our products for which alternative sources may not be readily available. In addition, all our orders are placed through individual purchase orders and, therefore, our suppliers may stop supplying parts to us at any time. The reliance on a single source or limited number of suppliers could result in increased costs, delivery problems and reduced control over product pricing and quality. 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 and mechanical parts, is lengthy and would consume a substantial amount of time of our technical personnel and management. If we were required to change manufacturers in a short period of time, our business would be disrupted. In addition, we may be unsuccessful in identifying a new manufacturer capable of meeting and willing to meet our needs on terms that we would find acceptable. Consolidation involving suppliers could further reduce the number of alternatives available to us and affect the cost of parts, which would make our products less competitive and result in lower margins.

RECENTLY ENACTED REGULATORY CHANGES MAY CAUSE US TO INCUR INCREASED COSTS.

Recently enacted changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002, will

increase our expenses as we evaluate the implications of new rules and devote resources to respond to these new requirements. In particular, we expect to incur additional selling and general administrative expenses as we implement Section 404 of the Sarbanes-Oxley Act, which requires management to report on, and our independent external auditor to attest to, our internal controls over financial reporting. Compliance with these new rules could also result in continued diversion of management's time and attention, which could prove to be disruptive to normal business operations. Furthermore, the impact of these changes could make it more difficult for us to attract and retain qualified persons to serve on our Board of Directors or as executive officers, which could harm our business.

In March 2005, foreign issuers, such as us, were given an extra year's grace by the Securities and Exchange Commission to comply with Section 404 of Sarbanes-Oxley, which means August 31, 2006 for EXFO. While we currently anticipate that we will complete all such actions on time and according to rules, we cannot at this time provide absolute assurance that all such actions will be timely completed and in compliance with rules, with the possible consequence that our external auditors may not be able to provide an unqualified attestation report under Section 404 of Sarbanes-Oxley, as amended.

WE ARE SUBJECT TO LAWS, REGULATIONS AND CONTRACTUAL OBLIGATIONS AND REQUIREMENTS RELATING TO OUR CUSTOMER CONTRACTS, AND OUR FAILURE TO ADDRESS THESE LAWS, REGULATIONS, OBLIGATIONS AND REQUIREMENTS OR COMPLY THEREWITH COULD HARM OUR BUSINESS.

We have agreements relating to the sale of our products to our customers and, as a result, we are subject to various statutes and regulations and contractual obligations and requirements. We are also subject to environmental statutes and regulations. We may also be subject to investigation for compliance with such statutes, regulations, obligations and requirements. Any failure to comply therewith could harm our business.

THE PRICE OF OUR SECURITIES IS VOLATILE AND MAY DECLINE.

The market price of our securities has been, and is likely in the future to be, subject to substantial and rapid fluctuations. Such fluctuations may be due to factors specific to us, such as changes in our operating results, contract wins with major customers or new product introductions, or caused by our competitors, changes in analysts' ratings, or the liquidity of our stock. Fluctuations in stock price may also be due to factors related to the global telecommunications industry or the securities markets in general. These fluctuations have often been unrelated or disproportionate to the operating performance of the specific companies whose stocks are traded. These broad market and industry factors may have a material adverse effect on the market price of our securities, regardless of our actual operating performance. Shareholders should be willing to incur the risk of such fluctuations.

WE REQUIRE EMPLOYEES WHO ARE KNOWLEDGEABLE ABOUT THE SPECIALIZED NATURE OF OUR BUSINESS. IF WE ARE UNABLE TO ATTRACT AND RETAIN SUFFICIENT NUMBERS OF HIGHLY 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 the 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 employee base due to the highly specialized nature of telecommunications test and measurement as well as life sciences and industrial technologies. Our current personnel may be inadequate and we may fail to assimilate and train new employees. Highly skilled employees with the education and training that we require - especially employees with significant experience and expertise, international business development, product management, sales, engineering and operation - may be difficult to find. Once trained, our employees may also be hired by our competitors or leave the organization.

OUR BUSINESS STRATEGY AND ABILITY TO MAINTAIN OUR COMPETITIVE POSITION DEPEND ON THE CONTINUED SERVICES OF GERMAIN LAMONDE, OUR CHAIRMAN OF THE BOARD, PRESIDENT AND CHIEF EXECUTIVE OFFICER. HIS LOSS COULD ADVERSELY AFFECT OUR BUSINESS.

Our ability to maintain our competitive position depends to a significant extent on the efforts and abilities of Germain Lamonde, our Chairman of the Board, President and Chief Executive Officer. His managerial, technical and other services could be difficult to replace. We do not have "key person" life insurance policies covering any employee.

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

Our success and ability to compete depend to a significant extent on our proprietary technology, since that is how we attempt to keep others from using the innovations that are central to our existing and future products. We currently hold 32 U.S., six Canadian, six European and one Chinese-issued patents and have 15 U.S., 14 Canadian and one European patent applications pending, along with two patent applications pending under the Patent Cooperation. We also rely on a combination of copyright and trademark laws, trade secrets, confidentiality procedures, contractual provisions and license agreements to protect our proprietary technology. We may have to engage in litigation in order to protect our patents and other intellectual property rights, or to determine the validity or scope of the proprietary rights of others. This kind of litigation can be time-consuming and expensive, regardless of whether we win or lose. Because it is critical to our success that we are able to prevent competitors from copying our innovations, we intend to continue to seek patent and trade secret protection for our technologies.

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

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

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, for this reason, we expect that third-party infringement claims involving technologies may increase. If an infringement claim is filed against us, we may be prevented from using some of our technologies and may incur significant costs to resolve the claim. Conversely, we may be required to spend significant resources to monitor and police our intellectual property rights.

We could incur substantial costs in defending ourselves and our customers against infringement claims 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.

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

Our products are designed to help network service providers, cable operators and manufacturers of optical networks and components ensure network reliability. We also leverage our core telecom technologies for life sciences

and industrial applications. The failure of our products to perform to client expectations could give rise to product liability and warranty claims. We carry insurance for product liability and take accounting reserves for warranty claims that we consider adequate in view of industry practice.

In addition, we may face other types of claims by third parties in relation to the conduct of our business; 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.

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

We may from time to time become involved in various lawsuits and

legal proceedings. For example, we are a defendant in a putative securities class action filed in the United States District Court for the Southern District of New York involving approximately 300 other issuing companies. Litigation is subject to inherent uncertainties, and an adverse result in these or other matters that may arise from time to time could have a material adverse effect on our business, results of operations or financial condition. Any litigation to which we are subject could require significant involvement of our senior management and may divert management attention from our business and operations.

IF WE SUFFER LOSS TO OUR FACTORIES OR FACILITIES, OUR OPERATIONS COULD BE SERIOUSLY HARMED.

Our factories and facilities are subject to catastrophic loss 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 operation.

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

Our historical operating results reflect substantial benefits from programs sponsored by federal and provincial governments for the support of research and development activities, as well as in relation to other activities. For example, research and development tax credits and grants represented 23.2% of our gross research and development expenses for the year ended August 31, 2005.

If unexpected changes in the laws or government policies terminate or adversely modify the Canadian and Quebec government programs, under which we receive the majority of 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 increase our research and development activities outside Canada or Quebec, which could result from, among other things, future acquisitions, the increased activities may not be eligible for these programs. If we 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.

OUR CURRENT PRINCIPAL STOCKHOLDER HAS EFFECTIVE CONTROL OVER OUR BUSINESS.

As of November 1, 2005, Germain Lamonde, our Chairman of the Board, President and Chief Executive Officer, held 92.54% of the voting rights in our stock. By virtue of such 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.

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 technological 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. Accordingly, we may need to raise additional capital in the future.

Our ability to obtain additional financing will be subject to a number of factors, including market conditions and our operations performance. These factors may render the timing, amount, terms and conditions of additional financing unattractive for us. If we raise additional funds by selling equity securities, the relative ownership of our existing investors could be diluted or the new investors could obtain terms more favorable than previous investors. In February 2004, we closed a public offering of 5.2 million subordinate voting shares to a syndicate of Canadian-based underwriters for net proceeds of US$29.2 million. If we raise funds through debt financing, we could incur significant borrowing costs. 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.

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 as well as our ability to expand and update these infrastructures in response to our evolving needs. Any failure to manage, expand or update our information technology infrastructures or any failure in the operation of this infrastructure could harm our business.

Despite implementing security measures, our information systems are vulnerable to damages from computer viruses, natural disasters, unauthorized access and other similar disruptions. Any system failure, accident or security breach could result in disruptions to our operations. To the extent that any disruption or security breach results in a loss or damage to our data, or inappropriate disclosure of our 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.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Our legal name and commercial name is EXFO Electro-Optical Engineering Inc. /EXFO Ingenierie electro-optique inc. Our head office is located at 400 Godin Avenue, Vanier, 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, New York, New York 10011. Our Transfer Agents and Registrars is CIBC Mellon Trust Company, 2001 University Street, Suite 1600, Montreal, Quebec, Canada, H3A 2A6. This annual report contains trademarks and registered trademarks of us and other companies.

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

On December 20, 2000, we acquired all of the shares of EXFO Burleigh Products Group Inc. (formerly Burleigh Instruments, Inc.) ("EXFO Burleigh"), Burleigh Instruments GmBH and Burleigh Instruments (U.K.) Ltd. for an aggregate purchase price of US$189.3 million, comprised of 6,488,816 of our subordinate voting shares and US$42.5 million in cash pursuant to the terms of an Agreement of Merger and Plan of Reorganization among us, EXFO Sub, Inc. and the selling shareholders, dated November 4, 2000, as amended on December 20, 2000. In April 2002, the name of Burleigh Instruments, Inc. was changed to EXFO Burleigh Products Group Inc. On November 12, 2002, Burleigh Instruments (UK) Ltd. was dissolved. EXFO Burleigh is a U.S. company, which was manufacturing precision scientific instruments used in basic and applied research engineering and production test applications in a variety of fields.

On March 15, 2001, we acquired all of the shares of EXFO Photonic Solutions Inc. (formerly EFOS Inc.) ("EXFO Photonic"), a privately held company in Toronto, Canada, for a total consideration of US$110.1 million, of which US$25.1 million was paid in cash. We also issued 3,700,000 of our subordinate voting shares in connection with the acquisition. In September 2001, the name EFOS Inc. was changed to EXFO Photonic Solutions Inc.

EXFO Photonic, operating since 1984, is a supplier of precision light-based adhesive spot curing products as well as curing process control for the global optical component manufacturing market and other non-telecom markets. Its products deliver precise doses of the appropriate spectral light into photo-sensitive and heat-cured adhesives to significantly reduce bonding time and increase repeatability in optical component and other manufacturing activities. EXFO Photonic light-based curing technologies are supported by an extensive understanding of bonding and material sciences and by a broad intellectual property portfolio, including, as of November 1 2005, 15 patents and 12 patents pending.

Also on March 16, 2001, our wholly owned subsidiary, Burleigh Automation Inc. ("Burleigh Automation"), acquired substantially all the assets of Vanguard Technical Solutions, Inc., a wholly owned subsidiary of DT Industries, Inc. for a purchase price of US$600,000 paid in cash. Vanguard, an automation equipment manufacturer in Tucson, Arizona, specialized in the design and manufacturing of ultra-precision assembly equipment for sensitive process and critical assembly challenges on the production floor. This acquisition, which complemented our acquisition of Burleigh, was planned to fit with our overall strategy at that time of providing customers with a

comprehensive solution for the assembly, alignment and testing of optical components and subsystems. Since September 2001, Burleigh Automation has ceased operations and we have transferred all material intellectual property assets and most of the physical assets of Burleigh Automation to EXFO Burleigh.

In November 2001, we acquired all of the shares of Avantas Networks Corporation and simultaneously changed the name of that company to EXFO Protocol Inc. ("EXFO Protocol"). We paid a total consideration of US$69.4 million (or US$95.0 million for the equity minus US$25.6 million of cash in the hands of the acquired company) to acquire EXFO Protocol. Consideration paid consisted of 4,374,573 of our subordinate voting shares and US$9.8 million in cash, net of cash acquired. EXFO Protocol, a company based in

Montreal, Canada operating since 1998 is a supplier of fiber-optic testing and optical network performance management equipment that supports a wide range of protocols and data transmission rates.

During fiscal 2001, we were forced to align our cost structure to market conditions. On June 27, 2001, we announced the reduction of non-customer-related expenses, postponement of plans to build a new facility in the Quebec Metro High-Tech Park, termination of non-cure operations of Nortech, a subsidiary that specialized in manufacturing fiber-optic temperature sensors, and reduction of our work force by 15%.

During fiscal 2002, we were forced to re-align our cost structure to market conditions. First, on December 5, 2001, we announced the lowering of our operating expenses, a freeze in employee salaries, and the reduction of our workforce by 10%. Then, on May 15, 2002, we announced a further 20% reduction of our global workforce in an effort to lower our cost structure. In May 2002, we performed an assessment of the carrying value of goodwill and intangible assets recorded in conjunction with the three acquisitions made during the previous eighteen (18) months. Considering the ongoing unfavourable market conditions, we recorded a charge of US$222.2 million to write down a significant portion of goodwill and a charge of US$23.7 million to write down a significant portion of acquired core technology. Also, overall for fiscal 2002, we wrote off US$18.5 million in excess and obsolete inventories.

In August 2002, EXFO Burleigh received confirmation of the extension of its contract with the U.S. Air Force Research Laboratory into phase 2 of a project for the development by EXFO Burleigh of new high-precision actuator system. The contract for phase 2 provided for an additional funding of US$1.7 million and extended through the first quarter of 2005.

In October 2002, our newly created, wholly owned subsidiary, EXFO Gnubi Products Group Inc. ("EXFO Gnubi"), acquired substantially all the assets of GNUBI COMMUNICATIONS L.P., including its technology, expertise, customer base, inventories and capital assets. Consideration paid consisted of US$1.9 million in cash and 1,479,290 of our subordinate voting shares. Furthermore, an additional cash amount of US$241,000, based on sales volumes, was paid in fiscal 2004 in accordance with earn out provisions. With the acquisition of these assets, EXFO Gnubi, based in Dallas, Texas, continues the operations of GNUBI COMMUNICATIONS, L.P., as a supplier of multi-channel telecom and datacom testing solutions serving optical transport equipment manufacturers and research and development laboratories. At the time of the asset acquisition, 30 employees of gnubi communications transferred to EXFO Gnubi.

During fiscal 2003, we were required to implement further restructuring measures as a result of depressed spending levels in the telecommunications industry and geo-political and economic uncertainty. We reduced our workforce by 30%, rationalized our business activities and consolidated certain manufacturing operations. These measures incurred charges of US$4.1 million. The rationalization and consolidation initiatives involved the reorganization of our business into two new reportable market segments:

Telecom Division and Photonics and Life Sciences Division and the exiting of the optical component manufacturing automation business. Our Telecom Division consists of the former Portable and Monitoring and telecom related Industrial and Scientific product lines. Our Photonics and Life Sciences Division includes previous non-telecom Industrial and Scientific product lines. Each division has been structured with its own sales, marketing, manufacturing, research and development and management teams.

In May 2003, we performed our annual impairment test on goodwill recorded in conjunction with the acquisitions of EXFO Burleigh, EXFO Photonic and EXFO Protocol and also reviewed the carrying value of intangible assets related to these acquisitions. As a result of this assessment, we concluded that the carrying value of goodwill related to EXFO Burleigh and the carrying value of intangible assets related to EXFO Burleigh and EXFO Photonic was impaired and we recorded a charge of US$4.5 million to write down goodwill and a pre-tax charge of US$2.9 million to write down acquired core technology. Of the total impairment loss of US$7.4 million, US$6.9 million is related to EXFO Burleigh for goodwill and acquired core technology and US$0.6 million is related to EXFO Photonic for acquired core technology.

In addition, in an effort to simplify our structure and stream-line our operations, the operations of EXFO Protocol were merged with those of the Corporation as of September 1, 2003 and effective December 1, 2003, the operations of EXFO Gnubi were merged with those of EXFO America Inc.

In fiscal 2004, EXFO also closed a public offering of 5.2 million subordinate voting shares to a syndicate of Canadian-based underwriters for net proceeds of $29.2 million (Cdn$38.4 million).

Furthermore in fiscal 2004, we consolidated our protocol test operations (EXFO Protocol and EXFO Gnubi) in Montreal, Canada to improve efficiency and reduce costs.

In addition, we renewed our collective bargaining agreement with unionized manufacturing employees in Quebec City, Canada. Such agreement will expire in February 2009.

During fiscal 2005, our Photonics and Life Sciences Division was renamed the Life Sciences and Industrial Division to better reflect its market focus.

Finally, during fiscal 2005, we completed the consolidation of our Life Sciences and Industrial Division in Toronto and we recorded $482,000 in restructuring expenses. Altogether, we incurred $2.5 million in restructuring and other charges since the fourth quarter of 2004 in conjunction with this consolidation process. Following this process all of the operating activities of EXFO Burleigh were transferred mainly in Toronto.

B. BUSINESS OVERVIEW

COMPANY OVERVIEW

EXFO is a recognized expert in the global telecommunications industry through the design and manufacture of advanced and innovative test and measurement solutions. The Telecom Division, which represents our main business activity, offers a complete range of dedicated and integrated test

solutions to network service providers (NSPs), cable operators, system vendors and component manufacturers in approximately 70 countries. One of our strong competitive advantages is our modular test platform design - based on a PC/Windows-centric architecture - which offers a series of test modules that maximize technology reuse across multiple market segments at minimal redesign cost. The Life Sciences and Industrial Division, formerly called the Photonics and Life Sciences Division, mainly leverages core telecom technologies to offer value-added solutions for life sciences applications and high-precision

assembly processes, such as those required for microelectronics and optoelectronics.

We were founded in 1985 in Quebec City, Canada. Our original products were focused on the needs of installers and operators of fiber-optic networks. Customers use these field-portable testing products for the installation, maintenance, monitoring and troubleshooting of optical networks. In 1996, we supplemented our product portfolio with an extensive line of high-end products that are mainly dedicated to research and development as well as manufacturing activities of optical component manufacturers and system vendors.

In the last four years, we have enhanced our competitive position through the acquisition of two protocol test businesses in order to expand our product offering and address our customers' requirements more completely. In November 2001, we acquired Avantas Networks Corporation (renamed EXFO Protocol Inc.), a supplier of protocol-testing and optical-network performance management equipment for NSPs. This transaction was highly strategic because it enabled us to combine optical and protocol test modules inside a single field-portable test platform to help our customers increase revenues and reduce operating costs. In October 2002, our wholly-owned subsidiary, EXFO Gnubi, purchased substantially all the assets of gnubi communications, L.P., a supplier of multi-channel telecom and datacom testing solutions for the system manufacturer market. These strategic acquisitions, which were consolidated in Montreal in fiscal 2004, enabled us to more than double our addressable market, as we expanded from optical testing to protocol testing applications, and to offer a more complete line of test solutions to our customers.

Previously, we had completed two acquisitions to bolster growth in the optical component manufacturing market. We acquired Burleigh Instruments, Inc. (renamed EXFO Burleigh Products Group Inc.) in December 2000 for its wavelength measurement instruments and nanopositioning alignment systems. We also added EFOS Inc. (renamed EXFO Photonic Solutions Inc.) in March 2001 for its precision light-based, adhesive spot-curing technology. We have since exited the optical component manufacturing automation business.

In fiscal 2005, we launched 15 new products, including a next-generation SONET/SDH analyzer for characterizing converged, IP-based networks; a 10 Gigabit Ethernet (GigE) test solution to assess quality of service in core and metro networks; a new software suite for remote Ethernet testing and commissioning applications; an all-band component analyzer for FTTx and coarse wavelength-division multiplexing (CWDM) applications in the manufacturing/R&D market; a series of three handheld test instruments for the installation and maintenance market; and an optical spectrum analyzer (OSA) for CWDM applications in metro and access networks. In addition, we formed an alliance with ADC Telecom to provide a unique remote Ethernet test solution for first-mile applications.

In 2005, we also consolidated our leadership position in the FTTx test market by recognizing significant revenue from two leading carriers in the United States deploying fiber in their access networks. Our top customer accounted for 23.3% of sales in 2005. Subsequent to the year-end, we were

selected as sole-source supplier for all fiber deployment test applications by Deutsche Telecom AG - including FTTx.

We recorded a foreign exchange loss of $1.3 million in fiscal 2005 due to the significant increase in the value of the Canadian dollar versus the US dollar during that year. In addition to this foreign exchange loss, our P&L (profits and losses) line items in 2005 were also negatively affected by the

appreciation of the Canadian dollar, since a significant portion of our expenses are incurred in Canadian dollars while we report our results in US dollars.

In the third quarter of fiscal 2005, EXFO was named recipient of the 2005 Growth Strategy Leadership Award by Frost & Sullivan, a leading market research firm in the telecommunications test sector. The award is presented annually to the company whose visionary growth strategy generates the largest market-share gains in the global fiber-optic test equipment market in the previous year. Based on a report by Frost & Sullivan, we increased our market share from 8.4% in 2003 to 10.3% in 2004. This marked the second consecutive year that we earned this industry award.

Finally, during fiscal 2005, we completed the consolidation of our Life Sciences and Industrial Division in Toronto and we recorded $482,000 in restructuring expenses. Altogether, we incurred $2.5 million in restructuring and other charges since the fourth quarter of 2004 in conjunction with this consolidation process.

INDUSTRY OVERVIEW

Leading telecom operators (telcos), mostly in the United States, accelerated fiber deployments deeper in their access networks during the last year because of competition from cable TV operators (cablecos) to offer consumers bundled voice, data and video services. This broadband competition between telcos and cablecos contributed to an increase in wireline capital expenditures in 2005, especially in the United States.

Leading US telcos, along with a number of Tier-II and Tier-III players, opted for an assortment of deployment strategies, including fiber-to-the-node (FTTN), fiber-to-the-curb (FTTC), fiber-to-the-home (FTTH) or its equivalent fiber-to-the premises (FTTP), depending on their estimates of how much bandwidth will be required to meet the challenge from the cablecos. These deployments, which fall under the generic FTTx name, are not as prevalent in Europe and Asia. However, test trials are underway in these regions as a means to increase revenues by delivering video services to undercut competition. Note that Japan and Korea already have FTTx deployment programs, aimed at delivering 100 Mb/s to every home, well underway.

As the demand for broadband services increases worldwide, voice, data and video are becoming mere applications on converged, IP-based networks. Telcos around the world are migrating from public switched telephone networks (PSTN) to packet-based, IP networks in order to achieve substantial reductions in operating expenses and increased profitability. British Telecom Group, for example, announced it will spend (British Pound)10 billion over five years on its 21st Century Network to reduce operating expenses by up to (British Pound)1.0 billion per year through a single network carrying voice, data and video signals.

Legacy SONET/SDH networks were designed in the late 1970s to carry voice traffic. Their efficiency however can often times drop to as low as 30% when combining voice, data and video services. Next-generation networks, such as those announced by British Telecom, represent a major technological improvement, since they can deliver triple-play services at near 100%

efficiency, regardless of the payload content, while significantly reducing the cost of operating and maintaining networks.

These key market trends affected multiple segments of the global telecommunications supply chain in 2005. System manufacturers benefited from orders by both telcos and cablecos for next-generation, converged IP networks as well as from major investments by telcos in access networks. Component vendors saw incremental demand for optical components that support FTTx and IP-based systems. Some test and measurement equipment vendors attracted the attention of telcos, cablecos, system manufacturers and component vendors, especially ones offering test solutions for IP optical networking and/or FTTx applications.

KEY INDUSTRY TRENDS AND STRATEGY

As a market-driven company, we try to identify the key industry trends in order to leverage technological discontinuities and convert them into value-creating market opportunities. Following are key market trends for fiscal 2006 and beyond and how we intend to take advantage of them.

BROADBAND COMPETITION LEADING TO ACCESS INVESTMENTS

Intense competition between telcos and cablecos continues unabated in North America. Both industries are competing to increase revenue and profitability through bundled offerings, while reducing churn. This broadband competition is prompting massive capital investments in access networks in order to increase bandwidth, flexibility and scalability, while continuing metro ring expansion. Telcos are deploying fiber-to-the-node (FTTN; ~20 Mb/s), fiber-to-the-curb (FTTC; ~40 Mb/s) or fiber-to-the-premises (FTTP; ~100 Mb/s), depending on estimates of which video compression techniques will be adopted and how much bandwidth will be required to meet the challenge from the cablecos (~40 Mb/s). The closer the fiber is to the premises and the higher the transmission rates, the better it is for EXFO, which offers the most comprehensive line of FTTx test solutions on the market. Following agreements with Verizon and SBC Communications, we are increasingly leveraging our leadership in passive optical network (PON) testing and broad portfolio of FTTx-ready technologies outside North America, given our long-established customer relationships in Europe and Asia. We are participating in several FTTx trials worldwide and recently were selected as sole-source supplier for all fiber deployment test applications by Deutsche Telecom AG - including FTTx. While our FTTx market penetration was excellent in 2005, we believe this is just the beginning of a long-term deployment trend.

MIGRATION TOWARDS CONVERGED, IP-BASED NETWORKING

Network operators around the world are migrating from public switched telephone networks (PSTN) to packet-based, Internet protocol (IP) networks in order to achieve substantial reductions in operating expenses and increased profitability. For example, British Telecom Group announced it will spend (British Pound)10 billion over five years on its 21CN initiative (21st Century Network) to reduce operating expenses by up to (British Pound)1 billion per year, while enabling revenue expansion into differentiated, higher-margin new services - all thanks to a single network carrying voice, data and video signals.

Legacy SONET/SDH networks were designed in the late 1970s to optimize voice traffic, but they can drop to 30% efficiency when data and video applications are added. Next-generation networks, such as those announced by British Telecom, represent a major technological improvement, since they can deliver triple-play services at almost 100% efficiency while significantly

reducing operating and maintenance costs.

Anticipating this market opportunity, we shifted our focus from legacy SONET/SDH and Ethernet technologies to next-generation protocol test solutions aimed at the deployment of converged, IP-based networks. Product launches in 2005 included a next-generation SONET/SDH analyzer, featuring the latest in generic framing procedure (GFP), virtual concatenation (VCAT) and link-capacity adjustment scheme (LCAS); a 10 Gigabit Ethernet (GigE) test solution, a remote Ethernet tester to ensure quality of service (QoS); and additional Ethernet test capabilities to help carriers operate their high-performance core, metro and edge networks. We also formed an alliance with ADC Telecom to provide a unique remote Ethernet test solution for first-mile applications. Subsequent to the year-end, we launched 10 GigE and Fibre Channel test solutions for the system vendor market.

Given the protocol test market is significantly larger than the optical test market, our rich product pipeline in protocol testing, and four consecutive quarters of sales growth in protocol testing with the last quarter exceeding 10% of Telecom Division revenues, we have high expectations for this product line. We expect that protocol sales will outgrow optical sales to eventually account for 50% of our Telecom Division revenues, even though our optical segment will continue to increase.

On the life sciences and industrial side:

Fluorescence imaging is one of the fastest-growing segments of the microscope industry. To take advantage of this market opportunity, we have partnered with major microscope manufacturers in the last two years to deliver the leading fluorescence illumination system in North America. We're now seeking similar penetration in Europe and Asia through regional partnerships with microscope manufacturers.

The aging baby-boomer market is placing stringent demands on manufacturers of medical equipment for devices like in-vitro balloon catheters, hearing aids and asthma inhalers. Similarly, high-tech consumers are pushing for the continued miniaturization of devices such as digital cameras, personal digital assistants (PDAs) and cellular phones. Given the demand for higher volumes and miniature sizes, manufacturers of medical and electronic devices are requiring exceptional control and repeatability for their precision assembly applications. EXFO has responded to this dual trend by bringing to market an automated spot-curing platform that can be controlled via a personal computer.

KEY PERFORMANCE INDICATORS FOR FISCAL 2006

As expected, our strategic directions for fiscal 2006, and consequently our key performance indicators (KPIs), will not be radically different from those in 2005. Since we are highly focused on creating value for our shareholders, delivering the highest level of profitable growth is at the heart of our actions. We intend to:

- INCREASE SALES MORE THAN 15% YEAR-OVER-YEAR MAINLY THROUGH MARKET-SHARE GAINS. To achieve this goal, we intend to exploit the aforementioned market opportunities (See "Key Industry Trends and Strategy") and concentrate on solid execution.

- GENERATE MORE THAN 5% IN EARNINGS FROM OPERATIONS. Higher sales

volumes, increased contribution from higher-margin protocol test solutions, improved operating efficiencies and continued cost controls should help us reach our objective. This metric assumes no significant currency fluctuations nor closed acquisitions in fiscal 2006. If an acquisition is completed in 2006, this metric will be revised accordingly.

- DERIVE AT LEAST 40% OF SALES FROM PRODUCTS ON THE MARKET TWO YEARS OR LESS. At EXFO, we remain attuned to customer and market requirements, not to technology for the sake of it. This ambitious innovation target is fully aligned with our fundamental goals of differentiating ourselves from the competition, increasing market share and revenue, as well as improving gross margin and profitability.

THE EXFO SOLUTION

We offer an extensive range of test and measurement solutions to the global telecommunications industry. Our success has been largely predicated on our core expertise in optical telecommunications. We also leverage this expertise to develop products for life sciences and high-precision assembly applications. Our solution is based on the following key attributes:

MODULAR SYSTEM DESIGN. In 1996, we established an industry first by launching the original modular optical test platform. This system design consists of a PC-based, Windows-driven platform that can accommodate several test modules performing various types of measurements. We have since developed new compatible test platforms and extended our test module offering for both NSPs and system manufacturers based on the same modular design. Our modular design provides the following advantages:

- Unlike stand-alone units, new test modules can be rapidly developed to address changing industry requirements.

- As customers' testing requirements change, they can purchase additional modules that are compatible with their previously purchased platforms, thus protecting their initial investments.

- Our standard graphical user interface reduces training costs because customers are familiar with previously acquired software products.

- The flexibility of our systems allows customers to develop customized and automated solutions for their specific test requirements.

- Our test platforms are PC-based and Windows-driven, thus they can support third-party software solutions.

HIGH DEGREE OF TECHNOLOGICAL INNOVATION. We have established a strong reputation for technological innovation over the last 20 years. In fact, we believe this attribute represents a key differentiator for us within a competitive marketplace. Following are some of our industry firsts:

- The first PC-based modular test platform for field applications;.

- The first all-in-one optical loss test set combining several

instruments;.

- The first portable polarization mode dispersion (PMD) analyzer;
- The first modular platform to combine optical and protocol test solutions; and
- The first line of portable test instruments designed for FTTx testing.

HIGH-QUALITY PRODUCTS. Product quality is an integral part of our solution. Our Quebec City-based operations have maintained ISO 9001 certification since 1994 and they are now certified to the new 2000 edition of the standard, as are our Toronto operations. Our manufacturing plant in Montreal, Quebec, received ISO 9001/2000 certification on November 16, 2005. All of our products meet required industry standards, and some of our products meet additional voluntary standards, such as those set by Telcordia, formerly Bellcore, IEC, and other industry-leading standards bodies. During manufacturing, each product has a related quality assurance plan, with rigorous checkpoints, to ensure product conformity. Various tasks in the quality assurance process among all our facilities include quality control, conformity testing, product documentation, product improvement, regulatory compliance, metrology and calibration.

Our product designs comply with Directive 2002/96/EC, a legislation enacted by the European Union regarding the disposal of waste electrical and electronic equipment (WEEE), for all products exported to Europe. In regard to the Directive 2002/96/EC (RoHs), we and other test and measurement manufacturers have been warranted an unlimited exemption.

PRODUCTS

Our test platforms, namely the FTB-400 Universal Test System (UTS), IQS-500 Intelligent Test System (ITS) and EPX Multi-Channel Test Systems, are at the core of our product portfolio. The FTB-400 field-testing platform provides NSPs with a simple, yet efficient way to perform multiple, advanced test operations for installation, maintenance and troubleshooting applications. Our IQS-500 ITS and EPX Multi-Channel Test Systems, which are designed for manufacturing and R&D applications, test converging telecom and datacom networks increasingly based on IP technology. All platforms and related test modules are supported by integrated and highly intuitive graphical user interfaces (GUIs), enabling the user to easily store, handle and retrieve a large amount of data.

The following table summarizes the principal types of test instruments for the telecommunications industry, typical applications and the format in which we offer them:

		FORMAT			
		NSP MARKET		MANUFACTUR	
INSTRUMENT TYPE	TYPICAL APPLICATION	FTB 400 UTS MODULES	FTB 400 HANDHELDS	IQS-500 ITS MODULES	EPX
Broadband source	Used for testing wavelength dependent behavior of fiber cables and DWDM optical components.			X	

Channel selector	Selects and isolates any International Telecommunication Union (ITU) DWDM channel in the CBand for bit-error-rate testing and protocol-layer analysis.	X	X

		FORMAT			
INSTRUMENT TYPE	TYPICAL APPLICATION	NSP MARKET		MANUFACTUR	
		FTB 400 UTS MODULES	HANDHELDS	IQS-500 ITS MODULES	EPX
Chromatic dispersion analyzer	Measures increasing levels of chromatic dispersion in high-capacity optical networks. Chromatic dispersion is a physical phenomenon inherent to optical fiber and optical components that causes information bits to spread along a network. This degrades the quality of the transmission signal and, in turn, limits the transmission speed carried by optical networks.	X			
Clip-on coupling device	Clips to an optical fiber and allows non-invasive testing.		X		
Fibre Channel tester	Brings FC-0, FC-1 and FC-2 logical layer Fiber Channel testing to services delivered via transport protocols, such as DWDM, SONET/SDH and dark fiber. It provides valuable timing information and buffer credit estimation for Fiber Channel network deployment.	X		X	
Gigabit Ethernet tester	Measures data integrity for high-speed Internet protocol telecommunications in metro and edge networks.	X		X	
Laser wavelength meter	Performs high-accuracy, absolute wavelength measurements of continuous wave (CW) and/or pulsed laser sources				
Laser spectrum analyzer	Performs high-resolution, spectral characterization of con-continuous CW laser sources				
Live fiber detector	Clips on to a fiber and is used				

	to detect the presence and direction of a signal without interrupting the traffic.		X	
Loss test set	Integrates a power meter and a light source to manually or automatically measure the loss of optical signal along a fiber.	X	X	X
Multiwavelength meter	Measures the power and drift for multiple wavelengths in a DWDM system.	X		X
Narrowly tunable laser	A laser that can be precisely tuned to simulate a DWDM light sources. Used primarily in testing optical amplifiers.			X
Next-generation SONET/SDH analyzer	Full SONET/SDH protocol testing functionality, including support for GFP, V.CAT, and LCAS next generation enhancements.	X		X
Optical amplifier	Boosts the power of laser sources. Used for the testing and calibration of test systems.			X
Optical coupler	Used in test system to combine sources or signals. Also used as splitters to monitor signals.			X

		FORMAT		
INSTRUMENT TYPE	TYPICAL APPLICATION	NSP MARKET		MANUFACTUR
		FTB 400 UTS MODULES	HANDHELDS	IQS-500 ITS MODULES	EPX
Optical fiber parameter analyzer	Measures the geometric and light guiding properties of an optical fiber. Used in new fiber research and development and quality control applica-tions.				
Optical power meter	Measures the power of an optical signal. It is the basic tool for the verification of transmitters, amplifiers and optical transmission path integrity.	X	X	X	
Optical power	Provides a highly accurate and				

reference module	traceable measurement of power for the calibration or verification of other power measurement instruments.			X
Optical return loss meter	Combines a laser and a power meter to measure the amount of potentially degrading back reflection.	X	X	X
Optical spectrum analyzer	Produces a graphical representation of power versus wavelength for an optical signal. Useful for measuring the drift, power and signal-to-noise ratio for each wavelength in a DWDM system.	X		X
Optical switch	Provides switching between fibers. Used to provide flexible and automated test setups such as the measurement of multiple fibers or components with multiple ports with one instrument.	X		X
Optical time domain reflectometer (OTDR)	Like a radar, it measures the time of arrival of reflections of an optical signal to determine the distance to the breaks or points of excessive loss in a fiber network.	X		
Optical waveguide analyzer	Provides the refractive index profile of glass and fused silica-based devices used in next generation networks.			
Passive component analyzer	Characterizes passive wavelength-selective devices, such as multiplexers, demultiplexers and add/drop filters, with respect to absolute wavelength in order to guarantee their performance within DWDM systems.			
Passive optical network (PON) power meter	Determines the power level of different signal types, including continuous (e.g., TV signal at 1550 nm) and framed (e.g., ATM or Ethernet at 1490 nm or 1310 nm) within a passive optical network. Various baud rates are covered, ranging from 155 Mb/s to 2.5 Gb/s, for both synchronous and non-synchronous signals.		X	
Polarization-dependent loss meter	Measures the difference in loss of power for the different states of polarization.			X

Polarization mode dispersion analyzer	Measures the dispersion of light that is caused by polarization. Generally used to determine the speed-distance limitation of fiber and cables.	X		X

		FORMAT			
INSTRUMENT TYPE	TYPICAL APPLICATION	NSP MARKET		MANUFACTUR	
		FTB 400 UTS MODULES	HANDHELDS	IQS-500 ITS MODULES	EPX
SONET/SDH analyzer	Provide accurate bit-error rate and performance analysis of SONET/SDH overhead format that reflect the quality of a transmission system.	X		X	
Stable light source	Emitting diode or lasers used in connection with a power meter to measure signal loss.	X	X	X	
Synchronization analyzer	Portable, stand-alone tester for network synchronization analysis and wander measurement in wireless and wireline transport networks.				
Talk set	A device that attaches to an optical fiber and serves as a temporary voice link facilitating coordination of work among installation crews.	X	X		
Variable optical attenuator	Used in network simulation setups to provide calibrated variable reduction of the strength of an optical signal.		X	X	
Visual fault locator	A visible laser that can be connected to an optical fiber network to help locate breaks or points of excessive loss.	X	X		
Widely tunable laser	Can produce laser light across a broad range of wavelengths. Used to test DWDM components and value-added optical modules.			X	

PRODUCTS FOR NETWORK SERVICE PROVIDERS

We offer an extensive range of field-portable optical test, measurement and monitoring solutions that are mainly used by NSPs, but can also be utilized by system vendors. These products are available as handheld test instruments, portable platforms with related modules, and as rack-mount chassis with related modules. Our handheld instruments are durable, compact and easy to use. Our second-generation field-testing platform, the FTB-400 UTS, is available in three configurations: The two-slot option is ideal for OTDR, OLTS and GigE applications, while the seven-slot option is used for dispersion characterization (PMD and CD), DWDM testing (OSA and MWM) and protocol (SONET/SDH/datacom) testing. Our newest addition, the eight-slot option, is a high-performance, multiple-protocol configuration that allows users to combine next-generation SONET/SDH functions with Ethernet, Fibre Channel and optical-layer testing capabilities. Our portable platforms are PC-centric, Windows-based, highly flexible and fully scalable. Their large robust touchscreens are very practical for field use.

In addition, we offer the FTB-100 Mini-OTDR with an integrated power meter option. This cost-effective platform provides field technicians with basic OTDR testing capabilities.

In 2005, we launched a new family of value-added handhelds to perform optical loss testing in the outside plant environment. Furthermore, we expanded our OTDR product line by adding a new four-lambda OTDR to better suit the installers' market.

PRODUCTS FOR SYSTEM/COMPONENT MANUFACTURERS

Our system/component vendor solutions, mainly built around our IQS-500 ITS and EPX platforms, are available as test modules or stand-alone benchtop instruments. The next-generation IQS-500 platform can efficiently run as many as 100 optical test modules using a single controller unit. The IQS-500 platform is equipped with the software and hardware technology to support single-button operation for automated testing. Its system-based

approach--one box, several test modules--combined with an open architecture (PXI, Windows, LabVIEW(TM), etc.) and ease of programming, produces a highly flexible test environment.

The IQS-500 also provides backward compatibility with recent IQ-generation test modules, while delivering all the power and advantages of a next-generation platform. EXFO's wide selection of high-performance test modules includes high-speed power meters, light sources, WDM laser sources, tunable laser sources, variable attenuators, optical spectrum analyzers, polarization mode dispersion (PMD) analyzers, multi-wavelength meters, channel selectors, polarization dependent loss (PDL) and optical return loss (ORL) meters, polarization controllers and optical switches.

The highly flexible EPX platforms are available in two formats. With up to 17 protocol test modules per unit, the EPX16 performs numerous tasks within one hardware platform. The EPX8 uses the same upgradeable, multi-channel design in a smaller footprint. Combining multiple rates, protocols and channels within a single unit, these systems are ideal for cross-connect, ADM, DWDM, production and load testing. Direct Ethernet access capability and a Java-based GUI make the EPX platforms powerful test solutions that are easy to use. Other user-friendly features include saving and restoring test configurations, connecting remotely with a Web browser, scripting, logging and sharing test resources with other users.

In 2005, we introduced a new FTTH/CWDM passive component test system

that allows manufacturers to measure insertion loss (IL), polarization-dependent loss (PDL) and optical return loss (ORL) in a single test sequence.

Our system/component vendor products also address testing issues that cannot be handled by standard test modules or stand-alone bench-top instruments. We have developed a number of integrated test systems and offer them as off-the-shelf solutions to suit a wide range of customer needs. In addition, we have created a software development kit for developers who prefer writing their own programs for our instruments. Following is list of integrated test systems that we provide for characterizing optical components, sub-systems and networks:

o CWDM/FTTH passive optical component test system	Used to automatically characterize all critical specifications, including spectral insertion loss, polarization-dependent loss and optical return loss of a CWDM passive component or a FTTH splitter with a high degree of accuracy, ease of use and speed.
o Multifiber test system	Used for quality-assurance testing of multifiber patchcords and interconnect assemblies. These devices, including hybrid and fan-out patchcords, are commonly used in fiber systems.
o Cable assembly test system	Used to perform insertion loss and mandrel-free reflection measure-ments with the highest degree of accuracy and repeatability on short fiber assemblies.

o Optical calibration test system	Used to calibrate power meters, light sources, variable attenuators and optical time domain reflectometers.
o DWDM passive component test system	Used to automatically characterize all critical specifications, including spectral insertion loss, polarization-dependent loss and optical return loss of a DWDM passive component with a high degree of accuracy, ease of use and speed.

PRODUCTS FOR LIFE SCIENCES AND INDUSTRIAL APPLICATIONS

Over the years, we have developed and acquired a number of core technologies that we leverage in selected high-precision assembly and life sciences markets. For example, we offer several light-based curing solutions for optical component manufacturing and have optimized our approach for other industries, such as semiconductor, microelectronic, and medical device manufacturing, in order to maximize revenues. Our Novacure(R), Acticure(R), and Omnicure(R) systems deliver precise doses of the appropriate spectral

light onto photosensitive adhesives to significantly reduce bonding time and increase repeatability. These light-based curing systems, supported by patented optical feedback, thermal control, and radiometry technology, produce a high-quality bonding solution that is unmatched in the industry. Our technology and application knowledge place us at the forefront of this market.

In 2005, our X-Cite(TM) 120 Fluorescence Illumination System, which offers 1,500 hours of lamp life, established itself as the leading fluorescence microscopy solution in North America. We have created partnerships with major microscope manufacturers, who resell this microscope accessory to their new and installed base of customers through their own sales channels.

On the light-based curing side, we introduced an automated spot-curing platform, the OmniCure(TM) Series 2000 that can be controlled via a personal computer.

The following table summarizes the principal types of high-precision assembly and life science solutions we provide and their typical applications:

LIGHT SOURCES AND ACCESSORIES

PRODUCT TYPE	PRODUCT	TYPICAL APPLICATION
UV Light Sources	Novacure(R) Acticure(R) Omnicure(R) S1000 Omnicure(R) S2000	Used to initiate photo chemistry r polymer-based materials for a variety applications such as adhesive manufacturing of high value-added it medical devices, micro-electron opto-electronic components, display storage devices.
Fluorescent Light Sources	X-Cite(R) 120 X-Cite(R) 120 PC	Fluorescence light source that attach to most microscopes currently sol Zeiss, Olympus and Leica.
Computer Control Module	ACS-1000	Electronic interface module used to c UV light sources to computers o networks for process automation.

LIGHT SOURCES AND ACCESSORIES

PRODUCT TYPE	PRODUCT	TYPICAL APPLICATION
Optical Accessories		Optional custom delivery optics use

		UV light sources to tailor the proper light beam to end-user applications.
High Power Fiber Light Guide		Provides an equal distribution of l to multiple cure sites with 50% more than standard fiber guides

OPTICAL INSTRUMENTS

PRODUCT TYPE	PRODUCT	TYPICAL APPLICATION
Radiometer	R5000	Handheld, broadband optical radiom conjunction with EXFO UV light sourc process quality control at the end-us
Cure-Ring Radiometer		Measures the output power of light cure ring; ideal for applications tha uniform 360(degree) exposure
Precise Motors/Stages	IW-700 Inchworm Motors TSE-820 Inchworm Stages UHVL Inchworm Motors	High resolution optical alignment, alignment, semiconductor positioning research

PRECISION POSITIONING INSTRUMENTS

PRODUCT TYPE	PRODUCT LINE	TYPICAL APPLICATION
Micromanipulators	PCS-6000 Micromanipulators PCS-5000 Micromanipulators	Electrophysiology research such as recording experiments on the brain nervous system
Microscope Platforms	Gibraltar Platform/Stage	Applications using upright microscope
Microinjection Systems	MIS-5000 Microinjection Manipulator PiezoDrill Inertial Impact Drill	Microinjection and nuclear transfer f and reproductive sciences research
Microelectrode Positioner	LSS-8000 Inchworm System	Electrophysiology research such as in recording experiments

RESEARCH AND DEVELOPMENT

We believe that our future success largely depends on our ability to maintain and enhance our core technology and product functionality. To keep developing new products and enhancements, it is important that we retain and recruit highly skilled personnel. Our Telecom Division's research and development department is headed by a Vice-President of Research and Development, while our Life Sciences and Industrial Division has a Director of Research and Development. As of November 1, 2005, our research and development departments included 188 full-time engineers, scientists and technicians, of whom 26 hold post-graduate degrees. Gross research and development expenditures in fiscal 2005 reached $15.9 million, compared to $15.7 million in 2004 and $17.1 million in 2003. We launched 15 new products in fiscal 2005

compared to 20 in 2004 and 15 in 2003. Approximately 42% of sales in fiscal 2005 originated from products that have been on the market two years or less

compared to 32% in 2004 and 49% in 2003.

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

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

- 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. Adherence to these inter-related portfolio review and stage-gate processes enabled us to be named winners of the Outstanding Corporate Innovator Award in 2000 by the U.S.-based Product Development and Management Association.

We also maintain research and development programs for our life science and industrial activities in Toronto, Canada. The product development process is managed using a similar stage-gate process, and projects are reviewed and approved through a quarterly portfolio review. The future success of our life science and industrial operations largely depends on our ability to maintain and enhance our core technology in light-based curing, fluorescence illumination systems and piezoelectric positioning.

Strong R&D capabilities in Toronto have made it possible to bring a number of successful new products to market quickly and retain customer intimacy. In the process, it has enhanced our ability to customize products for special applications and to develop original equipment manufacturing (OEM) products under partnerships and exclusive contracts. Outside consultants are often used for added support in areas like software development, mechanical design and rapid prototyping.

CUSTOMERS

Our global and diversified telecom customer base relies on our test and measurement solutions to enable optical networks to perform impeccably during their complete life cycles: research, development, manufacturing, installation, maintenance and real-time monitoring. We also have selected customers in high-precision assembly and life science sectors that require our solutions to render them more efficient in their respective fields. Our telecom customers include carriers, cable television companies, public utilities, private network operators third-party installers, equipment rental companies, system manufacturers, component vendors and laboratory researchers. Our life science and industrial customers consist of major manufacturers of medical devices, microelectronics, optical displays, electronic storage systems and photonic components, as well as universities, medical schools, governments, as well as private and industrial research laboratories. In fiscal 2005, our top customer accounted for 23.3% of our sales and our top three customers represented 28.4% of our sales. In comparison, our top customer accounted for 13.8% of sales and top three customers 20.8% in 2004, while in 2003, our top customer accounted for 9.2% of sales and our top three customers 17.5%.

With regard to geographic distribution, sales to customers in the Americas (US, Canada and Central & South America) represented 68% of our sales in fiscal 2005, while sales to customers in EMEA (Europe, Middle East and Africa) and Asia-Pacific accounted for 20% and 12% of sales, respectively. In 2004 and 2003, the sales split was 66% for the Americas, 18% for EMEA and 16% for Asia-Pacific.

SALES

We sell our telecom test and measurement solutions through direct and indirect sales channels in North America and around the world.

In North America, 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 representatives and distributors in US metropolitan areas and regional sales managers 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 supported by regional sales managers. Our main sales offices and service centers in North America are located in Addison, Texas, and Quebec City, Canada. They are supplemented by a regional presence in cities across the US and Canada.

On the international front, we have sales personnel covering strategic areas such as EMEA (Europe, Middle East and Africa), APAC (Asia-Pacific region) and Latin America. Our sales network in EMEA is supported by a main office and service center in Paris, France, which maintains our head of European sales operations and also provides repair and calibration services for our EMEA customers. We also have additional sales offices in multiple countries across EMEA to serve and support our various customers and distributors.

As for APAC, our main sales offices for South East Asia is located in Singapore, while our main office for mainland China is located in Beijing, China, which also acts as a service center to better serve our customer base

in the whole Asia-Pacific region. In addition, we have other sales offices in strategic locations around the world to support our network of distributors and various customers.

We rely on a network of more than 90 distributors worldwide to work with us in supporting mostly our international sales and to participate in a large number of our international events. We believe that the local presence and cultural attributes of our distributors allow us to better serve our global markets.

Our direct telecom sales team consists of a Vice-President of Global Sales supported by five regional sales Directors that are leading a widely distributed team of more than 55 people acting as key account managers, regional sales managers, sales engineers and application engineers. They are located throughout major metropolitan areas around the world. This group of sales professionals has on average more than 12 years of experience in the fields of telecommunications, fiber optics, or test and measurement. 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.

The main office for our Life Sciences and Industrial Division is located in Toronto, Canada. We use mixed sales channels to serve various markets supported by this division, depending on product line and geography. Optical light sources and related accessories used for industrial applications are sold in North America through a network of more than 10 manufacturer representatives and, internationally, through a network of more than 20 distributors. The X-Cite 120 Fluorescence Illumination System is sold through value-added reseller agreements with major microscope companies and system integrators in North America; negotiations are underway to extend these agreements worldwide. Nanopositioning products are sold directly to customers in North America, which includes the United States and Canada, and internationally through a network of technical distributors. To gain additional access to the nanopositioning life science research market in the United States and Canada, distributor agreements are in place with major microscope manufacturers, which include Leica, Nikon, Olympus and Zeiss. These companies often combine the sale of their microscopes with our product.

PRODUCT MANAGEMENT, MARKETING/COMMUNICATIONS AND CUSTOMER SUPPORT

PRODUCT MANAGEMENT

Our telecom Product Management Group consists of two Vice-Presidents - one responsible for our Optical product line and the other for our Protocol product line - as well as product managers who have various degrees in engineering, science and business administration. Product managers, under the direction of the respective Vice-Presidents, 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. Finally, strategic marketing specialists analyze our markets, compile competitive information and identify macro-trends in our sector.

Our Life Sciences and Industrial Group consists of a Director - responsible for both life sciences and precision assembly sectors - as well as product managers who have various degrees in engineering, science and business administration. Product managers, under the direction of the Director, are responsible for all aspects of their business line marketing programs including product strategy, new product introductions, definition of new features and functions, pricing, product launches and advertising campaigns.

MARKETING/COMMUNICATIONS

The Telecom Division's Marketing-Communications team, which consists mainly of project managers, marketing writers, translators and graphic artists, supports our Product Management Group by producing marketing and corporate documentation. Literature includes specification sheets, application notes, product catalogues, advertising copy and an electronic corporate newsletter. This Marketing-Communications team is also responsible for all sales tools required by our worldwide sales force and for updating the marketing contents of our website.

The Life Sciences & Industrial Division's Marketing-Communications team shares a variety of marketing initiatives. This group is assisted by product managers, who provide the technical data and collaborative support required to produce product specification sheets, catalogues, application notes and multimedia marketing tools. This Marketing-Communications team is also responsible for all advertising material, Website updates, events planning (including trade shows) and direct promotional marketing such as mass mailings and telemarketing. This team also provides the sales tools required by the Life Sciences and Industrial Division's worldwide sales channels, including maintaining our elite partner program.

CUSTOMER SUPPORT

Customer support is deemed a corporate mandate at EXFO. As such, our Customer Support Group handles requests from customers worldwide. Our Customer Support Department consists of three distinct units: Inside Sales, Technical Support and After-Sales Service.

Inside Sales is mainly responsible for guiding customers in purchasing the correct equipment for their respective applications, issuing quotations and promoting our Flexcare service program. In order to provide customers with one central point of contact, our service representatives work with the customer from purchasing equipment to helping them service the equipment, if necessary. These services are provided in English, French, Spanish and Chinese.

Within our Technical Support team, we have agents who provide troubleshooting support to our customers as well as trainers and installers who offer on-site servicing for more complex equipment.

To offer superior after-sales service worldwide, we have service centers based in North America, Europe and Asia. These service centers provide technical support, software upgrades, calibration and repairs for our customers.

MANUFACTURING

Our manufacturing operations consist mainly of material planning, procurement, sub-assembly, final assembly and test, software loading, calibration, quality assurance, shipping, billing and customs management. As of November 1, 2005, we had 250 employees involved in our manufacturing

operations. Most of our manufacturing activities, which occupy a total of approximately 61,300 square feet, are spread among four buildings in three cities.

Our Telecom Division occupies 50,000 square feet in Quebec City, Canada, spanning two sites, and 3,300 square feet in Montreal, Canada. These 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 and 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.

- PRODUCT ENGINEERING AND QUALITY. This department, which supports our production cells, acts like a gatekeeper to ensure the quality of our products and the effectiveness of our manufacturing processes. It is responsible for the transfer of products from research and development to manufacturing, product improvement, documentation, metrology, and the quality assurance and regulatory compliance process. Quality assurance 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 stringent industry requirements and our customers' performance requirements. Our quality assurance program has been certified ISO 9001/2000 at our two locations in Quebec City, Canada and our Montreal site received the same certification on November 16, 2005.

- 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 biggest portion of our cost of goods and will continue to grow as we rely more and more on outsourcing our manufacturing. Our performance is tightly linked to vendor performance, requiring greater emphasis on this critical aspect of our business.

Our Life Sciences and Industrial Division's manufacturing operations occupy 8,000 square feet in Toronto, Canada. This group manufactures light sources and related accessories, fluorescence illumination systems and precise positioning equipment for the life sciences and high-precision assembly markets. Operations consist of manufacturing, procurement, warehousing, quality control and document control managed by various elements of the ISO 9001 certified quality system. Recognizing the importance of reduced time-to-market for our solutions, we have focused efforts on designing products with an emphasis on standardization, modularity, as well as ease of fabrication and assembly. Following are key manufacturing responsibilities in Toronto:

MANUFACTURING - consists primarily of assembly and test capabilities where all major manufacturing elements are subcontracted to various key suppliers. These components are integrated into assemblies and tested in order

to ensure all operating specifications have been met for each product manufactured. Capacity and production planning are utilized on an ongoing

basis to ensure that adequate resources are available to meet forecasted and actual demand.

PROCUREMENT - activities are focused on developing key suppliers that are able to manufacture components to our specifications and ensuring the most competitive price has been attained. Supplier evaluation is the joint departmental effort of operations, engineering and the quality group.

WAREHOUSE/RECEIVING - in-coming inspection and warehousing of components used for product realization, along with shipping and custom transactions, are controlled in this area.

DOCUMENT CONTROL - configuration control on all released products is maintained by managing the system for engineering change.

QUALITY CONTROL - Receiving inspection, final product verification, control of non-conforming product, control of inspection, test and measurement equipment are control by in area.

COMPETITION

The telecommunications test and measurement industry is highly competitive and subject to rapid change as a result 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:

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

Generally, competitors fall into two categories. The first category consists of global test and measurement vendors, who complement their broad range of products with optical test and measurement equipment. These companies include Agilent Technologies, Inc., Ando Corporation, Anritsu Corporation, JDS Uniphase Corporation, Spirent plc and Tektronix, Inc.

The second category refers to niche companies in the test and measurement industry. These companies typically have limited product lines and in some cases may be geographically limited in their customer base. Such companies include Digital Lightwave, Inc., Ixia and Sunrise Telecom Incorporated.

Competition for our life sciences and industrial solutions is quite varied, depending upon product line. Competitors that sell light-based curing products include Hamamatsu, Ushio and Matsushita (Panasonic) in Asia, with Hamamatsu increasing its presence in North America. With regard to our X-Cite 120 Fluorescence Illumination System, main competitors consist of microscope manufacturers who have developed lamp housings for low-wattage mercury burners

in-house. Finally, our motion control Life Science instruments, which are designed for various life science applications, compete against products from companies like Sutter Instruments and Narishige.

REGULATORY ENVIRONMENT

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

In the United States, our products must comply with the regulations of several agencies of the U.S. federal government, including the Federal Communications Commission (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 electro magnetic compatibility (EMC) requirements to insure they do not generate and are immune from electrical noise which could possibly cause undesirable operation, as well as affect other surrounding devices. Depending upon the product, compliance with these rules may necessitate applying for and obtaining an FCC equipment authorization prior to importing into the United States, or marketing, any units of the relevant product. Additionally, some of our products must comply with the FDA's non-medical performance standards and related rules concerning light-emitting products, such as lasers. The FDA's regulations are intended to promote safety by limiting human exposure to harmful non-iodizing radiation. Similarly, our products must comply with safety standards adopted by OSHA.

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 by the Canadian Standards association as well as EMC requirements adopted by Industry Canada. Countries in the European Union require product compliance as dictated by an applicable directive, often referred to as CE marking. This includes testing to ensure compliance with harmonized European Norm (EN) standards for both product safety and EMC requirements. Other significant types of regulations not described in this annual report also may apply, depending upon the relevant product and country of destination.

In Europe, with the implementation of the WEEE directives for recycling of electronic products in selected European Countries (2002-96-CE), we have appointed a task force committee consisting of our management and employees, distributors and other partners as the case may be, to ensure full compliance with regulations and oversee the management, logistics, recycling rate, disposal services and activities related to recycling of electronic equipment and products within the member states.

INTELLECTUAL PROPERTY

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

confidentiality agreements.

We currently hold 32 from U.S., six from Canada, two from Germany, two from the United Kingdom, two from France, and one from China-issued patents and we have 15 from U.S., 14 from Canada, two from China, one from Germany and two Patent Cooperation Treaty patent applications pending. These issued and pending patents cover various aspects of our products and processes. The expiration dates of our issued patents range from April 19, 2011 to October 5, 2025.

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

- a method and apparatus for identification and characterization of multiple fibers using an OTDR. This invention targets fiber-to-the-home testing applications where a single technician needs to verify that the multiple fibers in a distribution cable are correctly identified and then measure their loss;

- the measurement of attenuation of optical fibers using bidirectional transmission of information via the fiber for which patents were granted in the United States and Canada. This invention forms the basis of our FOT-930 and FTB-3920 products;

- a method and apparatus for characterizing optical power levels in three-wavelength, bidirectional fiber-to-the-home systems. This invention describes how the optical power can be measured at the two-downstream and one upstream wavelengths used to connect a residence or business customer, while maintaining the signal continuity necessary to keep the home-based Optical Network Terminal operating. A PCT patent application has been filed and is in process. This invention forms the basis of the two-port version of our PPM-350B PON Power Meter.

- a method and apparatus to determine optical phase delay, which forms the basis of our new FTB-5800 product for the measurement of chromatic dispersion in field-installed optical fibers. A US patent has been granted, and applications have been submitted in Canada, Europe (pursuant to PCT), and China;

- an optical spectrum analyzer using optical fibers as input and output "slits". This invention forms the basis of our FTB-5240, FTB-5240B and IQ-5250 products. A US patent and a Chinese patent have been granted and applications are in process in the United States, Canada, and Europe (pursuant to PCT);

- the light-curing system with closed-loop control and work-piece recording which is at the heart of the spot-curing systems manufactured by EXFO Photonic Solutions and for which patents were granted in the United States and Canada;

- Intelli-lampTM patents used in the spot curing and fluorescence microscopy illumination systems optimize lamp performance in EXFO Photonic Solutions systems. Two patents have been granted in the US, and applications are pending in Canada and Germany.

- the portable test gear for TDM and packet-based communications for which patent applications have been filed in Canada, the United States and pursuant to the Patent Cooperation Treaty form the basis

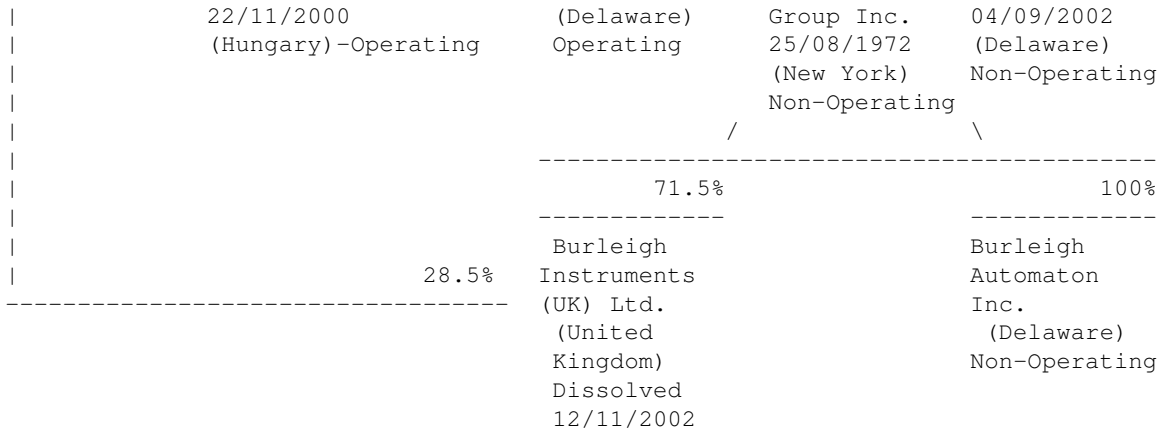
of the technology used by EXFO Protocol for a number of its protocol testing products.

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

C. ORGANIZATIONAL STRUCTURE

As of November 1, 2005, the following chart presents our corporate structure, the jurisdiction of incorporation of our subsidiaries and the percentage of shares that we hold in those subsidiaries.

[GRAPHIC OMITTED -- ORGANIZATIONAL CHART]



D. PROPERTY, PLANT AND EQUIPMENT

Our main offices and facilities are located in Quebec City, Canada where we now occupy two buildings. These buildings house our executive and administrative offices, research and development facilities and production facilities. We also have facilities in Montreal, Canada (formerly EXFO Protocol) and in Toronto, Canada (EXFO Photonic). EXFO Burleigh's facilities are located in Victor, New York and are presently for sale.

In addition, we maintain sales offices and/or have regional sales managers located in China, France, Germany, Great Britain, Italy, Japan, Singapore and the United States.

In September 2002, we obtained ownership of one of the buildings housing production facilities in Quebec City that was previously leased from a company controlled by EXFO's president and chief executive officer. In September 2003, due to down-sizing efforts, we were able to move all of our Quebec City activities into two buildings, rather than three. Though we no longer occupy the facilities at 465 Godin Avenue in Vanier, we remain bounded by the lease until November 30, 2006. However, on September 1, 2004, we were released from our obligations under the lease with a final payment of $194,000 (CA$250,000).

The following table sets forth information with respect to the main facilities that we occupy as of November 1, 2005.

LOCATION	USE OF SPACE	SQUARE FOOTAGE	TYPE
436 Nolin Street Vanier (Quebec)	Manufacturing of telecom products	44,164	
400 Godin Avenue Vanier (Quebec)	Research and Development, Manufacturing, Executive and Administrative	128,800	
2260 Argentia Road Mississauga (Ontario)	Partially occupied for Research and Development, Manufacturing of Life Science and Industrial products and	25,328	(1)

	Administrative	
2650 Marie-Curie St-Laurent (Quebec)	Research and Development, Manufacturing and Administrative	26,000
7647 Main Street Fishers Victor (New York)	Unoccupied	0 (2)

1) 10,672 square feet have been subleased to a third party. The total square footage leased is 36,000.

2) The total square footage owned is 40,000, is unoccupied and is presently for sale.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of the consolidated financial condition and results of operations of EXFO Electro-Optical Engineering Inc. for the fiscal years ended August 31, 2003, 2004 and 2005, should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this Annual Report. Our consolidated financial statements are reported in US dollars and have been prepared in accordance with generally accepted accounting principles in Canada, or Canadian GAAP. Significant differences in measurement and disclosure from generally accepted accounting principles in the United States, or U.S. GAAP, are set out in note 21 to our consolidated financial statements.

The following discussion and analysis of financial condition and results of operations is dated November 3, 2005.

INDUSTRY OVERVIEW

Leading telecom operators (telcos), mostly in the United States, accelerated fiber deployments deeper in their access networks during the last year because they are involved in a triple-play war (even quadruple-play with wireless telephony) against cable TV operators (cablecos) to offer consumers bundled voice, data and video services. This broadband war between telcos and cablecos contributed to an increase in wireline capital expenditures in 2005, especially in the United States.

Leading US telcos, along with a number of Tier-II and Tier-III players, opted for an assortment of deployment strategies, including fiber-to-the-node (FTTN), fiber-to-the-curb (FTTC), fiber-to-the-home (FTTH) or its equivalent fiber-to-the premises (FTTP), depending on the bets they placed in terms of how much bandwidth will be required to meet the challenge from the cablecos. These deployments, which fall under the generic FTTx name, are not as prevalent in Europe and Asia. However, test trials are underway in these regions as a means to increase revenues by delivering video services to undercut competition. Note that Japan and Korea already have FTTx deployment programs, aimed at delivering 100 Mb/s to every home, well underway.

As the demand for broadband services increases worldwide, voice, data

and video are becoming mere applications on converged, IP-based networks. Telcos around the world are migrating from public switched telephone networks (PSTN) to packet-based, IP networks in order to achieve substantial reductions in operating expenses and increased profitability. British Telecom Group, for example, announced it will spend (British Pound)10 billion over five years on its 21st Century Network to reduce operating expenses by up to (British Pound) 1.0 billion per year through a single network carrying voice, data and video signals.

Legacy SONET/SDH networks were designed in the late 1970s to carry voice traffic. Their efficiency however can often times drop to as low as 30% when combining voice, data and video services. Next-generation networks, such as those announced by British Telecom, represent a major technological improvement, since they can deliver triple-play services at near 100% efficiency, regardless of the payload content, while significantly reducing the cost of operating and maintaining networks.

These key market trends affected multiple segments of the global telecommunications supply chain in 2005. System manufacturers benefited from orders by both telcos and cablecos for next-generation, converged IP networks as well as from major investments by telcos in access networks. Component vendors saw incremental demand for optical components that support FTTx and IP-based systems. Some test and measurement equipment vendors attracted the attention of telcos, cablecos, system manufacturers and component vendors, especially ones offering test solutions for IP optical networking and/or FTTx applications.

COMPANY OVERVIEW

EXFO is a recognized expert in the global telecommunications industry through the design and manufacture of advanced and innovative test and measurement solutions. The Telecom Division, which represents our main business activity, offers a complete range of dedicated and integrated test solutions to network service providers (NSPs), cable operators, system vendors and component manufacturers in approximately 70 countries. One of our strong competitive advantages is our modular test platforms design, based on a PC/Windows-centric architecture, which offers a series of test modules that maximize technology reuse across multiple market segments at minimal redesign cost. The Life Sciences and Industrial Division, formerly called Photonics and Life Sciences Division, mainly leverages core telecom technologies to offer value-added solutions for life sciences applications and high-precision assembly processes, such as those required for microelectronics and optoelectronics.

This year marked EXFO's 20th anniversary, as the company was founded in 1985 in Quebec City, Canada. Our original products were focused on the needs of installers and operators of fiber-optic networks. Customers use these field-portable testing products for the installation, maintenance, monitoring and troubleshooting of optical networks. In 1996, we supplemented our product portfolio with an extensive line of high-end products that are mainly dedicated to research and development as well as manufacturing activities of optical component manufacturers and system vendors.

In the last four years, we have enhanced our competitive position through the acquisition of two protocol test businesses in order to expand our product offering and address our customers' requirements more completely. In November 2001, we acquired Avantas Networks Corporation (renamed EXFO Protocol Inc.), a supplier of protocol-testing and optical-network performance

management equipment for NSPs. This transaction was highly strategic because it enabled us to combine optical and protocol test modules inside a single field-portable test platform to help our customers increase revenues and reduce operating costs. In October 2002, our wholly-owned subsidiary, EXFO Gnubi, purchased substantially all the assets of GNUBI COMMUNICATIONS, L.P., a supplier of multi-channel telecom and datacom testing solutions for the system manufacturer market. These strategic acquisitions, which were consolidated in Montreal in fiscal 2004, enabled us to more than double our addressable market, as we expanded from optical testing to protocol testing applications, and to offer a more complete line of test solutions to our customers.

Previously, we had completed two acquisitions to bolster growth in the optical component manufacturing market. We acquired Burleigh Instruments, Inc. (renamed EXFO Burleigh Products Group Inc.) in December 2000 for its wavelength measurement instruments and nanopositioning alignment systems. We also added EFOS Inc. (renamed EXFO Photonic Solutions Inc.) in March 2001 for its precision light-based, adhesive spot-curing technology. We have since exited the optical component manufacturing automation business.

In fiscal 2005, we launched 15 new products, including a next-generation SONET/SDH analyzer for characterizing converged, IP-based networks; a 10 Gigabit Ethernet (GigE) test solution to assess quality of service in core and metro networks; a new software suite for remote Ethernet testing and commissioning applications; an all-band component analyzer for FTTx and coarse wavelength-division multiplexing (CWDM) applications in the manufacturing/R&D market; a series of three handheld test instruments for the installation and maintenance market; and an optical spectrum analyzer (OSA) for CWDM applications in metro and access networks. In addition, we formed an alliance with ADC Telecom to provide a unique remote Ethernet test solution for first-mile applications.

In 2005, we also consolidated our leadership position in the FTTx test market by recognizing significant revenue from two leading U.S. carriers deploying fiber in their access networks. Our top customer accounted for 23.3% of sales in 2005. Subsequent to the year-end, we were supplier for all fiber deployment test applications by Deutsche Telecom AG - including FTTx.

We recorded a foreign exchange loss of $1.3 million in fiscal 2005 due to the significant increase in the value of the Canadian dollar versus the US dollar during that year. In addition to this foreign exchange loss, our P&L (profits and losses) line items in 2005 were also negatively affected by the appreciation of the Canadian dollar, since a significant portion of our expenses are incurred in Canadian dollars while we report our results in US dollars.

In the third quarter of fiscal 2005, EXFO was named recipient of the 2005 Growth Strategy Leadership Award by Frost & Sullivan, a leading market research firm in the telecommunications test sector. The award is presented annually to the company whose visionary growth strategy generates the largest market-share gains in the global fiber-optic test equipment market in the previous year. Based on a report by Frost & Sullivan, we increased our market share from 8.4% in fiscal 2003 to 10.3% in 2004. This marked the second consecutive year that we earned this industry award.

Finally, during fiscal 2005, we completed the consolidation of our Life Sciences and Industrial Division in Toronto and we recorded $482,000 in restructuring expenses. Altogether, we incurred $2.5 million in restructuring and other charges since the fourth quarter of 2004 in conjunction with this consolidation process.

SALES

We sell our products to a diversified customer base in approximately 70 countries through our direct sales force and, indirectly, through distribution channels. Most of our sales are denominated in US dollars and Euros.

Historically, it has been very unusual to have any customer account for more than 10% of our sales. However, in both fiscal 2004 and 2005, we had one customer that accounted for 13.8% and 23.3% of our sales, respectively. In fiscal 2005, our top three customers accounted for 28.4%, compared to 20.8% in 2004. We believe the sales concentration in fiscal 2005 is largely due to our leadership position in the FTTx test market, as a large portion of our sales to our top customer was for a series of products related to FTTx deployment. We expect this sales concentration to decrease in fiscal 2006, as we continue efforts to diversify our customer base.

Despite the fact that we had one customer that accounted for a substantial part of our sales in fiscal 2005, we believe that we have a vast array of products and a diversified customer base, both in terms of industry sector and geographical area, which provides us with reasonable protection against concentration of sales and credit risk.

COST OF SALES

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

OPERATING EXPENSES

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

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

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

Operating charges related to our restructuring plans have been recorded as a separate component of operating expenses. These charges consist primarily of severance expenses, costs to exit leased facilities as well as write-offs of long-lived assets.

OUR STRATEGY

STRATEGIC OBJECTIVES FOR FISCAL 2005

In our fiscal 2004 Annual Report, we had established three strategic objectives for fiscal 2005. We planned to increase sales through market-share gains, maximize profitability and focus on innovation. The following section reviews our strategic objectives for fiscal 2005 and the results achieved for each of these objectives.

INCREASE SALES THROUGH MARKET-SHARE GAINS

In fiscal 2005, we focused on continued market-share gains to achieve growth. We posted our second-best sales performance in history, growing sales 30.3% to $97.2 million in fiscal 2005, compared to a stated goal of 20%. Considering that the telecommunications market slightly improved in fiscal 2005, this is a clear indication that we gained market share overall. For

fiscal 2005, our Telecom Division and our Life Sciences and Industrial Division reported sales increases of 36.1% and 8.6%, respectively.

MAXIMIZE PROFITABILITY

Returning to profitability remains a top priority at EXFO. In fiscal 2005, we substantially reduced our loss from operations from $10.6 million in fiscal 2004 to $199,000 in 2005. The loss from operations incurred in fiscal 2005 includes restructuring and other charges of $292,000, recorded in conjunction with the consolidation of the operations of our Life Sciences and Industrial Division and stock-based compensation costs of $963,000.

FOCUS ON INNOVATION

In fiscal 2005, innovation was a key driver at EXFO. We maintained a significant level of research and development investments and introduced 15 new products to the marketplace. We invested $15.9 million in gross research and development expenses, an amount similar to 2004. In fiscal 2005, 42.4% of our sales originated from products that have been on the market for two years or less, which is slightly below our stated goal of 45% for fiscal 2005. While we slightly missed our target, this represents a significant improvement over the prior year (31.7%), thanks to the 20 new products brought to the marketplace in fiscal 2004 - several of which were released in the second half of the fiscal year - and the 15 new ones launched in fiscal 2005.

STRATEGIC OBJECTIVES FOR FISCAL 2006

For fiscal 2006, we believe general market conditions will moderately improve as carriers around the world will intensify triple-play investments in an effort to bolster revenues and/or provide a defensive/offensive measure in the telcos vs. cablecos battle to deliver video, data and voice services to residential and business customers. This ongoing trend will prompt increased capital expenditures (CAPEX) mainly in the access network market, likely over several years to come. On a more global basis, the migration of these services onto a single, IP-based network to reduce operating expenditures will instigate increased CAPEX in the network core. On the strength of our market-driven R&D program, we are well-positioned for these latest industry trends.

As one might expect, our strategic directions, and therefore our key performance indicators, will not be radically different from those of 2005. Since we are highly focused on creating value for our shareholders, providing

the highest degree of profitable growth is at the heart of our actions. We intend to maintain our long-term focus on profitable growth by increasing sales through further market-share gains; maximize profitability through proper execution and efficiency of our cost-reduction programs; and focus on innovation to positively position the organization for the long-term growth opportunities that exist in our space.

INCREASE SALES THROUGH MARKET-SHARE GAINS

In fiscal 2006, we will continue focusing on market-share gains and growing faster than our end markets. In fiscal 2005, our 30.3% sales growth in a slightly increasing market condition clearly indicated that we gained market share. As mentioned earlier, EXFO was named recipient of the 2005 Growth Strategy Leadership Award by Frost & Sullivan.The award is presented annually to the company whose visionary growth strategy generates the largest market-share gains in the global fiber-optic test equipment market in the previous year. Based on Frost & Sullivan, we increased our market share from 8.4% in fiscal 2003 to 10.3% in 2004. For fiscal 2006, we intend once again to

grow sales faster than the market by leveraging our sustained R&D investments in areas such as next-generation Internet protocol (IP) and FTTx testing, by intensifying our sales and marketing efforts, both domestic and international, as well as by strengthening and expanding our business relationships with major accounts.

MAXIMIZE PROFITABILITY

Profitability remains a top priority and we expect that sales growth combined with a strong focus on operations will increase our earnings from operations in fiscal 2006, assuming no acquisition.

FOCUS ON INNOVATION

In fiscal 2006, innovation will continue to be a major growth vehicle for us, as it significantly drives not only revenue and profitability but also allows us to better position ourselves in the long term. We remain convinced that our commitment to innovation will pay off in the long term and support our growth and profitability targets as demonstrated during the last fiscal year. We have maintained a significant level of R&D investment since the telecom peak in 2001 and brought 15 new products to the marketplace in fiscal 2005. Now that our net R&D investments as a percentage of sales are right in line with our long-term model, we intend, for fiscal 2006 and beyond, to increase our investment in R&D activities in proportion to our sales growth. Our numerous but focused R&D initiatives should enable our new products to continue gaining traction with customers and lead to further growth, market-share gains and increased profitability in the coming years.

KEY PERFORMANCE INDICATORS

As measures to assess the realization of our strategic plan and its objectives, we have set out three consolidated key performance indicators for fiscal 2006. They are summarized as follows:

STRATEGIC OBJECTIVES FOR FISCAL 2006	KEY PERFORMANCE INDICATORS FOR FISCAL 2006

Increase sales through market-share gains	15% sales growth year-over-year
Maximize profitability	5% in earnings from operations
Focus on innovation	40% of sales from new products (on the market two years or less)

CAPABILITY TO DELIVER RESULTS

At EXFO, we believe that we have the capabilities to deliver expected results thanks to outstanding products, an excellent reputation in the marketplace, a sound financial position, as well as an experienced workforce and management team.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

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

For products in which software is not incidental, revenues are separated into two categories: product and post-contract customer support (PCS) revenues, based upon vendor-specific objective evidence of fair value. Product revenues for these sales are recognized as described above. PCS revenues are deferred and recognized ratably over the years of the support arrangement. PCS revenues are recognized at the time the product is delivered when provided within one year of delivery; the costs of providing this support

are insignificant (and accrued at the time of delivery) and no software upgrades are provided.

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

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

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

Most sales arrangements do not generally include acceptance clauses. However, if a sales arrangement does include an acceptance provision, acceptance occurs upon the earliest of the receipt of a written customer acceptance or the expiration of the acceptance period. For these sales arrangements, the sale is recognized when acceptance occurs.

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

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

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

RESEARCH AND DEVELOPMENT TAX CREDITS AND GOVERNMENT GRANTS. We record research and development tax credits and government grants based on our interpretation of tax laws and grant programs, especially regarding related eligible projects and expenses, and when there is reasonable assurance that we have complied and will continue to comply with all conditions and laws. Also, our judgment and estimates are based on historical experience. It is possible, however, that the tax authorities or the sponsors of the grant programs have a different interpretation of laws and application of conditions related to the programs or that we do not comply with all conditions related to grants in the future, which could adversely affect our future results. Furthermore, a significant part of our tax credits are refundable against income taxes payable, causing their ultimate realization to be dependent upon the generation of taxable income. If we obtain information that causes our

forecast of future taxable income to change or if actual taxable income differs from our forecast, we may have to revise the carrying value of these tax credits, which would affect our results in the period in which the change was made. We review the recoverability of such tax credits on a quarterly basis.

IMPAIRMENT OF LONG-LIVED ASSETS AND GOODWILL. We assess impairment of goodwill on an annual basis, or more frequently, if events or circumstances indicate that it might be impaired. Recoverability of goodwill is determined at the reporting unit level using a two-step approach. First, the carrying value of a reporting unit is compared to its fair value, which is determined based on a combination of discounted future cash flows and a market approach. If the carrying value of a reporting unit exceeds its fair value, the second step is performed. In this step, the amount of impairment loss, if any, represents the excess of the carrying value of goodwill over its fair value and the loss is charged to earnings in the period in which it is incurred. For the purposes of this impairment test, the fair value of goodwill is estimated in the same way as goodwill is determined in business combinations; that is, the excess of the fair value of a reporting unit over the estimated fair value of its net identifiable assets.

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

FUTURE INCOME TAXES. We account for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement values and tax values of assets and liabilities, using enacted income tax rates for the years in which the differences are expected to reverse. In assessing the recoverability of our future income tax assets, we consider whether it is more likely than not that some or all of the future income tax assets will not be realized. The ultimate realization of our future income tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences will become deductible. As at August 31, 2005, we had established a full valuation allowance against our future income tax assets. The valuation allowance will be reversed once management will have concluded that realization of future income tax assets is more likely than not.

STOCK-BASED COMPENSATION COSTS. Since September 1, 2003, we account for all forms of employee stock-based compensation using the fair value-based method. This method requires that we make estimates about the risk-free interest rate, the expected volatility of our shares and the expected life of the awards.

On September 1, 2004, we prospectively adopted the following new Canadian Institute of Chartered Accountants (CICA) handbook sections:

- Section 1100, "Generally Accepted Accounting Principles"
- Section 1400, "General Standards of Financial Statement Presentation"

Furthermore, in January 2005, the CICA issued four new accounting standards in relation to financial instruments: Section 3855, "Financial Instruments - Recognition and measurement"; Section 3865, "Hedges"; Section

1530, "Comprehensive Income"; and Section 3251, "Equity". These new standards apply to fiscal years beginning on or after October 1, 2006, and we will adopt them on September 1, 2007.

Please refer to note 2 to our consolidated financial statements included elsewhere in this Annual Report for further information about these new standards and their impact on our financial statements.

RESULTS OF OPERATIONS

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

CONSOLIDATED STATEMENTS OF EARNINGS DATA:	2005	2004	2003	2005
Sales	$ 97,216	$ 74,630	$ 61,930	100.0%
Cost of sales (1)	44,059	34,556	36,197	45.3
Gross margin	53,157	40,074	25,733	54.7
Operating expenses				
Selling and administrative	31,782	25,890	26,991	32.7
Net research and development	12,190	12,390	15,879	12.5
Amortization of property, plant and equipment	4,256	4,935	5,210	4.4
Amortization of intangible assets	4,836	5,080	5,676	5.0
Impairment of long-lived assets and goodwill	--	620	7,427	--
Restructuring and other charges	292	1,729	4,134	0.3
Total operating expenses	53,356	50,644	65,317	54.9
Loss from operations	(199)	(10,570)	(39,584)	(0.2)
Interest and other income	2,524	1,438	1,245	2.6
Foreign exchange loss	(1,336)	(278)	(1,552)	(1.4)
Earnings (loss) before income taxes	989	(9,410)	(39,891)	1.0
Income taxes	2,623	(986)	15,059	2.7
Net loss for the year	$ (1,634)	$ (8,424)	$ (54,950)	(1.7)%
Basic and diluted net loss per share	$ (0.02)	$ (0.13)	$ (0.87)	

Segment information				
Sales:				
Telecom Division	$ 80,120	$ 58,882	$ 48,753	82.4%
Life Sciences and Industrial Division	17,096	15,748	13,177	17.6%
	$ 97,216	$ 74,630	$ 61,930	100.0%
Operating earnings (loss): (2)				
Telecom Division	$ 763	$ (5,557)	$ --	0.8%
Life Sciences and Industrial Division	(962)	(5,013)	--	(1.0)
	$ (199)	$ (10,570)	$ --	(0.2)%
Research and development data:				
Gross research and development	$ 15,878	$ 15,668	$ 17,133	16.3%
Net research and development	$ 12,190	$ 12,390	$ 15,879	12.5%
CONSOLIDATED BALANCE SHEETS DATA:				
Total assets	$ 190,957	$ 172,791	$ 146,254	

(1) The cost of sales is exclusive of amortization, shown separately. Including inventory write-
an unusual gain of $473,000 for the year ended August 31, 2003.
(2) Comparative information for fiscal 2003 for the loss from operations is not available and
determine.

SALES

FISCAL 2005 VS. 2004

In fiscal 2005, our global sales increased 30.3% to $97.2 million from $74.6 million in 2004, with an 82%-18% split in favor of our Telecom Division.

TELECOM DIVISION

In fiscal 2005, sales of our Telecom Division increased 36.1% to $80.1 million from $58.9 million in 2004. Since the second half of fiscal 2004, we have benefited from an increased demand for our test solutions following the deployment of fiber deeper into access networks (FTTx). In fiscal 2005, we consolidated our leadership position in the FTTx test market by recognizing significant revenue from two leading U.S. carriers deploying fiber in their access networks. Our largest customer, who purchased several orders of FTTx test equipment, accounted for 28.2% of telecom sales in fiscal 2005 (17.5% in 2004). In addition, the positive spending environment helped us increase our sales in 2005.

Although sales of our protocol test products increased sequentially each quarter in fiscal 2005 and reached more than 10% of Telecom revenues in the fourth quarter of 2005, they still fell below 10% for the whole fiscal year. Our penetration of the protocol test market has been modest since, in 2003, we refocused our efforts onto next-generation solutions, which are at the basis of the whole trend toward IP convergence. We expect that protocol

sales will equal optical sales on a medium- to long-term basis given that the protocol test market is more than double the size of the optical test market, our rich product pipeline in protocol testing, and increasing customer traction. We remain confident that the solid product portfolio we are building for this crucial end-market will lead to long-term growth for EXFO.

LIFE SCIENCES AND INDUSTRIAL DIVISION

In fiscal 2005, sales of our Life Sciences and Industrial Division increased 8.6% to $17.1 million from $15.7 million in 2004. The increase in sales in fiscal 2005, compared to 2004, is mainly due to market-share gains in the fluorescence illumination market as well as increased sales activities in the curing market.

Overall, for the two divisions, net accepted orders increased 35.6% to $101.7 million in fiscal 2005 from $75.0 million in 2004. Our net book-to-bill ratio rose to 1.05 in fiscal 2005, from 1.00 in 2004. The increased demand for our test solutions for FTTx applications, market-share gains in the telecommunications and life sciences markets as well as the slight improvement in the telecommunications market environment helped us increase our bookings year-over-year.

For the upcoming quarters, we expect the sales split between the two divisions to remain in the same range as for fiscal 2005.

FISCAL 2004 VS. 2003

In fiscal 2004, our global sales increased 20.5% to $74.6 million from $61.9 million in 2003, with a 79%-21% split in favor of our Telecom Division.

TELECOM DIVISION

In fiscal 2004, sales of our Telecom Division increased 20.8% to $58.9 million from $48.8 million in 2003. In 2004, despite a relatively stable carrier spending environment compared to the previous year, we continued to gain market share, which helped us increase our sales year-over-year. We believe these market-share gains are mainly attributable to our optical field-testing products, which represent our traditional core business, since sales of our protocol-layer test solutions represented just over 10% of our Telecom sales in fiscal 2004. In addition, we benefited from a slight recovery in the telecom system and optical manufacturing markets. Finally, revenues from FTTx test solutions were higher than expected, especially with a leading U.S. carrier, which contributed to our sales increase.

LIFE SCIENCES AND INDUSTRIAL DIVISION

In fiscal 2004, sales of our Life Sciences and Industrial Division increased 19.5% to $15.7 million from $13.2 million in 2003. The increase in sales is due to the greater demand for our high-precision assembly solutions.

GEOGRAPHIC DISTRIBUTION

During fiscal 2005, sales to the Americas, Europe-Middle East-Africa (EMEA) and Asia-Pacific (APAC) accounted for 68%, 20% and 12% of global sales, respectively. Our sales to the Americas, which increased 34% year-over-year, benefited from the recent deployments of fiber deeper in access networks (mainly in the United States). Our sales to EMEA increased more significantly (42%) year-over-year, mainly due to market-share gains in both divisions,

following our efforts to develop this important end-market. Finally, our sales to APAC remained flat in dollars year-over-year. A significant portion of our sales to this region of the world are made through price-driven tenders that may vary in number and importance from quarter to quarter. Also, the competitive landscape in this market led to pricing pressure, which prevented us from increasing our sales year-over-year.

The geographic distribution of our sales remained unchanged as a percentage of sales in fiscal 2004, compared to 2003, since all geographic areas had the same growth level. Sales to Americas, EMEA and APAC accounted for 66%, 18% and 16% of global sales, respectively, for both fiscal years.

Through our two divisions, we sell our products to a broad range of customers, including network service providers, cable operators, optical system and component manufacturers, as well as customers in the life sciences and high-precison assembly sectors. In fiscal 2004 and 2005, one customer represented more than 10% of our sales with 13.8% of sales ($10.3 million) in fiscal 2004 and 23.3% of sales ($22.6 million) in 2005. During 2003, no customer accounted for more than 10% of our sales. In fiscal 2005, our top three customers accounted for 28.4% of sales, compared to 20.8% in 2004.

GROSS MARGIN

Gross margin amounted to 54.7%, 53.7% and 41.6% of sales for fiscal 2005, 2004 and 2003, respectively.

FISCAL 2005 VS. 2004

The increase in our gross margin in fiscal 2005, compared to 2004, can be explained by the following factors. First, we were able to reduce our cost of goods sold by better leveraging our supplier base and by developing innovative new products with a cost-effective design. Also, the significant rise in sales (30.3% year-over-year) resulted in an increase in manufacturing activities, allowing us to better absorb our fixed manufacturing costs. Furthermore, streamlined operations following our consolidation actions in fiscal 2004 and 2005 and cost-reduction programs allowed us to further improve our gross margin. In addition, the shift in the geographic distribution of our sales resulted in more sales made to the Americas market, where gross margins tend to be higher because we sell direct to the customers. However, a stronger Canadian dollar, compared to the US dollar, prevented us, to some extent, from further improving our gross margin as some cost of sales elements are denominated in Canadian dollars. As well, the different customer mix and aggressive pricing pressure observed in fiscal 2005 also prevented us from further improving our gross margin.

Over the past months, we adjusted the design of some of our products and we experienced higher sales than expected. Consequently, we were able to reuse excess inventories that were written off during the telecom downturn for approximately $1.6 million in fiscal 2005, or 1.7% of sales, compared to approximately $600,000 or 0.8% of sales in 2004. Inventory write-offs recorded during the telecom downturn were based on management best estimate at that time.

FISCAL 2004 VS. 2003

The increase in our gross margin in fiscal 2004, compared to 2003, can be explained by several factors. First, the rise in sales (20.5%

year-over-year) helped increase our gross margin. Increased manufacturing activities allowed us to better absorb our fixed manufacturing costs. In addition, our cost-reduction measures, the consolidation of manufacturing sites and our enhanced efficiency further contributed to the increase in gross margin. However, a stronger Canadian dollar, compared to the US dollar year-over-year, prevented us, to some extent, from further improving our gross margin as some cost of sales elements are denominated in Canadian dollars. Finally, the gross margin recorded in fiscal 2003 included a charge of $4.1 million, or 6.7% of sales, for excess and obsolete inventories and an unusual gain of $473,000, or 0.7% of sales.

OUTLOOK FOR FISCAL 2006

Considering the expected sales growth in 2006, the effect of our recent consolidation actions, the cost-effective design of our products and our tight control on operating costs, we expect our gross margin to improve in fiscal 2006. However, our gross margin may fluctuate quarter-over-quarter as our sales may fluctuate. Furthermore, our gross margin can be negatively affected by increased competitive pricing pressure, increased obsolescence costs, shifts in product mix, under-absorption of fixed manufacturing costs and increases in product offerings by other suppliers in our industry. Finally, a potential increase in the strength of the Canadian dollar would have a negative impact on our gross margin in 2006.

SELLING AND ADMINISTRATIVE

Selling and administrative expenses were $31.8 million, $25.9 million and $27.0 million for fiscal 2005, 2004 and 2003, respectively.

As a percentage of sales, selling and administrative expenses amounted to 32.7%, 34.7% and 43.6% for fiscal 2005, 2004 and 2003, respectively.

FISCAL 2005 VS. 2004

The increase in our selling and administrative expenses in dollars in fiscal 2005, compared to 2004, is mainly due to our decision to significantly increase our sales activities to better leverage the significant R&D investments of the prior years which resulted in highest sales and marketing expenditures (including head-counts). In addition, our significant increase in revenues allowed us to reduce our selling and administrative expenses on a percentage basis. In addition, our commission expenses increased year-over-year, especially due to the increase in sales to the Americas market; which resulted in higher sales and marketing expenditures (including head-counts). Furthermore, a stronger Canadian dollar, compared to the US dollar year-over-year, as more than half of these are incurred in Canadian dollars. Also, stock-based compensation costs were higher in fiscal 2005 ($626,000) than in 2004 ($265,000), further increasing our selling and administrative expenses year-over-year. Finally, costs to comply with Section 404 of the Sarbanes-Oxley Act of 2002 further increased our SG&A (selling and administrative) year-over-year. However, we were able to mitigate the increase in our selling and administrative expenses as well as reduce these expenses in percentage of sales year-over-year due to tight cost-control measures and the consolidation of our Life Sciences and industrial Division. In addition, our significant increase in revenues allowed us to reduce our selling and administrative expenses on a percentage basis.

FISCAL 2004 VS. 2003

In fiscal 2004, thanks to our restructuring actions and tight cost-control measures, we were able to reduce our selling and administrative expenses by 4% year-over-year, while our sales increased 20.5% in that same period. However, several factors prevented us from further reducing these expenses year-over-year. A higher sales volume in fiscal 2004, compared to 2003, caused our commission and marketing expenses to increase. In addition, since September 1, 2003, we account for stock-based compensation costs related to awards granted to our employees, which caused our selling and administrative expenses to increase year-over-year. Furthermore, in fiscal 2003, we recorded an unusual gain of $239,000 related to a grant recovery. Finally, a stronger Canadian dollar, compared to the US dollar year-over-year, further increased our selling and administrative expenses, as more than half of these are incurred in Canadian dollars.

OUTLOOK FOR FISCAL 2006

For fiscal 2006, we expect our selling and administrative expenses to increase in dollars and remain relatively stable as a percentage of sales. In particular, we expect our commission expenses to increase as sales volume increases. Also, considering our goal of becoming the leading player in the telecom test and measurement space, we will intensify our sales and marketing efforts, both domestic and international, which will also cause our expenses to rise. Finally, a potential increase in the strength of the Canadian dollar would also cause our selling and administrative expenses to increase.

RESEARCH AND DEVELOPMENT

GROSS RESEARCH AND DEVELOPMENT EXPENSES

Gross research and development expenses totaled $15.9 million, $15.7 million and $17.1 million for fiscal 2005, 2004 and 2003, respectively. As a percentage of sales, gross research and development expenses amounted to 16.3%, 21.0% and 27.7% for fiscal 2005, 2004 and 2003, respectively, while net research and development expenses accounted for 12.5%, 16.6% and 25.6% for these respective periods.

FISCAL 2005 VS. 2004

We incurred most of our gross research and development expenses in Canadian dollars as we have consolidated most of our research and development activities in Canada. Consequently, the significant increase in the strength of the Canadian dollar, compared to the US dollar year-over-year, caused our gross research and development expenses to increase in fiscal 2005, compared to 2004. However, this increase was mostly offset by the decrease in our gross research and development expenses in our Life Sciences and Industrial Division following the consolidation of this Division in Toronto. The decrease in our gross research and development expenses as a percentage of sales in fiscal 2005 compared to 2004, is directly attributable to the significant increase in sales year-over-year while these expenses remained relatively flat.

FISCAL 2004 VS. 2003

The decrease in our gross research and development expenses in fiscal 2004, compared to 2003, both in dollars and as percentage of sales, can be explained by several factors. First, our restructuring actions, the consolidation of our protocol operations in Montreal, as well as tight cost-control measures, contributed to the reduction of our gross research and development expenses year-over-year. In addition, before the end of the year,

we refocused the research and development activities of our Life Sciences and Industrial Division. Finally, mix and timing of our research and development projects, especially in our Telecom Division, caused our gross research and development expenses to decrease year-over-year. On the other hand, a stronger Canadian dollar, compared to the US dollar year-over-year, increased our gross research and development expenses, as most of these are incurred in Canadian dollars.

TAX CREDITS AND GRANTS

Tax credits and grants from the Canadian federal and provincial governments for research and development activities were $3.7 million, $3.3 million and $3.6 million for fiscal 2005, 2004 and 2003, respectively.

FISCAL 2005 VS. 2004

The increase in our tax credits in fiscal 2005, compared to 2004, is mainly related to the increase in our eligible gross research and development expenses in Canada, since we were entitled to similar grant programs and tax credits year-over-year. Following the consolidation of our research and development activities in Canada, we incurred most of our research and development expenses in Canada, where we are entitled to research and development tax credits.

FISCAL 2004 VS. 2003

The decrease in our tax credits and grants in fiscal 2004, compared to 2003, is mainly related to the decrease in our eligible gross research and development expenses incurred in Canada, since we were entitled to similar tax credits year-over-year.

We still invested significantly in research and development activities in fiscal 2005 as we firmly believe that innovation and new product introductions are key in gaining market share in the current economic environment and ensuring the long-term growth and profitability of the company.

OUTLOOK FOR FISCAL 2006

For fiscal 2006, we expect to increase our gross research and development expenses in proportion to our revenues, as a reflection of our focus on innovation, our desire to gain market share and our goal to exceed customer needs and expectations. Also, a potential increase in the strength of the Canadian dollar would cause our net research and development expenses to increase, as most of these are incurred in Canadian dollars.

AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT

For fiscal 2005, amortization of property, plant and equipment was $4.3 million, compared to $4.9 million in 2004 and $5.2 million in 2003. The decrease in amortization expenses in fiscal 2005, compared to 2004, despite the significant increase in the strength of the Canadian dollar compared to the US dollar, is mainly due to the fact that some of our property, plant and equipment became fully amortized during fiscal 2004.

OUTLOOK FOR FISCAL 2006

For fiscal 2006, despite a potential increase in the strength of the Canadian dollar, we expect the amortization of property, plant and equipment

to decrease compared to 2005 considering that some of these assets became fully amortized in 2005 or will become fully amortized in 2006.

AMORTIZATION OF INTANGIBLE ASSETS

In conjunction with the business combinations we completed over the past few years, we recorded intangible assets, primarily consisting of core technology. These intangible assets resulted in amortization expenses of $4.8 million, $5.1 million and $5.7 million for fiscal 2005, 2004 and 2003, respectively. The decrease in amortization expenses in fiscal 2005, compared to 2004, is mainly due to the fact that some of our core technologies became fully amortized during fiscal 2005.

The decrease in amortization expenses in fiscal 2004, compared to 2003, is the result of the $2.9 million impairment charge recorded in the third quarter of fiscal 2003.

OUTLOOK FOR FISCAL 2006

For fiscal 2006, we expect the amortization of intangible assets to approximate $3.3 million, assuming no acquisitions are made during this period.

IMPAIRMENT OF LONG-LIVED ASSETS AND GOODWILL

FISCAL 2003

In May 2003, we performed our annual impairment test of goodwill for all our reporting units, except for newly acquired EXFO Gnubi. Also, considering market conditions in the telecommunications industry and the persisting unfavorable conditions affecting our subsidiaries' industries at that time, we reviewed the carrying value of intangible assets related to these reporting units, consisting primarily of acquired core technology.

As a result of this assessment, we concluded that the carrying value of goodwill related to EXFO Burleigh and the carrying value of intangible assets related to EXFO Burleigh and EXFO Photonic Solutions were impaired, and we recorded an impairment charge of $4.5 million to write down goodwill and a pre-tax impairment charge of $2.9 million to write down acquired core technology. Of the total impairment charge of $7.4 million, $6.9 million was related to EXFO Burleigh for goodwill and acquired core technology and $555,000 was related to EXFO Photonic Solutions for acquired core technology.

The write-down of goodwill and acquired core technology of EXFO Burleigh was required, considering that we exited the optical component manufacturing automation business, whose revenue potential represented a long-term prospect. The write-down of acquired core technology from EXFO Photonic Solutions was required because revenue potential related to this long-lived asset was less than expected in the short and medium term due to the state of the market at the time.

However, no impairment of goodwill and intangible assets was required for EXFO Protocol since we believed that revenue potential from the protocol-layer testing market would remain strong in the short and medium term.

For the purposes of estimating fair value, we used a combination of discounted future cash flows and a market approach (sales multiples). The discounted future cash flows were estimated using periods ranging between

eight and ten years, discount rates ranging between 15% and 20%, and an annual growth rate ranging between nil and 35%. The sales multiples used in the market approach ranged between 0.7 and 2.3. The assumptions used reflected our best estimates.

FISCAL 2004 AND 2005

In fiscal 2004, we put one of our buildings located in Quebec City up for sale and received, at the beginning of fiscal 2005, a formal purchase offer for this building. Based on that offer, we concluded that the building was impaired and we recorded an impairment charge of $620,000 in fiscal 2004, representing the excess of the carrying value of the building over its expected selling price. However, during the first quarter of fiscal 2005, some conditions of the formal offer were not met and the offer was declined. During fiscal 2005, we withdrew the building from the market. As at August 31, 2004, the building was not shown as a long-lived asset held for sale in the balance

sheet because it was still used and, consequently, it was not available for immediate sale. This building reports to the Telecom Division.

In May 2004 and 2005, we performed our annual impairment test for goodwill and concluded that it was not impaired. Goodwill will be reviewed for impairment in May 2006, or prior if events or circumstances indicate it might be impaired.

RESTRUCTURING AND OTHER CHARGES

FISCAL 2003

In fiscal 2003, we implemented a restructuring plan to align our cost structure with market conditions. Under that plan, we recorded charges of $4.1 million, including $2.8 million in severance expenses for the 172 employees who were terminated throughout the company, $512,000 for impaired long-lived assets and $855,000 for future payments on exited leased facilities located around the world. Our estimation of the fair value of such future payments took into account the estimated sublease rentals over the remaining terms of the exited leases.

FISCAL 2004 AND 2005

In fiscal 2004, the Board of Directors approved a restructuring plan to consolidate the operations of our Life Sciences and Industrial Division, transferring EXFO Burleigh's operations mainly to EXFO Photonic Solutions facilities in Toronto. The consolidation process, which started in August 2004, was completed during fiscal 2005.

Overall, for that process, we incurred $2.5 million in restructuring and other charges from which $2.0 million were recorded in fiscal 2004 and the remaining $482,000 were recorded in fiscal 2005. The overall costs, which were recorded in the restructuring and other charges in the statements of earnings of the corresponding years, are detailed as follows: $855,000 for severance expenses for the layoff of all employees of EXFO Burleigh; $1.3 million mainly for the impairment of the EXFO Burleigh building; and the remaining $399,000 for other expenses such as training and recruiting expenses and transfer of assets.

The EXFO Burleigh building was put up for sale in fiscal 2004, but it is not yet sold because of the difficult real estate market in Rochester, NY.

The building is available for sale in its present condition and we expect to sell the property within the next twelve months. Consequently, in accordance with CICA handbook, section 3475, "Disposal of Long-Lived Assets and Discontinued Operations", it was shown in the balance sheet as a long-lived asset held for sale. The fair value used to determine the impairment loss of the building represents our best estimate of its selling price based upon the municipal valuation. Since September 1, 2004, the building is no longer amortized.

Finally, in fiscal 2005, we recorded adjustments of $190,000 to the fiscal 2003 plan because actual charges, mainly for leased equipment, were lower than expected.

Our restructuring plans and cost-reduction measures represented our best efforts to respond to the difficult market conditions of the past years. Although we believe that such restructuring actions were appropriate and delivered the expected results, changes in market or industry conditions may lead us to incur additional restructuring actions and cost-reduction measures in the coming years.

INTEREST AND OTHER INCOME

Our interest income mainly resulted from our short-term investments, less interests and bank charges. Interest and other income amounted to $2.5 million, $1.4 million and $1.2 million for fiscal 2005, 2004 and 2003, respectively. The increase in interest income in fiscal 2005, compared to 2004, is due in part to the increase in our cash and short-term investments following our public offering in February 2004, the cash flows from operating activities and the increase in interest rates year-over-year. Also, in fiscal 2005, we recovered R&D tax credits earned in previous years and we were granted $249,000 in interest by the tax authorities.

In fiscal 2004, we recorded one-time revenue of $265,000 for the sale of non-core technologies. Without this revenue, interest and other income would have been relatively flat compared to 2003.

Assuming no acquisitions are made in fiscal 2006, we expect our interest income to increase during that fiscal year should interest rates increase and because our cash and short-term investments should increase with cash flows from operating activities.

FOREIGN EXCHANGE LOSS

Foreign exchange loss amounted to $1.3 million, $278,000 and $1.6 million for fiscal 2005, 2004 and 2003, respectively.

Foreign exchange gains and losses are the result of the translation of operating activities denominated in currencies other than the Canadian dollar. The significant exchange loss recorded during fiscal 2005 is the result of the significant increase in the value of the Canadian dollar compared to the US dollar in fiscal 2005. For instance, the year-end exchange rate was Cdn$1.3167 = US$1.00 in fiscal 2004 compared to Cdn$1.1889 = US$1.00 in 2005, representing an increase of nearly 10% in the value of the Canadian dollar. The average exchange rate for fiscal 2005 was Cdn$1.2315 = US$1.00, compared to Cdn$1.3301 = US$1.00 in 2004.

During the same period last year, the Canadian dollar value remained relatively stable throughout the year, resulting in a slight exchange loss

during that period. In addition, higher levels of activity in fiscal 2005, compared to 2004, further increased the foreign exchange loss in 2005.

It should be noted that additional foreign exchange rate fluctuations flow through the P&L line items as a significant portion of our operating elements are denominated in Canadian dollars and and we report our results in US dollars.

We manage our exposure to currency risks with forward exchange contracts. In addition, some of our Canadian entities' operating activities are denominated in US dollars or other currencies, which further hedges this risk. However, a potential increase in the value of the Canadian dollar, compared to the US dollar, would have a negative impact on our operating results.

INCOME TAXES

Our income tax expense was $2.6 million for fiscal 2005, compared to an income tax recovery of $986,000 for 2004, and an income tax expense of $15.1 million for 2003.

The income tax expense recorded in fiscal 2005 represents income taxes payable in some specific tax jurisdictions, mainly at the Canadian federal level. Income taxes payable at this specific level is reduced by research and development tax credits that are recorded against gross research and development expenses.

The income tax recovery recorded in fiscal 2004 is mainly due to the $1.4 million unusual income tax recovery recorded during that year, offset in part by income taxes payable in some specific tax jurisdictions, mainly at the Canadian Federal level. The unusual tax recovery was due to the receipt, during that period, of income taxes paid in previous periods following the reception of a tax assessment.

Since fiscal 2003, we have been recording a full valuation allowance against our future income tax assets because it is more likely than not that these assets will not be recovered. The valuation allowance will be reversed once management will have concluded that realization of future income tax assets is more likely than not. Consequently, our income tax rates are distorted compared to statutory rates. Please refer to note 16 of our consolidated financial statements included elsewhere in this Annual Report for a full reconciliation of the income tax provision.

LIQUIDITY AND CAPITAL RESOURCES

CASH REQUIREMENTS AND CAPITAL RESOURCES

As at August 31, 2005, cash and short-term investments consisted of $112.0 million, while our working capital was at $135.3 million. Our cash and short-term investments increased $22.9 million in fiscal 2005, compared to 2004, mainly due to the cash flows from operating activities of $14.0 million as well as an unrealized foreign exchange gain of $10.0 million on cash and short-term investments. However, this increase was partially offset by the cash payment of $1.5 million for the purchase of property, plant and equipment as well as intangible assets. The unrealized foreign exchange gain resulted from the translation, in US dollars, of our Canadian dollar-denominated cash and short-term investments and was recorded in the cumulative translation

adjustment in the balance sheet.

Our short-term investments consist of commercial paper issued by six high-credit quality corporations and trusts; therefore, we consider the risk of non-performance of these financial instruments to be remote. For the purposes of managing our cash position, we have established a cash management policy, which we follow and monitor on a regular basis. These short-term investments will be used for working capital and other general corporate purposes, including potential acquisitions.

We believe that our cash on hand and short-term investments, combined with an available line of credit of $5.8 million, will be sufficient to meet our liquidity and capital requirements for the foreseeable future. However, possible additional operating losses and/or possible investments in or acquisitions of complementary businesses, products or technologies may require additional financing. There can be no assurance that additional debt or equity

financing will be available when required or, if available, that it can be secured on satisfactory terms. Our line of credit bears interest at prime rate.

The following table summarizes our commitments as at August 31, 2005:

YEARS ENDING AUGUST 31,	2006	2007	2008	2009	2010 AND LATER	
Long-term debt	$ 134,000	$ 147,000	$ 51,000	$ --	$ --	$
Operating leases	1,050,000	952,000	632,000	584,000	1,029,000	
Total commitments	$ 1,184,000	$ 1,099,000	$ 683,000	$ 584,000	$ 1,029,000	$

SOURCES AND USES OF CASH

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

In fiscal 2004, pursuant to a public offering in Canada, we issued 5.2 million subordinate voting shares for net proceeds of $29.2 million (Cdn$38.4 million) after deducting underwriting commissions of $1.2 million (Cdn$1.6 million). These net proceeds were recorded as short-term investments. Cash flows provided by financing activities in fiscal 2004 were attributable to the net proceeds of this offering.

OPERATING ACTIVITIES

Cash flows provided by operating activities amounted to $14.0 million in fiscal 2005, compared to $751,000 in 2004 and $5.6 million in 2003.

Cash flows provided by operating activities in fiscal 2005 were mainly attributable to the net earnings after items not affecting cash of $9.1 million and the positive net change in non-cash operating items of $4.9 million. This net change in non-cash operating items is mainly due to the decrease of $6.1 million of our income taxes and tax credits recoverable following the collection, during the year, of income taxes and tax credits recoverable from previous periods. On the other hand, our accounts receivable increased by $838,000 and our inventories increased by $699,000. The increase of our accounts receivable is related to the increase in sales. Our inventories slightly increased despite the significant rise in sales due to tight inventory management.

Cash flows provided by operating activities in fiscal 2004 were mainly attributable to the net earnings after items not affecting cash of $5.7 million, offset in part by the net increase of our non-cash operating items of $4.9 million; that is, our accounts receivable increased by $2.7 million, our income taxes and tax credits recoverable increased by $2.5 million and our inventories decreased by $1.0 million. The increase in our accounts receivable is directly related to the significant sales growth in fiscal 2004. The increase in our income taxes and tax credits recoverable is mainly due to the payment during the year of income taxes and to the recognition, during the year, of research and development tax credits not yet recovered. On the other hand, our increased sales level combined with tight inventory management enabled us to reduce our inventories overall.

We have delivered positive cash flows from operating activities for the last three fiscal years, despite the fact that we posted a net loss in each of these years.

INVESTING ACTIVITIES

Cash flows used by investing activities totaled $13.0 million in fiscal 2005, compared to $29.7 million in 2004 and $9.9 million in 2003.

In fiscal 2005, we acquired $11.5 million worth of short-term investments with cash flows from operating activities and cash on-hand and paid $1.5 million for the purchase of property, plant and equipment as well as intangible assets.

In fiscal 2004, we acquired $28.6 million worth of short-term investments with the net proceeds of the public offering. In addition, we paid $1.1 million for the purchase of property, plant and equipment as well as intangible assets.

FORWARD EXCHANGE CONTRACTS

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

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

As at August 31, 2005, we held contracts to sell US dollars at various forward rates, which are summarized as follows:

EXPIRY DATES	CONTRACTUAL AMOUNTS	WEIGHTED AVERAGE CONTRACTUAL FORWARD RATES
September 2005 to August 2006	$ 26,000,000	1.2630
September 2006 to November 2007	7,600,000	1.2500

As at August 31, 2005, the fair value of our forward exchange contracts, which represents the difference between their contractual amounts and their current trading value, amounted to an unrecognized gain of $2.9 million.

RELATED-PARTY TRANSACTIONS

In fiscal 2003, we acquired a building from a company owned by the President of EXFO for a cash consideration of $930,000. This transaction was measured at the fair market value since it was not conducted during the normal course of operations, the change in ownership interest in the building was substantive and the fair market value was supported by independent appraisal.

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In addition, for the years ended August 31, 2003 and 2004, we leased facilities from the company owned by the President of EXFO. The annual rental expense amounted to $331,000 and nil, respectively. The rental expense for fiscal 2003 included $234,000 for future payments on an exited leased facility. As at August 31, 2004, restructuring charges payable included $194,000 due to the company owned by the President of EXFO in connection with this exited leased facility. In September 2004, EXFO was released from its obligations under that lease, and it paid the full amount due to the related company. These rental expenses were measured at the fair market value since they were incurred during the normal course of operations.

CONTINGENCY

As discussed in note 12 to our consolidated financial statements included elsewhere in this Annual Report, EXFO was named as a defendant in a U.S. securities class action related to its initial public offering (IPO) in June 2000. The complaints allege that the prospectus and the registration statement for the IPO failed to disclose that the underwriters allegedly received excessive commissions and that the underwriters and some investors collaborated in order to inflate the price of EXFO's stock in the after-market.

In June 2003, a committee of the EXFO's Board of Directors conditionally approved a proposed settlement between the issuer defendants, the individual defendants, and the plaintiffs. If approved, the settlement would provide, among other things, a release of the EXFO and of the individual defendants for the conduct alleged in the action to be wrongful in the amended complaint. EXFO would agree to undertake other responsibilities under the settlement, including agreeing to assign away, not assert, or release certain potential claims EXFO may have against its underwriters. Any direct financial impact of the proposed settlement is expected to be borne by EXFO's insurance carriers.

On June 25, 2004, the Plaintiffs moved for Preliminary Approval of the settlement. The court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005, the court

issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The court also appointed the Notice Administrator for the settlement and ordered that the notice of the settlement be distributed to all settlement class members beginning on November 15, 2005, and completed by January 15, 2006. The settlement fairness hearing has been set for April 26, 2006. Following the hearing, if the court determines that the settlement is fair to the class members, the settlement will be approved. There can be no assurance that this proposed settlement would be approved and implemented in its current form, or at all. Therefore, it is not possible to predict the final outcome of the case, nor determine the amount of any possible losses. If the settlement process fails, EXFO will continue to defend its position in this litigation that the claims against it, and its officers, are without merit. Accordingly, no provision for this case has been made in the consolidated financial statements as at August 31, 2005.

SHARE CAPITAL AND STOCK-BASED COMPENSATION PLANS

SHARE CAPITAL

As at November 3, 2005, EXFO had 37,900,000 multiple voting shares outstanding, entitling to ten votes each, and 30,674,617 subordinate voting shares outstanding. The multiple voting shares and the subordinate voting shares are unlimited as to number and without par value.

LONG-TERM INCENTIVE PLAN

In January 2005, EXFO made certain amendments to the existing Stock Option Plan, including the renaming of the plan to Long-Term Incentive Plan, which now includes restricted share units (RSUs) in addition to stock options. RSUs are "phantom" shares that rise and fall in value based on the value of EXFO's subordinate voting shares and are redeemable for actual subordinate voting shares or cash, at the discretion of the Board of Directors, on the vesting dates established by the Board of Directors at the time of grant. The vesting dates are subject to a minimum of three years and a maximum of ten years from the award date. RSUs granted under the plan expire at the latest ten years from the date of grant.

DEFERRED SHARE UNIT PLAN

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

The aggregate number of subordinate voting shares covered by stock options, RSUs and DSUs granted under the Long-Term Incentive Plan and the Deferred Share Unit Plan was 2,963,678 as at August 31, 2005. The maximum number of subordinate voting shares issuable under these two plans cannot exceed 6,306,153 shares.

The following tables summarize information about stock options, RSUs and DSUs granted to the members of the Board of Directors and to Management and Corporate Officers of the company and its subsidiaries as at August 31, 2005:

STOCK OPTIONS	NUMBER	% OF ISSUED AND OUTSTANDING	WEIGHTED AVERAGE EXERCISE PRICE
Chairman of the Board, President and CEO (one individual)	168,424	6%	$ 9.34
Board of Directors (five individuals)	194,375	7%	$ 6.23
Management and Corporate Officers (nine individuals)	340,091	12%	$ 14.39
	702,890	25%	$ 10.92

RESTRICTED SHARE UNITS	NUMBER	% OF ISSUED AND OUTSTANDING
Chairman of the Board, President and CEO (one individual)	13,089	7%
Management and Corporate Officers (nine individuals)	151,096	86%
	164,185	93%

DEFERRED SHARE UNITS	NUMBER	% OF ISSUED AND OUTSTANDING
Board of Directors (five individuals)	23,734	100%

OFF-BALANCE SHEET ARRANGEMENTS

As of August 31, 2005, our off-balance sheet arrangements consisted of letters of guarantee and forward exchange contracts, which are respectively described in details in note 12 and 18 to our consolidated financial statements, included elsewhere in this Annual Report.

VARIABLE INTEREST ENTITY

As of August 31, 2005, we did not have significant interests in any variable interest entities.

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, 2005.

NAME AND MUNICIPALITY OF RESIDENCE	POSITIONS WITH EXFO
STEPHEN BULL Cap-Rouge, Quebec	Vice-President, Research and Development, Telecom Divis
NORMAND DUROCHER St-Sauveur, Quebec	Vice-President Human Resources
ALLAN FIRHOJ Georgestown, Ontario	Vice-President and General Manager, Life Sciences and Industrial Division
BENOIT FLEURY Saint-Lazare, Quebec	Vice-President, Protocol-Layer Product Management and Business Development
ETIENNE GAGNON Sillery, Quebec	Vice-President, Optical-Layer Product Management and Customer Service
LUC GAGNON St-Augustin-de-Desmaures, Quebec	Vice-President, Telecom Manufacturing Operations
JUAN-FELIPE GONZALEZ Montreal, Quebec	Vice-President, Global Telecom Sales
GERMAIN LAMONDE Cap-Rouge, Quebec	Chairman of the Board, President and Chief Executive Officer
PIERRE MARCOUILLER Magog, Quebec	Independent Director
GUY MARIER Lakefield Gore, Quebec	Independent Director
PIERRE PLAMONDON, CA Quebec City, Quebec	Vice-President, Finance and Chief Financial Officer
BENOIT RINGUETTE Quebec City, Quebec	Corporate Secretary and Legal Counsel
DAVID A. THOMPSON Newton, North Carolina	Independent Director
ANDRE TREMBLAY Outremont, Quebec	Independent Director
MICHAEL UNGER Woodbridge, Ontario	Independent Lead Director

The address of each of our executive officers, senior managers and Directors is c/o EXFO Electro-Optical Engineering Inc., 400 Godin Avenue, Vanier, Quebec, Canada. The following is a brief biography of each of our executive officers, senior managers and Directors.

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

NORMAND DUROCHER was appointed Vice-President of Human Resources in April 2004. In addition to managing the company's human resources team, his main responsibility is to develop and implement a human resources plan that supports EXFO's business strategy. Mr. Durocher began his career in labor relations in the Cable division of Nortel and then took on several key roles at Nortel Networks and Nordx/CDT, all relating to human resources and operations. Since then, Normand Durocher has accumulated more than 25 years' experience in operations and human resources management within the telecommunications industry. Prior to joining EXFO, Mr. Durocher ran his own human resources consulting business. Normand Durocher holds a Bachelor of Science from the Universite de Montreal and also completed the Advanced Human Resources program at Dalhousie University in Halifax, Nova Scotia, Canada

ALLAN FIRHOJ was appointed Vice-President and General Manager, Life Sciences and Industrial Division in July 2003. Prior to that, he held the position of General Manager of EXFO Photonic Solutions Inc. since November 2001. He is responsible for the overall strategic direction and management of the Life Sciences and Industrial Division. Mr. Firhoj joined EFOS Inc. in 1996, where he was responsible for Sales, Marketing and Business Development of the Dental Curing-Products Division. Following the sale of this division to Dentsply International in 1997, he was appointed Director of Marketing and Business Development. Mr. Firhoj continued in this capacity until being appointed to the position of General Manager of EXFO Photonic Solutions Inc. Prior to joining the company, Mr. Firhoj spent six years with The Horn Group, a plastics business involved in medical devices/instrumentation and office communication equipment. He successively held the positions of ISO 9000 Implementation Manager, Technical Sales Manager as well as Marketing and Business Development Manager. In this latter role, he successfully contributed to increasing sales in their medical market by an annual average of 60% during a three-year period. Mr. Firhoj holds a bachelor's degree in Political Science from Bishop's University in Lennoxville, Quebec.

BENOIT FLEURY was appointed Vice-President, Protocol-Layer Product Management and Business Development for our protocol-layer product line in February 2004. His main responsibility consists in defining the product line strategy and developing strategic partnerships to enhance our presence in this market segment. Mr. Fleury has 20 years of experience in the optical telecommunications industry. He began his career as a systems engineer at Northern Telecom, and then progressed to various key positions in the areas of product management, operations engineering, product development, account marketing and product marketing - all associated with Nortel's leading optical systems. From 2001 to 2003, prior to joining EXFO, Mr. Fleury was Vice-President of Product Line Management and Marketing at Ceyba, an Ottawa-based optical systems startup. Mr. Fleury holds a bachelor's degree in Electrical Engineering from McGill University as well as a master's degree, also in Electrical Engineering, from Concordia University. He also completed a Marketing Management Program from Duke University.

ETIENNE GAGNON was appointed Vice-President of Optical-Layer Product

Management and Customer Service in May 2003. Mr. Etienne Gagon is not related to Mr. Luc Gagnon. He is responsible for EXFO's general marketing direction, on both the product level and communications level, and also oversees our customer service department. For nearly three years, before returning to EXFO in early 2003, Mr. Gagnon was Vice-President of Sales and Marketing at TeraXion, an optical component manufacturer based in Quebec City. Mr. Gagnon began his career as a design engineer for Bombardier/Canadair, where he worked on the Canadian Regional Jet project between 1990 and 1993. Later, he held the position of Business Development Manager for France Telecom in Hungary. In 1994, he joined EXFO's European office as a Regional Sales Manager, and in 1996, he was brought back to Quebec City to head the OSP marketing group. Mr. Gagnon then went on to become the Director of our Outside Plant division in 1998, and remained in that function until he joined TeraXion in 2000. Mr. Gagnon holds a bachelor's degree in Mechanical Engineering from the Ecole Polytechnique School of Engineering (University of Montreal), and a master's degree in European Business from the Ecole nationale superieure des telecommunications in France.

LUC GAGNON was appointed Vice-President, Telecom Manufacturing Operations in May 2003. Mr. Luc Gagnon is not related to Mr. Etienne Gagnon. He is responsible for ensuring the smooth operation of all manufacturing activities, which include production, purchasing, product engineering, quality assurance, planning, manufacturing engineering, product configuration, transportation and customs, as well as material resources. Prior to his recent nomination, Mr. Gagnon held the position of Production Director since 2000. Before joining EXFO, he had 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 1991 to 1993. Mr. Gagnon holds a bachelor's degree in electrical engineering and master's degree in engineering, both from the Universite de Sherbrooke, in Canada.

JUAN-FELIPE GONZALEZ assumed the position of Vice-President, Global Telecom Sales in July 2003. Prior to that he had been our Vice-President, International Sales since September 1998. From January 1997 to September 1998, he was our International Sales Director and, from September 1993 to January 1997, our Sales Manager for Latin America and the Caribbean. Prior to joining us in September 1993, Mr. Gonzalez was Marketing and Sales Director at Reyde, Barcelona, a plastics technical product corporation in Spain. Mr. Gonzalez holds a bachelor's degree in Industrial Chemistry from Complutense University of Madrid in Spain and a master's degree in Business Administration from the School of Industrial Organization in Spain.

GERMAIN LAMONDE, a company founder, has been Chairman of the Board, President and CEO of EXFO since its inception in 1985. Mr. Lamonde is responsible for the overall management and direction of EXFO and its subsidiaries. Mr. Lamonde has served on the boards of several organizations such as the Canadian Institute for Photonic Innovations, the Pole QCA Economic Development Corporation and the National Optics Institute of Canada. He is also a founding member and Governor of the Canadian-based International Institute of Telecommunications and an Emeritus Member of the Canadian Academy of Engineering. Mr. Lamonde holds a bachelor's degree in physics engineering from the University of Montreal's School of Engineering, a master's degree in optics from Laval University, and is also a graduate of the Ivey Executive Program offered by the University of Western Ontario.

PIERRE MARCOUILLER has served as our Director since May 2000. Mr. Marcouiller is Chairman of the Board and Chief Executive Officer of Camoplast Inc., an international manufacturer specialized in industrial manufacturing of rubber tracks, molded composite and thermoplastic components and off-road tracked vehicles. He is the founder and has been the sole shareholder of Nexcap Inc., an investment company in the manufacturing sector, since December

1996. Mr. Marcouiller worked with Venmar Ventilation Inc., a private ventilation equipment manufacturer, from January 1983 to December 1996. From 1991 to 1996, he was the controlling shareholder of Venmar, where he also held the position of President and General Manager from 1986 to 1996. Mr. Marcouiller is also a Director of Heroux-Devtek Inc., a public company specialized in the design, development and manufacturing of aerospace, defense and industrial products; more specifically in landing gear, aerostructure and gas turbine components. Mr. Marcouiller also holds Directorships in other privately held companies. Pierre Marcouiller holds a bachelor's degree in business administration from Universite du Quebec in Trois-Rivieres and a MBA from Universite de Sherbrooke, both in Canada.

GUY MARIER has served as our Director since January 2004. Formerly President of Bell Quebec between 1999 and 2003, Guy Marier completed his successful 33-year career at Bell as Executive Vice-President of the Project Management Office of Bell Quebec, before retiring at the end of 2003. Mr. Marier began at Bell Canada in 1970 and quickly became an executive. From 1988 to 1990, he headed up Bell Canada International's investments and projects in Saudi Arabia and, for the three following years, served as President of Telebec, a subsidiary of Bell Canada. He then returned to the parent company to hold various senior management positions. Mr. Marier was appointed to our Board of Directors in January 2004 and also sits on the Board of Bell Nordiq, a wholly-owned subsidiary of Bell Canada that manages the business and affairs of both Telebec L.P. and NorthernTel L.P. Mr. Marier holds a bachelor of Arts from the University of Montreal and a Bachelor of Business Administration from the UNIVERSITE DU QUEBEC A MONTREAL.

PIERRE PLAMONDON has been our Vice-President, Finance and Chief Financial Officer since January 1996 and was a Director from December 1999 to May 2000. Prior to joining us, Mr. Plamondon served as senior manager for Price Waterhouse, from September 1981 to December 1995 in Canada and France. Mr. Plamondon holds a bachelor's degree in Business Administration and a license in Accounting, both from Laval University in Quebec City, Canada. Mr. Plamondon has been a member of the Canadian Institute of Chartered Accountants since 1983 and a member of the Board of Directors of SOVAR Inc. (Societe de valorisation des applications de la recherche de l'Universite Laval) since December 2000.

BENOIT RINGUETTE has been our in-house Legal 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 from Laval University in Quebec City, Canada.

DAVID A. THOMPSON has served as our Director since June 2000. Dr. David A. Thompson is currently Vice-President and Director of Hardware & Equipment Technology Strategy at Corning Cable Systems, where he has held this position since January 2002. Prior to this nomination, he acted as Corning Incorporated's Division Vice-President for the Strategic Planning & Innovation Effectiveness in Research, Development and Engineering. Dr. Thompson first joined Corning Incorporated's Research and Development Division in 1976 as a Senior Chemist in glass research. He then took on several technology Directorship and strategic planning roles for Corning's Component and Photonics Technologies Divisions between 1988 and 1998; and, in 1999, he was appointed technical leader for the creation of the new Samsung-Corning Micro-Optics joint venture. David A. Thompson holds a Bachelor of Science in chemistry from Ohio State University and a doctorate in inorganic chemistry

from the University of Michigan. He holds 13 patents and has over 20 technical publications in the areas of inorganic chemistry, glass technology and telecommunications.

ANDRE TREMBLAY has served as our Director since June 2000. Andre Tremblay has more than 20 years experience in the telecommunications industry, where he has been actively involved in the conception, financing and management of several companies. For almost 10 years, Mr. Tremblay served as President and Chief Executive Officer of Microcell Telecommunications Inc., which he led from its formation on through the different phases of its evolution. He has also provided early-stage financing, along with strategic advice and direction, for start-up technology firms and sits on the Boards of Directors of a number of corporations and non-profit organizations. Andre Tremblay holds bachelor's degrees in management and in accounting from Laval University, a master's degree in taxation from the Universite de Sherbrooke and is also a graduate of Harvard Business School's Advanced Management Program.

MICHAEL UNGER has served as our Director since May 2000. He worked with Nortel Networks Limited, now Nortel Networks Corporation, from 1962 to 2000. Mr. Unger's most recent position was President of Nortel's Optical Networks Business Unit, a position he held from May 1998 to April 2000. Prior to this appointment, Mr. Unger was Nortel's Group Vice-President, Transport Networks from March 1990 to May 1998. Mr. Unger also serves on the Board of Tundra Semiconductor Corporation a publicly traded company with its shares listed on The Toronto Stock Exchange that designs, develops and markets networking and network access technology for use by communications infrastructure equipment companies. He is also a member of the Board of Directors of a number of privately-held companies active in the areas of photonic and optical components, optical network systems and solutions for cable operators and other communications service providers. Mr. Unger holds a bachelor's degree in Science from Concordia University in Canada.

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.

B. COMPENSATION

DIRECTOR COMPENSATION

In the financial year ended August 31, 2005, each director who are not employees of the Corporation or any of its subsidiaries received the level of compensation set forth in the table below as annual compensation payable in a combination of cash and Deferred Share Units ("DSU") as chosen by the Director pursuant to the Deferred Share Unit Plan.

Annual Retainer for Directors: (1)	CDN$50,000(2)	US$40,600 (3)
Annual Retainer for Committee Chairman:	CDN$5,000	US$4,060 (3)
Annual Retainer for Committee Members:	CDN$3,000	US$2,436 (3)

Fees for all Meetings Attended per day in Person:	CDN$1,000	US$812 (3)
Fees for all Meetings Attended per day by Telephone:	CDN$500	US$406 (3)

(1) All the Directors elected to receive 50% of their Annual Retainer in form of Deferred Share Units.
(2) The Annual Retainer for Mr. David A. Thompson is US$50,000 (CDN$61,575).
(3) The compensation information has been converted from Canadian dollars to U.S. dollars based upon an average foreign exchange rate of $CDN1.2315 = US$1.00 for 2005.

In the financial year ended August 31, 2005, the Directors who are not employees received the following compensation in the form indicated:

NAME	ANNUAL COMPENSATION PAID IN CASH (US$) (1)	ANNUAL COMPENSATION PAID IN DSUS (#) (2)	FAIR VALUE OF DSUS AT THE TIME OF GRANT (US$)(3)	F
Pierre Marcouiller (4)	25,173	4,537	20,300	
Guy Marier (5)	25,173	4,537	20,300	
Dr. David A. Thompson (6)	27,440	5,586	25,000	
Andre Tremblay (7)	26,797	4,537	20,300	
Michael Unger (8)	26,797	4,537	20,300	

(1) The compensation information has been converted from Canadian dollars to U.S. dollars based upon an average foreign exchange rate of $CDN1.2315 = US$1.00 for 2005 except for Mr. David A. Thompson who is paid in US currency. The Annual Compensation includes, as the case may be, the retainer for Director, Committee Members and Committee Chairman.
(2) Indicates the number of Subordinate Voting Shares granted under the Deferred Share Unit Plan. A DSU is converted in a Subordinate Voting Share when a Director ceases to be a member of the Board.
(3) The value at the time of grant of a DSU is determined based on the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and the NASDAQ National Market on the last trading day preceding the grant date, using the noon buying rate of the Federal Reserve Bank of New York on the grant date to convert the NASDAQ National Market closing price to Canadian dollars, as required. The value at vesting of a DSU is equivalent to the market value of a Subordinate Voting Share when a DSU is converted to such Subordinate Voting Share.
(4) Member of the Audit Committee and the Human Resources Committee.
(5) Member of the Audit Committee and the Human Resources Committee.
(6) Member of the Human Resources Committee.
(7) Member of the Human Resources Committee and Chairman of the Audit Committee.
(8) Member of the Audit Committee, Chairman of the Human Resources Committee and Lead Director.

EXECUTIVE COMPENSATION

The table below shows compensation information during the three most recently completed financial years for Mr. Germain Lamonde, the Chairman of the Board, President and Chief Executive Officer of the Corporation, Mr. Pierre Plamondon, the Vice-President Finance and Chief Financial Officer, the three other most highly compensated executive officers of the Corporation and its subsidiaries who were serving the Corporation at the end of the financial year (collectively, the "Named Executive Officers"). This information includes the US dollar value of base salaries, bonus awards and long-term incentive plan payments, the number of options or Restricted Share Units ("RSUs") granted, and other compensation, if any, whether paid or deferred.

NAME AND PRINCIPAL POSITION	FINANCIAL YEARS	SALARY (1) ($)	BONUS (2) ($)	OTHER ANNUAL COMPENSATION ($)	SECURITIES UNDER OPTIONS (3) (#)	RE U
Germain Lamonde, President and Chief Executive Officer	2005	243,605 (US) 300,000 (CDN)	121,729 (US) 149,909 (CDN)	--	17,942	
	2004	206,751 (US) 275,000 (CDN)	57,115 (US) 75,969 (CDN)	--	--	
	2003	185,848 (US) 275,000 (CDN)	25,247 (US) 37,359 (CDN)	--	50,000	

NAME AND PRINCIPAL POSITION	FINANCIAL YEARS	SALARY (1) ($)	BONUS (2) ($)	OTHER ANNUAL COMPENSATION ($)	SECURITIES UNDER OPTIONS (3) (#)	RE U
Pierre Plamondon, Vice-President Finance and Chief Financial Officer	2005	151,441 (US) 186,500 (CDN)	48,735 (US) 60,017 (CDN)	--	5,383	
	2004	135,328 (US) 180,000 (CDN)	17,451 (US) 23,211 (CDN)	--	--	
	2003	118,267 (US) 175,000 (CDN)	9,547 (US) 14,127 (CDN)	--	25,000	
Juan-Felipe Gonzalez, Vice-President, Global Telecom Sales	2005	246,323 (US) 303,347 (CDN)	6,015 (US) 7,407 (CDN)	--	5,482	
	2004	231,597 (US) 308,047 (CDN)	563,867 (US) 750,000 (CDN)(6)	--	--	
	2003	163,896 (US)	7,500 (US)	--	30,000	

Stephen Bull	2005	121,803 (US) 150,000 (CDN)	32,559 (US) 40,097 (CDN)	--	3,589
Vice-President Research & Development	2004	112,773 (US) 150,000 (CDN)	12,437 (US) 16,543 (CDN)	--	--
	2003	81,098 (US) 120,000 (CDN)	8,138 (US) 12,042 (CDN)	--	15,000
Etienne Gagnon	2005	113,683 (US) 140,000 (CDN)	34,389 (US) 42,349 (CDN)	--	3,158
Vice-President, Optical-Layer Product Management and Customer Service	2004	99,241 (US) 132,000 (CDN)	7,540 (US) 11,157 (CDN)	--	--
	2003	81,098 (US)(8) 120,000 (CDN)	2,550 (US) 4,013 (CDN)	--	20,000

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(1) The compensation information for Canadian residents has been converted from Canadian dollars to U.S. dollars based upon an average foreign exchange rate of CDN$1.2315 = US$1.00 for 2005, CDN$1.3301 = US$1.00 for 2004 and CDN$1.4797 = US$1.00 for 2003. The currency conversions cause these reported salaries to fluctuate from year-to-year because of the fluctuation in exchange rate.

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

(3) Indicates the number of Subordinate Voting Shares underlying the options granted under the Long-Term Incentive Plan during the financial year indicated.

(4) Indicates the number of Restricted Share Units granted under the Long-Term Incentive Plan during the financial year indicated.

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

(6) Pursuant to the terms of his employment agreement, Mr. Juan-Felipe Gonzalez did receive a cash payment of CDN$750,000 since he did not voluntarily resign and was not dismissed with cause prior to September 2003. An amount of CDN$500,000 was disbursed on October 17, 2003 and the remaining CDN$250,000 was disbursed on January 25, 2004.

(7) Indicates the amount paid by the Corporation during the financial year for relocation allowance (CDN$20,000) (US$15,036) plus the amount referred in note 5 above (CDN$1,576) (US$1,185).

(8) This amount represents Mr. Gagnon annual base salary. Since Mr. Gagnon joined the Corporation in January 13, 2003, the base salary paid to Mr. Gagnon for the financial year ended August 31, 2003 amounted to US$49,906 (CDN$73,846).

EMPLOYMENT AGREEMENTS

We have an employment agreement with Mr. Germain Lamonde. The agreement is for an indeterminate period and the compensation is reviewed annually. In the event of the termination of Mr. Lamonde's employment without cause, Mr. Lamonde will be entitled to severance payments (in no case exceeding 24 months of remuneration) and the vesting of all stock options and

RSUs. In addition, in the event that Mr. Lamonde's employment is terminated following a merger or an acquisition by a third party of substantially all of the Corporation's assets or of the majority of our share capital or if Mr. Lamonde voluntarily resigns, he will be entitled to the vesting of all stock options and RSUs.

We also have employment agreements with Mr. Pierre Plamondon, Mr. Juan-Felipe Gonzalez, Mr. Stephen Bull and Mr. Etienne Gagnon.

The employment agreement with Mr. Pierre Plamondon, our Vice-President, Finance and Chief Financial Officer is for an indeterminate period and the compensation is reviewed annually. In the event of termination of Mr. Plamondon's employment without cause, Mr. Plamondon will be entitled to severance payments which in no case exceeding 18 months of the current base salary. In addition, in the event Mr. Plamondon's employment is terminated following a merger or an acquisition by a third party of substantially all of our assets or of the majority of its share capital, he will be entitled to the immediate vesting of all stock options and RSUs.

The agreement with Mr. Gonzalez provided for Mr. Gonzalez's employment as Vice-President Global Telecom Sales. In the event Mr. Gonzalez's employment terminates for any reason whatsoever and he is unable to accept new employment due to his non-competition obligations to us, Mr. Gonzalez may receive compensation for a period of 18 months following the date of termination in amounts varying from 5% to 50% of his base monthly salary at the time of termination depending on the cause of the termination. The employment agreement is for an indeterminate period and compensation is reviewed annually.

The agreement with Mr. Stephen Bull, our Vice-President, Research and Development is for an indeterminate period and the compensation is reviewed annually. In the event of termination of Mr. Bull's employment without cause, Mr. Bull will be entitled to severance payments (in no case exceeding 18 months of the current base salary). In addition, in the event Mr. Bull's employment is terminated following a merger or an acquisition by a third party of substantially all of our assets or of the majority of our share capital, he will be entitled to the immediate vesting of all stock options and RSUs.

The employment agreement with Mr. Etienne Gagnon, our Vice-President, Optical-Layer Product Management and Customer Service is for an indeterminate period and the compensation is reviewed annually. In the event of termination of Mr. Gagnon's employment without cause, Mr. Gagnon's will be entitled to severance payments (in no case exceeding 18 months of the current base salary). In addition, in the event Mr. Gagnon's employment is terminated following a merger or an acquisition by a third party of substantially all of our assets or of the majority of our share capital, he will be entitled to the immediate vesting of all stock options and RSUs.

LONG-TERM INCENTIVE COMPENSATION

LONG-TERM INCENTIVE PLAN

We have a Long-Term Incentive Plan for our Directors, executive officers, employees and consultants and those or our subsidiaries as determined by our Board of Directors, to attract and retain competent Directors, executive officers, employees and consultants motivated to work toward ensuring our success and to encourage them to acquire our shares.

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

Introduced in May 2000, amended in October 2004 and effective in January 2005, the Long-Term Incentive Plan is designed to motivate Directors, officers, employees and consultants to share interest with our shareholders over the long-term. A copy of the Long-Term Incentive Plan has been filed as exhibit 4.35 to this annual report. It is subject to Human Resources Committee review to ensure maintenance of its market competitiveness. Our Board has full and complete authority to interpret the Plan and to establish the rules and regulations applying to it and to make all other determinations it deems necessary or useful for the administration of the Plan, provided that such interpretations, rules, regulations and determinations are consistent with the rules of all stock exchanges on which our securities are then traded and with all relevant securities legislation.

The Long-Term Incentive Plan provides for the issuance of options to purchase Subordinate Voting Shares and the issuance of Restricted Share Units ("RSUs") redeemable for actual Subordinate Voting Shares or the equivalent in cash to Directors, officers, employees and consultants. Our Board of Directors upon recommendation of the Human Resources Committee designates the recipients of options or RSUs and determines the number of Subordinate Voting Shares covered by each option or RSU, the dates of vesting, the expiry date and any other conditions relating to these options or RSUs, in each case in accordance with the applicable legislation of the securities regulatory authorities. During the financial year ended August 31, 2005, options and RSUs were granted based on merit.

The exercise price of the options is determined by our Board of Directors at the time of granting the options, subject to compliance with the rules of all stock exchanges on which the Subordinate Voting Shares are listed and with all relevant securities legislation. In any event, the price at which the Subordinate Voting Shares may be purchased may not be lower than the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and the NASDAQ National Market on the last trading day preceding the grant date, using the noon buying rate of the Federal Reserve Bank of New York on the grant date to convert the NASDAQ National Market closing price to Canadian dollars. Any option issued is non-transferable.

The aggregate number of subordinate voting shares covered by options granted during the financial year ended August 31, 2005 was 246,233 at a weighted average exercise price of $4.59 (CDN$5.68) per subordinate voting share. At the end of the financial year ended August 31, 2005, there were 2,763,759 subordinate voting shares covered by options granted and outstanding pursuant to the Long-Term Incentive Plan having a weighted average exercise price of US$12.87 (CDN$19.22) per option. Since August 31, 2005 and until November 15, 2005 no options were granted.

The fair value at the time of grant of a RSU is equal to the market value of Subordinate Voting Shares at the time RSUs are granted. At the end of financial year ended August 31, 2005, there were a total of 176,185 RSUs granted pursuant to the Long-Term Incentive Plan having a weighted average fair value at the time of grant of US$4.68 (CDN$5.72) per RSU. Since August 31, 2005 and until November 15, 2005 we did not grant any RSUs.

The maximum number of Subordinate Voting Shares that are issuable under the Plan shall not exceed 6,306,153 Subordinate Voting Shares, which represents 9.2% of our issued and outstanding voting shares as of November 1,

2005. The maximum number of Subordinate Voting Shares that may be granted to any one individual shall not exceed 5% of the number of outstanding Subordinate Voting Shares.

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

All RSUs first vesting can not be earlier than the third anniversary date of their grant. Some RSUs granted in the financial year ended August 31, 2005 vest at a rate of 1/3 annually commencing on the third anniversary date of the grant in February 2005 and others at a rate of 55%, 35% and 10%, on the third, fourth and fifth anniversary dates of the grant in January 2005. Some RSUs granted in the financial year ended August 31, 2005 vest on the fifth anniversary date of the grant in January 2005 but are subject to early vesting on the third and fourth anniversary dates of the grant on the attainment of performance objectives as determined by our Board of Directors. Accordingly, subject to the attainment of performance objectives, the first early vesting is up to 1/3 of the units on the third anniversary date of the grant and the second early vesting is up to 50% of the remaining units on the fourth anniversary date of the grant. If such vesting date falls into any black-out period or any other restrictive period during which the RSU holder is not entitled to trade our Subordinate Voting Shares, then the units shall vest on the first trading day the RSU holder is entitled to trade after such black-out period or restrictive period.

Any option granted pursuant to the Long-Term Incentive Plan will lapse (i) immediately upon the termination of the relationship with us or one of our subsidiaries for a good and sufficient cause for employees or officers or at the date on which an employee or an officer resigns or leaves his employment with us or one of our subsidiaries (or within 30 days if the holder's employment is terminated for reasons not related to cause); and (ii) 30 days after a Director ceases to be a member of our Board of Directors or one of our subsidiaries. In the event of retirement or disability, any option held by an employee lapses 30 days after the date of any such disability or retirement. In the event of death, any option held by the optionee lapses 6 months after the date of death.

Any RSU granted pursuant to the Long-Term Incentive Plan will lapse (i) immediately, where vesting of a unit is subject to the attainment of performance objectives, if such performance objectives have not been attained (or postponed at a further vesting date as determined by the Board of Directors); (ii) immediately, whether or not subject to attainment of performance objectives, upon the termination of the relationship with us or one of our subsidiaries for a good and sufficient cause for employees or officers or at the date on which an employee or an officer resigns or leaves his employment with us or one of our subsidiaries.

Any RSU granted pursuant to the Long-Term Incentive Plan will vest immediately, to a certain proportion as determined by the Plan, upon the termination of the relationship of an employee or officer with us or one of our subsidiaries (i) for reasons not related to cause; (ii) because of death or permanent disability and (iii) retirement.

The following table summarizes information about stock options granted to the members of the Board of Directors, and to Management and Corporate Officers of us and our subsidiaries as at August 31, 2005:

	NUMBER OF OPTIONS	% OF ISSUED AND OUTSTANDING OPTIONS	WEIGHTED AVER PRICE ($US/
President and CEO (one individual)	168,424	6.09%	9.
Board of Directors (five individuals)	194,375	7.03%	6.
Management and Corporate Officers (nine individuals)	340,091	12.31%	14.

The following table summarizes information about RSUs granted to the members of the Board of Directors and to Management and Corporate Officers of us and our subsidiaries as at August 31, 2005:

	NUMBER OF RSUS	% OF ISSUED AND OUTSTANDING RSUS	WEIGHTED AV VALUE AT T GRANT
President and CEO (one individual)	13,089	7.43%	4.6
Board of Directors (five individuals)	--	--	-
Management and Corporate Officers (nine individuals)	151,096	85.76%	4.6

DEFERRED SHARE UNIT PLAN

Introduced in October 2004 and effective as of January 2005, the Deferred Share Unit Plan is designed to align more closely the interests of its non-employee Directors with those of our shareholders. A copy of the Deferred Share Unit Plan has been filed as exhibit 4.36 to this annual report.

Under the Deferred Share Unit Plan, non-employee Directors shall receive up to 100 % of their retainer fees in the form of Deferred Share Units ("DSUs"), each of which has a fair value at the time of grant equal to the market value of a Subordinate Voting Share at the time DSUs are credited to the Directors. The value of a DSU, when converted to Subordinate Voting Shares, is equivalent to the market value of a Subordinate Voting Share at the time the conversion takes place. DUSs attract dividends in the form of additional DSUs at the same rate as dividends on Subordinate Voting Share. When a Director ceases to be a member of our Board of Directors, the DSUs are either converted and paid in Subordinate Voting Shares purchased on the open

market or issued by us. Such Subordinate Voting Shares issued by us will be issued from the same pool of Subordinate Voting Shares reserved for issuance pursuant to the Long-Term Incentive Plan, which is 9.2% of the total issued and outstanding voting shares.

The following table summarizes information about DSUs granted to the non-employee members of our Board of Directors as at August 31, 2005:

	NUMBER OF DSUS	% OF ISSUED AND OUTSTANDING DSUS	WEIGHTED AVERAG VALUE AT THE TI GRANT $US/D
Board of Directors (five individuals)	23,734	100%	4.47

DEFERRED SHARE UNIT GRANTS IN LAST FINANCIAL YEAR

The aggregate number of Deferred Share Units ("DSUs") credited to non-employee Directors during the financial year ended August 31, 2005 was 23,734. The fair value at the time of grant of a DSU is equal to the market value of a Subordinate Voting Share at the time DSUs are credited to the Directors. At the end of the financial year ended August 31, 2005, there were a total of 23,734 DSUs credited to Directors pursuant to the Deferred Share Unit Plan having a fair value at the time of grant of US$105,998 (CDN$130,421).

DSUs attract dividends in the form of additional DSUs at the same rate as dividends on Subordinate Voting Shares. The DSUs are converted and paid in Subordinate Voting Shares at the time a Director ceases to be a member of our Board of Directors.

Therefore, the value at vesting of a DSU, when converted to Subordinate Voting Shares, is equivalent to the market value of a Subordinate Voting Share at the time the conversion takes place. The table below shows information regarding DSU grants made under the Deferred Share Unit Plan during the financial year ended August 31, 2005.

During the financial year ended August 31, 2005, the following DSUs were granted to the Directors:

DSUS #	WEIGHTED AVERAGE FAIR VALUE AT THE TIME OF GRANT US$/DSU	VESTING
23,734	4.47	At the time Director cease to be a member of the Board of the Corporation

RESTRICTED SHARE UNIT GRANTS IN LAST FINANCIAL YEAR

The aggregate number of Restricted Share Units (RSUs) granted during the financial year ended August 31, 2005 was 176,185. The fair value at the time of grant of a RSU is equal to the market value of Subordinate Voting Shares at the time RSUs are granted. At the end of the financial year ended August 31, 2005, there were a total of 176,185 RSUs granted pursuant to the Long-Term Incentive Plan having a weighted average fair value at the time of grant of US$4.68 (CDN$5.72) per RSU. All RSUs first vesting can not be earlier than the third anniversary date of their grant. Some RSUs granted in the financial year ended August 31, 2005 vest at a rate of 1/3 annually commencing on the third anniversary date of the grant in February 2005 and others at a rate of 55%, 35% and 10%, on the third, fourth and fifth anniversary dates of the grant in January 2005. Some RSUs granted in the financial year ended August 31, 2005 vest on the fifth anniversary date of the grant in January 2005 but are subject to early vesting on the third and fourth anniversary dates of the grant on the attainment of performance objectives as determined by our Board of Directors. Accordingly, subject to the attainment of performance objectives, the first early vesting is up to 1/3 of the units on the third anniversary date of the grant and the second early vesting is up to 50% of the remaining units on the fourth anniversary date of the grant.

RSUs attract dividends in the form of additional RSUs at the same rate as dividends on Subordinate Voting Shares. The RSUs are redeemed for actual Subordinate Voting Shares or the equivalent in cash at the discretion

of our Board of Directors on the vesting dates established by our Board of Directors at the time of grant in its sole discretion.

Therefore, the value at vesting of a RSU, when converted to Subordinate Voting Shares, is equivalent to the market value of a Subordinate Voting Share at the time the conversion takes place. The table below shows information regarding RSU grants made under the Long-Term Incentive Plan during the financial year ended August 31, 2005.

During the financial year ended August 31, 2005, the following RSUs were granted:

RSUS #	FAIR VALUE AT THE TIME OF GRANT S$/RSU	VESTING (1)
129,000	4.69	55%, 35% and 10%, on the third, fourth and fifth anniversary dates of the grant in January 2005 (2)
35,185	4.69	100% on the fifth anniversary date of the grant in January 2005 subject to early vesting up to 1/3 on the third anniversary date of the grant and up to 50% of the remaining units on the fourth anniversary date of the grant if the performance objectives are fully attained (3)
12,000	4.51	1/3 on each of the third, fourth and fifth anniversary dates of the grant in February 2005 (4)

(1) All RSUs first vesting can not be earlier than the third anniversary date of their grant.

(2) Those RSUs granted in the financial year ended August 31, 2005 vest at a rate of 55%, 35% and 10% on the third, fourth and fifth anniversary dates of the grant in January 2005.

(3) Those RSUs granted in the financial year ended August 31, 2005 vest on the fifth anniversary date of the grant in January 2005 but are subject to early vesting on the third and fourth anniversary dates of the grant on the attainment of performance objectives as determined by our Board of Directors. Accordingly, subject to the attainment of performance objectives, the first early vesting is up to 1/3 of the units on the third anniversary date of the grant and the second early vesting is up to 50% of the remaining units on the fourth anniversary date of the grant.

(4) Those RSUs granted in the financial year ended August 31, 2005 vest at a rate of 1/3 annually commencing on the third anniversary date of the grant in February 2005.

NUMBER OF SUBORDINATE VOTING SHARES RESERVED FOR FUTURE ISSUANCE

During the financial year ended August 31, 2005, 23,734 Deferred Share Units, 176,185 Restricted Share Units and 246,233 options were granted to Directors, officers and employees. Such awards were issued from the same pool of Subordinate Voting Shares reserved for issuance pursuant to the Long-Term Incentive Plan which is 9.2% of the total and outstanding voting shares. Therefore, as of November 1, 2005 the number of Subordinate Voting Shares reserved for future issuance is 3,182,504.

SHARE PURCHASE PLAN

In September 1998, we established a stock purchase plan for officers, Directors and key employees as amended in April 2000. A total of 707,264 subordinate voting shares were issued and fully paid under the 1998 Stock Purchase Plan, having a weighted average cash consideration of $0.67 (CA$0.98) per share. The plan provides that all shares issued under the plan are restricted as to sale and transferability for a minimum period of five years upon the date of acquisition.

On April 3, 2000, we adopted a share plan that replaced the 1998 Stock Purchase Plan. No additional shares will be issued under the share plan. The share plan established restrictions on the rights of the holders of subordinate voting shares who hold those shares as a result of the conversion of the Class "F" shares issued under the 1998 Stock Purchase Plan. The share

plan also required the subordinate voting shares to be held in trust by a trustee until August 31, 2004, except for 249,977 subordinate voting shares that were released between October 21, 2003 and January 20, 2004. The share plan also provided for the earlier release of shares in the event that the employment of a holder of shares is terminated or upon the occurrence of a change of control. The share plan did not permit any transfer, except within the trust to a registered retirement savings plan or a registered retirement income fund or to a trustee in bankruptcy. The share plan also established the conditions pursuant to which the shares of a shareholder are to be sold by the trustee on the public market. As of August 31, 2004, all the remaining subordinate voting shares that were held in trust under the share plan were released.

RESTRICTED STOCK AWARD PLAN

The EXFO Electrical-Optical Engineering Restricted Stock Award Plan (the "RSAP") was established to provide a means through which employees of EXFO Burleigh Products Group Inc. can be granted awards of restricted shares

("Restricted Shares") of Subordinate Voting Shares to promote retention and foster identity of interest between stockholders and employees of EXFO Burleigh Products Group Inc.

The effective date of the RSAP was December 20, 2000. The expiration date of the RSAP is the business day next following the final grant of Restricted Shares under the RSAP, which was December 20, 2000. However, the administration of the RSAP did continue until all awards of Restricted Shares have been forfeited or settled. The aggregate number of shares subject to the RSAP was 360,000. Stock awards granted under the RSAP vest over a 4 year period, with 25% vesting on an annual basis commencing on the first anniversary of the date of grant. The last vesting occurred on December 20, 2004, the Human Resources Committee administered the RSAP until that date. Therefore the administration of the RSAP terminated on December 20, 2004.

Awards of Restricted Shares were subject to forfeiture and restrictions on transfer until the Restricted Shares became vested at which point a stock certificate was issued to a participant with respect to the number of vested shares, which are then freely transferable. Restricted Shares become vested, subject to a participant's continued employment with us or our affiliates, on each of the first four anniversaries of the date of grant of an award of Restricted Shares.

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

Upon the voluntary resignation of a participant, the termination of a participant's employment for cause, the termination of a participant who is not designated a member of EXFO Burleigh Products Group Inc. "Management Team" without cause prior to a change in control of us or a termination without cause of a participant who is designated a member of EXFO Burleigh Products Group Inc. Management Team that is initiated by EXFO Burleigh Products Group Inc. prior to a change in control of us, the unvested portion of the participant's award of Restricted Shares were forfeited. However the RSAP provided discretion to the Human Resources Committee in the application of the forfeiture provisions where a change in circumstances rendered such action appropriate. During the financial year ended August 31, 2005, EXFO Burleigh

Products Group Inc. was required to lay off the remaining of the participants (excluding a few that were transferred to our other offices) as a result of a consolidation due to a sharp downturn in its market. The Human Resources Committee decided that the awards of RSAP participants affected by the lay-offs would not be subject to forfeiture, though the transfer restrictions remained in place until the occurrence of the vesting dates originally contemplated by the award.

Upon the termination without cause of a participant who was designated a member of EXFO Burleigh Products Group Inc. Management Team that was initiated by us or a termination of a participant's employment without cause following a change in control of the Corporation, a participant's award of Restricted Stock became fully vested and all restrictions lapsed.

In the event of a change in control, the committee administering the RSAP could in its discretion remove restrictions on Restricted Shares or provide for the cancellation of awards in exchange for payment in respect of

the Restricted Shares subject to an award.

STOCK APPRECIATION RIGHTS PLAN

On August 4, 2001, we established a Stock Appreciation Rights Plan ("SAR Plan") for the benefit of certain employees residing in countries where the granting of options under the Stock Option Plan is not feasible in our opinion. The Board has full and complete authority to interpret the SAR Plan and to establish the rules and regulations applying to it and to make all other determinations it deems necessary or useful for the administration of the SAR Plan.

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

Our Board of Directors has delegated to Management the task of designating the recipients of stock appreciation rights, the date of vesting, the expiry date and other conditions. Under the terms of the SAR Plan, the exercise price of the stock appreciation rights may not be lower than the highest of the closing prices of the Subordinate Voting Shares on the Toronto Stock Exchange and on the NASDAQ National Market on the last trading day preceding the grant date, using the noon buying rate of the Federal Reserve Bank of New York on the grant date to convert the NASDAQ National Market closing price to Canadian dollars. Stock appreciation rights are non-transferable.

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

As of November 1, 2005, there were 19,000 SAR's outstanding.

DEFERRED PROFIT SHARING PLAN

We maintain a deferred profit sharing plan for certain eligible Canadian resident employees. Under this plan, we may contribute an amount equal to 1% until May 31, 2005 and 2% starting June 1, 2005, of each employee's gross salary to that employee's individual deferred profit sharing plan to the extent that such employee contributes at least 2% of his or her gross salary to his or her individual tax-deferred registered retirement savings plan. As a cost control measure, we temporarily suspended our contributions under this plan commencing in June 2002 and re-established contributions commencing January 2003. In the year ended August 31, 2005, the aggregate amount of contributions under the plan was $179,000 (CA$221,000).

Mr. Germain Lamonde is not entitled to participate in this plan.

401(K) PLAN

We maintain a 401(k) plan for eligible United States resident employees of our subsidiaries. Employees become eligible to participate in the 401(k) plan on the first day of the month following the completion of three months of continuous service. Employees may elect to defer their current compensation up to the lesser of 1% of eligible compensation or the statutorily prescribed annual limit and have the deferral contributed to the 401(k) plan. The 401(k) plan permits, but does not require, us to make additional matching contributions to the 401(k) plan on behalf of the eligible participants, subject to a maximum of 50% of the first 6% of the participant's current compensation subject to certain legislated maximum contribution limits. In the year ended August 31, 2005, we made an aggregate of $134,000 in matching contributions to the 401(k) plan. Contributions by employees or by us to the 401(k) plan and income earned on plan contributions are generally not taxable to the employees until withdrawn and contributions by us are generally deductible by us when made. At the direction of each participant, the trustees of the 401(k) plan invest the assets of the 401(k) plan in selected investment options.

INDEMNIFICATION OF DIRECTORS AND EXECUTIVE OFFICERS AND LIMITATION OF LIABILITY

Our by-laws require us, subject to the limitations provided by law, to indemnify our present or former Directors and officers or any persons who act or acted at our request as Directors or officers of a body CORPORATE for all costs, losses, charges and expenses that arose or may arise by reason of their status as Directors or officers of us or such body corporate. A policy of Directors' and officers' liability insurance is maintained by us which insures our Directors and officers and those of our subsidiaries against liability incurred by, arising from or against them for certain of their acts, errors or omissions. Accordingly, we maintain insurance protection against liability incurred by our officers and Directors as well as those of our subsidiaries in the performance of their duties. The entire premium, amounting to US$245,000 from September 30, 2005 to September 30, 2006, is paid by us. The aggregate limit of liability in respect of any and all claims is US$10 million per year. The policy provides for the indemnification of Directors and officers in the case of claims for which we have not indemnified or are not permitted by law to indemnify them, and for the reimbursement of us, subject to a deductible of US$100,000, except for securities claims where the deductible is US$500,000.

C. BOARD PRACTICES

BOARD OF DIRECTORS

Our Directors are elected at the annual meeting of shareholders for one-year terms and serve until their successors are elected or appointed, unless they resign or are removed earlier. Our articles of incorporation provide for a Board of Directors of a minimum of three (3) and a maximum of twelve (12) Directors. Our Board of Directors presently consists of six Directors. Under the CANADA BUSINESS CORPORATIONS ACT, twenty-five percent of the Directors and of the members of any committee of the Board of Directors must be resident Canadians. We have no arrangements with any of our Directors providing for the payment of benefits upon their termination of service as Director except for the vesting of their respective Deferred Share Units as detailed above.

Since September 1, 2004 until November 1, 2005, the Board met a total of seven (7) times. Attendance at all meetings was perfect, except Mr. David A. Thompson who was absent two times and Mr. Andre Tremblay who was absent one time.

COMMITTEES OF THE BOARD OF DIRECTORS

Our Board of Directors has established an audit committee, a human resources committee and a disclosure committee.

Our audit committee will recommend a firm to be appointed as independent auditors to audit financial statements and to perform services related to the audit, review the scope and results of the audit with the independent auditors, review with management and the independent auditors our annual operating results and consider the adequacy of the internal accounting procedures and the effect of the procedures relating to the auditors' independence. Further to changes to NASDAQ corporate governance rules and Securities and Exchange rules flowing from the adoption of the SARBANES-OXLEY ACT, our audit committee charter is being revised every financial year to ensure that we comply with all new requirements. Accordingly, in March 2005, the Board updated and adopted an Audit Committee Charter. A copy of this Audit Committee Charter has been filed as Exhibit 11.6 to the annual report and is also readily available from EXFO's website at www.exfo.com. The audit committee is composed of four independent Directors: Andre Tremblay, Michael Unger, Guy Marier and Pierre Marcouiller. The chairperson of the audit committee is Andre Tremblay.

During the fiscal year ended August 31, 2005, the Audit Committee met a total of four (4) times and attendance was perfect at all meetings, as all members attended all meetings.

Our human resources committee will evaluate, review and supervise our procedures with regards to human resources and will assess the performance of our executive officers and the chief executive officer. This committee will also review annually the remuneration of the Directors and will recommend to the Board of Directors general remuneration policies regarding salaries, bonuses and other forms of remuneration for our Directors, executive officers and employees as a whole. Finally, the human resources committee will review our organizational structure annually and the development and maintenance of a succession plan. Accordingly, in March 2005, the Board updated and adopted a Human Resources Committee Charter which integrates the Compensation Committee Charter and the Nominating and Governance Committee Charter. A copy of this Human Resources Committee Charter has been filed as Exhibit 11.7 to the annual report and is also readily available from EXFO's website at www.exfo.com. The

human resources committee is composed of five independent Directors: Pierre Marcouiller, Guy Marier, David A. Thompson, Andre Tremblay and Michael Unger. The chairperson of the human resources committee is Michael Unger.

During the fiscal year ended August 31, 2005, the Human Resources committee met a total of two times and attendance was perfect at all meetings, with the excepton of one meeting missed by Mr. David A. Thompson.

The disclosure committee is responsible for overseeing our disclosure practices. This committee consists of the chief executive officer, the chief financial officer, investor relations the manager of financial reporting and accounting as well as our legal counsel and corporate secretary.

In addition, in order to deal with issues arising from our implication in the IPO class action suit, in October 2002, our Board of Directors appointed a litigation committee composed of four of our independent Directors.

D. EMPLOYEES

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

As of November 1, 2005, we had a total of 685 employees, up from a total of 649 on December 15, 2004. We have 614 employees in Canada, primarily based in Quebec, and 71 employees based outside of Canada. 194 are involved in research and development, 250 in manufacturing, 128 in sales and marketing, 72 in general administrative positions and 41 in communications and customer support. We have agreements with almost all of our employees covering confidentiality and non-competition. Only manufacturing employees based in Quebec City plants are represented by a collective bargaining agreement, which expires in 2009. We have never experienced a work stoppage. We believe that relations with our employees and bargaining unit are good.

E. SHARE OWNERSHIP

The following table presents information regarding the ownership of Subordinate Voting Shares, Exercisable "in-the-money" and "out-the-money" options and the beneficial ownership of our share capital as of November 1, 2005 by our Chief Executive Officer, Chief Financial Officer, our Directors, our three other most highly compensated executive officers, our other executive officers as a group and all of our Directors and executive officers as a group.

Each multiple voting share is convertible at the option of the holder into one subordinate voting share. Holders of our subordinate voting shares are entitled to one (1) vote per share and holders of our multiple voting shares are entitled to ten (10) votes per share.

NAME	SUBORDINATE VOTING SHARES OWNED		CURRENTLY EXERCISABLE OPTIONS OWNED AS OF NOVEMBER 1, 2005				TOTAL SUBORDINATE VOTING SHARES BENEFICIALLY OWNED (3)		MULTI SHARES OW
			IN-THE-MONEY(1)		OUT-THE-MONEY(2)				
	NUMBER	PERCENT	NUMBER	PERCENT	NUMBER	PERCENT	NUMBER	PERCENT	NUMBE
Germain Lamonde (4)	93,000	*	37,500	*	100,482	*	230,982	*	37,900,
Pierre Plamondon	35,427(5)	*	18,750	*	53,285	*	107,462	*	
Pierre	5,000	*	15,625	*	23,003	*	43,628	*	

Marcouiller										
Guy Marier	1,000	*	--	*	3,125	*	4,125	*		
David A. Thompson	2,100	*	15,625	*	17,734	*	35,459	*		
Andre Tremblay	6,650(6)	*	15,625	*	19,691	*	41,966	*		
Michael Unger	--	*	15,625	*	20,568	*	36,193	*		
Juan-Felipe Gonzalez	50,752	*	7,500	*	80,150	*	138,402	*		
Stephen Bull	21,573	*	11,255	*	24,727	*	57,550	*		
Etienne Gagnon	5,000	*	5,000	*	789	*	10,789	*		
Other executive officers as a group	8,452	*	18,750	*	45,169	*	72,371	*		
All of our Directors and executive officers as a group	228,954	*	161,250	*	388,723	1.3	778,927	2.5	37,900,	

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* Less than 1%.

(1) "In-the-money" options are options for which the market value of the underlying securities is higher than the price at which such securities may be bought from the Corporation. As of November 1, 2005 the market value of a Subordinate Voting Share was US$4.43.

(2) "Out-the-money" options are options for which the market value of the underlying securities is lower than the price of which such securities may be bought from the Corporation.

(3) Beneficial ownership is determined in accordance with the rules of the SEC and generally includes voting or investment power with respect to securities. Options that are currently exercisable (including options that have an exercise price above the market price) are deemed to be outstanding and to be beneficially owned by the person holding such options for the purpose of computing the percentage ownership of such person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person. Accordingly, DSUs and RSUs are not included.

(4) The number of shares held by Germain Lamonde includes 1,900,000 multiple voting shares held of record by Fiducie Germain Lamonde, 36,000,000 multiple voting shares held of record by G. Lamonde Investissements Financiers inc. and 93,000 subordinate voting shares held of record by Placements Lamonde SENC.

(5) The number of shares held by Pierre Plamondon includes 6,874 subordinate voting shares held of record by Fiducie Pierre Plamondon.

(6) The number of subordinate voting shares held of record by Andre Tremblay is held by 9104-5559 Quebec Inc, a company controlled by Mr. Tremblay.

The following table presents information regarding stock options held

as of November 1, 2005 by our Chief Executive Officer, Chief Financial Officer, our Directors, our three other most highly compensated executive officers and our other executive officers as a group.

NAME	SECURITIES UNDER OPTIONS GRANTED (1) (#)	EXERCISE PRICE (2) (US$/SECURITY)	EXPIRATIO
Germain Lamonde.....	25,402	$26.00	June 29,
	5,080	$22.25	January 10
	70,000	$9.13	October 10
	50,000	$1.58	September 2
	17,942	$4.51	February 1
Pierre Plamondon.....	8,700	$26.00	June 29,
	10,000	$45.94	September 1
	5,000	$34.07	October 11
	9,240	$22.25	January 10
	19,000	$9.13	October 10
	25,000	$1.58	September 2
	5,383	$5.13	October 26
Pierre Marcouiller.....	2,000	$26.00	June 29,
	400	$22.25	January 10
	17,966	$9.13	October 10
	1,037	$12.69	December 1
	2,479	$5.65	March 1,
	12,500	$1.58	September 2
	12,500	$3.51	October 27
Guy Marier.....	12,500	$4.65	March 24,
David A. Thompson.....	2,000	$26.00	June 29,
	400	$22.25	January 10
	15,334	$9.13	October 10
	12,500	$1.58	September 2
	12,500	$3.51	October 27
Andre Tremblay.....	2,000	$26.00	June 29,
	400	$22.25	January 10
	17,291	$9.13	October 10
	12,500	$1.58	September 2
	12,500	$3.51	October 27
Michael Unger.....	2,000	$26.00	June 29,
	400	$22.25	January 10
	18,168	$9.13	October 10
	12,500	$1.58	September 2
	12,500	$3.51	October 27
Juan Felipe Gonzalez.....	6,900	$26.00	June 29,
	15,000	$45.94	September 1
	15,000	$34.07	October 11
	15,630	$22.25	January 10
	15,000	$9.13	October 10
	15,000	$12.22	January 3,
	15,000	$1.58	September 2
	5,482	$5.13	October 26
Stephen Bull.....	900	$26.00	June 29,

5,000	$45.94	September 1
2,930	$22.25	January 10
15,000	$9.13	October 10
15,000	$1.58	September 2
3,589	$5.13	October 26

NAME	SECURITIES UNDER OPTIONS GRANTED (1) (#)	EXERCISE PRICE (2) (US$/SECURITY)	EXPIRATIO
Etienne Gagnon.....	15,000	$3.19	January 7,
	3,158	$5.13	October 26
Other Executive Officers as a group.....	3,000	$45.94	September 1
	4,000	$34.07	October 11
	3,250	$22.25	January 10
	10,000	$23.40	March 15,
	18,000	$9.13	October 10
	26,250	$1.58	September 2
	15,000	$4.65	March 24,
	12,679	$5.13	October 26
	2,000	$4.51	February 1

(1) Underlying securities: subordinate voting shares
(2) The exercise price of options granted is determined based on the highest of the closing prices of the subordinate voting shares on the Toronto Stock Exchange and the NASDAQ National Market on the last trading day preceding the grant date, using the noon buying rate of the Federal Reserve Bank of New York on the grant date to convert the NASDAQ National Market closing price to Canadian dollars, as required.

The following table presents information regarding Deferred Share Units and Restricted Share Units held by our Chief Executive Officer, our Chief Financial Officer, our Directors, our three other most highly compensated executive officers, our other executive officers as a group and all of our Directors and executive officers as a group.

	DSUS			RSU	
NAME	NUMBER	PERCENTAGE	WEIGHTED AVERAGE FAIR VALUE AT THE TIME OF GRANT US$/DSU (1)	NUMBER	PERCENTAG
Germain Lamonde	--	--	--	13,089 (3)	7.4
Pierre Plamondon	--	--	--	3,927 (3)	2.2
	--	--	--	30,000 (4)	17.0

Pierre Marcouiller	4,537 (5)	19.1%	4.47	--	-
Guy Marier	4,537 (5)	19.1%	4.47	--	-
David A. Thompson	5,586 (5)	23.6%	4.47	--	-
Andre Tremblay	4,537 (5)	19.1%	4.47	--	-
Michael Unger	4,537 (5)	19.1%	4.47	--	-
Juan-Felipe Gonzalez	--	--	--	3,998 (3)	2.3
	--	--	--	30,000 (4)	17.0
Stephen Bull	--	--	--	2,618 (3)	1.5
	--	--	--	30,000 (4)	17.0
Etienne Gagnon	--	--	--	2,304 (3)	1.3
	--	--	--	7,500 (4)	4.3
Other executives officers as a group	--	--	--	9,249 (3)	5.2
	--	--	--	31,500 (4)	17.9
All of the directors and executive officers as a group	--	--	--	35,185 (3)	20.0
	23,734	100%	4.47	129,000 (4)	73.2

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(1) The weighted average fair value at the time of grant is the average of the fair value at the time of grant of a DSU which is equal to the market value of a Subordinate Voting Share at the time DSUs are credited to the Directors.

(2) The fair value at the time of grant of a RSU is equal to the market value of Subordinate Voting Shares at the time RSUs are granted.

(3) Those RSUs will vest on the fifth anniversary date of the grant in January 2005 but are subject to early vesting on the third and fourth anniversary date of the grant on the attainment of performance objectives as determined by the Board of Directors. Accordingly, subject to the attainment of performance objectives, the first early vesting is up to 1/3 of the units on the third anniversary date of the grant and the second early vesting is up to 50% of the remaining units on the fourth anniversary date of the grant.

(4) Those RSUs will vest at a rate of 55%, 35% and 10%, on the third, fourth and fifth anniversary dates of the grant in January 2005.

(5) Those DSUs will vest at the time Director cease to be a member of the Board of the Corporation.

ESCROWED SECURITIES

The following table presents information regarding the number of securities of each class of the Corporation held, to the Corporation's knowledge as of November 1, 2005, in escrow and the percentage outstanding

securities of that class.

DESIGNATION OF CLASS	NUMBER OF SECURITIES HELD IN ESCROW	PERCENTAGE OF CLASS
Subordinate Voting Shares	493,096 (1)	1.6%
Multiple Voting Shares	--	--

(1) CIBC Mellon Trust Company is the Escrow agent. The shares held in Escrow will be released to shareholder on October 4, 2006.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. MAJOR SHAREHOLDERS

The following table presents information regarding the beneficial ownership of our share capital as of November 1, 2005 by persons or groups of affiliated persons known by us to own more than 5% of our voting shares.

	MULTIPLE VOTING SHARES BENEFICIALLY OWNED (1)		SUBORDINATE VOTING SHARES BENEFICIALLY OWNED (1)		TOTAL VO
NAME	NUMBER	PERCENT	NUMBER	PERCENT	P
Germain Lamonde (2)	37,900,000	100%	230,982	*	
Fiducie Germain Lamonde (3)	1,900,000	5%	Nil	Nil	
G. Lamonde Investissements Financiers inc. (4)	36,000,000	95%	Nil	Nil	
Placements Lamonde, SENC (5)	Nil	Nil	93,000	*	
Kern Capital Management, LLC (6)	Nil	Nil	4,658,000	15.19%	
FMR Corporation (7)	Nil	Nil	4,597,100	14.99%	
Skyline Asset Management LP (8)	Nil	Nil	1,893,100	6.17%	

* Less than 1%

(1) Beneficial ownership is determined in accordance with the rules of the SEC and generally includes voting or investment power with respect to securities. Options that are currently exercisable (including options that have an exercise price above the market price) are deemed to be outstanding and to be beneficially owned by the person holding such options for the purpose of computing the percentage ownership of such person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person.

(2) The number of shares held by Germain Lamonde includes 1,900,000 multiple voting shares held of record by Fiducie Germain Lamonde and 36,000,000 multiple voting shares held of record by G. Lamonde Investissements Financiers inc. and 93,000 subordinate voting shares held of record by Placements Lamonde, SENC.
(3) Fiducie Germain Lamonde is a family trust for the benefit of Mr. Lamonde and members of his family.
(4) G. Lamonde Investissements Financiers inc. is a company controlled by Mr. Lamonde.
(5) Placements Lamonde, SENC is a parternship controlled by Mr. Lamonde.
(6) As of September 30, 2005, Kern Capital Management LLC controls the voting rights attached to this number of subordinate voting shares through relationships with several clients and does not beneficially own directly this number of subordinate voting shares.
(7) As of September 30, 2005, Fidelity Management and Research Company, a wholly owned subsidiary of FMR Corporation, is the beneficial owner of this number of subordinate voting shares as a result of acting as investment advisor to various investment companies.
(8) As of September 30, 2005, Skyline Asset Management LP apparently controls the voting rights attached to this number of subordinate voting shares but we were unable to obtain a confirmation from Skyline.

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

As of November 21, 2005, 30,674,617 subordinate voting shares were outstanding. Approximately 96% (29,525,530) of our subordinate voting shares were held in bearer form and the remainder (1,149,087 subordinate voting shares) was held by 178 record holders. As of November 21, 2005, we believe approximately 58% of our outstanding subordinate voting shares were held in the United States.

B. RELATED PARTY TRANSACTIONS

INDEBTEDNESS OF DIRECTORS, EXECUTIVE OFFICERS AND EMPLOYEES

We have guaranteed the repayment of a loan granted to an employee by a financial institution for the purchase of our Class "F" shares that were converted into subordinate voting shares immediately prior to our initial public offering. As of August 31, 2005 and November 1, 2005, the total principal amount guaranteed by us was $56,200.

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

LEASES

Until September 1, 2004, we had a lease agreement with G. Lamonde Investissements financiers inc., a company controlled by Mr. Germain Lamonde, for premises located at 465 Godin Avenue in Vanier, Quebec. Until September 1, 2003, these premises were used for our executive and administrative offices which were, since then, moved into a building that we own. For fiscal year 2004, this space was unoccupied. This lease was renewed in December 2001 for five years, with all terms and conditions remaining the same. However, on September 1, 2004, we were released from our obligations under the lease with

a final payment of $194,000 (CA$250,000). The annual rent for this lease was $CA144,000.

LOCATION	SQUARE FOOTAGE	ANNUAL RENT	EXPIRY DATE
465 Godin	24,000	CA$144,000	November 30, 2006

Based on third-party valuations of the property values, we believe this lease agreement was at prevailing market terms.

In September 2002, we acquired from G. Lamonde Investissements financiers inc. the building located at 436 Nolin Street that houses some of our manufacturing activities. Previous to this acquisition, we had a lease agreement with this company for these premises. We paid CA$1,450,000 for the building and this purchase price is based on an independent third party valuation and the transaction was approved by our audit committee and the Board of Directors with Mr. Lamonde abstaining.

ITEM 8. FINANCIAL INFORMATION

A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

See Item 18, "Financial Statements" for certain information required by this section.

Valuation and qualifying accounts as well as Export sales are as follows (in thousands of US dollars);

ALLOWANCE FOR DOUBTFUL ACCOUNTS

	YEARS ENDED AUGUST 31,	
	2005	2004
Balance - Beginning of year	$ 510	$ 568
Addition charged to earnings	316	403
Write-offs of uncollectible accounts	(23)	(48)
Recovery of uncollectible accounts	(464)	(456)
Foreign currency translation adjustment	13	43
Balance - End of year	$ 352	$ 510

VALUATION ALLOWANCE ON FUTURE INCOME TAX ASSETS

	YEARS ENDED AUGUST 31,	
	2005	2004
Balance - Beginning of year	$ 32,613	$ 28,846
Addition charged to earnings	3,375	3,954
Foreign currency translation adjustment	2,418	(187)
Balance - End of year	$ 38,406	$ 32,613

EXPORT SALES

Export and domestic sales in thousands of US dollars and as a percentage of total sales are as follows:

	YEARS ENDED AUGUST 31,				
	2005		2004		20
Export Sales	$ 90,386	93%	$ 68,812	92%	$ 57,1
Domestic Sales	6,830	7	5,818	8	4,8
	$ 97,216	100%	$ 74,630	100%	$ 61,9

LEGAL PROCEEDINGS

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

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

registration statement and had the ability to prevent its issuance or cause it to be corrected. The plaintiffs in this suit seek an unspecified amount for damages suffered.

In July 2002, the issuers filed a motion to dismiss the plaintiffs' amended complaint and judgment was rendered on February 19, 2003. Only one of the claims against the company was dismissed. On October 8, 2002, the claims against its officers were dismissed pursuant to the terms of Reservation of Rights and Tolling Agreements entered into with the plaintiffs.

In June 2003, a committee of the company's Board of Directors conditionally approved a proposed settlement between the issuer defendants, the individual defendants, and the plaintiffs. If approved, the settlement would provide, among other things, a release of the company and of the individual defendants for the conduct alleged in the action to be wrongful in the amended complaint. The company would agree to undertake other responsibilities under the settlement, including agreeing to assign away, not assert, or release certain potential claims the company may have against its underwriters. Any direct financial impact of the proposed settlement is expected to be borne by the company's insurance carriers.

On June 25, 2004, the Plaintiffs moved for Preliminary Approval of the settlement. The court granted the preliminary approval motion on February 15, 2005, subject to certain modifications.

On August 31, 2005, the court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The court also appointed the Notice Administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members beginning on November 15, 2005, and completed by January 15, 2006. The settlement fairness hearing has been set for April 26, 2006. Following the hearing, if the court determines that the settlement is fair to the class members, the settlement will be approved. There can be no assurance that this proposed settlement would be approved and implemented in its current form, or at all. Therefore, it is not possible to predict the final outcome of the case, nor determine the amount of any possible losses. If the settlement process fails, the company will continue to defend its position in this litigation that the claims against it, and its officers, are without merit. Accordingly, no provision for this case has been made in the consolidated financial statements as at August 31, 2005.

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

DIVIDEND POLICY

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

B. SIGNIFICANT CHANGES

No significant changes occurred since the date of our annual consolidated financial statements included elsewhere in this Annual Report.

ITEM 9. OFFER AND LISTING

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

	NASDAQ (US$)		TSX (CDN$)	
	HIGH	LOW	HIGH	LOW
September 1, 2000 to August 31, 2001	57.75	11.80	85.00	17.82
September 1, 2001 to August 31, 2002	15.00	1.35	23.80	2.05
September 1, 2002 to August 31, 2003	3.63	1.40	5.60	2.30
September 1, 2003 to August 31, 2004	7.09	2.71	9.15	3.75
September 1, 2004 to August 31, 2005	5.51	3.92	6.90	4.92
2004 1st Quarter	4.26	2.71	5.53	3.75
2004 2nd Quarter	7.09	3.29	9.15	4.40
2004 3rd Quarter	5.23	4.08	6.90	5.68
2004 4th Quarter	5.38	4.11	6.95	5.50
2005 1st Quarter	5.51	4.27	6.90	5.73
2005 2nd Quarter	5.24	4.29	6.42	5.35
2005 3rd Quarter	4.99	3.93	6.05	4.95
2005 4th Quarter	5.00	3.92	6.10	4.92
2005 May	4.28	3.93	5.30	4.95
2005 June	4.62	3.92	5.71	4.92
2005 July	4.91	4.12	6.05	5.12
2005 August	5.00	4.61	6.10	5.53
2005 September	5.00	4.76	5.92	5.60
2005 October	5.05	4.32	5.89	5.15
2005 November (until November 21)	4.75	4.43	5.71	5.24

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

On November 21, 2005, the last reported sale price for our subordinate voting shares on the NASDAQ National Market was US$ 4.72 per share and the last reported sale price for our subordinate voting shares on the Toronto Stock Exchange was CA$ 5.62 per share.

ITEM 10. ADDITIONAL INFORMATION

A. SHARE CAPITAL

Not Applicable

B. MEMORANDUM AND ARTICLES OF ASSOCIATION

Incorporated by reference to our registration statement on Form F-1 dated June 9, 2000 (File No. 333-38956).

C. MATERIAL CONTRACTS

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

D. EXCHANGE CONTROLS

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

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

E. TAXATION

UNITED STATES TAXATION

The information set forth below under the caption "United States Taxation" is a summary of the material U.S. federal income tax consequences of the ownership and disposition of subordinate voting shares by a U.S. Holder, as defined below. These discussions are not a complete analysis or listing of all of the possible tax consequences of such transactions and do not address all tax considerations that may be relevant to particular holders in light of their personal circumstances or to persons that are subject to special tax rules. In particular, the information set forth under the caption "United States Taxation" deals only with U.S. Holders that hold subordinate voting shares as capital assets within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended, and who do not at any time own individually, nor are treated as owning 10% or more of the total combined voting power of all classes of our stock entitled to vote. In addition, this description of U.S. tax consequences does not address the tax treatment of special classes of U.S. Holders, such as financial institutions, regulated investment companies, traders in securities who elect to mark-to-market their securities, tax-exempt

entities, insurance companies, partnerships, persons holding subordinate voting shares as part of a hedging, integrated or conversion transaction or as part of a "straddle," U.S. expatriates, persons subject to the alternative minimum tax, persons who acquired their subordinate voting shares through the exercise or cancellation of employee stock options or otherwise as compensation for services, dealers or traders in securities or currencies and

holders whose "functional currency" is not the U.S. dollar. This summary does not address estate and gift tax consequences or tax consequences under any foreign, state or local laws other than as provided in the section entitled "Canadian Federal Income Tax Considerations" provided below.

As used in this section, the term "U.S. Holder" means a beneficial owner of subordinate voting shares that is for U.S. federal income tax puposes:

(a) an individual citizen or resident of the United States;
(b) a corporation created or organized under the laws of the United States or any state thereof and the District of Columbia;
(c) an estate the income of which is subject to United States federal income taxation regardless of its source;
(d) a trust if (1) a court within the United States is able to exercise primary jurisdiction over its administration and one or more U.S. persons have authority to control all substantial decisions of the trust or (2) the trust has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person; or
(e) any other person whose worldwide income or gain is otherwise subject to U.S. federal income taxation on a net income basis;

If a partnership or other flow-through entity holds subordinate voting shares, the U.S. federal income tax treatment of a partner will generally depend upon the status of the partner or other owner and upon the activities of the partnership or other flow-through entity. If you are a partner of a partnership holding subordinate voting shares, you should consult your tax advisor.

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

The following discussion is based upon:

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

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

The following discussion is for general information only and is not intended to be, nor should it be construed to be, legal or tax advice to any holder of subordinate voting shares and no opinion or representation with respect to the U.S. federal income tax consequences to any holder is made. Holders of subordinate voting shares are urged to consult their tax advisors as to the particular consequences to them under U.S. federal, state, local and applicable foreign tax laws of the acquisition, ownership and disposition of subordinate voting shares.

DIVIDENDS

Subject to the discussion of passive foreign investment companies below, the gross amount of any distribution paid by us to a U.S. Holder will generally be subject to U.S. federal income tax as foreign source dividend income to the extent paid out of our current or accumulated earnings and profits, as determined under U.S. federal income tax principles. Such income will be includable in the gross income of a U.S. Holder on the day received by the U.S. Holder. The amount of any distribution of property other than cash will be the fair market value of such property on the date of the distribution. In the case of a taxable corporate U.S. Holder, such dividends will be taxable as ordinary income and will not be eligible for the corporate dividends received deduction, which is generally allowed to U.S. corporate shareholders on dividends received from a domestic corporation. In the case of an individual U.S. Holder, under recently enacted tax legislation such dividends should generally be eligible for a maximum tax rate of 15% for dividends received before January 1, 2009, provided such holder holds the subordinate voting shares for at least 60 days and certain other conditions are satisfied, including, as we believe to be the case, that we are not a "passive foreign investment company" To the extent that an amount received by a U.S. Holder exceeds such holder's allocable share of our current and accumulated earnings and profits, such excess will be applied first to reduce such U.S. Holder's tax basis in his subordinate voting shares, thereby increasing the amount of gain or decreasing the amount of loss recognized on a subsequent disposition of the subordinate voting shares. Then, to the extent such distribution exceeds such U.S. Holder's tax basis, it will be treated as capital gain. We do not currently maintain calculations of our earnings and profits for U.S. federal income tax purposes.

The gross amount of distributions paid in Canadian dollars, or any successor or other foreign currency, will be included in the income of such U.S. Holder in a U.S. dollar amount calculated by reference to the spot exchange rate in effect on the day the distributions are paid regardless of whether the payment is in fact converted into U.S. dollars. If the Canadian dollars, or any successor or other foreign currency, are converted into U.S. dollars on the date of the payment, the U.S. Holder should not be required to recognize any foreign currency gain or loss with respect to the receipt of Canadian dollars as distributions. If, instead, the Canadian dollars are converted at a later date, any currency gains or losses resulting from the conversion of the Canadian dollars will be treated as U.S. source ordinary income or loss for foreign tax credit purposes. U.S. Holders are urged to consult their own tax advisors concerning the U.S. tax consequences of acquiring, holding and disposing of Canadian dollars.

A U.S. Holder may be entitled to deduct, or claim a foreign tax credit for, Canadian taxes that are withheld on dividends received by the U.S. Holder, subject to applicable limitations in the Code. Any amounts recognized as dividends will generally constitute foreign source "passive income" or, in the case of certain U.S. Holders, "financial services income" for U.S. foreign tax credit purposes. A U.S. Holder will have a basis in any Canadian dollars distributed equal to their U.S. dollar value on the payment date. The rules governing the foreign tax credit are complex, and additional limitations on the credit apply to individuals receiving dividends from foreign corporations if the dividends are eligible for the 15% maximum tax rate on dividends

described above. U.S. Holders are urged to consult their tax advisors regarding the availability of the foreign tax credit under their particular circumstances.

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

SALE OR EXCHANGE

A U.S. Holder's initial tax basis in the subordinate voting shares will generally be cost to the holder. A U.S. Holder's adjusted tax basis in the subordinate voting shares will generally be the same as cost, but may differ for various reasons including the receipt by such holder of a distribution that was not made up wholly of earnings and profits as described above under the heading "Dividends." Subject to the discussion of passive foreign investment companies below, gain or loss realized by a U.S. Holder on the sale or other disposition of subordinate voting shares will be subject to U.S. federal income taxation as capital gain or loss in an amount equal to the difference (if any) between the U.S. Holder's adjusted tax basis (determined in U.S. dollars) in the subordinate voting shares and the U.S. dollar value of the amount realized on the disposition of such subordinate voting shares. Capital gains of non-corporate taxpayers, including individuals, derived with respect to a sale, exchange or other disposition prior to January 1, 2009 of subordinate voting shares held for more than one year are subject to a maximum federal income tax rate of 15%. The deductibility of capital losses is subject to limitations. In the case of a non-corporate U.S. Holder, the federal tax rate applicable to capital gains will depend upon:

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

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

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

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

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

- such gain is effectively connected with the conduct by such Non-U.S. Holder of a trade or business in the United States; or

- in the case of any gain realized by an individual Non-U.S.

Holder, such Non-U.S. Holder is present in the United States for 183 days or more in the taxable year of such sale and certain other conditions are met.

FOREIGN PERSONAL HOLDING COMPANY

Under recently enacted legislation, the foreign personal holding company rules are repealed for taxable years of U.S. shareholders ending after December 31, 2004.

PASSIVE FOREIGN INVESTMENT COMPANY

We believe that our subordinate voting shares should not currently be treated as stock of a passive foreign investment company for United States federal income tax purposes, but this conclusion is a factual determination made annually and thus may be subject to change based on future operations as well as the composition and valuation of our assets. In particular, a significant portion of our gross assets are comprised of cash and short-term investments, which the PFIC rules treat as passive without regard to the purpose for which we hold those assets. If the proportion of these passive assets were to increase relative to the fair market value of our other assets, we may be treated as a passive foreign investment company. In general, we will be a passive foreign investment company with respect to a U.S. Holder if, for any taxable year in which the U.S. Holder holds our subordinate voting shares, either:

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

For this purpose, passive income includes income such as:

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

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

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

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

Generally, "excess distributions" are any distributions to the U.S. Holder in respect of the subordinate voting shares during a single taxable year that are greater than 125% of the average annual distributions received by the U.S. Holder in respect of the subordinate voting shares during the

three preceding taxable years or, if shorter, the U.S. Holder's holding period for the subordinate voting shares.

Under the passive foreign investment company rules,

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

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

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

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

UNITED STATES BACKUP WITHHOLDING AND INFORMATION REPORTING

A U.S. Holder will generally be subject to information reporting with respect to dividends paid on, or proceeds of the sale or other disposition of, our subordinate voting shares that are paid within the United States or through some U.S. related financial intermediaries to U.S. Holders, unless the U.S. Holder is a corporation or comes within certain other categories of exempt recipients. A U.S. Holder that is not an exempt recipient will

generally be subject to backup withholding with respect to the proceeds from the sale or the disposition of, or with respect to dividends on, subordinate

voting shares unless the U.S. Holder provides a taxpayer identification number and otherwise complies with applicable requirements of the backup withholding rules. In addition, backup withholding may apply if the U.S. Holder fails to provide an accurate taxpayer identification number, or to report interest and dividends required to be shown on its federal income tax returns. Backup withholding is not an additional tax. Any amount withheld under these rules will be creditable against the U.S. Holder's U.S. federal income tax liability or refundable to the extent that it exceeds such liability. A U.S Holder who does not provide a correct taxpayer identification number may be subject to penalties imposed by the United States Internal Revenue Service.

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

CANADIAN FEDERAL INCOME TAX CONSIDERATIONS

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

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

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

Under the ITA and the Convention, dividends paid or credited, or

deemed to be paid or credited, on the subordinate voting shares to a U.S. person who owns less than 10% of the voting shares will be subject to Canadian

withholding tax at the rate of 15% of the gross amount of those dividends or deemed dividends. If a U.S. person is a corporation and owns 10% or more of the voting shares, the rate is reduced from 15% to 5%. Subject to specified limitations, a U.S. person may be entitled to credit against U.S. federal income tax liability for the amount of tax withheld by Canada.

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

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

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

Holders of subordinate voting shares are urged to consult their own tax advisors to determine the particular tax consequences to them, including the application and effect of any state, local or foreign income and other tax laws, of the acquisition, ownership and disposition of subordinate voting shares.

F. DIVIDENDS AND PAYING AGENTS

Not Applicable.

G. STATEMENT BY EXPERTS

Not Applicable.

H. DOCUMENTS ON DISPLAY

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

document.

You may review a copy of our filings with the SEC, including exhibits and schedules filed with it, at the SEC's public reference facilities at 100 F Street, N.E., Washington, D.C. 20549 and at the regional offices of the SEC located at 233 Broadway, New York, New York 10279 and at the Northwestern Atrium Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. You may also obtain copies of such materials from the Public Reference Section of the SEC, Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. You may call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. The SEC maintains a Web site (HTTP://WWW.SEC.GOV) that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC. Although we make many of our filings with the SEC electronically as a foreign private issuer, we are not obligated to do so.

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

We are required to file reports and other information with the SEC under the Securities Exchange Act of 1934. Reports and other information filed by us with the SEC may be inspected and copied at the SEC's public reference facilities described above. As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements and our officers, Directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act. Under the Exchange Act, as a foreign private issuer, we are not required to publish financial statements as frequently or as promptly as United States companies.

I. SUBSIDIARY INFORMATION

See Item 4.C. of this annual report.

ITEM 11. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK

CURRENCY RISK

Our functional currency is the Canadian dollar. We are exposed to currency risks due to the export of our Canadian-manufactured products, the large majority of which are denominated in US dollars. These risks are partially hedged by operating expenses denominated in US dollars, the purchase of raw materials in US dollars and forward exchange contracts. The increased strength of the Canadian dollar, compared to the US dollar, over the last two years caused our operating expenses, as well as our foreign exchange loss, to increase. Any further increase in the value of the Canadian dollar in the upcoming months will negatively affect our results of operations.

We enter into forward exchange contracts to manage the risk of exchange rate fluctuations between the Canadian and US dollar on cash flows

related to anticipated future revenue streams denominated in US dollars. We do not enter into forward exchange contracts for hedging purposes.

Considering the significant increase in the value of the Canadian dollar compared to the US dollar during fiscal 2005, we entered into additional forward exchange contracts to protect our results of operations. As at August 31, 2004, we held forward exchange contracts to sell US dollars at various forward exchange rates with a contractual value of $15.9 million compared to $33.6 million as at August 31, 2005.

The following table summarizes the forward exchange contracts in effect as at August 31, 2005, classified by expected transaction dates, none of which exceed three fiscal years, as well as the notional amounts of such contracts (in thousands of US dollars) along with the weighted average contractual exchange rates under such contracts. The notional amounts of such contracts are used to calculate the contractual payments to be made under these contracts.

	YEARS ENDING AUGUST 31,		
	2006	2007	2008
Forward exchange contracts to sell US dollars in exchange for Canadian dollars			
Contractual amounts	$ 26,000	$ 7,000	$ 600
Weighted average contractual exchange rates	1.2630	1.2516	1.2314

FAIR VALUE

The fair value of forward exchange contracts, which represents the difference between their contractual amounts and their current trading values, amounted to an unrecognized gain of $2,937,000 as at August 31, 2005.

INTEREST RATE RISK

We are exposed to the impact of interest rate changes and changes in the market values of our available-for-sale securities. We do not use derivative financial instruments for our available-for-sale securities. As at August 31, 2005, our available-for-sale securities consist of debt instruments issued by six (seven in 2004) high-credit quality corporations and trusts. These debt instruments bear interest at fixed rates and may have their fair market value adversely impacted due to a rise in interest rates. However, due to their very short-term maturity, we consider this risk to be insignificant. For the purposes of managing our cash position, we have established a cash management policy, which we follow and monitor on a regular basis. These available-for-sale securities will be used for working capital and other general corporate purposes, including potential acquisitions.

CREDIT RISK

Financial instruments that potentially subject us to credit risk consist primarily of our cash, our short-term investments, our accounts receivable and our forward exchange contracts. As mentioned in the interest rate risk section, our short-term investments consist of debt instruments

issued by high-credit quality corporations and trusts. Our cash and forward exchange contracts are held with or issued by high-credit quality financial institutions; therefore, we consider the risk of non-performance on these instruments to be remote.

Generally, we do not require collateral or other security from customers for trade accounts receivable; however, credit is extended to customers following an evaluation of creditworthiness. In addition, we perform ongoing credit reviews of all our customers and establish an allowance for doubtful accounts receivable when accounts are determined to be uncollectible. Allowance for doubtful accounts amounted to $510,000 and $352,000 as at August 31, 2004 and 2005, respectively.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES.

Not Applicable.

PART II.

ITEM 13. DEFAULTS, DIVIDENDS ARREARAGES AND DELINQUENCIES

Not Applicable.

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

Not Applicable.

ITEM 15. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this annual report. Based on that evaluation, the Chief Executive Officer and Chief Financial Office have concluded that these disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting during the period covered by this annual report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Board of Directors has determined that Mr. Andre Tremblay, CA, chairman of our audit committee is an audit committee financial expert. Mr. Tremblay is independent of management. For a description of Mr. Tremblay's education and experience, please refer to Item 6A. The other members of the Audit Committee are Mr. Pierre Marcouiller, Mr. Guy Marier and Mr. Michael

Unger which are all Independent. For a description of their respective education and experience, please also refer to Item 6A.

ITEM 16B. CODE OF ETHICS

In 2003, we adopted a code of ethics that applies to our chief executive officer, our chief financial officer and our manager of financial reporting and accounting. A copy of this code of ethics has been filed as exhibit 11.1 to this annual report. In March 2005, the Board updated and adopted the following policies:

- Board of Directors Corporate Governance Guidelines;
- Code of Ethics for our Principal Executive Officer and Senior Financial Officers;
- Ethics and Business Conduct Policy;
- Statement of Reporting Ethical Violations (Whistle Blower).

A copy of those policies has been filed respectively as exhibits 11.2 to 11.5 inclusively to this annual report. All these policies are also readily available on our website at www.exfo.com. Accordingly, we believe that our corporate governance practices are in alignment to current regulatory requirements.

As reported at item 7B of this annual report, previous to the coming into force of the requirement for a code of ethics, we had entered into a lease agreement with G. Lamonde Investissements financiers inc., a company controlled by our chief executive officer, for premises located at 465 Godin Avenue in Vanier, Quebec and on September 1, 2004, we were released from our obligations under this lease with a final payment of $194,000. In addition, in September 2002, we acquired from G. Lamonde Investissements financiers inc. the building located at 436 Nolin Street. The purchase price paid was based on an independent third party valuation and the transaction was approved by our audit committee and Board of Directors with Mr. Lamonde abstaining.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

AUDIT FEES

During the financial years ended August 31, 2004 and August 31, 2005, our principal accountant, PricewaterhouseCoopers LLP, billed us aggregate amounts of $189,000 and $214,000, respectively for the audit of our annual consolidated financial statements and services in connection with statutory and regulatory filings.

AUDIT-RELATED FEES

During the financial years ended August 31, 2004 and August 31, 2005, our principal accountant, PricewaterhouseCoopers LLP, billed us aggregate amounts of nil and $62,000, respectively for services related to Sarbanes-Oxley Act.

TAX FEES

During the financial years ended August 31, 2004 and August 31, 2005, our principal accountant, PricewaterhouseCoopers LLP, billed us aggregate amounts of $301,000 and $185,000, respectively for services related to tax compliance, tax advice and tax planning.

ALL OTHER FEES

Not applicable.

AUDIT COMMITTEE PRE-APPROVAL POLICIES AND PROCEDURES

On September 25, 2002, our audit committee adopted a policy requiring prior approval by the audit committee of the annual audit plan and fees. In the event any adjustments to audit fees may be required during the course of a financial year, such adjustments shall be approved by the chairman of the audit committee, acting alone, and shall be reported to the full audit committee at its next meeting.

In the case of non-audit fees (excluding tax matters), the policy provides that proposals shall be submitted to the chairman of the audit committee and our chief financial officer at the same time and the chairman of the audit committee will be responsible for approval of such proposal, subject to any modifications that he may require. The chairman will make a report to the full audit committee at its next meeting.

As concerns tax services to be provided by our principal accountant, our policy provides that the principal accountant will present to the audit committee for pre-approval, on or before the beginning of each financial year, an engagement for tax matters that are foreseeable for the upcoming year and the audit committee shall be responsible for pre-approval thereof, subject to any modifications it may make to such proposals. In the event tax services are required that were not pre-approved by the audit committee, the procedure set forth in the previous paragraph will apply.

During the financial year ended on August 31, 2005, 100% of tax fees were approved by the audit committee pursuant to this policy. During the financial year ended on August 31, 2005, only full-time permanent employees of our principal accountant, PricewaterhouseCoopers LLP, performed work to audit our financial statements.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not Applicable.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

Not Applicable.

PART III.

ITEM 17. FINANCIAL STATEMENTS

Not Applicable.

ITEM 18. FINANCIAL STATEMENTS

See pages F-2 to F-42.

ITEM 19. EXHIBITS

NUMBER	EXHIBIT
1.1	Amended Articles of Incorporation of EXFO (incorporated by reference to Ex Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).
1.2	Amended By-laws of EXFO (incorporated by reference to Exhibit 1.2 of EXFO's Form-20F dated January 15, 2003, File No. 000-30895).
1.3	Amended and Restated Articles of Incorporation of EXFO (incorporated by referenc EXFO's annual report on Form 20-F dated January 18, 2001, File No. 000-30895).
2.1	Form of Subordinate Voting Share Certificate (incorporated by reference to Ex Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).
2.2	Form of Registration Rights Agreement between EXFO and Germain Lamonde d (incorporated by reference to Exhibit 10.13 of EXFO's Registration Statement o June 9, 2000, File No. 333-38956).
3.1	Form of Trust Agreement among EXFO, Germain Lamonde, GEXFO Investissements Te Fiducie Germain Lamonde and G. Lamonde Investissements Financiers inc. (incorp to Exhibit 4.2 of EXFO's Registration Statement on Form F-1 filed on June 333-38956).
4.1	Agreement of Merger and Plan of Reorganization, dated as of November 4, 2000, EXFO Sub, Inc., EXFO Burleigh Instruments, Inc., Robert G. Klimasewki, William J. Farrell and William S. Gornall (incorporated by reference to Exhibit 4.1 of E on Form 20-F dated January 18, 2001, File No. 000-30895).
4.2	Amendment No. 1 to Agreement of Merger and Plan of Agreement, dated as of Decemb among EXFO, EXFO Sub, Inc., EXFO Burleigh Instruments, Inc., Robert G. Klimasews Jr., David J. Farrell and William S. Gornall (incorporated by reference to Ex annual report on Form 20-F dated January 18, 2001, File No. 000-30895).
4.3	Agreement of Merger, dated as of August 20, 2001, by and among EXFO, Buyer Networks Corporation and Shareholders of Avantas Networks corporation (incorpora Exhibit 4.3 of EXFO's annual report on Form 20-F dated January 18, 2002, File No
4.4	Amendment No. 1 dated as of November 1, 2002 to Agreement of Merger, dated as by and among EXFO, 3905268 Canada Inc., Avantas Networks Corporation and Shar Networks (incorporated by reference to Exhibit 4.4 of EXFO's annual report January 18, 2002, File No. 000-30895).
4.5	Offer to purchase shares of Nortech Fibronic Inc., dated February 6, 2000 among Noel, 9086-9314 Quebec inc., Michel Bedard, Christine Bergeron and Societe en Quebec Enr. and Certificate of Closing, dated February 7, 2000 among the same summary in English) (incorporated by reference to Exhibit 10.2 of EXFO's Regist Form F-1 filed on June 9, 2000, File No. 333-38956).
4.6	Share Purchase Agreement, dated as of March 5, 2001, among EXFO Electro-Optical John Kennedy, Glenn Harvey and EFOS Corporation (incorporated by reference to Ex Registration Statement on Form F-3 filed on July 13, 2001, File No. 333-65122).
4.7	Amendment Number One, dated as of March 15, 2001, to Share Purchase Agreement, d 2001, among EXFO Electro-Optical Engineering, Inc., John Kennedy, Glenn Corporation. (incorporated by reference to Exhibit 4.2 of EXFO's Registration St filed on July 13, 2001 File No. 333-65122).
4.8	Share Purchase Agreement, dated as of November 2, 2001 between JDS Uniphase Inc. Inc. (incorporated by reference to Exhibit 4.8 of EXFO's annual report on Form 18, 2002, File No. 000-30895).
4.9	Intellectual Property Assignment and Sale Agreement between EFOS Inc., EX Engineering, Inc., John Kennedy, Glenn Harvey and EFOS Corporation. (incorpora Exhibit 4.3 of EXFO's Registration Statement on Form F-3 filed on July 333-65122).
4.10	Offer to acquire a building, dated February 23, 2000, between EXFO and Groupe accepted by Groupe Mirabau inc. on February 24, 2000 (including summary in Engl

by reference to Exhibit 10.3 of EXFO's Registration Statement on Form F-1 fil
File No. 333-38956).

4.11 Lease Agreement, dated December 1, 1996, between EXFO and GEXFO Investisseme
inc., as assigned to 9080-9823 Quebec inc. on September 1, 1999 (including
(incorporated by reference to Exhibit 10.4 of EXFO's Registration Statement o
June 9, 2000, File No. 333-38956).

NUMBER	EXHIBIT
4.12	Lease Agreement, dated March 1, 1996, between EXFO and GEXFO Investissements T as assigned to 9080-9823 Quebec inc. on September 1, 1999 (including s (incorporated by reference to Exhibit10.5 of EXFO's Registration Statement o June 9, 2000, File No. 333-38956).
4.13	Lease renewal of the existing leases between 9080-9823 Quebec inc. and EXFO, 2001(incorporated by reference to Exhibit 4.13 of EXFO's annual report on Form 18, 2002, File No. 000-30895).
4.14	Loan Agreement between EXFO and GEXFO Investissements Technologiques inc., dat assigned to 9080-9823 Quebec inc. on September 1, 1999 (including summary in Eng by reference to Exhibit 10.9 of EXFO's Registration Statement on Form F-1 fil File No. 333-38956).
4.15	Resolution of the Board of Directors of EXFO, dated September 1, 1999, authoriz GEXFO Distribution Internationale inc. from GEXFO Investissements Technologiq summary in English) (incorporated by reference to Exhibit 10.10 of EXFO's Regist Form F-1 filed on June 9, 2000, File No. 333-38956).
4.16	Form of Promissory Note of EXFO issued to GEXFO Investissements Technologiques 2000) (incorporated by reference to Exhibit 10.12 of EXFO's Registration St filed on June 9, 2000, File No. 333-38956).
4.17	Term Loan Offer, dated March 28, 2000, among EXFO and National Bank of Canada on April 3, 2000 (including summary in English) (incorporated by reference t EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38
4.18	Employment Agreement of Germain Lamonde dated May 29, 2000 (incorporated by r 10.15 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File N
4.19	Employment Agreement of Bruce Bonini dated as of September 1, 2000 (incorporat Exhibit 4.24 of EXFO's annual report on Form 20-F dated January 18, 2002, File N
4.20	Employment Agreement of Juan-Felipe Gonzalez dated as of September 1, 2000 reference to Exhibit 4.25 of EXFO's annual report on Form 20-F dated January 000-30895).
4.21	Employment Agreement of David J. Farrell dated as of December 20, 2000 (incorp to Exhibit 4.26 of EXFO's annual report on Form 20-F dated January 18, 2002, Fil
4.22	Deferred Profit Sharing Plan, dated September 1, 1998 (incorporated by reference EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38
4.23	Stock Option Plan, dated May 25, 2000 (incorporated by Reference to Exhi Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).
4.24	Share Plan, dated April 3, 2000 (incorporated by reference to Exhibit 10.8 of E Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).
4.25	Directors' Compensation Plan (incorporated by reference to Exhibit 10.17 of E Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).
4.26	Restricted Stock Award Plan, dated December 20, 2000 (incorporated by reference EXFO's annual report on Form 20-F dated January 18, 2001, File No. 000-30895).
4.27	Asset Purchase Agreement by and Among EXFO Electro-Optical Engineering Inc., Group Inc., gnubi communications, L.P., gnubi communications General Pa communications Limited Partner, LLC, gnubi communications, Inc., Voting T Irrevocable Voting Trust Agreement Among Carol Abraham Bolton, Paul Abraham and James Ray Stevens and Daniel J. Ernst dated September 5, 2002 (incorporated by r 4.30 of EXFO's annual report on Form 20-F dated January 15, 2003, File No. 000-3

4.28	EXFO Protocol Inc. Executive Employment Agreement with Sami Yazdi signed (incorporated by reference to Exhibit 4.28 of EXFO's annual report on Form 20-2003, File No. 000-30895).
4.29	Second Amending Agreement to the Employment Agreement of Bruce Bonini dated 2002, (incorporated by reference to Exhibit 4.29 of EXFO's annual report on Form 15, 2004, File No. 000-30895).
4.30	Severance and General Release Agreement with Bruce Bonini dated August 8, 2003, reference to Exhibit 4.30 of EXFO's annual report on Form 20-F dated January 000-30895).
4.31	Separation Agreement and General Release with Sami Yazdi dated April 1, 2003, reference to Exhibit 4.31 of EXFO's annual report on Form 20-F dated January 000-30895).
4.32	Executive Employment Agreement of James Stevens dated as of October 4, 2003, reference to Exhibit 4.32 of EXFO's annual report on Form 20-F dated January 000-30895).

NUMBER	EXHIBIT
4.33	Termination Terms for John Holloran Jr. dated May 28, 2003, (incorporated by r 4.33 of EXFO's annual report on Form 20-F dated January 15, 2004, File No. 000-3
4.34	Employment Agreement of Pierre Plamondon dated as of September 1, 2002, (incorp to Exhibit 4.34 of EXFO's annual report on Form 20-F dated January 15, 2004, Fil
4.35	Long-Term Incentive Plan, dated May 25, 2000, amended in October 2004 and eff 2005.
4.36	Deferred Share Unit Plan, effective January 12, 2005.
8.1	Subsidiaries of EXFO (list included in Item 4C of this annual report).
11.1	Code of Ethics for senior financial officers, (incorporated by reference to Exh annual report on Form 20-F dated January 15, 2004, File No. 000-30895).
11.2	Board of Directors Corporate Governance Guidelines.
11.3	Code of Ethics for our Principal Executive Officer and Senior Financial Officers
11.4	Ethics and Business Conduct Policy.
11.5	Statement of Reporting Ethical Violations (Whistle Blower).
11.6	Audit Committee Charter.
11.7	Human Resources Committee Charter.
12.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sar 2002.
12.2	Certification of the Chief Executive Officer Pursuant to Section 906 of the Sar 2002.
13.1	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sar 2002.
13.2	Certification of the Chief Financial Officer Pursuant to Section 906 of the Sar 2002.

SIGNATURES

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

EXFO ELECTRO-OPTICAL ENGINEERING INC.

By: /s/ Germain Lamonde

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

Date: November 23, 2005.

CERTIFICATIONS

I, Germain Lamonde, Chairman of the Board, President and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 20-F of EXFO Electro-Optical Engineering Inc. ("EXFO");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of EXFO as of, and for, the periods presented in this report;

4. EXFO's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for EXFO and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to EXFO, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Evaluated the effectiveness of EXFO's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;and

   c) Disclosed in this report any change in EXFO's internal

control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, EXFO's internal control over financial reporting.

5. EXFO's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to EXFO's auditors and the audit committee of EXFO's Board of Directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect EXFO's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in EXFO's internal control over financial reporting.

Date: November 23, 2005.

/s/ Germain Lamonde

Germain Lamonde
Chairman of the Board,
President and Chief Executive Officer

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), the undersigned officer of EXFO, hereby certifies, to such officer's knowledge, that:

1. The annual report of Form 20-F for the year ended August 31, 2005 of EXFO fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in this annual report fairly presents, in all material respects, the financial condition and results of operations of EXFO.

Date: November 23, 2005.

/s/ Germain Lamonde

Germain Lamonde
Chairman of the Board,
President and Chief Executive Officer

The foregoing certification is being furnished solely pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code) and is not being filed as part of the Report or as separate disclosure document.

I, Pierre Plamondon, Vice-President Finance and Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 20-F of EXFO Electro-Optical Engineering Inc. ("EXFO");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of EXFO as of, and for, the periods presented in this report;

4. EXFO's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for EXFO and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to EXFO, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Evaluated the effectiveness of EXFO's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;

   c) Disclosed in this report any change in EXFO's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, EXFO's internal control over financial reporting.

5. EXFO's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to EXFO's auditors and the audit committee of EXFO's Board of Directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect EXFO's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in EXFO's internal control over financial reporting.

Date: November 23, 2005.

/s/ Pierre Plamondon

Pierre Plamondon, CA
Vice-President Finance
and Chief Financial Officer

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), the undersigned officer of EXFO, hereby certifies, to such officer's knowledge, that:

1. The annual report of Form 20-F for the year ended August 31, 2005 of EXFO fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in this annual report fairly presents, in all material respects, the financial condition and results of operations of EXFO.

Date: November 23, 2005.

/s/ Pierre Plamondon

Pierre Plamondon, CA
Vice-President Finance
and Chief Financial Officer

The foregoing certification is being furnished solely pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code) and is not being filed as part of the Report or as separate disclosure document.

REPORT OF INDEPENDENT AUDITORS

TO THE SHAREHOLDERS OF
EXFO ELECTRO-OPTICAL ENGINEERING INC.

We have audited the balance sheets of EXFO ELECTRO-OPTICAL ENGINEERING INC. as at August 31, 2005 and 2004 and the consolidated statements of earnings, deficit and contributed surplus and cash flows for each of the three years in the period ended August 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at August 31, 2005 and 2004 and the results of its operations and its cash flows for each of the three years in the period ended August 31, 2005 in accordance with Canadian generally accepted accounting principles. Furthermore, in our opinion, the financial statement schedules on the changes in the allowance for doubtful accounts and in the valuation allowance of future income tax assets included in Form 20-F present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

/s/ PriceWaterhouseCoopers LLP

CHARTERED ACCOUNTANTS

Quebec, Quebec, Canada
September 30, 2005

COMMENTS BY AUDITORS FOR U.S. READERS ON CANADA-U.S. REPORTING DIFFERENCES

In the United States of America, reporting standards for auditors require the addition of an explanatory paragraph (following the opinion paragraph) when there are changes in accounting principles that have a material effect on the comparability of the Company's financial statements, such as the changes described in note 2 to the consolidated financial statements. Our report to the Shareholders dated September 30, 2005 is expressed in accordance with Canadian reporting standards which do not require a reference to such changes in accounting principles in the auditors' report when the changes are properly accounted for and adequately disclosed in the financial statements.

/s/ PriceWaterhouseCoopers LLP

CHARTERED ACCOUNTANTS

Quebec, Quebec, Canada
September 30, 2005

EXFO ELECTRO-OPTICAL ENGINEERING INC.
CONSOLIDATED BALANCE SHEETS

(in thousands of US dollars)

	AS AT AUGUST 31,	
	2005	2004
ASSETS		
CURRENT ASSETS		
Cash	$ 7,119	$ 5,159
Short-term investments (notes 8 and 18)	104,883	83,969
Accounts receivable (notes 8 and 18)		
Trade	13,945	12,080
Other	2,007	1,532
Income taxes and tax credits recoverable (notes 4 and 8)	2,392	7,836
Inventories (notes 4, 5 and 8)	17,749	15,371
Prepaid expenses	1,112	1,513
	149,207	127,460
INCOME TAXES AND TAX CREDITS RECOVERABLE (notes 4 and 8)	459	449
PROPERTY, PLANT AND EQUIPMENT (notes 4, 6 and 8)	13,719	15,442
LONG-LIVED ASSET HELD FOR SALE (note 4)	1,600	1,600
INTANGIBLE ASSETS (notes 4, 7 and 8)	5,602	9,447
GOODWILL (notes 4 and 7)	20,370	18,393
	$ 190,957	$ 172,791
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities (note 9)	$ 12,201	$ 11,393
Deferred revenue	1,584	805
Current portion of long-term debt	134	121
	13,919	12,319
DEFERRED REVENUE	1,568	1,123
GOVERNMENT GRANTS (note 15)	1,872	1,690
LONG-TERM DEBT (note 10)	198	332
	17,557	15,464
COMMITMENTS (note 11)		
CONTINGENCIES (note 12)		
SHAREHOLDERS' EQUITY		

Share capital (note 13)	521,875	521,733
Contributed surplus	2,949	1,986
Deficit	(381,846)	(380,212)
Cumulative translation adjustment	30,422	13,820
	173,400	157,327
	$ 190,957	$ 172,791

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

EXFO ELECTRO-OPTICAL ENGINEERING INC.
CONSOLIDATED STATEMENTS OF EARNINGS

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

	YEARS ENDED AUGUST 31	
	2005	2004
SALES (note 19)	$ 97,216	$ 74,630
COST OF SALES (1,2)	44,059	34,556
GROSS MARGIN	53,157	40,074
OPERATING EXPENSES		
Selling and administrative (1)	31,782	25,890
Net research and development (1) (notes 4 and 15)	12,190	12,390
Amortization of property, plant and equipment	4,256	4,935
Amortization of intangible assets	4,836	5,080
Impairment of long-lived assets and goodwill (note 4)	--	620
Restructuring and other charges (note 4)	292	1,729
TOTAL OPERATING EXPENSES	53,356	50,644
LOSS FROM OPERATIONS	(199)	(10,570)
Interest and other income	2,524	1,438
Foreign exchange loss	(1,336)	(278)
EARNINGS (LOSS) BEFORE INCOME TAXES (note 16)	989	(9,410)
INCOME TAXES (notes 4 and 16)	2,623	(986)

NET LOSS FOR THE YEAR	$ (1,634)	$ (8,424)
BASIC AND DILUTED NET LOSS PER SHARE	$ (0.02)	$ (0.13)
BASIC WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING (000'S)	68,526	66,020
DILUTED WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING (000'S) (note 17)	68,981	66,615
(1) STOCK-BASED COMPENSATION COSTS INCLUDED IN: (note 14)		
Cost of sales	$ 143	$ 62
Selling and administrative	626	265
Net research and development	194	122
	$ 963	$ 449

(2) The cost of sales is exclusive of amortization, shown separately. The cost of sales for the August 31, 2003 includes inventory write-offs of $4,121 (note 4).

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

EXFO ELECTRO-OPTICAL ENGINEERING INC.
CONSOLIDATED STATEMENTS OF DEFICIT AND CONTRIBUTED SURPLUS

(in thousands of US dollars)

DEFICIT

	YEARS ENDED AUGUST 31,		
	2005	2004	2003
BALANCE - BEGINNING OF YEAR	$(380,212)	$(371,788)	$(316,838)
ADD			
Net loss for the year	(1,634)	(8,424)	(54,950)
BALANCE - END OF YEAR	$(381,846)	$(380,212)	$(371,788)

CONTRIBUTED SURPLUS

	YEARS ENDED AUGUST 31,		
	2005	2004	2003

BALANCE - BEGINNING OF YEAR	$1,986	$1,519	$1,487
ADD			
Premium on resale of share capital	--	18	32
Stock-based compensation costs	963	449	--
BALANCE - END OF YEAR	$2,949	$1,986	$1,519

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

EXFO ELECTRO-OPTICAL ENGINEERING INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of US dollars)

	YEARS ENDED AUGUST 31,	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss for the year	$ (1,634)	$ (8,424)
Add (deduct) items not affecting cash		
Discount on short-term investments	(302)	197
Stock-based compensation costs	963	449
Inventory and tax credit write-offs	--	--
Amortization	9,092	10,015
Impairment of long-lived assets and goodwill	--	620
Restructuring and other charges	--	1,261
Future income taxes	--	--
Deferred revenue	977	1,404
Government grants	--	154
	9,096	5,676
Change in non-cash operating items		
Accounts receivable	(838)	(2,677)
Income taxes and tax credits	6,096	(2,464)
Inventories	(699)	1,016
Prepaid expenses	544	(449)
Accounts payable and accrued liabilities	(164)	(351)
	14,035	751
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to short-term investments	(585,665)	(653,348)
Proceeds from disposal and maturity of short-term investments	574,207	624,722
Additions to property, plant and equipment and		

intangible assets	(1,501)	(851)
Business combination	--	(241)
	(12,959)	(29,718)
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of long-term debt	(121)	(109)
Net proceeds of offering (note 13)	--	29,164
Share issue expenses	(6)	(137)
Exercise of stock options	148	254
Redemption of share capital	--	(5)
Resale of share capital	--	23
	21	29,190
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH	863	(430)
CHANGE IN CASH	1,960	(207)
CASH - BEGINNING OF YEAR	5,159	5,366
CASH - END OF YEAR	$ 7,119	$ 5,159
SUPPLEMENTARY INFORMATION		
Interest paid	$ 30	$ 408
Income taxes paid (recovered)	$ (669)	$ 120

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

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

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

1 NATURE OF ACTIVITIES

EXFO Electro-Optical Engineering Inc. ("EXFO") designs, manufactures and markets a comprehensive line of test and measurement solutions for the global telecommunications industry. The Telecom Division, which represents the company's main business activity, offers integrated test solutions to network service providers, cable operators, system vendors and optical component manufacturers. The Life Sciences and Industrial Division mainly leverages core telecom technologies to offer value-added solutions life sciences applications and high-precision assembly processes, such as those required for microelectronics, optoelectronics and medical devices. EXFO's products are sold in approximately 70 countries around the world.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") in Canada and significant differences in measurement and disclosure from U.S. GAAP are set out in note 21. These consolidated financial statements include the accounts of the company and its domestic and international subsidiaries. All significant intercompany accounts and transactions have been eliminated.

ACCOUNTING ESTIMATES

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

REPORTING CURRENCY

The functional currency of the company is the Canadian dollar. The company has adopted the US dollar as its reporting currency. The financial statements are translated into the reporting currency using the current rate method. Under this method, the financial statements are translated into the reporting currency as follows: assets and liabilities are translated at the exchange rate in effect on the date of the balance sheet, while revenues and expenses are translated at the monthly average exchange rate. All gains and losses resulting from the translation of the financial statements from the functional currency to the reporting currency are included in the cumulative translation adjustment in shareholders' equity.

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

FOREIGN CURRENCY TRANSLATION

FOREIGN CURRENCY TRANSACTIONS

Transactions denominated in currencies other than the functional currency are translated into the functional currency as follows: monetary assets and liabilities are translated at the exchange rate in effect on the date of the balance sheet, and revenues and expenses are translated at the exchange rate in effect on the date of the transaction. Non-monetary assets and liabilities are translated at historical rates. Gains and

losses arising from such translation are reflected in the statements of earnings.

FOREIGN SUBSIDIARIES

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

FORWARD EXCHANGE CONTRACTS

Forward exchange contracts are utilized by the company to manage its foreign currency exposure. The company's policy is not to utilize those derivative financial instruments for trading or speculative purposes.

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

Realized and unrealized gains or losses associated with forward exchange contracts, which have been terminated or cease to be effective prior to maturity, are deferred in the balance sheet and recognized in the earnings of the period in which the underlying hedged transaction is recognized.

SHORT-TERM INVESTMENTS

Short-term investments are valued at the lower of cost and market value. Cost consists of acquisition cost plus amortization of discount or less amortization of premium. All investments with original maturity of three months or less and that are not required for the purposes of meeting short-term cash requirements are classified as short-term investments.

INVENTORIES

Inventories are valued on an average cost basis, at the lower of cost and replacement cost for raw materials and at the lower of cost and net realizable value for work in progress and finished goods.

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

PROPERTY, PLANT AND EQUIPMENT AND AMORTIZATION

Property, plant and equipment are recorded at cost less related government grants and research and development tax credits. Amortization

is provided on a straight-line basis over the estimated useful lives as follows:

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

INTANGIBLE ASSETS, GOODWILL AND AMORTIZATION

Intangible assets primarily include the cost of core technology and software, net of accumulated amortization. Core technology represents the existing technology acquired in business combinations that has reached technological feasibility. Amortization is provided on a straight-line basis over the estimated useful lives of five years for core technology and four and ten years for software.

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

The company elected to perform its annual impairment test in May of each fiscal year for all its existing reporting units and it recorded an impairment charge for goodwill in fiscal 2003 (note 4).

IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets are reviewed for impairment when events and circumstances indicate that cost may not be recoverable. Impairment exists when the carrying value of an asset or group of assets is greater than the undiscounted future cash flows expected to be provided by the asset or group of assets. The amount of impairment loss, if any, is the excess of the carrying value over the fair value. The company assesses fair value of long-lived assets based on discounted future cash flows. The company recorded impairment charges for long-lived assets in fiscal 2003 and 2004 (note 4).

WARRANTY

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

REVENUE RECOGNITION

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

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

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

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

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

Most sales arrangements do not generally include acceptance clauses. However, when a sales arrangement does include an acceptance provision, acceptance occurs upon the earliest of receipt of a written customer acceptance or expiration of the acceptance period. For these sales arrangements, the sale is recognized when acceptance occurs.

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

ADVERTISING COSTS

Advertising costs are expensed as incurred.

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

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

GOVERNMENT GRANTS

Grants related to operating expenses are included in earnings when the related expenses are incurred. Grants related to capital expenditures are deducted from the related assets. Grants related to job creation and training programs for extended periods are deferred and amortized on a straight-line basis over the minimum period during which the created job must be maintained or training provided. Grants are included in earnings or deducted from the related assets, provided there is reasonable assurance that the company has complied and will comply with all the conditions related to the grant.

RESEARCH AND DEVELOPMENT EXPENSES

All expenses related to research, as well as development activities that do not meet generally accepted criteria for deferral are expensed as incurred, net of related tax credits and government grants. Development expenses that meet generally accepted criteria for deferral, in accordance with the Canadian Institute of Chartered Accountants (CICA) handbook Section 3450, "Research and Development", are capitalized, net of related tax credits and government grants, and are amortized against earnings over the estimated benefit period. Research and development expenses are mainly comprised of salaries and related expenses, material costs as well as fees paid to third-party consultants.

As at August 31, 2005, the company had not deferred any development costs.

INCOME TAXES

The company provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement values and tax values of assets and liabilities, using enacted income tax rates for the years in which the differences are expected to reverse.

The company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized. Since 2003, the company records a full valuation allowance against future income tax assets (notes 4 and 16).

EARNINGS PER SHARE

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

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

stock-based compensation costs) be used to purchase common shares of the company at the average market price of the common shares during the year.

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

STOCK-BASED COMPENSATION COSTS

Since September 1, 2003, the company accounts for all forms of employee stock-based compensation using the fair value-based method. Stock-based compensation costs are amortized to expense over the vesting periods.

Prior to fiscal 2004, no stock-based compensation costs were recognized for employee stock-based compensation. However, the company is required to disclose pro forma information with respect to net loss and net loss per share as if stock-based compensation costs were recognized in the financial statements using the fair value-based method for outstanding stock options granted prior to September 1, 2003 (note 14).

NEW ACCOUNTING STANDARDS AND PRONOUNCEMENTS

ADOPTED IN FISCAL 2005

On September 1, 2004, the company prospectively adopted the CICA handbook Sections 1100 and 1400, "Generally Accepted Accounting Principles" and "General Standards of Financial Statement Presentation". Among other things, these new sections define generally accepted accounting principles (GAAP), establish the relative authority of various types of CICA Accounting Standards Board pronouncements and clarify the role of "industry practice" in applying GAAP. The adoption of these new standards had no impact on the financial statements of the company.

TO BE ADOPTED AFTER FISCAL 2005

In January 2005, the CICA issued four new accounting standards in relation to financial instruments: Section 3855, "Financial Instruments - Recognition and measurement"; Section 3865, "Hedges"; Section 1530, "Comprehensive Income"; and Section 3251, "Equity".

Section 3855 expands on Section 3860, "Financial Instruments - Disclosure and Presentation", by prescribing when a financial instrument is to be recognized on the balance sheet and at what amount. It also specifies how financial instrument gains and losses are to be presented in the financial statements.

Section 3865 provides an alternative to Section 3855 for entities that choose to designate qualifying transactions as hedges for accounting purposes. It replaces and expands on Accounting Guideline 13, "Hedging Relationships", and on the hedging guidance in Section 1650, "Foreign Currency Translation", by specifying how hedge accounting is applied and what disclosures it requires.

Section 1530, "Comprehensive Income", introduces a new requirement to temporarily present certain gains and losses outside net income.

Consequently, Section 3250, "Surplus", has been revised as Section 3251, "Equity".

Sections 1530, 3251, 3855 and 3865 apply to fiscal years beginning on or after October 1, 2006. The company will adopt these new standards on September 1, 2007. While the company is currently assessing the effects of these new standards, impacts consistent with the adjustments described under note 21 item b) of these consolidated financial statements are expected.

EXFO ELECTRO-OPTICAL ENGINEERING INC.
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3 BUSINESS COMBINATION

GNUBI COMMUNICATIONS, L.P.

On October 7, 2002, a newly created wholly-owned subsidiary of the company, EXFO Gnubi Products Group Inc. ("EXFO Gnubi"), acquired substantially all the assets of GNUBI COMMUNICATIONS, L.P., a U.S. company supplying multi-channel telecom and datacom testing solutions for optical transport equipment manufacturers as well as research and development laboratories.

This acquisition was settled for a total consideration valued at $4,904,000 including acquisition-related costs of $162,000. The consideration paid consisted of $2,108,000 in cash (including a cash contingent consideration of $241,000, paid in fiscal 2004, based on EXFO Gnubi sales volume for the twelve months following the acquisition) and the issuance of 1,479,290 subordinate voting shares, valued at $2,796,000.

The cash contingent consideration was accounted for as an additional acquisition cost and was allocated to acquired core technology.

The fair value of the subordinate voting shares issued was determined based on the market price of the shares beginning three days before and ending three days after the number of shares became fixed based on a formula, being September 10, 2002.

This acquisition was accounted for using the purchase method and, consequently, the results of operations of the acquired business have been included in the consolidated statement of earnings of the company since October 7, 2002, being the date of acquisition.

During fiscal 2004, EXFO Gnubi's operations were consolidated with the parent company's operations in Montreal, Canada.

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

Assets acquired	
Current assets	$ 755
Property, plant and equipment	334

Core technology	750
Current liabilities assumed	(134)
Net identifiable assets acquired	1,705
Goodwill	2,958
Purchase price	4,663
Less: Subordinate voting shares issued	2,796
Cash paid on the date of acquisition	$ 1,867

Acquired goodwill is deductible for income tax purposes.

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

4 SPECIAL CHARGES

IMPAIRMENT OF LONG-LIVED ASSETS AND GOODWILL

2003

In May 2003, the company performed its annual impairment test on goodwill for all its reporting units, except for newly acquired EXFO Gnubi. Also, considering market conditions in the telecommunications industry and the persisting unfavorable conditions affecting the subsidiaries' industries at the time, the company reviewed the carrying value of intangible assets related to these reporting units, consisting primarily of acquired core technology.

As a result of this assessment, the company concluded that the carrying value of goodwill related to EXFO Burleigh and the carrying value of intangible assets related to EXFO Burleigh and EXFO Photonic Solutions was impaired, and it recorded a charge of $4,505,000 to write down goodwill and a pre-tax charge of $2,922,000 to write down acquired core technology. Of the total impairment loss of $7,427,000, $6,872,000 was related to EXFO Burleigh for goodwill and acquired core technology, and $555,000 was related to EXFO Photonic Solutions for acquired core technology.

For the purposes of estimating the fair values, the company used a combination of discounted future cash flows and a market approach (sales multiples). The discounted future cash flows were estimated using periods ranging between eight and ten years, discount rates ranging between 15% and 20% and annual growth rates ranging between nil and 35%. The sales multiples used in the market approach ranged between 0.7 and 2.3.

The assumptions supporting the estimates of the fair values and the undiscounted future cash flows, including industry conditions, reflected management's best estimations.

2004

In fiscal 2004, the company put one of its buildings (located in Quebec City) up for sale and received, at the beginning of fiscal 2005, a formal purchase offer for this building. Based on that offer, the company concluded that the building was impaired and it recorded an impairment loss of $620,000 in fiscal 2004, representing the excess of the carrying value of the building over its expected selling price. However, during the first quarter of fiscal 2005, some conditions of the formal offer were not met and the offer was declined. During fiscal 2005, the company withdrew the building from the market. As at August 31, 2004, the building was not shown as a long-lived asset held for sale in the balance sheet because it was still used by the company and, consequently, it was not available for immediate sale. This building reports to the Telecom Division.

RESTRUCTURING AND OTHER CHARGES AND INVENTORY WRITE-OFFS

2003

During fiscal 2003, the company implemented a restructuring plan to align its cost structure to market conditions. Under that plan, the company recorded charges of $4,134,000, including $2,767,000 in severance expenses for the 172 employees who were terminated throughout the company, $512,000 for impaired long-lived assets and $855,000 for future payments on exited leased facilities. Those charges were included in the restructuring and other charges in the statement of earnings for the year ended August 31, 2003. In addition, the company recorded $4,121,000 in inventory write-offs for excess and obsolete inventories, which were included in the cost of sales in the statement of earnings for that same year.

2004 AND 2005

During fiscal 2004, the company approved a restructuring plan to consolidate the operations of its Life Sciences and Industrial Division, transferring EXFO Burleigh's operations mainly to EXFO Photonic Solutions facilities in Toronto. This consolidation process, which started in August 2004, was completed during fiscal 2005.

Overall, for that process, the company incurred $2,515,000 in restructuring and other charges from which $2,033,000 were recorded in fiscal 2004 and the remaining $482,000 were recorded in fiscal 2005. The overall costs, which were recorded in the restructuring and other charges in the statements of earnings of the corresponding years, are detailed as follows: $855,000 for severance expenses for the layoff of all employees of EXFO Burleigh, $1,261,000 mainly for the impairment of the EXFO Burleigh building and the remaining $399,000 for other expenses such as training and recruiting expenses and transfer of assets.

The EXFO Burleigh building was put up for sale in fiscal 2004, but it is

not yet sold because of the difficult real estate market in Rochester, NY. The building is available for sale in its present condition and management expects to sell the property within the next twelve months. Consequently, in accordance with CICA handbook, section 3475, "Disposal of Long-Lived Assets and Discontinued Operations", it was shown in the balance sheet as a long-lived asset held for sale. The fair value used to determine the impairment loss of the building represents the company's best estimate of its selling price based upon the municipal valuation. Since September 1, 2004, the building is no longer amortized.

Finally, in fiscal 2005, the company recorded adjustments of $190,000 to the fiscal 2003 plan because actual charges, mainly for leased equipment, were lower than expected.

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

The following table summarizes changes in the restructuring charges payable since August 31, 2002:

YEAR ENDED AUGUST 31, 2005

	BALANCE AS AT AUGUST 31, 2004	ADDITIONS	PAYMENTS	ADJU
FISCAL 2004 PLAN				
Severance expenses	$ 467	$ 83	$ (550)	$
Other	--	399	(399)	
	467	482	(949)	
FISCAL 2003 PLAN				
Severance expenses	109	--	(77)	
Exited leased facilities	386	--	(229)	
Other	197	--	(46)	
	692	--	(352)	
FISCAL 2001 PLAN				
Exited leased facilities	10	--	(10)	
	10	--	(10)	
Total for all plans (note 9)	$ 1,169	$ 482	$(1,311)	$

YEAR ENDED AUGUST 31, 2004

	BALANCE AS AT AUGUST 31, 2003	ADDITIONS	PAYMENTS	ADJU
FISCAL 2004 PLAN				
Severance expenses	$ --	$ 772	$ (305)	$
	--	772	(305)	
FISCAL 2003 PLAN				
Severance expenses	1,233	--	(870)	
Exited leased facilities	748	--	(362)	
Other	295	--	(90)	
	2,276	--	(1,322)	
FISCAL 2002 PLANS				
Other	68	--	(68)	
	68	--	(68)	
FISCAL 2001 PLAN				
Exited leased facilities	124	--	(72)	
	124	--	(72)	
Total for all plans (note 9)	$ 2,468	$ 772	$(1,767)	$

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

YEAR ENDED AUGUST 31, 2003

	BALANCE AS AT AUGUST 31, 2002	ADDITIONS	PAYMENTS
FISCAL 2003 PLAN			
Severance expenses	$ --	$ 2,767	$(1,534)
Exited leased facilities	--	855	(107)
Other	--	512	(217)
	--	4,134	(1,858)

FISCAL 2002 PLANS

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

Severance expenses	231	--	(231)
Other	68	--	--
	299	--	(231)
FISCAL 2001 PLAN			
Exited leased facilities	483	--	(359)
	483	--	(359)
Total for all plans	$ 782	$ 4,134	$(2,448)

FUTURE INCOME TAX ASSETS AND RESEARCH AND DEVELOPMENT TAX CREDITS RECOVERABLE

During fiscal 2003, the company reviewed the carrying value of its future income tax assets and its research and development tax credits recoverable. Considering market conditions and because the company recorded losses in fiscal 2002 and 2003, it concluded that it was more likely than not that its future income tax assets and some of its non-refundable research and development tax credits were not recoverable and that a valuation allowance and a write-off were required. Accordingly, the company recorded a full valuation allowance of $28,385,000 against its future income tax assets, mainly related to the parent company, EXFO Protocol and EXFO Burleigh and wrote off $2,297,000 in non-refundable research and development tax credits related to EXFO Protocol. The valuation allowance was included in the income taxes in the statement of earnings for the year ended August 31, 2003 (note 16). Research and development tax credit write-offs were included in the net research and development expenses in the statement of earnings for that same year (note 15).

5 INVENTORIES

	AS AT AUGUST 31,	
	2005	2004
Raw materials	$ 9,373	$ 7,244
Work in progress	934	1,370
Finished goods	7,442	6,757
	$17,749	$15,371

6 PROPERTY, PLANT AND EQUIPMENT

	AS AT AUGUST 31,		
	2005		
	COST	ACCUMULATED AMORTIZATION	
Land and land improvements	$ 3,179	$ 815	$
Buildings	9,206	2,250	
Equipment	33,216	29,553	
Leasehold improvements	2,395	1,659	
	47,996	$ 34,277	
Less:			
Accumulated amortization	34,277		
	$ 13,719		$

As at August 31, 2004 and 2005, unpaid purchases of property, plant and equipment amounted to $358,000 and $111,000, respectively.

7 INTANGIBLE ASSETS AND GOODWILL

	AS AT AUGUST 31,		
	2005		
	COST	ACCUMULATED AMORTIZATION	
Core technology	$ 35,554	$ 32,214	$
Software	6,607	4,345	
	42,161	$ 36,559	
Less:			
Accumulated amortization	36,559		
	$ 5,602		$

Amortization expenses for intangible assets in each of the next five fiscal years will amount to $3,190,000 in 2006, $893,000 in 2007, $429,000 in 2008, $352,000 in 2009 and $325,000 in 2010.

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

Changes in the carrying value of goodwill are as follows:

	AS AT AUGUS
	2005
Balance - Beginning of year	$ 18,393
Foreign currency translation adjustment	1,977
Balance - End of year (note 19)	$ 20,370

8 CREDIT FACILITIES

The company has a line of credit which provides for advances of up to Cdn$10,000,000 (US$8,411,000). This line of credit, which is renewable annually, bears interest at prime rate (prime rate in 2004). Short-term investments, accounts receivable, inventories and all tangible and intangible assets of the company were pledged as collateral against this line of credit. As at August 31, 2005, an amount of Cdn$3,163,000 (US$2,661,000) was reserved from this line of credit for letters of guarantee and forward exchange contracts.

9 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	AS AT AUG
	2005
Trade	$ 5,781
Salaries and social benefits	4,526
Warranty	725
Tax on capital	538
Restructuring charges (notes 4 and 20)	150
Other	481
	$ 12,201

Changes in the warranty provision are as follows:

	AS AT AUGUST
	2005
Balance - Beginning of year	$ 390

Provision	869
Settlements	(583)
Foreign currency translation adjustment	49
Balance - End of year	$ 725

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

10 LONG-TERM DEBT

	AS AT AUGU
	2005
Loans collateralized by equipment, bearing interest at 9.6%, repayable in monthly instalments of $13,000 including principal and interest, maturing in 2008	$ 332
Less: Current portion	134
	$ 198

As at August 31, 2005, minimum principal repayments required in each of the next three years will amount to $134,000 in 2006, $147,000 in 2007 and $51,000 in 2008.

11 COMMITMENTS

The company entered into operating leases for certain of its premises and equipment, which expire at various dates through May 2011. As at August 31, 2005, minimum rentals payable under these operating leases in each of the next five years will amount to $1,050,000 in 2006, $952,000 in 2007, $632,000 in 2008, $584,000 in 2009 and $594,000 in 2010. As at August 31, 2005, the total commitment under these operating leases amounts to $4,247,000.

For the years ended August 31, 2003, 2004 and 2005, rental expenses amounted to $1,718,000, $1,219,000 and $1,370,000, respectively (note 20).

12 CONTINGENCIES

CLASS ACTION

On November 27, 2001, a class action suit was filed in the United States

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

On April 19, 2002, the plaintiffs filed an amended complaint containing master allegations against all of the underwriters in all of the 310 cases included in this class action and also filed an amended complaint containing allegations specific to four of the company's underwriters, the company and two of its executive officers. In addition to the allegations mentioned above, the amended complaint alleges that the

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

In July 2002, the issuers filed a motion to dismiss the plaintiffs' amended complaint and judgment was rendered on February 19, 2003. Only one of the claims against the company was dismissed. On October 8, 2002, the claims against its officers were dismissed pursuant to the terms of Reservation of Rights and Tolling Agreements entered into with the plaintiffs.

In June 2003, a committee of the company's Board of Directors conditionally approved a proposed settlement between the issuer defendants, the individual defendants, and the plaintiffs. If approved,

the settlement would provide, among other things, a release of the company and of the individual defendants for the conduct alleged in the action to be wrongful in the amended complaint. The company would agree to undertake other responsibilities under the settlement, including agreeing to assign away, not assert, or release certain potential claims the company may have against its underwriters. Any direct financial impact of the proposed settlement is expected to be borne by the company's insurance carriers.

On June 25, 2004, the Plaintiffs moved for Preliminary Approval of the settlement. The court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005, the court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The court also appointed the Notice Administrator for the settlement and ordered that notice of the settlement be distributed to all settlement class members beginning on November 15, 2005, and completed by January 15, 2006. The settlement fairness hearing has been set for April 26, 2006. Following the hearing, if the court determines that the settlement is fair to the class members, the settlement will be approved. There can be no assurance that this proposed settlement would be approved and implemented in its current form, or at all. Therefore, it is not possible to predict the final outcome of the case, nor determine the amount of any possible losses. If the settlement process fails, the company will continue to defend its position in this litigation that the claims against it, and its officers, are without merit. Accordingly, no provision for this case has been made in the consolidated financial statements as at August 31, 2005.

LETTERS OF GUARANTEE

As at August 31, 2005, in the normal course of its operations, the company had outstanding letters of guarantee of Cdn$1,418,000 (US$1,193,000), which expire at various dates through fiscal 2008 and that were reserved from the line of credit.

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

13 SHARE CAPITAL

Authorized - unlimited as to number, without par value

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

The following table summarizes the share capital activity since August 31, 2002:

	MULTIPLE VOTING SHARES		SUBORDINATE V
	NUMBER	AMOUNT	NUMBER
Balance as at August 31, 2002	37,900,000	$ 1	23,565,185
Business combination (note 3)	-	-	1,479,290
Exercise of stock options (note 14)	-	-	25,498
Exercise of stock awards (note 14)	-	-	69,935
Redemption	-	-	(21,515)
Resale	-	-	21,515
Balance as at August 31, 2003	37,900,000	1	25,139,908
Public offering (1)	-	-	5,200,000
Exercise of stock options (note 14)	-	-	111,071
Exercise of stock awards (note 14)	-	-	89,504
Redemption	-	-	(5,340)
Resale	-	-	5,340
Share issue expenses	-	-	-
Balance as at August 31, 2004	37,900,000	1	30,540,483
Exercise of stock options (note 14)	-	-	71,699
Exercise of stock awards (note 14)	-	-	53,592
Share issue expenses	-	-	-
Balance as at August 31, 2005	37,900,000	$ 1	30,665,774

(1) On February 12, 2004, pursuant to a Canadian public offering, the company issued 5,200,000 subordinate voting shares for net proceeds of $29,164,000 (Cdn$38,438,400), after deduction of underwriting commission of $1,215,000 (Cdn$1,601,000). The net proceeds of this offering were invested in commercial paper that is presented in the short-term investments in the balance sheet (note 18).

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

14 STOCK-BASED COMPENSATION PLANS

The maximum number of subordinate voting shares issuable under the Long-Term Incentive Plan and the Deferred Share Unit Plan cannot exceed 6,306,153 shares. The maximum number of subordinate voting shares that may be granted to any individual on an annual basis cannot exceed 5% of the number of outstanding subordinate voting shares.

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

LONG-TERM INCENTIVE PLAN

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

STOCK OPTIONS

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

The following table summarizes stock option activity since August 31, 2002:

	YEARS ENDED AUGUST 31,			
	2005		2004	
	NUMBER	WEIGHTED AVERAGE EXERCISE PRICE (CDN$)	NUMBER	WEIGHTED AVERAGE EXERCISE PRICE (CDN$)
Outstanding - Beginning of year	2,934,518	$ 21	3,176,613	$ 23
Granted	246,233	6	536,500	5
Exercised	(71,699)	(3)	(111,071)	(3)
Forfeited	(345,293)	(27)	(667,524)	(23)
Outstanding - End of year	2,763,759	$ 19	2,934,518	$ 21
Exercisable - End of year	1,650,404	$ 28	1,331,707	$ 32

The weighted average grant-date fair value of stock options granted during fiscal 2004 and 2005 amounted to $2.73 and $3.51, respectively.

The fair value of stock options granted in fiscal 2003 (for pro forma only), 2004 and 2005 was estimated using the Black-Scholes options valuation model with the following weighted average assumptions:

	YEARS ENDED AUGUST 31,		
	2005	2004	
Risk-free interest rate	3.6%	2.7%	
Expected volatility	95%	100%	
Dividend yield	Nil	Nil	
Expected life	66 months	49 months	36 mo

If the fair value-based method had been applied to stock options granted prior to September 1, 2003 and outstanding as at August 31, 2003, 2004 and 2005, the net loss and the net loss per share would have been as follows on a pro forma basis:

	YEARS ENDE	
	2005	
Net loss for the year	$ (1,634)	$
Pro forma adjustment for stock-based compensation costs	131	
Pro forma net loss for the year	$ (1,503)	$
Basic and diluted net loss per share	$ (0.02)	$
Basic and diluted pro forma net loss per share	$ (0.02)	$

The following table summarizes information about stock options as at August 31, 2005:

	STOCK OPTIONS OUTSTANDING			
EXERCISE PRICE (CDN$)	NUMBER	WEIGHTED AVERAGE EXERCISE PRICE (CDN$)	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	
$2.50 to $3.36	542,054	$ 2.50	7.1 years	
$3.96 to $5.60	620,342	5.04	5.2 years	
$6.22 to $9.02	243,770	6.53	8.4 years	
$14.27 to $20.00	507,446	15.87	6.2 years	
$29.70 to $43.00	600,846	36.29	5.2 years	
$51.25 to $68.17	205,771	65.83	5.0 years	
$83.66	43,530	83.66	5.0 years	
	2,763,759	$ 19.22	6.0 years	

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

RESTRICTED SHARE UNITS (RSUS)

RSUs are "phantom" shares that rise and fall in value based on the value of the company's subordinate voting shares and are redeemable for actual subordinate voting shares or cash at the discretion of the Board of Directors on the vesting dates established by the Board of Directors at the time of grant. The vesting dates are subject to a minimum term of three years and a maximum term of ten years from the award date. RSUs granted under the plan expire at the latest ten years from the date of grant.

During fiscal 2005, the company granted 176,185 RSUs that were outstanding as at August 31, 2005. However, none of them were exercisable at that date. As at August 31, 2005, the weighted average remaining contractual life of the outstanding RSUs was 9.4 years. The weighted average grant-date fair value of these RSUs was $4.68.

DEFERRED SHARE UNIT PLAN

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

During fiscal 2005, the company granted 23,734 DSUs that were outstanding as at August 31, 2005 to the members of the Board of Directors.

The weighted average grant-date fair value of these DSUs was $4.47.

STOCK APPRECIATION RIGHTS PLAN

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

Considering the market price of the common shares of $4.67 as at August 31, 2005, compensation cost for those stock appreciation rights was nominal as at August 31, 2005.

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

The following table summarizes stock appreciation rights activity since

August 31, 2002:

	YEARS ENDED AUGUST 31,			
	2005		2004	
	NUMBER	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding - Beginning of year	13,000	$ 16	9,000	$ 24
Granted	6,000	4	6,000	5
Forfeited	-	-	(2,000)	(19)
Outstanding - End of year	19,000	$ 12	13,000	$ 16
Exercisable - End of year	7,500	$ 24	4,250	$ 30

The following table summarizes information about stock appreciation rights as at August 31, 2005:

	STOCK APPRECIATION RIGHTS OUTSTANDING	
EXERCISE PRICE	NUMBER	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE
$2.10	2,000	7.6 years
$4.51 to $4.65	12,000	9.0 years
$22.25	2,500	5.4 years
$45.94	2,500	5.0 years
	19,000	7.9 years

RESTRICTED STOCK AWARD PLAN

In December 2000, the company established a Restricted Stock Award Plan for employees of EXFO Burleigh. This plan expired in December 2004. Each stock award entitled employees to receive one subordinate voting share at a purchase price of nil. Stock awards granted under the plan vested over a four-year period, with 25% vesting on an annual basis commencing on the first anniversary of the date of grant. According to the plan, upon the involuntary termination of a member of the defined management team, all outstanding restricted stock awards granted to such an employee automatically vested.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The following table summarizes restricted stock awards activity since August 31, 2002:

	YEARS ENDE
	2005
Outstanding - Beginning of year	53,592
Exercised	(53,592)
Forfeited	-
Outstanding - End of year	-

15 OTHER DISCLOSURES

NET RESEARCH AND DEVELOPMENT EXPENSES

Net research and development expenses comprise the following:

	YEARS E	
	2005	
Gross research and development expenses	$ 15,878	$
Research and development tax credits and grants	(3,688)	
Research and development tax credit write-offs (note 4)	-	
	$ 12,190	$

Tax credits written off in fiscal 2003 can be carried forward against future years' income taxes payable over the next eight years.

GOVERNMENT GRANTS

During 1998, the company entered into an agreement with the Quebec Minister of Industry, Commerce, Science and Technology (the "Minister"). Pursuant to this agreement, the Minister agreed to contribute, in the form of grants, up to a maximum of Cdn$2,220,000 (US$1,867,000) over the period from January 1, 1998, through December 31, 2002, payable based on the number of full-time jobs created during the period.

The above grants are subject to the condition that jobs created pursuant to the agreement be maintained for a period of at least five years from the date of creation. Should this condition not be met by the company, the Minister may enforce various recourse options, which include

suspension or cancellation of the agreement or repayment of amounts received by the company. Since the beginning of this program, the company has claimed the maximum amount of Cdn$2,200,000 (US$1,867,000), of which Cdn$770,000 (US$647,000) was credited to earnings. The balance of Cdn$1,450,000 (US$1,220,000) was included in government grants in the balance sheet. This latter amount will be recognized upon the final approval by the sponsor of the program.

Furthermore, since 2000, companies operating in the Quebec City area are eligible for a refundable credit granted by the Quebec provincial government. This credit is earned based on the increase of eligible production and marketing salaries incurred in the Quebec City area at a rate of 40%. Since 2000, the company has claimed a total of Cdn$5,815,000 (US$4,891,000) under this program, of which Cdn$5,041,000 (US$4,239,000) was credited to earnings, the balance of Cdn$774,000 (US$652,000) was included in government grants in the balance sheet. This latter amount will be recognized in the statement of earnings upon the final approval of eligible salaries by the sponsor of the program.

Should repayments of any amounts received pursuant to these agreements be required, such repayments, less related deferred revenue, will be charged to earnings as the amount of any repayment becomes known.

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

Cost of sales for the years ended August 31, 2003, 2004 and 2005, is net of government grants of $518,000, $3,000 and $89,000, respectively.

Selling and administrative expenses for the years ended August 31, 2003, 2004 and 2005, are net of government grants of $286,000, $5,000 and $32,000, respectively.

Research and development expenses for the years ended August 31, 2003, 2004 and 2005, are net of government grants of $45,000, $80,000 and $22,000, respectively.

DEFINED CONTRIBUTION PLANS

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

- Deferred profit-sharing plan

  The company maintains a plan for certain eligible Canadian resident employees, under which the company may elect to contribute an amount equal to 1% (until May 2005 and 2% thereafter) of an employee's gross salary, provided that the employee has contributed at least 2% of his/her gross salary to a tax-deferred registered retirement savings plan. Cash contributions to this plan and expenses for the

years ended August 31, 2003, 2004 and 2005, amounted to Cdn$93,000 (US$63,000), Cdn$141,000 (US$106,000) and Cdn$221,000 (US$179,000), respectively.

o 401K plan

The company maintains a 401K plan for eligible U.S. resident employees. Under this plan, the company must contribute an amount equal to 3% of an employee's current compensation. During the years ended August 31, 2003, 2004 and 2005, the company recorded cash contributions and expenses totaling $253,000, $187,000 and $134,000, respectively.

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

16 INCOME TAXES

The reconciliation of the income tax provision calculated using the combined Canadian federal and provincial statutory income tax rate with the income tax provision in the financial statements is as follows:

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

	YEARS	
	2005	
Income tax provision at combined Canadian federal and provincial statutory tax rate (31% in 2005, 32% in 2004 and 34% in 2003)	$ 307	$
Increase (decrease) due to:		
Foreign income taxed at different rates	(580)	
Non-taxable income	(827)	
Non-deductible expenses	784	
Tax deductions	(81)	
Reduction of Canadian federal statutory tax rate	-	
Effect of consolidation of subsidiaries	(209)	
Previous year tax recovery upon a tax assessment	-	
Other	(146)	
Change in valuation allowance	3,375	

	$ 2,623	$
The income tax provision consists of the following:		
Current		
Canadian	$ 2,513	$
United States	6	
Other	104	
	2,623	
Future		
Canadian	(1,445)	
United States	(1,723)	
Other	(207)	
	(3,375)	
Valuation allowance		
Canadian	1,445	
United States	1,723	
Other	207	
	3,375	
	$ 2,623	$
Details of the company's income taxes:		
Earnings (loss) before income taxes		
Canadian	$ 3,092	$
United States	(953)	
Other	(1,150)	
	$ 989	$

Most of the company's income tax provision for fiscal 2005 represents income taxes payable at the Canadian federal level, which are reduced by research and development tax credits that are recorded against gross research and development expenses.

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

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

Future income tax assets	
Long-lived assets	$
Provisions and accruals	
Government grants	
Deferred revenue	
Share issue expenses	
Research and development expenses	
Losses carried forward	
Valuation allowance	
Future income tax liabilities	
Research and development tax credits	
Future income tax assets, net	$

As at August 31, 2005, the company had available operating losses in several tax jurisdictions, against which a full valuation allowance of $18,424,000 was established. The following table summarizes the year of expiry of these operating losses by tax jurisdiction:

	CANADA	
YEAR OF EXPIRY	FEDERAL	PROVINCIAL
2006	$ 63,000	$ -
2007	1,710,000	73,000
2008	5,614,000	61,000
2009	5,921,000	3,563,000
2010	4,211,000	2,211,000
2014	81,000	-
2015	1,775,000	1,778,000
2022	-	-
2023	-	-
2024	-	-
2025	-	-
Indefinite	2,041,000	2,349,000
	$ 21,416,000	$ 10,035,000

In addition to operating losses, as at August 31, 2005, the company had available research and development expenses in Canada amounting to $24,420,000 at the federal level and $20,668,000 at the provincial level, against which a full valuation allowance of $7,292,000 was established. These expenses can be carried forward indefinitely against future years' taxable income in their respective tax jurisdiction.

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

17 LOSS PER SHARE

The following table summarizes the reconciliation of the basic weighted average number of shares outstanding and the diluted weighted average number of shares outstanding:

	YEARS EN
	2005
Basic weighted average number of shares outstanding (000's)	68,526
Dilutive effect of stock options (000's)	422
Dilutive effect of restricted stock awards (000's)	17
Dilutive effect of deferred share units (000's)	8
Dilutive effect of restricted share units (000's)	8
Diluted weighted average number of shares outstanding (000's)	68,981
Stock options excluded from the calculation of the diluted weighted average number of shares because their exercise price was greater than the average market price of the common shares (000's)	1,962

The diluted net loss per share for the years ended August 31, 2003, 2004 and 2005, was the same as the basic net loss per share since the dilutive effect of stock options, restricted stock awards, deferred share units and restricted share units should not be included in the calculation; otherwise, the effect would be anti-dilutive. Accordingly, diluted net loss per share for those years was calculated using the basic weighted average number of shares outstanding.

18 FINANCIAL INSTRUMENTS

SHORT-TERM INVESTMENTS

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

Short-term investments consist of the following:

Commercial paper denominated in Canadian dollars, bearing interest at annual rates of 2.44% to 2.75% in 2005 and 2.00% to 2.14% in 2004, maturing on different dates between September 2005 and January 2006 in fiscal 2005, and October 2004 and January 2005 in fiscal 2004	$
Mutual funds denominated in Canadian dollars	
	$

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

FAIR VALUE

Cash, accounts receivable, as well as accounts payable and accrued liabilities, are financial instruments whose carrying values approximate their fair values.

The fair value of the long-term debt amounted to $481,000 and $344,000 as at August 31, 2004 and 2005. The fair value of short-term investments, based on market value, amounted to $83,969,000 and $104,883,000 as at August 31, 2004 and 2005, respectively.

The fair value of forward exchange contracts, which represents the difference between their contractual amounts and their current trading value, amounted to an unrecognized gain of $1,975,000 and $2,937,000 as at August 31, 2004 and 2005, respectively.

CREDIT RISK

Financial instruments that potentially subject the company to credit risk consist primarily of cash, short-term investments, accounts receivable and forward exchange contracts. The company's short-term investments consist of debt instruments issued by six (seven in 2004) high-credit quality corporations and trusts. The company's cash and forward exchange contracts are held with or issued by high-credit quality financial institutions; therefore, the company considers the risk of non-performance on these instruments to be remote.

Generally, the company does not require collateral or other security from customers for trade accounts receivable; however, credit is extended to customers following an evaluation of creditworthiness. In addition, the company performs ongoing credit reviews of all its customers and establishes an allowance for doubtful accounts receivable when accounts are determined to be uncollectible. Allowance for doubtful accounts

amounted to $510,000 and $352,000 as at August 31, 2004 and 2005, respectively.

INTEREST RATE RISK

As at August 31, 2005, the company's exposure to interest rate risk is summarized as follows:

Cash	Non-interest bearing
Short-term investments	As described above
Accounts receivable	Non-interest bearing
Accounts payable and accrued liabilities	Non-interest bearing
Long-term debt	As described in note 10

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

FORWARD EXCHANGE CONTRACTS

The company is exposed to currency risks as a result of its export sales of products manufactured in Canada, substantially all of which are denominated in US dollars. These risks are partially hedged by forward exchange contracts and certain operating expenses. As at August 31, 2004 and 2005, the company held contracts to sell US dollars at various forward rates, which are summarized as follows:

	CONTRACTUAL AMOUNTS	WEIGHTED AVERAGE CONTRACTUAL FORWARD RATES
As at August 31, 2004		
September 2004 to August 2005	$ 7,480	1.5427
September 2005 to March 2007	8,400	1.3622
As at August 31, 2005		
September 2005 to August 2006	$ 26,000	1.2630
September 2006 to November 2007	7,600	1.2500

19 SEGMENT INFORMATION

In September 2003, the company reorganized its business under two reportable segments: the Telecom Division and the Life Sciences and Industrial Division. The Telecom Division offers integrated test solutions to network service providers, cable operators, system vendors and component manufacturers throughout the global telecommunications industry. The Life Sciences and Industrial Division mainly leverages developed and acquired core telecom technologies for high-precision assembly and research sectors.

The reporting structure reflects how the company manages its business and how it classifies its operations for planning and measuring performance.

Until August 31, 2003, the company was organized under one reportable segment, being the development, manufacturing and marketing of fiber-optic test, measurement and monitoring solutions for the global telecommunications industry.

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

The following tables present information by segment:

	YEAR ENDED AUGUST 31, 2	
	TELECOM DIVISION	LIFE SCIENCES A INDUSTRIAL DIVIS
Sales	$ 80,120	$ 17,
Earnings (loss) from operations	$ 763	$ (
Unallocated items:		
Interest and other income		
Foreign exchange loss		
Earnings before income taxes		
Income taxes		
Net loss for the year		
Amortization of capital assets	$ 6,504	$ 2,
Stock-based compensation costs	$ 897	$
Capital expenditures	$ 1,408	$

	YEAR ENDED AUGUST 31, 2	
	TELECOM DIVISION	LIFE SCIENCES A INDUSTRIAL DIVIS
Sales	$ 58,882	$ 15,
Loss from operations	$ (5,557)	$ (5,
Unallocated items:		
Interest and other income		
Foreign exchange loss		

Loss before income taxes		
Income taxes		
Net loss for the year		
Amortization of capital assets	$ 6,643	$ 3,
Stock-based compensation costs	$ 417	$
Impairment of long-lived assets (note 4)	$ 620	$
Restructuring and other charges (note 4)	$ -	$ 1,
Capital expenditures	$ 607	$

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

	YEAR ENDED AUGUST 31, 2	
	TELECOM DIVISION	LIFE SCIENCES A INDUSTRIAL DIVIS
Sales	$ 48,753	$ 13,17

Comparative information for fiscal 2003 for the loss from operations and related information as well as capital expenditures is not provided for each reportable segment because this information is not available and is impracticable to determine.

Total assets by reportable segment are detailed as follows:

	2
Telecom Division	$ 64,
Life Sciences and Industrial Division	11,

Unallocated assets	114,
	$ 190,

Unallocated assets are comprised of cash, short-term investments and income taxes and tax credits recoverable.

Carrying value of goodwill by reportable segment is detailed as follows:

	2
Telecom Division	$ 16,
Life Sciences and Industrial Division	4,
	$ 20,

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

	YEARS
	2005
United States	$ 56,282
Canada	6,830
Latin America	3,127
	66,239
Europe, Middle East and Africa	19,396
Asia-Pacific	11,581
	$ 97,216

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

Sales were allocated to geographic regions based on the country of residence of the related customers. In fiscal 2004 and 2005, one customer represented more than 10% of sales with 13.8% of sales ($10,325,000) in fiscal 2004 and 23.3% ($22,629,000) in fiscal 2005. In fiscal 2003, no single customer accounted for 10% of sales or more. For fiscal 2004 and 2005, the most important customer purchased from the Telecom Division.

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

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

	AS AT AUGUST 31,	
	2005	2004
Canada	$ 35,690	$ 37,948
United States	5,601	6,934
	$ 41,291	$ 44,882

Long-lived assets consist of property, plant and equipment, the long-lived asset held for sale, intangible assets and goodwill.

20 RELATED PARTY TRANSACTIONS

In fiscal 2003, the company acquired a building from a company owned by the President of EXFO for a cash consideration of $930,000. This transaction was measured at the fair market value since it was not conducted during the normal course of operations, the change in ownership interest in the building was substantive and the fair market value was supported by an independent appraisal.

For the years ended August 31, 2003 and 2004, the company leased facilities from the company owned by the President of EXFO. The annual rental expense amounted to $331,000 and nil, respectively. The rental expense for fiscal 2003 included $234,000 for future payments on an exited leased facility; this expense was recorded in the restructuring and other charges in the statement of earnings for that year (notes 4 and 9). As at August 31, 2004, restructuring charges payable included $194,000 due to the company owned by the President of the EXFO in connection with this exited leased facility. However, in September 2004, EXFO was released from its obligations under that lease, and it paid the full amount due to the related company. These rental expenses were measured at the fair market value since they were incurred during the normal course of operations.

21 UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

As a registrant with the Securities and Exchange Commission in the United States (SEC), the company is required to reconcile its financial statements for significant differences between generally accepted accounting principles as applied in Canada (Canadian GAAP) and those applied in the United States (U.S. GAAP). Furthermore, additional significant disclosures required under U.S. GAAP and Regulation S-X of the SEC are also provided in the accompanying financial statements and

notes. The following summarizes the significant quantitative differences between Canadian and U.S. GAAP, as well as other significant disclosures required under U.S. GAAP and Regulation S-X of the SEC not already provided in the accompanying financial statements.

RECONCILIATION OF NET LOSS TO CONFORM TO U.S. GAAP

The following summary sets out the significant differences between the company's reported net loss and net loss per share under Canadian GAAP as compared to U.S. GAAP. Please see corresponding explanatory notes in the Reconciliation Items section.

		YEAR	
		2005	
Net loss for the year in accordance with Canadian GAAP		$ (1,634)	$
Stock-based compensation costs	a)	-	
Unrealized gains (losses) on forward exchange contracts	b)	(1,286)	
Amortization of intangible assets	c)	-	
Write-down of goodwill and intangible assets	c)	-	
Income tax effect on reconciliation items		-	
Net loss for the year in accordance with U.S. GAAP		(2,920)	
Other comprehensive income (loss)			
Foreign currency translation adjustment		15,669	
Unrealized gains on forward exchange contracts	b)	2,313	
Reclassification of losses on forward exchange contracts in net loss	b)	(65)	
Comprehensive income (loss)		$ 14,997	$
Basic and diluted net loss per share in accordance with U.S. GAAP		$ (0.04)	$
Basic weighted average number of shares outstanding (000's)		68,526	

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

RECONCILIATION OF SHAREHOLDERS' EQUITY TO CONFORM TO U.S. GAAP

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

		AS AT	
		2005	
Shareholders' equity in accordance with Canadian GAAP		$ 173,400	$
Forward exchange contracts	b)	2,937	
Goodwill	c)	(11,042)	
Other		-	
Shareholders' equity in accordance with U.S. GAAP		$ 165,295	$

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

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

The following table summarizes the shareholders' equity activity under U.S. GAAP since August 31, 2002:

		SHARE CAPITAL	CONTRIBUTED SURPLUS	DEFICIT	DEFERRED STOCK-BASED COMPENSATION COSTS	OTHER CAPITA
Balance as at August 31, 2002		$ 560,943	$ 1,487	$(406,387)	$ (2,867)	$ 7,693
Net loss for the year		-	-	(48,201)	-	-
Stock-based compensation costs	a)	1,507	-	-	1,589	(2,264
Foreign currency transaction adjustment		-	-	-	-	-
Business combination (note 13)		2,796	-	-	-	-
Exercise of stock options (note 13)		45	-	-	-	-
Premium on resale of share capital		-	32	-	-	-
Balance as at August 31, 2003		565,291	1,519	(454,588)	(1,278)	5,429
Net loss for the year		-	-	(9,571)	-	-
Stock-based compensation costs	a) e)	1,737	-	-	339	(760
Foreign currency						

transaction adjustment		-	-	-	-	-
Unrealized gains on forward exchange contracts	b)	-	-	-	-	-
Public offering (note 13)		29,164	-	-	-	-
Exercise of stock options (note 13)		254	-	-	-	-
Share issue expenses (note 13)		(137)	-	-	-	-
Premium on resale of share capital		-	18	-	-	-
Balance as at August 31, 2004		596,309	1,537	(464,159)	(939)	4,669
Net loss for the year		-	-	(2,920)	-	-
Stock-based compensation costs	a) e)	1,213	-	-	(776)	425
Foreign currency transaction adjustment		-	-	-	-	-
Unrealized gains on forward exchange contracts	b)	-	-	-	-	-
Exercise of stock options (note 13)		148	-	-	-	-
Share issue expenses (note 13)		(6)	-	-	-	-
Balance as at August 31, 2005		$ 597,664	$ 1,537	$(467,079)	$ (1,715)	$ 5,094

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

Accumulated other comprehensive income (loss) is comprised of the following:

	AS AT AUGUST 31,	
	2005	2004
Foreign currency translation adjustment		
Current year	$ 15,669	$ 5,969
Cumulative effect of prior years	11,188	5,219
	26,857	11,188
Unrealized gains on forward exchange contracts		
Current year	2,248	689
Cumulative effect of prior years	689	-

2,937	689
$ 29,794	$ 11,877

STATEMENTS OF CASH FLOWS

For the years ended August 31, 2003, 2004 and 2005, there were no significant differences between the statements of cash flows under Canadian GAAP as compared to U.S. GAAP, except for the subtotal before change in non-cash operating items, whose presentation is not permitted under U.S. GAAP.

RECONCILIATION ITEMS

a) ACCOUNTING FOR STOCK-BASED COMPENSATION

Until August 31, 2003, and to conform to U.S. GAAP, the company measured stock-based compensation costs using the intrinsic value method (APB 25, "Accounting for Stock Issued to Employees"). However, since September 1, 2003, and as described in item e) below, the company accounts for stock-based compensation costs for awards granted after that date, using the fair value-based method to conform to Statement of Financial Accounting Standard (SFAS) 123, "Accounting for Stock-Based Compensation".

STOCK PURCHASE PLAN

Under APB 25, compensation costs related to the stock purchase plan were measured as the difference between the fair value of the purchased stock and the purchase price paid by plan participants. Compensation costs were amortized to expense over a period of five years, being the restriction period. This plan terminated at the time of the Initial Public Offering on June 29, 2000. Compensation costs related to this plan became fully amortized during fiscal 2004.

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

LONG-TERM INCENTIVE PLAN (FORMELY STOCK OPTION PLAN)

Until August 31, 2003, and under APB 25, compensation costs related to the long-term incentive plan were measured as the difference between the market price of the underlying stock at the date of grant and the exercise price of the option. These compensation costs were amortized to expense over the estimated vesting period up to a maximum of four years. Compensation costs related to stock options granted prior to September 1, 2003, and accounted for under APB 25 became fully amortized during fiscal 2004.

RESTRICTED STOCK AWARD PLAN

Under APB 25, compensation costs related to the restricted stock award plan were measured as the difference between the market price of the underlying stock at the date of grant and the exercise price, which is nil. These compensation costs were amortized to expense over the estimated vesting period up to a maximum of four years, being the acquisition period. Compensation costs related to this plan became fully amortized during fiscal 2004.

Until August 31, 2003, no compensation costs were recognized for these stock-based compensation plans under Canadian GAAP.

b) FORWARD EXCHANGE CONTRACTS

The forward exchange contracts entered into by the company prior to September 1, 2003, do not qualify for hedge accounting treatment under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities"; accordingly, changes in the fair value of these derivatives are charged to earnings. However, on September 1, 2003, the company implemented the documentation for the designation, documentation and assessment of the effectiveness of its forward exchange contracts, for the purposes of applying hedge accounting. With this documentation in place, the forward exchange contracts entered into by the company after September 1, 2003, qualify for hedge accounting treatment under U.S. GAAP. Consequently, under U.S. GAAP, changes in the fair value of these contracts are charged to other comprehensive income. Upon the recognition of the hedged sales, accumulated changes in fair value are reclassified in the statements of earnings.

Under Canadian GAAP, foreign exchange translation gains and losses on forward exchange contracts are recognized as an adjustment of the revenue when the corresponding sales are recorded, regardless of whether the contracts were entered into before or after September 1, 2003.

The company estimates to $950,000 the amount of unrealized gain on forward exchange contracts as of August 31, 2005 that will be reclassified to net earnings over the next twelve months.

c) WRITE-DOWN OF GOODWILL AND INTANGIBLE ASSETS

2003

In fiscal 2003, Canadian and U.S. GAAP were harmonized to eliminate the existing differences in the assessment and measurement of impairment loss for goodwill and intangible assets. Thus, in fiscal 2003, goodwill and intangible assets were tested for impairment using similar methodologies. However, considering that the existing carrying value of goodwill and intangible assets was lower under

U.S. GAAP than under Canadian GAAP, the required impairment loss under U.S. GAAP was lower and a permanent difference in the carrying value of goodwill exists between Canadian and U.S. GAAP.

Upon the impairment test, under U.S. GAAP, the company recorded a charge of $872,000 to write down the goodwill of EXFO Burleigh and a pre-tax charge of $377,000 to write down the acquired core technology of EXFO Burleigh, compared to a write-down of $4,505,000 for goodwill and a write-down of $2,922,000 for intangible assets under Canadian GAAP, creating a reconciliation item of $6,178,000 in the statement of earnings for the year ended August 31, 2003.

Furthermore, considering differences in the carrying value of intangible assets between Canadian GAAP and U.S. GAAP due to impairment losses, adjustments to the amortization of such assets and related future income taxes were also required in fiscal 2003.

d) RESEARCH AND DEVELOPMENT TAX CREDITS

Under Canadian GAAP, all research and development tax credits are recorded as a reduction of gross research and development expenses. Under U.S. GAAP, tax credits that are refundable against taxable income are recorded in the income taxes. These tax credits amounted to $1,761,000 and $2,169,000 for fiscal 2004 and 2005, respectively. In fiscal 2003, we had a net expense of $176,000 following the write-off of tax credits. This difference had no impact on the net loss and the net loss per share figures for the reporting years.

e) NEW ACCOUNTING STANDARDS AND PRONOUNCEMENTS

ADOPTED IN FISCAL 2004 AND STILL APPLICABLE IN 2005

On September 1, 2003, the company prospectively adopted SFAS 123, "Accounting for Stock-Based Compensation", under the revised transition provisions of SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure". Upon the adoption of SFAS 123 and SFAS 148, the company recognized stock-based compensation costs for stock options granted to employees since September 1, 2003, using the fair value-based method. The company adopted this Statement in order to conform to the newly adopted rules under Canadian GAAP. As a result of the adoption of the fair value-based method, the accounting for stock-based compensation under Canadian GAAP and U.S. GAAP is the same for awards granted on or after September 1, 2003.

TO BE ADOPTED AFTER FISCAL 2005

In November 2004, the Financial Accounting Standard Board (FASB) issued SFAS 151, "Inventory Costs", an amendment to ARB No. 43, Chapter 4. The amendments made by SFAS 151 will improve financial reporting by clarifying that any abnormal amount of idle facility

expenses, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and by requiring the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. This SFAS is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The company will adopt this new statement on September 1, 2005, and its adoption will have no significant impact on its financial statements.

In December 2004, the FASB issued SFAS 123(R), "Share-Based Payments". This statement supersedes ABP 25, "Accounting for Stock Issued to Employees" and related implementation guidance, and revises SFAS 123 in a number of areas. Under SFAS 123(R), all forms of share-based payment to employees result in compensation cost recognized in financial statements. This statement is effective for fiscal years beginning after June 15, 2005. The company will adopt this statement on September 1, 2005, and its adoption will have no significant impact on its financial statements.

In May 2005, the FASB issued SFAS 154, "Accounting Changes and Errors Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3". This statement replaces APB Opinion No. 20, "Accounting Changes", and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements", and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. In general, this statement requires a company to account for the adoption of a new accounting policy by applying the new principle to prior accounting periods as if that principle had always been adopted. This statement is effective for accounting changes or corrections of errors in fiscal years beginning after December 15, 2005.

ACCOUNTING FOR STOCK-BASED COMPENSATION

Under U.S. GAAP, until August 31, 2003, the company elected to measure compensation costs related to grants of stock options and stock awards using the intrinsic value method of accounting. In this instance, however, under SFAS 123, the company is required to make pro forma disclosures of net loss, and net loss per share as if the fair value-based method of accounting had been applied to awards granted prior to September 1, 2003. Consequently, if the fair value-based method had been applied to these awards, the pro forma net loss per share would have been the same as the net loss per share in fiscal 2005, lower than the net loss per share in 2004 (by $0.01) and higher than the net loss per share in 2003 (by $0.01).

The fair value of options or awards granted was estimated using the Black-Scholes options pricing model.

EXHIBIT INDEX

NUMBER	EXHIBIT
1.1	Amended Articles of Incorporation of EXFO (incorporated by reference to Exhibit 3.1 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).
1.2	Amended By-laws of EXFO (incorporated by reference to Exhibit 1.2 of EXFO's annual report on Form-20F dated January 15, 2003, File No. 000-30895).
1.3	Amended and Restated Articles of Incorporation of EXFO (incorporated by reference to Exhibit 1.3 of EXFO's annual report on Form 20-F dated January 18, 2001, File No. 000-30895).
2.1	Form of Subordinate Voting Share Certificate (incorporated by reference to Exhibit 4.1 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).

2.2 Form of Registration Rights Agreement between EXFO and Germain Lamonde dated July 6, 2000) (incorporated by reference to Exhibit 10.13 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).

3.1 Form of Trust Agreement among EXFO, Germain Lamonde, GEXFO Investissements Technologiques inc., Fiducie Germain Lamonde and G. Lamonde Investissements Financiers inc. (incorporated by reference to Exhibit 4.2 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).

4.1 Agreement of Merger and Plan of Reorganization, dated as of November 4, 2000, by and among EXFO, EXFO Sub, Inc., EXFO Burleigh Instruments, Inc., Robert G. Klimasewki, William G. May, Jr., David J. Farrell and William S. Gornall (incorporated by reference to Exhibit 4.1 of EXFO's annual report on Form 20-F dated January 18, 2001, File No. 000-30895).

4.2 Amendment No. 1 to Agreement of Merger and Plan of Agreement, dated as of December 20, 2000, by and among EXFO, EXFO Sub, Inc., EXFO Burleigh Instruments, Inc., Robert G. Klimasewski, William G. May, Jr., David J. Farrell and William S. Gornall (incorporated by reference to Exhibit 4.2 of EXFO's annual report on Form 20-F dated January 18, 2001, File No. 000-30895).

4.3 Agreement of Merger, dated as of August 20, 2001, by and among EXFO, Buyer Sub, and Avantas Networks Corporation and Shareholders of Avantas Networks corporation (incorporated by reference to Exhibit 4.3 of EXFO's annual report on Form 20-F dated January 18, 2002, File No. 000-30895).

4.4 Amendment No. 1 dated as of November 1, 2002 to Agreement of Merger, dated as of August 20, 2001, by and among EXFO, 3905268 Canada Inc., Avantas Networks Corporation and Shareholders of Avantas Networks (incorporated by reference to Exhibit 4.4 of EXFO's annual report on Form 20-F dated January 18, 2002, File No. 000-30895).

4.5 Offer to purchase shares of Nortech Fibronic Inc., dated February 6, 2000 among EXFO, Claude Adrien Noel, 9086-9314 Quebec inc., Michel Bedard, Christine Bergeron and Societe en Commandite Capidem Quebec Enr. and Certificate of Closing, dated February 7, 2000 among the same parties (including summary in English) (incorporated by reference to Exhibit 10.2 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).

4.6 Share Purchase Agreement, dated as of March 5, 2001, among EXFO Electro-Optical Engineering, Inc., John Kennedy, Glenn Harvey and EFOS Corporation (incorporated by reference to Exhibit 4.1 of EXFO's Registration Statement on Form F-3 filed on July 13, 2001, File No. 333-65122).

4.7 Amendment Number One, dated as of March 15, 2001, to Share Purchase Agreement, dated as of March 5, 2001, among EXFO Electro-Optical Engineering, Inc., John Kennedy, Glenn Harvey and EFOS Corporation. (incorporated by reference to Exhibit 4.2 of EXFO's Registration Statement on Form F-3 filed on July 13, 2001 File No. 333-65122).

4.8	Share Purchase Agreement, dated as of November 2, 2001 between JDS Uniphase Inc. and 3905268 Canada Inc. (incorporated by reference to Exhibit 4.8 of EXFO's annual report on Form 20-F dated January 18, 2002, File No. 000-30895).
4.9	Intellectual Property Assignment and Sale Agreement between EFOS Inc., EXFO Electro-Optical Engineering, Inc., John Kennedy, Glenn Harvey and EFOS Corporation. (incorporated by reference to Exhibit 4.3 of EXFO's Registration Statement on Form F-3 filed on July 13, 2001 File No. 333-65122).
4.10	Offer to acquire a building, dated February 23, 2000, between EXFO and Groupe Mirabau inc. and as accepted by Groupe Mirabau inc. on February 24, 2000 (including summary in English) (incorporated by reference to Exhibit 10.3 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).
4.11	Lease Agreement, dated December 1, 1996, between EXFO and GEXFO Investissements Technologiques inc., as assigned to 9080-9823 Quebec inc. on September 1, 1999 (including summary in English) (incorporated by reference to Exhibit 10.4 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).

NUMBER	EXHIBIT
4.12	Lease Agreement, dated March 1, 1996, between EXFO and GEXFO Investissements Technologiques inc., as assigned to 9080-9823 Quebec inc. on September 1, 1999 (including summary in English) (incorporated by reference to Exhibit 10.5 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).
4.13	Lease renewal of the existing leases between 9080-9823 Quebec inc. and EXFO, dated November 30, 2001(incorporated by reference to Exhibit 4.13 of EXFO's annual report on Form 20-F dated January 18, 2002, File No. 000-30895).
4.14	Loan Agreement between EXFO and GEXFO Investissements Technologiques inc., dated May 11, 1993, as assigned to 9080-9823 Quebec inc. on September 1, 1999 (including summary in English) (incorporated by reference to Exhibit 10.9 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).
4.15	Resolution of the Board of Directors of EXFO, dated September 1, 1999, authorizing EXFO to acquire GEXFO Distribution Internationale inc. from GEXFO Investissements Technologiques inc. (including summary in English) (incorporated by reference to Exhibit 10.10 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).
4.16	Form of Promissory Note of EXFO issued to GEXFO Investissements Technologiques inc. dated June 27, 2000) (incorporated by reference to Exhibit 10.12 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).

4.17 Term Loan Offer, dated March 28, 2000, among EXFO and National Bank of Canada as accepted by EXFO on April 3, 2000 (including summary in English) (incorporated by reference to Exhibit 10.11 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).

4.18 Employment Agreement of Germain Lamonde dated May 29, 2000 (incorporated by reference to Exhibit 10.15 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).

4.19 Employment Agreement of Bruce Bonini dated as of September 1, 2000 (incorporated by reference to Exhibit 4.24 of EXFO's annual report on Form 20-F dated January 18, 2002, File No. 000-30895).

4.20 Employment Agreement of Juan-Felipe Gonzalez dated as of September 1, 2000 (incorporated by reference to Exhibit 4.25 of EXFO's annual report on Form 20-F dated January 18, 2002, File No. 000-30895).

4.21 Employment Agreement of David J. Farrell dated as of December 20, 2000 (incorporated by reference to Exhibit 4.26 of EXFO's annual report on Form 20-F dated January 18, 2002, File No. 000-30895).

4.22 Deferred Profit Sharing Plan, dated September 1, 1998 (incorporated by reference to Exhibit 10.6 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).

4.23 Stock Option Plan, dated May 25, 2000 (incorporated by Reference to Exhibit 10.7 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).

4.24 Share Plan, dated April 3, 2000 (incorporated by reference to Exhibit 10.8 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).

4.25 Directors' Compensation Plan (incorporated by reference to Exhibit 10.17 of EXFO's Registration Statement on Form F-1 filed on June 9, 2000, File No. 333-38956).

4.26 Restricted Stock Award Plan, dated December 20, 2000 (incorporated by reference to Exhibit 4.21 of EXFO's annual report on Form 20-F dated January 18, 2001, File No. 000-30895).

4.27 Asset Purchase Agreement by and Among EXFO Electro-Optical Engineering Inc., EXFO Gnubi Products Group Inc., gnubi communications, L.P., gnubi communications General Partner, LLC, gnubi communications Limited Partner, LLC, gnubi communications, Inc., Voting Trust created by The Irrevocable Voting Trust Agreement Among Carol Abraham Bolton, Paul Abraham and James Ray Stevens, James Ray Stevens and Daniel J. Ernst dated September 5, 2002 (incorporated by reference to Exhibit 4.30 of EXFO's annual report on Form 20-F dated January 15, 2003, File No. 000-30895).

4.28 EXFO Protocol Inc. Executive Employment Agreement with Sami Yazdi signed November 2, 2001 (incorporated by reference to

	Exhibit 4.28 of EXFO's annual report on Form 20-F dated January 15, 2003, File No. 000-30895).
4.29	Second Amending Agreement to the Employment Agreement of Bruce Bonini dated as of September 1, 2002, (incorporated by reference to Exhibit 4.29 of EXFO's annual report on Form 20-F dated January 15, 2004, File No. 000-30895).
4.30	Severance and General Release Agreement with Bruce Bonini dated August 8, 2003, (incorporated by reference to Exhibit 4.30 of EXFO's annual report on Form 20-F dated January 15, 2004, File No. 000-30895).

NUMBER	EXHIBIT
4.31	Separation Agreement and General Release with Sami Yazdi dated April 1, 2003, (incorporated by reference to Exhibit 4.31 of EXFO's annual report on Form 20-F dated January 15, 2004, File No. 000-30895).
4.32	Executive Employment Agreement of James Stevens dated as of October 4, 2003, (incorporated by reference to Exhibit 4.32 of EXFO's annual report on Form 20-F dated January 15, 2004, File No. 000-30895).
4.33	Termination Terms for John Holloran Jr. dated May 28, 2003, (incorporated by reference to Exhibit 4.33 of EXFO's annual report on Form 20-F dated January 15, 2004, File No. 000-30895).
4.34	Employment Agreement of Pierre Plamondon dated as of September 1, 2002, (incorporated by reference to Exhibit 4.34 of EXFO's annual report on Form 20-F dated January 15, 2004, File No. 000-30895).
4.35	Long-Term Incentive Plan, dated May 25, 2000, amended in October 2004 and effective January 12, 2005.
4.36	Deferred Share Unit Plan, effective January 12, 2005.
8.1	Subsidiaries of EXFO (list included in Item 4C of this annual report).
11.1	Code of Ethics for senior financial officers, (incorporated by reference to Exhibit 11.1 of EXFO's annual report on Form 20-F dated January 15, 2004, File No. 000-30895).
11.2	Board of Directors Corporate Governance Guidelines.
11.3	Code of Ethics for our Principal Executive Officer and Senior Financial Officers.
11.4	Ethics and Business Conduct Policy.
11.5	Statement of Reporting Ethical Violations (Whistle Blower).
11.6	Audit Committee Charter.

11.7	Human Resources Committee Charter.
12.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
12.2	Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
13.1	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
13.2	Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.