EXFO ELECTRO OPTICAL ENGINEERING INC
Form 6-K
April 05, 2007

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

FORM 6-K

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

For the month of April 2007

EXFO Electro-Optical Engineering Inc.
(Translation of registrant's name into English)

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

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

Form 20-F þForm 40-F o

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

Yes oNo þ

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

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On April 3, 2007, EXFO Electro-Optical Engineering Inc., a Canadian corporation, reported its results of operations for the second fiscal quarter ended February 28, 2007. This report on Form 6-K sets forth the news release relating to EXFO's announcement and certain information relating to EXFO's financial condition and results of operations for the second fiscal quarter of the 2007 fiscal year. This press release and information relating to EXFO's financial condition and results of operations for the second fiscal quarter of the 2007 fiscal year are hereby incorporated as a document by reference to Form F-3 (Registration Statement under the Securities Act of 1933) declared effective as of July 30, 2001 and to Form F-3 (Registration Statement under the Securities Act of 1933) declared effective as of March 11, 2002 and to amend certain material information as set forth in these two Form F-3 documents.

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SIGNATURES

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

EXFO ELECTRO-OPTICAL ENGINEERING INC.

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

Date: April 5, 2007

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EXFO Reports Year-over-Year Increases in Sales and Net Earnings

§ Sales increase 17.1% to US$35.2 million from US$30.1 M in Q2 2006
§ GAAP net earnings improve 96.5% to US$2.7 million from US$1.4 million in Q2 2006
§ Gross margin reaches 57.5% compared to 55.3% in Q2 2006
§ Seven new products launched, mostly for broadband access, IPTV and next-gen networks

QUEBEC CITY, CANADA, April 3, 2007—EXFO Electro-Optical Engineering Inc. (NASDAQ: EXFO; TSX: EXF) reported today year-over-year increases in sales and net earnings for the second quarter ended February 28, 2007.

Sales increased 17.1% to US$35.2 million in the second quarter of fiscal 2007 from US$30.1 million in the second quarter of 2006 and decreased 1.0% from US$35.5 million in the first quarter of 2007. At the half-way mark of fiscal 2007, sales rose 23.9% year-over-year to US$70.8 million. Net bookings increased 28.8% to US$36.5 million for a book-to-bill ratio of 1.04 in the second quarter of fiscal 2007 from US$28.3 million in the same period last year and decreased 1.4% from US$37.0 million in the first quarter of 2007.

Gross margin improved to 57.5% of sales in the second quarter of fiscal 2007 from 55.3% in the second quarter of 2006 and 57.2% in the first quarter of 2007.

GAAP net earnings in the second quarter of fiscal 2007 increased 96.5% to US$2.7 million, or US$0.04 per diluted share, from US$1.4 million, or US$ 0.02 per diluted share, in the same period last year, but decreased 24.0% from US$3.5 million, or US$0.05 per diluted share, in the first quarter of 2007. GAAP net earnings in the second quarter of fiscal 2007 included US$0.6 million in amortization of intangible assets and US$0.2 million in stock-based compensation costs.

"I am satisfied about our financial results with bookings improving almost 30% year-over-year and GAAP net earnings nearly doubling during the same period, despite a challenging second quarter due to seasonality," said Germain Lamonde, EXFO's Chairman, President and CEO. "While net earnings are improving much faster than sales and bookings, I am particularly pleased that we are building a strong presence in strategic market areas like next-generation networking, broadband deployments for triple-play offerings, convergence to IP including all-important IPTV services, as well as growing FTTx rollouts."

"We have accelerated the development of our rich product families in key market segments while expanding our global reach to continue growing faster than our end-markets — like we have done in the past 21 years," Mr. Lamonde added. "Our 12 product launches at the half-way mark of the fiscal year, plus several others introduced early in the third quarter, are strengthening our competitive position in strategic market segments and should help us accelerate market-share gains. As a result, I expect that sales will increase significantly in the second half of fiscal 2007."

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Selected Financial Information
(In thousands of US dollars)

Segmented results:		**Q2 2007** (unaudited)		**Q2 2006** (unaudited)		**Q1 2007** (unaudited)
Sales:						
Telecom Division	$	29,297	$	25,254	$	29,522
Life Sciences and Industrial Division		5,910		4,812		6,025
Total	$	35,207	$	30,066	$	35,547
Earnings from operations:						
Telecom Division	$	1,078	$	1,220	$	1,803
Life Sciences and Industrial Division		1,003		188		956
Total	$	2,081	$	1,408	$	2,759
Other selected information:						
GAAP net earnings	$	2,684	$	1,366	$	3,533
Amortization of intangible assets	$	630	$	1,136	$	882
Stock-based compensation costs	$	241	$	281	$	285

Operating Expenses
Selling and administrative expenses amounted to US$12.2 million, or 34.6% of sales, in the second quarter of fiscal 2007 compared to US$9.3 million, or 30.9% of sales, in the same period last year and US$11.5 million, or 32.5% of sales, in the first quarter of 2007.

Gross research and development expenses totaled US$5.9 million, or 16.9% of sales, in the second quarter of fiscal 2007 compared to US$4.9 million, or 16.4% of sales, in the second quarter of 2006 and US$5.5 million, or 15.5% of sales, in the first quarter of 2007.

Net R&D expenses totaled US$4.7 million, or 13.3% of sales, in the second quarter of fiscal 2007 compared to US$3.9 million, or 13.0% of sales, in the same period last year and US$4.4 million, or 12.2% of sales, in the first quarter of 2007.

Second-Quarter Business Highlights
Market expansion — EXFO delivered year-over-year sales growth of 17.1% in the second quarter of fiscal 2007 due to market-share gains in optical testing, year-end revenue from a Tier-1 network service provider, a full three-month contribution from the Consultronics acquisition, heightened penetration of protocol test solutions, and increased acceptance of fluorescence microscopy and light-based curing solutions in the Life Sciences and Industrial Division. At the halfway mark of fiscal 2007, EXFO had increased its sales 23.9% compared to the same period in 2006, while the corporate objective for fiscal 2007 is 20% year-over-year growth.

Profitability — EXFO recorded earnings from operations of 5.9% in the second quarter of fiscal 2007 and 6.8% after six months into the fiscal year. This mid-year performance can largely be attributed to an increase in gross margin which, in turn, was positively affected by a higher proportion of protocol sales. EXFO expects its gross margin will reach 60% on a mid-term basis. The company's profitability goal for fiscal 2007 is 7% in earnings from operations.

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Innovation — EXFO launched seven new products in the second quarter and 12 at the half-way mark of fiscal 2007, including IPTV test capabilities for its Packet Blazer Gigabit Ethernet product line; an enhanced Packet Blazer test module for advanced, higher-layer Ethernet test applications; a standards-based VDSL2 test module to characterize IPTV and HDTV over copper access links; as well as a new variable optical attenuator (VOA) for R&D and manufacturing applications. Subsequent to the quarter-end, the company released a series of OTDR test modules for its popular FTB-200 and FTB-400 field-test platforms as well as a new remote fiber test system (RFTS). Sales derived from products that have been on the market two years or less represented 28.2% of total sales in the second quarter of fiscal 2007 and 30.5% after six months, while the published goal for fiscal 2007 is 35%.

Business Outlook

EXFO forecasted sales between US$36.0 million and US$39.0 million and GAAP net earnings between US$0.03 and US$0.06 per diluted share for the third quarter ending May 31, 2007. GAAP net earnings include US$0.01 per diluted share in amortization of intangible assets and stock-based compensation costs.

Conference Call and Webcast

EXFO will host a conference call today at 5 p.m. (EDT) to review its financial results for the second quarter of fiscal 2007. To listen to the conference call and participate in the question period via telephone, dial 1-416-620-5690. Germain Lamonde, Chairman, President and CEO, and Pierre Plamondon, CA, Vice-President of Finance and Chief Financial Officer, will participate in the call. An audio replay of the conference call will be available one hour after the event until 7 p.m. on April 10, 2007. The replay number is 1-402-977-9141 and the reservation number is 21331773. The audio Webcast and replay of the conference call will also be available on EXFO's Website at www.EXFO.com, under the Investors section.

About EXFO

EXFO is a recognized test and measurement expert in the global telecommunications industry. The Telecom Division, which represents the majority of the company's business, offers a full suite of test solutions and monitoring systems to network service providers, cable TV operators, telecom system vendors and component manufacturers in approximately 70 countries. EXFO is the global market leader for portable optical test solutions and a leading supplier of protocol and access test solutions to enable triple-play deployments and converged IP networking. Its PC/Windows-based modular FTB-200, FTB-400 and IQS-500 test platforms host a wide range of modular test solutions across optical, physical, data and network layers, while maximizing technology reuse across several market segments. The Life Sciences and Industrial Division, which leverages several core telecom technologies, offers value-added solutions in the life sciences and high-precision assembly sectors based on advanced spot-curing, fluorescence microscopy and nanopositioning solutions. For more information about EXFO, visit www.EXFO.com.

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Forward-Looking Statements

This news release contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995, and we intend that such forward-looking statements be subject to the safe harbors created thereby. Forward-looking statements are statements other than historical information or statements of current condition. Words such as *may, will, expect, believe, anticipate, intend, could, estimate*, *continue*, or the negative or comparable terminology are intended to identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events and circumstances are considered forward-looking statements. They are not guarantees of future performance and involve risks and uncertainties. Actual results may differ materially from those in forward-looking statements due to various factors including consolidation in the global telecommunications test and measurement industry; capital spending levels in the telecommunications, life sciences and high-precision assembly sectors; concentration of sales; fluctuating exchange rates and our ability to execute in these uncertain conditions; the effects of the additional actions we have taken in response to such economic uncertainty (including our ability to quickly adapt cost structures with anticipated levels of business, ability to manage inventory levels with market demand); market acceptance of our new products and other upcoming products; limited visibility with regards to customer orders and the timing of such orders; our ability to successfully integrate our acquired and to-be-acquired businesses; the retention of key technical and management personnel; and future economic, competitive and market conditions. Assumptions relating to the foregoing involve judgments and risks, all of which are difficult or impossible to predict and many of which are beyond our control. Other risk factors that may affect our future performance and operations are detailed in our Annual Report, on Form 20-F, and our other filings with the U.S. Securities and Exchange Commission and the Canadian securities commissions. We believe that the expectations reflected in the forward-looking statements are reasonable based on information currently available to us, but we cannot assure you that the expectations will prove to have been correct. Accordingly, you should not place undue reliance on these forward-looking statements. These statements speak only as of the date of this document. We undertake no obligation to revise or update any of them to reflect events or circumstances that occur after the date of this document.

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For more information

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EXFO Electro-Optical Engineering Inc.
Interim Consolidated Balance Sheet

(in thousands of US dollars)

	As at February 28, 2007 (unaudited)	As at August 31, 2006
Assets		
Current assets		
Cash	$ 9,108	$ 6,853
Short-term investments	105,521	104,437
Accounts receivable		
Trade, less allowance for doubtful accounts of $272 ($451 as at August 31, 2006)	21,793	20,891
Other	3,088	2,792
Income taxes and tax credits recoverable	2,138	2,201
Inventories (note 4)	23,428	24,623
Prepaid expenses	1,191	1,404
	166,267	163,201
Income taxes and tax credits recoverable	1,309	476
Property, plant and equipment	15,695	17,392
Intangible assets	9,459	10,948
Goodwill	25,675	27,142
	$ 218,405	$ 219,159
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 5)	$ 19,302	$ 17,337
Deferred revenue	2,089	1,772
Current portion of long-term debt	104	107
	21,495	19,216
Deferred revenue	3,294	2,632
Government grants	661	723
Long-term debt	282	354
	25,732	22,925

Contingency (note 6)		
Shareholders' Equity		
Share capital	149,578	148,921
Contributed surplus	4,101	3,776
Retained earnings (note 7)	6,217	–
Cumulative translation adjustment	32,777	43,537
	192,673	196,234
	$ 218,405	$ 219,159

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EXFO Electro-Optical Engineering Inc.
Interim Unaudited Consolidated Statements of Earnings

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

	Three months ended February 28, 2007	Six months ended February 28, 2007	Three months ended February 28, 2006	Six months ended February 28, 2006
Sales	$ 35,207	$ 70,754	$ 30,066	$ 57,110
Cost of sales (1,2)	14,970	30,199	13,440	25,504
Gross margin	20,237	40,555	16,626	31,606
Operating expenses				
Selling and administrative (1)	12,184	23,726	9,303	18,361
Net research and development (1) (note 8)	4,678	9,032	3,906	7,028
Amortization of property, plant and equipment	664	1,445	873	1,769
Amortization of intangible assets	630	1,512	1,136	2,357
Total operating expenses	18,156	35,715	15,218	29,515
Earnings from operations	2,081	4,840	1,408	2,091
Interest and other income	1,105	2,277	828	1,383
Foreign exchange gain (loss)	352	735	(213)	(531)
Earnings before income taxes	3,538	7,852	2,023	2,943
Income taxes (note 9)	854	1,635	657	1,222
Net earnings for the period	$ 2,684	$ 6,217	$ 1,366	$ 1,721
Basic net earnings per share	$ 0.04	$ 0.09	$ 0.02	$ 0.03
Diluted net earnings per share	$ 0.04	$ 0.09	$ 0.02	$ 0.02
Basic weighted average number of shares outstanding (000's)	68,839	68,807	68,591	68,581
Diluted weighted average number of shares outstanding (000's) (note 10)	69,546	69,465	69,152	69,105
(1) **Stock-based compensation costs included in:**				
Cost of sales	$ 27	$ 61	$ 30	$ 72

Selling and administrative	159	356	198	379
Net research and development	55	109	53	104
	$ 241	$ 526	$ 281	$ 555

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

The accompanying notes are an integral part of these consolidated financial statements.
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EXFO Electro-Optical Engineering Inc.
Interim Unaudited Consolidated Statements of Retained Earnings (Deficit)

(in thousands of US dollars)

Retained earnings (Deficit)

	Six months ended February 28, 2007	2006
Balance - Beginning of period (note 7)	$ –	$ (381,846)
Add		
Net earnings for the period	6,217	1,721
Balance - End of period	$ 6,217	$ (380,125)

Contributed surplus

	Six months ended February 28, 2007	2006
Balance - Beginning of period	$ 3,776	$ 2,949
Add (deduct)		
Stock-based compensation costs	499	555
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	(174)	–
Balance - End of period	$ 4,101	$ 3,504

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

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EXFO Electro-Optical Engineering Inc.
Interim Unaudited Consolidated Statements of Cash Flows

(in thousands of US dollars)

	Three months ended February 28, 2007	Six months ended February 28, 2007	Three months ended February 28, 2006	Six months ended February 28, 2006
Cash flows from operating activities				
Net earnings for the period	$ 2,684	$ 6,217	$ 1,366	$ 1,721
Add (deduct) items not affecting cash				
Discount on short-term investments	364	778	447	618
Stock-based compensation costs	241	526	281	555
Amortization	1,294	2,957	2,009	4,126
Deferred revenue	745	1,239	(193)	100
Government grants	–	(22)	–	–
	5,328	11,695	3,910	7,120
Change in non-cash operating items				
Accounts receivable	(210)	(3,245)	4,120	927
Income taxes and tax credits	(513)	(931)	(461)	(749)
Inventories	(510)	(129)	(1,775)	(2,908)
Prepaid expenses	133	135	88	(28)
Accounts payable and accrued liabilities	2,736	2,772	(446)	1,972
	6,964	10,297	5,436	6,334
Cash flows from investing activities				
Additions to short-term investments	(296,237)	(490,503)	(279,670)	(411,045)
Proceeds from disposal and maturity of short-term investments	291,413	482,916	288,500	420,899
Additions to property, plant and equipment and intangible assets	(835)	(1,646)	(933)	(1,568)
Net proceeds from disposal of property, plant and equipment	–	1,228	–	–
Business combination (note 3)	–	–	(17,497)	(17,497)
	(5,659)	(8,005)	(9,600)	(9,211)
Cash flows from financing activities				
Repayment of long-term debt	(24)	(51)	(42)	(74)
Exercise of stock options	362	483	137	156
	338	432	95	82
Effect of foreign exchange rate changes on cash	(276)	(469)	359	453
Change in cash	1,367	2,255	(3,710)	(2,342)

Cash - Beginning of period	7,741	6,853	8,487	7,119
Cash - End of period	$ 9,108	$ 9,108	$ 4,777	$ 4,777

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

EXFO Electro-Optical Engineering Inc.
Notes to Unaudited Interim Consolidated Financial Statements

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

1. Interim financial information

The financial information as at February 28, 2007 and for the three- and six-month periods ended February 28, 2006 and 2007 is unaudited. In the opinion of management, all adjustments necessary to present fairly the results of these periods in accordance with generally accepted accounting principles (GAAP) in Canada have been included. The adjustments made were of a normal and recurring nature. Interim results may not necessarily be indicative of results anticipated for the entire year.

These interim consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada and use the same accounting policies and methods used in the preparation of the company's most recent annual consolidated financial statements. However, all disclosures required for annual financial statements have not been included in these financial statements. Consequently, these interim consolidated financial statements should be read in conjunction with the company's most recent annual consolidated financial statements.

2. New accounting standards and pronouncements

In January 2005, the Canadian Institute of Chartered Accountants (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. Although the final adjustments will be based on the financial instruments that the company will be a party to on the adoption date, the company is currently assessing the effects of these new standards and impacts consistent with the adjustments described under note 20 item b) of the company's most recent annual consolidated financial statements are expected.

3. Business Combination

On January 26, 2006, the company acquired substantially all the assets of Consultronics Limited. Based in Toronto, Canada, and with operations in the United Kingdom and Hungary, Consultronics was a privately held company specializing in x-Digital Subscriber Line (xDSL), Internet Protocol TV and Voice-over-Internet Protocol (VoIP) test solutions for broadband access networks.

This acquisition was settled for a total cash consideration valued at $19,093,000, or $18,838,000 net of $255,000 of cash acquired. The total consideration included severance expenses of $660,000 for the termination of employees of the acquired business as well as other acquisition-related costs of $822,000.

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

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 statements of earnings of the company since January 26, 2006, being the date of acquisition.

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

Assets acquired		
Current assets	$	5,135
Property, plant and equipment		3,115
Core technology		8,709
Current liabilities assumed		(2,826)
Loans assumed		(402)
Net identifiable assets acquired		13,731
Goodwill		5,107
Purchase price, net of cash acquired	$	18,838

Acquired core technology is amortized on a straight-line basis over its estimated useful life of five years.

This business, including acquired goodwill, reports to the Telecom Division. Acquired goodwill is deductible for tax purposes.

4. Inventories

		As at February 28, 2007 (unaudited)		As at August 31, 2006
Raw materials	$	12,828	$	14,353
Work in progress		1,226		1,043
Finished goods		9,374		9,227
	$	23,428	$	24,623

5. Accounts payable and accrued liabilities

	As at February 28, 2007	As at August 31, 2006

	(unaudited)	
Trade	$ 9,848	$ 7,487
Salaries and social benefits	6,174	5,991
Warranty	789	1,006
Commissions	1,014	835
Restructuring charges	174	691
Other	1,303	1,327
	$ 19,302	$ 17,337

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EXFO Electro-Optical Engineering Inc.
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(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

Changes in the warranty provision are as follows:

	Six months ended February 28,	
	2007	2006
	(unaudited)	
Balance - Beginning of period	$ 1,006	$ 725
Provision	408	543
Settlements	(625)	(440)
Addition from business combination	–	31
Balance - End of period	$ 789	$ 859

Changes in the restructuring charges payable are as follows:

	Balance as at August 31, 2006	Payments	Balance as at February 28, 2007
		(unaudited)	(unaudited)
Fiscal 2006 plan			
Severance expenses	$ 631	$ (472)	$ 159
Fiscal 2003 plan			
Exited leased facilities	60	(45)	15
Total for all plans	$ 691	$ (517)	$ 174

6. Contingency

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

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

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 a decision was rendered on February 19, 2003. Only one of the claims against the company was dismissed. On October 8, 2002, the claims against its officers were dismissed 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.

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. A settlement fairness hearing was held on April 24, 2006; however, no ruling has been issued yet by the court.

The plaintiffs have continued to litigate against the underwriter defendants. The district court has directed that the litigation proceed within a number of "focus cases" rather than in all of the 310 cases that have been consolidated. The company's case is not one of these focus cases. On October 13, 2004, the district court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the district court's class certification decision. Because the company's settlement with the plaintiffs involves the certification of the case as a class action as part of the approval process, the impact of the Court of Appeals' ruling on the company's settlement is unclear. On January 5, 2007, the plaintiffs filed a petition for rehearing en banc by the Second Circuit. That request is still pending.

If the court determines that the settlement is fair to the class members, and that the settlement classes can be certified, the settlement will be approved. The settlement provides that, if the plaintiffs do not obtain any recovery from the underwriter defendants, the members of the class action would receive an amount not expected to exceed $2,507,678. Any direct financial impact plus any legal fees are expected to be borne by the company’s insurance carriers. However, 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 to 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 interim consolidated financial statements as at February 28, 2007.

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

7. Elimination of deficit

On August 31, 2006, upon the approval of the Board of Directors on that date, the company eliminated its deficit of $373,711,000 against its share capital.

8. Net research and development expenses

	Three months ended February 28, 2007	Six months ended February 28, 2007	Three months ended February 28, 2006	Six months ended February 28, 2006
	(unaudited)		(unaudited)	
Gross research and development expenses	$ 5,939	$ 11,448	$ 4,940	$ 8,946
Research and development tax credits and grants	(1,261)	(2,416)	(1,034)	(1,918)
	$ 4,678	$ 9,032	$ 3,906	$ 7,028

9. Income taxes

During the three- and six-month periods ended February 28, 2006 and 2007, the company recorded income taxes of $657,000, $1,222,000, $854,000 and $1,635,000, respectively. Most of these income taxes represent 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 in the statements of earnings.

The company records a full valuation allowance against its future income tax assets because it is more likely than not that these assets will not be recovered. This causes its income tax rate to be distorted in relation to its pre-tax accounting income.

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

10. Earnings per share

The following table summarizes the reconciliation of the basic weighted average number of shares outstanding and the diluted weighted average number of shares outstanding:

	Three months ended February 28, 2007	Six months ended February 28, 2007	Three months ended February 28, 2006	Six months ended February 28, 2006
	(unaudited)		(unaudited)	
Basic weighted average number of shares outstanding (000's)	68,839	68,807	68,591	68,581
Plus dilutive effect of:				
Stock options (000's)	468	451	466	446
Restricted share units (000's)	190	161	65	51
Deferred share units (000's)	49	46	30	27
Diluted weighted average number of shares outstanding (000's)	69,546	69,465	69,152	69,105
Stock awards excluded from the calculation of diluted weighted average number of shares outstanding because their exercise price was greater than the average market price of the common shares (000's)	1,213	1,299	1,829	1,816

11. Segment information

The company is organized 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 TV 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.

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

The following tables set out information by segment:

	Three months ended February 28, 2007			Six months ended February 28, 2007		
	Telecom Division	Life Sciences and Industrial Division	Total	Telecom Division	Life Sciences and Industrial Division	Total
		(unaudited)			(unaudited)	
Sales	$ 29,297	$ 5,910	$ 35,207	$ 58,819	$ 11,935	$ 70,754
Earnings from operations	$ 1,078	$ 1,003	$ 2,081	$ 2,881	$ 1,959	$ 4,840
Unallocated items:						
Interest and other income			1,105			2,277
Foreign exchange gain			352			735
Earnings before income taxes			3,538			7,852
Income taxes			854			1,635
Net earnings for the period			$ 2,684			$ 6,217

	Three months ended February 28, 2006			Six months ended February 28, 2006		
	Telecom Division	Life Sciences and Industrial Division	Total	Telecom Division	Life Sciences and Industrial Division	Total
		(unaudited)			(unaudited)	
Sales	$ 25,254	$ 4,812	$ 30,066	$ 47,330	$ 9,780	$ 57,110
Earnings from operations	$ 1,220	$ 188	$ 1,408	$ 1,708	$ 383	$ 2,091
Unallocated items:						
Interest and other income			828			1,383
Foreign exchange loss			(213)			(531)
			2,023			2,943

Earnings before income taxes				
Income taxes		657		1,222
Net earnings for the period	$	1,366	$	1,721

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Total assets by reportable segment are detailed as follows:

	As at February 28, 2007 (unaudited)	As at August 31, 2006
Total assets		
Telecom Division	$ 91,124	$ 93,853
Life Sciences and Industrial Division	9,205	11,339
Unallocated assets	118,076	113,967
	$ 218,405	$ 219,159

Unallocated assets are comprised of cash, short-term investments and income taxes and tax credits recoverable.

12. Stock-based compensation

On September 1, 2003, the company adopted the amendment made to the CICA Handbook Section 3870, “Stock-Based Compensation and Other Stock-Based Payments”. Accordingly, employee stock awards granted on or after September 1, 2003, were accounted for using the fair value-based method. However, if the fair value-based method had been applied to employee stock awards granted prior to September 1, 2003, and outstanding as at February 28, 2006 and 2007, the pro forma net earnings per share would have been the same as the net earnings per share for all reporting periods.

13. Differences between Canadian and U.S. GAAP

These interim consolidated financial statements are prepared in accordance with Canadian GAAP and significant differences in measurement and disclosure from U.S. GAAP are set out in note 20 to the company’s most recent annual consolidated financial statements. This note describes significant changes occurring since the most recent annual consolidated financial statements and provides a quantitative analysis of all significant differences. All disclosures required in annual financial statements under U.S. GAAP and Regulation S-X of the Securities and Exchange Commission in the United States have not been provided in these interim consolidated financial statements.

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Comprehensive income (loss) under U.S. GAAP

Comprehensive income (loss) under U.S. GAAP is as follows:

	Three months ended February 28, 2007	Six months ended February 28, 2007	Three months ended February 28, 2006	Six months ended February 28, 2006
	(unaudited)		(unaudited)	
Net earnings for the period in accordance with Canadian GAAP and U.S. GAAP	$ 2,684	$ 6,217	$ 1,366	$ 1,721
Other comprehensive income (loss)				
Foreign currency translation adjustment	(4,472)	(10,304)	4,263	7,311
Unrealized gains (losses) on forward exchange contracts	(3,718)	(5,793)	1,699	2,796
Reclassification of realized gains on forward exchange contracts in net earnings	(108)	(844)	(582)	(1,017)
Comprehensive income (loss) under U.S. GAAP	$ (5,614)	$ (10,724)	$ 6,746	$ 10,811

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:

	As at February 28, 2007	As at August 31, 2006
	(unaudited)	
Shareholders' equity in accordance with Canadian GAAP	$ 192,673	$ 196,234
Forward exchange contracts	(1,186)	5,451
Goodwill	(11,465)	(11,908)
Shareholders' equity in accordance with U.S. GAAP	$ 180,022	$ 189,777

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The following table summarizes the shareholders' equity activity under U.S. GAAP since August 31, 2006:

	Share capital	Contributed surplus	Deficit	Deferred stock-based compensation costs	Other capital	Accumulated other comprehensive income	Shareholders' equity
	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Balance as at August 31, 2006	$ 598,421	$ 1,537	$ (458,944)	$ (1,371)	$ 5,504	$ 44,630	$ 189,777
Net earnings for the period	–	–	3,533	–	–	–	3,533
Stock-based compensation costs	–	–	–	(347)	593	–	246
Foreign currency translation adjustment	–	–	–	–	–	(5,832)	(5,832)
Unrealized losses on forward exchange contracts	–	–	–	–	–	(2,811)	(2,811)
Exercise of stock options	121	–	–	–	–	–	121
Reclassification of stock-based compensation costs upon exercise of stock awards	47	–	–	–	(47)	–	–
Balance as at November 30, 2006	$ 598,589	$ 1,537	$ (455,411)	$ (1,718)	$ 6,050	$ 35,987	$ 185,034
Net earnings for the period	–	–	2,684	–	–	–	2,684
Stock-based compensation costs	–	–	–	(510)	750	–	240
Foreign currency translation adjustment	–	–	–	–	–	(4,472)	(4,472)
Unrealized losses on forward exchange contracts	–	–	–	–	–	(3,826)	(3,826)
Exercise of stock options	362	–	–	–	–	–	362
Reclassification of stock-based compensation costs upon exercise of stock awards	127	–	–	–	(127)	–	–
Balance as at February 28, 2007	$ 599,078	$ 1,537	$ (452,727)	$ (2,228)	$ 6,673	$ 27,689	$ 180,022

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Accumulated other comprehensive income is comprised of the following:

	As at February 28, 2007 (unaudited)	As at August 31, 2006
Foreign currency translation adjustment		
Current period	$ (10,304)	$ 12,322
Cumulative effect of prior periods	39,179	26,857
	28,875	39,179
Unrealized gains (losses) on forward exchange contracts		
Current period	(6,637)	2,514
Cumulative effect of prior periods	5,451	2,937
	(1,186)	5,451
	$ 27,689	$ 44,630

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 $659,000, $1,195,000, $776,000, and $1,547,000 for the three- and six-month periods ended February 28, 2006 and 2007, respectively. This difference has no impact on the net earnings and the net earnings per share for the reporting periods.

Statements of cash flows

For the three- and six-month periods ended February 28, 2006 and 2007, 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.

New accounting standards and pronouncements

In May 2005, the Financial Accounting Standard Board (FASB) issued Statement of Financial Accounting Standard (SFAS) 154, “Accounting Changes and Error 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 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. The company adopted this new statement on September 1, 2006, and its adoption had no effect on its financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), “Accounting for Uncertainty in Income Taxes”, which clarifies the accounting for uncertainties in income taxes recognized in accordance with SFAS 109, “Accounting for Income Taxes”. The interpretation is effective for fiscal years beginning after December 15, 2006. The company will adopt this interpretation on September 1, 2007, and is currently assessing the impact its adoption will have on its financial statements.

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On September 15, 2006, the FASB issued SFAS 157, "Fair Value Measurements", which establishes a framework for measuring fair value in GAAP, and is applicable to other accounting pronouncements, in which fair value is considered to be the relevant measurement attribute. SFAS 157 also expands disclosures about fair value measurement. This statement is effective for fiscal years beginning after November 15, 2007. The company will adopt this statement on September 1, 2008, and has not yet assessed the impact its adoption will have on its financial statements.

On February 15, 2007, the FASB issued SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115", which permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of this statement apply only to entities that elect the fair value option. However, the amendment to SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities", applies to all entities with available-for-sale and trading securities. This statement is effective for fiscal years beginning after November 15, 2007, but the company has not yet determined if it will adopt this statement, nor the impact it might have on its financial statements. Should the company decide to adopt SFAS 159, it will be adopted on September 1, 2008.

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

This discussion and analysis contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995 and we intend that such forward- looking statements be subject to the safe harbors created thereby. Forward-looking statements are statements other than historical information or statements of current condition. Words such as "may," "will," "expect," "believe," "anticipate," "intend," "could," "estimate", "continue" or the negative or comparable terminology are intended to identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. They are not guarantees of future performance and involve risks and uncertainties. Actual results may differ materially from those in the forward-looking statements due to various factors, including consolidation in the global telecommunications test and measurement industry; capital spending levels in the telecommunications, life sciences and high-precision assembly sectors; concentration of sales; fluctuating exchange rates and our ability to execute in these uncertain conditions; the effects of the additional actions we have taken in response to such economic uncertainty,(including our ability to quickly adapt cost structures with anticipated levels of business, ability to manage inventory levels with market demand); market acceptance of our new products and other upcoming products; limited visibility with regard to customer orders and the timing of such orders; our ability to successfully integrate our acquired and to-be-acquired businesses and to operate and manage businesses in foreign countries; the retention of key technical and management personnel; and future economic, competitive and market conditions. Assumptions relating to the foregoing involve judgments and risks, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Other risk factors that may affect our future performance and operations are detailed in our Annual Report on Form 20-F and our other filings with the U.S. Securities and Exchange Commission and the Canadian securities commission. 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 at the date of this document. We undertake no obligation to revise or update any of them to reflect events or circumstances that occur after the date of this document.

The following discussion and analysis of financial condition and results of operations is dated March 28, 2007.

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

INDUSTRY OVERVIEW

Global market demand for telecom test and measurement equipment should remain strong in the years to come as most network service providers (NSPs) are reassigning their capital expenditures to convert their networks to converged Internet protocol (IP)-based services, and to significantly increase network capacity to enable triple-play (voice, data and video) offerings. These market forces create needs for differentiated test solutions to help NSPs accelerate deployment and ensure service quality in their network build-outs.

With the ongoing globalization of the world's economy and the emergence of new consumer markets, NSPs are poised to capitalize on growing demand for communications and entertainment services. In 2006, some smaller telecom operators launched broadcast-quality video services based on IP communications. This technology, better known as IPTV, allows telephone companies (telcos) to efficiently offer TV, HDTV and interactive TV services to their broadband subscribers. Tier-1 and Tier-2 telcos are expected to launch similar IPTV services on a large scale in calendar 2007. While Web-based streaming video is offered for free on a best-effort basis, IPTV, whom many regard as the broadband "killer application," will require a high level of performance to ensure a quality user experience. NSPs, after all, do not want customer churn to prevent a meaningful return on their massive investments.

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To deliver a wide range of differentiated IP services, NSPs will continue transforming their legacy, circuit-switched networks into highly efficient, flexible and scalable packet-based IP architectures. Telcos and cablecos have already proven that they can generate significant revenues from higher-margin services on hybrid networks, while reducing operating costs. IPTV should only accelerate the migration towards fully converged, IP-based networks, since it typically allows NSPs to nearly double average revenue per user (ARPU).

The increasing reliance on telecom and IP-related services will continue driving bandwidth consumption, thus pushing the deployment of fiber deeper into access networks. Competition between telcos and cablecos has intensified as triple-play offerings are announced almost daily. Hybrid architectures combining copper and fiber (fiber-to-the-curb, or FTTC, and fiber-to-the-node, or FTTN), will keep expanding worldwide, since this is the quickest and least expensive method to increase bandwidth. To remain competitive with cablecos, telcos are migrating from former asymmetric digital subscriber line (ADSL), to current ADSL2+, and onto future very-high-data-rate digital subscriber line standard version 2 (VDSL2) technologies as interoperability becomes a reality. Telcos, however, will increasingly opt for all-fiber, passive optical network (PON)-based architectures (fiber-to-the-premises, or FTTP), with GPON becoming their preferred implementation, to meet heightened bandwidth requirements and to future-proof their networks. These decisions will apply not only to green-field deployments and high-rise buildings, but also to larger-scale rollouts as operating costs are less than FTTC and FTTN and cost of deployments are falling. We are still in the early stages of building access networks around the world.

Metro network deployments, taking advantage of carrier-grade Ethernet and metro-Ethernet technologies, are moving ahead to handle large increases in bandwidth consumption in access networks. These network upgrades, in turn, will eventually place a strain on long-haul networks, where excess capacity created by massive overspending in the late-90s is gradually being consumed. NSPs are more than ever committed to deploying next-generation SONET/SDH transport technologies, while 40 Gb/s deployments are expected to start in early 2008, creating new testing requirements at the optical and protocol layers.

These key market trends affected multiple segments of the global telecommunications supply chain in the last few months. System vendors 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 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 networking and/or FTTx applications.

COMPANY OVERVIEW

We reported sales of $35.2 million in the second quarter of fiscal 2007, which represented an increase of 17.1% year-over-year. At the half-way mark of our fiscal year, sales reached $70.8 million for a growth of 23.9% year-over-year. In comparison, our corporate performance metric for sales growth for fiscal 2007 was established at 20% year-over-year. Sales during the first half of fiscal 2007 included those of Consultronics Limited, a leading supplier of xDSL, IPTV and VoIP test equipment for copper-based broadband access networks, which was integrated into our Telecom Division following the closing of the acquisition in January 2006. Excluding these sales, we would have reported organic growth of 16.7% year-over-year at the half-way mark of fiscal 2007.

Looking at the bottom line, we recorded GAAP net earnings of $2.7 million, or $0.04 per diluted share, in the second quarter of fiscal 2007 compared to $1.4 million, or $0.02 per diluted share, for the same period in 2006. Midway through our fiscal year, we generated GAAP net earnings of $6.2 million, or $0.09 per diluted share, compared to $1.7 million, or $0.02 per diluted share, for the same period in 2006. As for earnings from operations, they reached 5.9% in the second quarter of fiscal 2007 and 6.8% midway through the fiscal year, close to our stated goal of 7% for the whole fiscal year.

During the second quarter of fiscal 2007, we launched seven new products including Internet protocol television (IPTV) test capabilities for our Packet Blazer Ethernet product line, an enhanced Packet Blazer test module for advanced Ethernet and higher-layer test applications, a very-high-speed digital subscriber loop, version 2 (VDSL2) test module to characterize IPTV and high-definition television (HDTV) over copper access links, a software upgrade for optical time-domain reflectometry (OTDR) characterization using the FTB-200 Compact Platform, as well as a new variable optical attenuator (VOA) for optical network testing and active component manufacturing applications.

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Subsequent to the quarter-end, we received a US patent entitled “Method and Apparatus for Testing Optical Networks,” which serves as the basis of our series of passive optical network (PON) power meters designed for field-testing applications. These test solutions are widely used by technicians characterizing fiber-to-the-home (FTTH) PONs, particularly near the optical network terminal (ONT) at the customer premises where triple-play services need to be activated.

During the first half of fiscal 2007, we have launched 12 new products. Sales derived from products that have been on the market two years or less represented 30.5% of total sales in the first half of fiscal 2007. Our published goal for fiscal 2007 is 35%.

During the first quarter of fiscal 2007, we implemented SAP at the Toronto, Canada and the Southampton, United Kingdom facilities of newly acquired Consultronics.

OUR STRATEGY, KEY PERFORMANCE INDICATORS AND CAPABILITY TO DELIVER RESULTS

For a complete description of our strategy and the related key performance indicators, as well as our capability to deliver results in fiscal 2007, please refer to the corresponding sections in our most recent Annual Report, filed with the securities commissions.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

For a complete description of our critical accounting policies and estimates, please refer to the corresponding section in our most recent Annual Report, filed with the securities commissions. The following details the changes in critical accounting policies that will be adopted in fiscal 2008.

In January 2005, the Canadian Institute of Chartered Accountants (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. We will adopt these new standards on September 1, 2007. Although the final adjustments will be based on the financial instruments that we will be a party to on the adoption date, we are currently assessing the effects of these new standards, and impacts consistent with the adjustments described under note 20 item b) of our most recent annual consolidated financial statements are expected.

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RESULTS OF OPERATIONS

The following discussion and analysis of our consolidated financial condition and results of operations for the periods ended February 28, 2006 and 2007, should be read in conjunction with our interim consolidated financial statements and the related notes thereto. Our interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP) and significant differences in measurement and disclosure from the United States generally accepted accounting principles (U.S. GAAP) are set out in note 13 to our interim consolidated financial statements. Our measurement currency is the Canadian dollar although we report our financial statements in US dollars. The following tables set forth interim consolidated statements of earnings data in thousands of US dollars, except per share data, and as a percentage of sales for the periods indicated:

	Three months ended February 28, 2007	Three months ended February 28, 2006	Six months ended February 28, 2007	Six months ended February 28, 2006
	(unaudited)		(unaudited)	
Sales	**$ 35,207**	$ 30,066	**$ 70,754**	$ 57,110
Cost of sales [(1)]	**14,970**	13,440	**30,199**	25,504
Gross margin	**20,237**	16,626	**40,555**	31,606
Operating expenses				
Selling and administrative	**12,184**	9,303	**23,726**	18,361
Net research and development	**4,678**	3,906	**9,032**	7,028
Amortization of property, plant and equipment	**664**	873	**1,445**	1,769
Amortization of intangible assets	**630**	1,136	**1,512**	2,357
Total operating expenses	**18,156**	15,218	**35,715**	29,515
Earnings from operations	**2,081**	1,408	**4,840**	2,091
Interest and other income	**1,105**	828	**2,277**	1,383
Foreign exchange gain (loss)	**352**	(213)	**735**	(531)
Earnings before income taxes	**3,538**	2,023	**7,852**	2,943
Income taxes	**854**	657	**1,635**	1,222
Net earnings for the period	**$ 2,684**	$ 1,366	**$ 6,217**	$ 1,721
Basic net earnings per share	**$ 0.04**	$ 0.02	**$ 0.09**	$ 0.03
Diluted net earnings per share	**$ 0.04**	$ 0.02	**$ 0.09**	$ 0.02
Segmented information:				
Sales:				
Telecom Division	**$ 29,297**	$ 25,254	**$ 58,819**	$ 47,330
Life Sciences and Industrial Division	**5,910**	4,812	**11,935**	9,780
	$ 35,207	$ 30,066	**$ 70,754**	$ 57,110
Earnings from operations:				
Telecom Division	**$ 1,078**	$ 1,220	**$ 2,881**	$ 1,708
Life Sciences and Industrial Division	**1,003**	188	**1,959**	383
	$ 2,081	$ 1,408	**$ 4,840**	$ 2,091
Research and development data:				
Gross research and development	**$ 5,939**	$ 4,940	**$ 11,448**	$ 8,946
Net research and development	**$ 4,678**	$ 3,906	**$ 9,032**	$ 7,028

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

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	Three months ended February 28, 2007	Three months ended February 28, 2006	Six months ended February 28, 2007	Six months ended February 28, 2006
	(unaudited)		(unaudited)	
Sales	**100.0%**	100.0%	**100.0%**	100.0%
Cost of sales (1)	**42.5**	44.7	**42.7**	44.7
Gross margin	**57.5**	55.3	**57.3**	55.3
Operating expenses				
Selling and administrative	**34.6**	30.9	**33.5**	32.2
Net research and development	**13.3**	13.0	**12.8**	12.3
Amortization of property, plant and equipment	**1.9**	2.9	**2.0**	3.0
Amortization of intangible assets	**1.8**	3.8	**2.2**	4.1
Total operating expenses	**51.6**	50.6	**50.5**	51.6
Earnings from operations	**5.9**	4.7	**6.8**	3.7
Interest and other income	**3.1**	2.7	**3.2**	2.4
Foreign exchange gain (loss)	**1.0**	(0.7)	**1.1**	(0.9)
Earnings before income taxes	**10.0**	6.7	**11.1**	5.2
Income taxes	**2.4**	2.2	**2.3**	2.2
Net earnings for the period	**7.6%**	4.5%	**8.8%**	3.0%
Segmented information:				
Sales:				
Telecom Division	**83.2%**	84.0%	**83.1%**	82.9%
Life Sciences and Industrial Division	**16.8**	16.0	**16.9**	17.1
	100.0%	100.0%	**100.0%**	100.0%
Earnings from operations:				
Telecom Division	**3.1%**	4.1%	**4.1%**	3.0%
Life Sciences and Industrial Division	**2.8**	0.6	**2.7**	0.7
	5.9%	4.7%	**6.8%**	3.7%
Research and development data:				
Gross research and development	**16.9%**	16.4%	**16.2%**	15.7%
Net research and development	**13.3%**	13.0%	**12.8%**	12.3%

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

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SALES

For the three months ended February 28, 2007, our global sales increased 17.1% to $35.2 million from $30.1 million for the same period last year, with an 83%-17% split in favor of our Telecom Division.

For the six months ended February 28, 2007, our global sales increased 23.9% to $70.8 million from $57.1 million for the same period last year, with an 83%-17% split in favor of our Telecom Division.

Telecom Division

For the three months ended February 28, 2007, sales of our Telecom Division increased 16.0% to $29.3 million from $25.3 million for the same period last year.

For the six months ended February 28, 2007, sales of our Telecom Division increased 24.3% to $58.8 million from $47.3 million for the same period last year.

During the second quarter and the first half of fiscal 2007, we posted organic growth due to some market-share gains in optical and protocol testing and continued spending in access networks fueled by the competitive dynamic between North American telephone and cable companies. Also, during the second quarter of fiscal 2007, we benefited from year-end revenue from our top customer, which contributed to the increase in sales year-over-year. Sales made to this customer represented 25.7% of our telecom sales in the second quarter of fiscal 2007, compared to 10.2% for the same period last year. They represented 21.2% of our telecom sales for the first half of fiscal 2007, compared to 13.0% for the same period last year.

In addition, Consultronics, which we acquired in January 2006, contributed to the increase in our telecom sales year-over-year (for both the second quarter and the first half of 2007). Although sales of Consultronics products were lower than at the time of the acquisition, we expect sales of these test solutions to increase over time. In addition, these solutions are now better leveraged by our global sales channels and we are also developing and launching new products that will integrate Consultronics' core knowledge and intellectual property. It should be noted that during the second quarter and the first half of fiscal 2007, a significant portion of sales of Consultronics' products were made to our top customer.

Finally, during the second quarter and the first half of fiscal 2007, we benefited from a significant increase in the demand for our protocol test solutions, which also contributed to the increase in our telecom sales year-over-year. Sales of our protocol test solutions represented more than 10% of our telecom sales for the second quarter and the first half of fiscal 2007. Based on these data points and given the much larger addressable market for protocol test solutions, we believe that protocol revenues should grow faster than our optical revenues.

Life Sciences and Industrial Division

For the three months ended February 28, 2007, sales of our Life Sciences and Industrial Division increased 22.8% to $5.9 million from $4.8 million for the same period last year.

For the six months ended February 28, 2007, sales of our Life Sciences and Industrial Division increased 22.0% to $11.9 million from $9.8 million for the same period last year.

The increase in sales in fiscal 2007, compared to 2006, is mainly due to increased sales activities in the curing and the fluorescence illumination markets.

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Net Bookings

Overall, for the two divisions, net accepted orders increased 28.8% to $36.5 million in the second quarter of fiscal 2007 from $28.3 million for the same period last year. Our book-to-bill ratio reached 1.04 in the second quarter of fiscal 2007, compared to 0.94 for the same period last year. In the previous quarter, the net book-to-bill ratio was 1.04. Our 28.8% increase in net accepted orders in the second quarter of fiscal 2007, compared to the same period last year, reflects the increased demand in our test solutions (especially in the Americas and in the Europe-Middle East-Africa (EMEA) regions), some market-share gains in the telecommunications and life sciences markets as well as the improvement in the telecommunications market environment.

Geographic distribution

For the three months ended February 28, 2007, sales to the Americas, Europe-Middle East-Africa (EMEA) and Asia-Pacific (APAC) accounted for 57%, 31% and 12% of global sales, respectively. For the corresponding period last year, sales to the Americas, EMEA and APAC accounted for 57%, 26% and 17% of global sales, respectively. For the six months ended February 28, 2007, sales to the Americas, EMEA and APAC accounted for 57%, 30% and 13% of global sales, respectively. For the corresponding period last year, sales to the Americas, EMEA and APAC accounted for 58%, 26% and 16% of global sales, respectively.

During the second quarter of fiscal 2007, sales to EMEA and the Americas increased (in dollars) 38.8% and 16.4%, respectively, while sales to APAC decreased 13.6%. During the first half of fiscal 2007, sales to EMEA, the Americas and APAC increased (in dollars) 44.5%, 20.8% and 2.3%, respectively.

The significant increase in sales in EMEA market, so far in fiscal 2007, is apparent in the results for all our product lines, following our efforts to aggressively develop this market in the last several years and investment in stronger support and service operations in this region. Many Tier-1 carriers in EMEA are migrating their traditional circuit-switched core networks to higher speed, dense wavelength division multiplexing (DWDM) and Next-Generation packet-based architectures, which is creating a market demand for our protocol test solutions and fiber characterization test kits.

In the Americas, sales to our top customer, who is located in the United States, significantly increased in dollars in the second quarter and the first half of fiscal 2007, compared to the corresponding periods last year. In the second quarter of fiscal 2007, we benefited from year-end revenue from this Tier-1 customer, which contributed to the significant increase in sales year-over-year. Also, this customer, along with other leading carriers, have continued their investments in access networks, fueled by the competitive pressure from cable companies to offer triple-play services (voice, data and video) to end-customers. Finally, Consultronics, whose customers are mainly located in the Americas, helped increase our sales to the Americas, year-over-year.

A significant portion of our sales to the APAC market are made through tenders, which vary in number and importance quarter-over-quarter, and typically experience seasonal trends. Also, we face significant competitive pricing pressure in this area, and as a result, we were unsuccessful on winning some deals.

Through our two divisions, we sell our products to a broad range of customers, including network service providers, cable TV operators, optical system and component manufacturers, as well as customers in the life sciences and high-precision assembly sectors. During the three months ended February 28, 2007, our top customer accounted for 21.4% ($7.5 million) of our global sales, and our top three customers accounted for 27.7% of our global sales. For the corresponding period last year, no customer accounted for more than 10% of our global sales, and our top three customers accounted for 20.3% of our global sales. For the six months ended February 28, 2007, our top customer accounted for 17.6% ($12.5 million) of our global sales, and our top three customers accounted for 23.0% of our global sales. For the corresponding period last year, our top customer accounted for 10.7% ($6.1 million) of our global sales, and our top three customers accounted for 19.8% of our global sales. As mentioned above, during the second quarter of fiscal 2007, we benefited from year-end revenue from our top customer, which contributed to the increase in sales to this customer during that period, as well as the increase in the percentage it represents.

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Gross Margin

Gross margin improved to 57.5% of sales for the three months ended February 28, 2007, from 55.3% for the same period last year.

Gross margin improved to 57.3% of sales for the six months ended February 28, 2007, from 55.3% for the same period last year.

The increase in our gross margin in the second quarter and the first half of fiscal 2007, compared to the corresponding periods last year, can be explained by the following factors. First, the increase in sales, year-over-year, resulted in an increase in manufacturing activities, allowing us to better absorb our fixed manufacturing costs. In addition, during the second quarter and the first half of fiscal 2007, our gross margin was positively affected by the increased sales of our protocol test solutions and by the contribution of Consultronics. Protocol and copper-access test solutions tend to have better margins than our optical ones. Furthermore, we were able to reduce our cost of goods sold by better leveraging our supplier base and by developing innovative new products with cost-effective design. Also, the shift in sales between EMEA and APAC had a positive impact on our gross margin as gross margin tend to be better in EMEA than in APAC. However, we are facing continued aggressive pricing pressure worldwide. Finally, during the first half of fiscal 2007, a stronger Canadian dollar, compared to the US dollar year-over-year, prevented us from further improving our gross margin as some cost of sales items are denominated in Canadian dollars.

Considering the expected sales growth in fiscal 2007, the expected increase in sales of protocol products (which tend to generate higher margins), the cost-effective design of our products, our tight control on operating costs as well as the full contribution of Consultronics, whose products have slightly higher margins than our optical ones, we expect our gross margin to improve in 2007 and beyond. However, our gross margin may fluctuate quarter-over-quarter as our sales may fluctuate. Furthermore, our gross margin can be negatively affected by increased competitive pricing pressure, customer concentration and/or consolidation, increased obsolescence costs, shifts in customer and product mix, under-absorption of fixed manufacturing costs and increases in product offerings by other suppliers in our industry. Finally, any further increase in the strength of the Canadian dollar would have a negative impact on our gross margin in fiscal 2007.

SELLING AND ADMINISTRATIVE

For the three months ended February 28, 2007, selling and administrative expenses were $12.2 million, or 34.6% of sales, compared to $9.3 million, or 30.9% of sales for the same period last year.

For the six months ended February 28, 2007, selling and administrative expenses were $23.7 million, or 33.5% of sales, compared to $18.4 million, or 32.2% of sales for the same period last year.

During the second quarter of fiscal 2007, we continued intensifying our sales and marketing activities to develop our markets and leverage the significant research and development investments of the prior years; this resulted in higher sales and marketing expenditures (including number of employees) year-over-year. In addition, our overall commission expenses increased in the second quarter of fiscal 2007, compared to the same period last year, due to the increase in sales year-over-year, and the shift in customer mix. In fact, during the second quarter of fiscal 2007, we had large orders sold directly to international customers for which we had to pay commissions to distributors. Furthermore, Consultronics, which we acquired in January 2006, contributed for the whole period to our selling and administrative expenses, compared to approximately one month in 2006, and therefore caused these expenses to increase year-over-year. However, a slightly weaker Canadian dollar, compared to the US dollar year-over-year, caused our selling and administrative expenses to slightly decrease, as more than half of these are incurred in Canadian dollars.

During the first half of fiscal 2007, intensified sales and marketing activities and the acquisition of Consultronics, as explained above, contributed to the increase in our selling and administrative expenses, compared to the same period last year. In addition, our overall commission expenses increased in the second half of fiscal 2007, compared to the same period last year, due to an increase in sales year-over-year, and the shift in customer mix. Also, a stronger Canadian dollar on average for the period, compared to the US dollar year-over-year, caused our selling and administrative expenses to increase year-over-year.

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Finally, during the second quarter and the first half of fiscal 2007, and despite an increase in sales, our selling and administrative expenses increased in percentage of sales, compared to the corresponding periods last year. Larger commissions on international sales as well as our efforts to develop international markets and operations contributed to the increase in these expenses as a percentage of sales.

For fiscal 2007, we expect our selling and administrative expenses to increase in dollars, and slightly exceed our initial range of 30% to 32% of sales for the whole fiscal year. In particular, in fiscal 2007, we will have the full impact of the acquisition of Consultronics on our selling and administrative expenses. Also, we expect our commission expenses to increase as the sales volume increases. Furthermore, considering our goal of becoming the leading player in the telecom test and measurement space, we will intensify our sales and marketing efforts, both domestic and international, which will also cause our expenses to rise. Finally, any further increase in the strength of the Canadian dollar would also cause our selling and administrative expenses to increase, as more than half of these expenses are incurred in Canadian dollars.

RESEARCH AND DEVELOPMENT

For the three months ended February 28, 2007, gross research and development expenses totalled $5.9 million, or 16.9% of sales, compared to $4.9 million, or 16.4% of sales for the same period last year.

For the six months ended February 28, 2007, gross research and development expenses totalled $11.4 million, or 16.2% of sales, compared to $8.9 million, or 15.7% of sales for the same period last year.

The increase in our gross research and development expenses in dollars in the second quarter and the first half of fiscal 2007, compared to the corresponding periods last year, is mostly due to the contribution of the Consultronics acquisition. In addition, over the last few quarters, we intensified our research and development activities in both divisions, which resulted in more gross research and development expenses, including additional employees, during the second quarter and the first half of fiscal 2007, compared to the corresponding periods last year. During the second quarter of fiscal 2007, a slightly weaker Canadian dollar, compared to the US dollar year-over-year, caused our gross research and development expenses to slightly decrease, as most of these are incurred in Canadian dollars. During the first half of fiscal 2007, the increased strength of the Canadian dollar, compared to the US dollar year-over-year, contributed to the increase in our gross research and development expenses.

The above-mentioned factors explain the increase of our gross research and development expenses as a percentage of sales for the second quarter and the first half of fiscal 2007, compared to the corresponding periods last year.

For the three months ended February 28, 2007, tax credits and grants from the Canadian federal and provincial governments for research and development activities were $1.3 million, or 21.2% of gross research and development expenses, compared to $1.0 million, or 20.9% of gross research and development expenses for the same period last year. For the six months ended February 28, 2007, these tax credits and grants were $2.4 million, or 21.1% of gross research and development expenses, compared to $1.9 million, or 21.4% of gross research and development expenses for the same period last year.

During the second quarter and the first half of fiscal 2007, tax credits and grants increased at the same rate as our gross research and development expenses compared to the corresponding periods last year as we were entitled to the same tax credits and grant programs year-over-year.

For the first half of fiscal 2007, 30.5% of our sales originated from products that have been on the market for two years or less, which is below our stated goal of 35% for fiscal 2007. Over the last few months, our successful FTTx products moved down to the denominator part of the ratio as they have been on the market for more than two years.

These products still contributed strongly to our sales in the first half of fiscal 2007.

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For fiscal 2007, we expect to increase our research and development expenses at almost the same rate as we grow our sales, given our focus on innovation, our desire to gain market shares and our goal to exceed customer needs and expectations and the full impact of the acquisition of Consultronics. We also intend to increasingly take advantage of talent pools around the world by establishing a research and development center focused on software development, in Pune, India. Finally, any further 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 the three months ended February 28, 2007, amortization of property, plant and equipment was $664,000, compared to $873,000 for the same period last year. For the six months ended February 28, 2007, amortization expenses amounted to $1.4 million, compared to $1.8 million for the same period last year. The decrease in amortization expenses in fiscal 2007, compared to 2006, despite the acquisition of Consultronics, is mainly due to the fact that some of our property, plant and equipment became fully amortized during fiscal 2006.

AMORTIZATION OF INTANGIBLE ASSETS

For the three months ended February 28, 2007, amortization of intangible assets was $630,000, compared to $1.1 million for the same period last year. For the six months ended February 28, 2007, amortization of intangible assets was $1.5 million, compared to $2.4 million for the same period last year. The decrease in amortization expenses in fiscal 2007, compared to 2006, despite the acquisition of Consultronics, is mainly due to the fact that some of our intangible assets became fully amortized during fiscal 2006 and the first quarter of 2007; namely, those related to our Life Sciences and Industrial Division and our protocol activities.

INTEREST AND OTHER INCOME

For the three months ended February 28, 2007, interest and other income amounted to $1.1 million, compared to $828,000 for the same period last year. During the second quarter of fiscal 2007, our interest income was higher than the corresponding period of 2006, mainly because of the increase in our average cash position due to cash flows from operating activities and because of the increase in interest rates. However, the decrease in the value of the Canadian dollar, compared to the US dollar year-over-year contributed to the decrease in our interest income to some extent as it is denominated in Canadian dollars.

For the six months ended February 28, 2007, interest and other income amounted to $2.3 million compared to $1.4 million for the same period last year. The increase in interest income year-over-year is the result of the increase in our average cash position due to cash flows from operating activities and the increase in interest rates. Also, the increased strength of the Canadian dollar compared to the US dollar year-over-year contributed to the increase in our interest income to some extent.

FOREIGN EXCHANGE GAIN (LOSS)

For the three months ended February 28, 2007, the foreign exchange gain amounted to $352,000, compared to a foreign exchange loss of $213,000 for the same period last year.

During the second quarter of fiscal 2007, the value of the Canadian dollar decreased quarter-over-quarter, compared to the US dollar, which resulted in a foreign exchange gain during the second quarter of 2007. On the other hand, during the second quarter of fiscal 2006, the value of the Canadian dollar increased quarter-over-quarter, compared to the US dollar, which resulted in a foreign exchange loss in the second quarter of fiscal 2006.

For the six months ended February 28, 2007, the foreign exchange gain amounted to $735,000 compared to a foreign exchange loss of $531,000 for the same period last year. The significant foreign exchange gain recorded in the first half of fiscal 2007 is the result of the significant decrease in the value of the Canadian dollar compared to the US dollar during this period. During the corresponding period last year, the value of the Canadian dollar increased compared to the US dollar, which resulted in a foreign exchange loss of $531,000.

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Foreign exchange gains and losses are the result of the translation of operating activities denominated in currencies other than the Canadian dollar. It should be noted that foreign exchange rate fluctuations also flow through the P&L line items as a significant portion of our operating items are denominated in Canadian dollars and we report our results in US dollars. The average value of the Canadian dollar compared to the US dollar in the second quarter of fiscal 2007 was CA$1.1656 = US$1.00 versus CA$1.1554 = $US1.00 during the same period last year, representing a decrease of 1% in the value of the Canadian dollar compared to the US dollar. The average value of the Canadian dollar compared to the US dollar in the first half of fiscal 2007 was CA$1.1463 = US$1.00 versus CA$1.1674 = $US1.00 during the same period last year, representing an increase of 2% in the value of the Canadian dollar compared to the US dollar.

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 these risks. However, any further increase in the value of the Canadian dollar, compared to the US dollar, would have a negative impact on our operating results.

INCOME TAXES

For the three months ended February 28, 2007, we recorded an income tax expense of $854,000 compared to $657,000 for the same period last year. For the six months ended February 28, 2007, we recorded an income tax expense of $1.6 million compared to $1.2 million for the same period last year.

Most of the income tax expense recorded in fiscal 2006 and 2007 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 in the statements of earnings.

We record 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 we 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.

LIQUIDITY AND CAPITAL RESOURCES

Cash Requirements and Capital Resources

As at February 28, 2007, cash and short-term investments totalled $114.6 million, while our working capital was at $144.8 million. Our cash and short-term investments increased $3.3 million in the second quarter of fiscal 2007, compared to the previous quarter, mainly due to the cash flows from operating activities of $7.0 million, offset by an unrealized foreign exchange loss on our cash and short-term investments of $2.8 million as well as the cash payment of $835,000 for the purchase of property, plant and equipment and intangible assets. The $2.8 million unrealized foreign exchange loss 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 twelve (fourteen as of November 30, 2006) quality, high-credit 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 other potential acquisitions.

We believe that our cash balances and short-term investments will be sufficient to meet our liquidity and capital requirements for the foreseeable future. In addition to these assets, we have unused available lines of credit of $10.5 million for working capital and other general corporate purposes and an unused line of credit of $10.3 million for foreign currency exposure related to forward exchange contracts. However, possible operating losses and/or possible investments in or acquisitions of complementary businesses, products or technologies may require additional financing. There can be no assurance that additional debt or equity financing will be available when required or, if available, that it can be secured on satisfactory terms. Our lines of credit bear interest at prime rate.

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Sources and Uses of Cash

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

Operating Activities

Cash flows provided by operating activities were $7.0 million for the three months ended February 28, 2007, compared to $5.4 million for the same period last year. Cash flows provided by operating activities in the second quarter of fiscal 2007 were mainly attributable to the net earnings before items not affecting cash of $5.3 million and the positive net change in non-cash operating items of $1.7 million. During the second quarter of 2007, our accounts payable and accrued liabilities increased, resulting in a positive effect on cash flows of $2.7 million. However, our income taxes and tax credits recoverable and our inventories increased during that period, resulting in negative effects on cash flows of $513,000 and $510,000, respectively. Timing of certain purchases and payments explain the increase in our accounts payable and accrued liabilities during the second quarter of fiscal 2007. Our income taxes and tax credits recoverable increased due to tax credits earned during the quarter but not yet recovered. Finally, our inventory slightly increased to support increased sales activities.

Cash flows provided by operating activities were $10.3 million for the six months ended February 28, 2007, compared to $6.3 million for the same period last year. Cash flows provided by operating activities in the first half of fiscal 2007 were mainly attributable to the net earnings before items not affecting cash of $11.7 million, offset in part by the negative net change in non-cash operating items of $1.4 million. During the first half of 2007, our accounts receivable and our income taxes and tax credits recoverable increased, resulting in negative effects on cash flows of $3.2 million and $931,000, respectively. On the other hand, our accounts payable and accrued liabilities increased during that period, resulting in a positive effect on cash flows of $2.8 million. The timing of our sales in 2007 explains the increase in our accounts receivable. Our income taxes and tax credits recoverable increased due to tax credits earned during the period but not yet recovered. Finally, our inventory slightly increased to support increased sales activities.

Investing Activities

Cash flows used by investing activities were $5.7 million for the three months ended February 28, 2007, compared to $9.6 million for the same period last year. In the second quarter of fiscal 2007, we acquired $4.8 million worth of short-term investments and paid $835,000 for the purchase of property, plant and equipment. During the corresponding period last year, we made cash payments of $17.5 million and $933,000 for the acquisition of Consultronics and the purchase of property, plant and equipment, respectively. In order to finance a portion of these payments, we disposed of $8.8 million worth of short-term investments during that quarter.

Cash flows used by investing activities were $8.0 million for the six months ended February 28, 2007, compared to $9.2 million for the same period last year. In the first half of fiscal 2007, we acquired $7.6 million worth of short-term investments and paid $1.6 million for the purchase of property, plant and equipment. On the other hand, during that same period, we received $1.2 million following the sale of one of our buildings located in Rochester, NY. For the corresponding period last year, similar reasons as those described above for the second quarter of 2006 explain the use of cash by investing activities during the first half of fiscal 2006.

FORWARD EXCHANGE CONTRACTS

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

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

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As at February 28, 2007, we held forward exchange contracts to sell US dollars at various forward rates, which are summarized as follows:

Expiry dates	Contractual amounts	Weighted average contractual forward rates
March 2007 to August 2007	$21,700,000	1.1520
September 2007 to December 2009	$48,300,000	1.1312

As at February 28, 2007, 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 loss of $1.3 million.

CONTINGENCY

As discussed in note 6 to our interim consolidated financial statements, 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 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 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 notice of the settlement be distributed to all settlement class members beginning on November 15, 2005. A settlement fairness hearing was held on April 24, 2006; however, no ruling has been issued yet by the court.

The plaintiffs have continued to litigate against the underwriter defendants. The district court has directed that the litigation proceed within a number of "focus cases" rather than in all of the 310 cases that have been consolidated. The company's case is not one of these focus cases. On October 13, 2004, the district court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the district court's class certification decision. Because the company's settlement with the plaintiffs involves the certification of the case as a class action as part of the approval process, the impact of the Court of Appeals' ruling on the company's settlement is unclear. On January 5, 2007, the plaintiffs filed a petition for rehearing en banc by the Second Circuit. That request is still pending.

If the court determines that the settlement is fair to the class members, and that the settlement classes can be certified, the settlement will be approved. The settlement provides that, if the plaintiffs do not obtain any recovery from the underwriter defendants, the members of the class action would receive an amount not expected to exceed $2,507,678. Any direct financial impact plus any legal fees are expected to be borne by the company's insurance carriers. However, 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 to 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 interim consolidated financial statements as at February 28, 2007.

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SHARE CAPITAL AND STOCK-BASED COMPENSATION PLANS

Share Capital

As at March 28, 2007, EXFO had 37,143,000 multiple voting shares outstanding, entitling to ten votes each and 31,765,556 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 and Deferred Share Unit Plan

The aggregate number of subordinate voting shares covered by stock options, restricted share units (RSUs) and deferred share units (DSUs) granted under the Long-Term Incentive Plan and the Deferred Share Unit Plan was 2,738,331 as at February 28, 2007. 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 February 28, 2007:

Stock Options	**Number**	**% of issued and outstanding**	**Weighted average exercise price**
Chairman of the Board, President and CEO (one individual)	179,642	8%	$9.05
Board of Directors (five individuals)	194,375	9%	$6.23
Management and Corporate Officers (eight individuals)	297,718	14%	$16.10
	671,735	**31%**	$**11.36**

Restricted Share Units (RSUs)	**Number**	**% of issued and outstanding**
Chairman of the Board, President and CEO (one individual)	59,913	11%
Management and Corporate Officers (ten individuals)	272,399	52%
	332,312	**63%**

Deferred Share Units (DSUs)	**Number**	**% of issued and outstanding**
Board of Directors (five individuals)	**54,305**	**100%**

OFF-BALANCE SHEET ARRANGEMENTS

As at February 28, 2007, our off-balance sheet arrangements consisted of letters of guarantee and forward exchange contracts. As at February 28, 2007, our letters of guarantee amounted to $1.9 million; these letters of guarantee expire at various dates through fiscal 2010 and the full amount was reserved from one of our lines of credit. Our forward exchange contracts are described above.

VARIABLE INTEREST ENTITY

As of February 28, 2007, we did not have interests in any variable interest entities.

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RISKS AND UNCERTAINTIES

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

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 few years, caused our operating expenses and our foreign exchange loss to increase. Any further increase in the value of the Canadian dollar in the coming months would negatively affect our results of operations.

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

Furthermore, given our strategic goals for growth and competitive positioning in our industry, we are continuously expanding into international markets. This exposes us to certain risks and uncertainties related to changes in local laws and regulations, multiple technological standards, protective legislation and pricing pressure.

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

The economic environment of our industry could also result in some of our customers experiencing difficulties and, consequently, this could have a negative effect on our results especially in terms of future sales and recoverability of accounts receivable. However, the sectorial and geographic diversity of our customer base provides us with a reasonable level of protection in this area. Finally, other financial instruments, which potentially subject us to credit risks, consist mainly of cash, short-term investments and forward exchange contracts. Our short-term investments consist of debt instruments issued by twelve quality, high-credit corporations and trusts. Our cash and forward exchange contracts are held with or issued by quality high-credit financial institutions; therefore, we consider the risk of non-performance on these instruments to be remote.

For a more complete understanding of risk factors that may affect us, please refer to the risk factors set forth in our disclosure documents published with securities commissions at www.sedar.com in Canada or www.edgar.com in the U.S.

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QUARTERLY SUMMARY FINANCIAL INFORMATION (Unaudited)
(tabular amounts in thousands of US dollars, except per share data)

	Q2-FY07	Q1-FY07	Q4-FY06	Q3-FY06
Sales	$ 35,207	$ 35,547	$ 35,733	$ 35,410
Cost of sales	$ 14,970	$ 15,229	$ 16,318	$ 15,453
Gross margin	$ 20,237	$ 20,318	$ 19,415	$ 19,957
Earnings from operations	$ 2,081	$ 2,759	$ 2,363	$ 3,608
Net earnings	$ 2,684	$ 3,533	$ 2,910	$ 3,504
Basic and diluted net earnings per share	$ 0.04	$ 0.05	$ 0.04	$ 0.05

	Q2-FY06	Q1-FY06	Q4-FY05	Q3-FY05
Sales	$ 30,066	$ 27,044	$ 26,304	$ 26,180
Cost of sales	$ 13,440	$ 12,064	$ 11,925	$ 11,478
Gross margin	$ 16,626	$ 14,980	$ 14,379	$ 14,702
Earnings from operations	$ 1,408	$ 683	$ 811	$ 509
Net earnings	$ 1,366	$ 355	$ 454	$ 276
Basic and diluted net earnings per share	$ 0.02	$ 0.01	$ 0.01	$ –