

TERAGO INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL RESULTS FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2016 AND 2015

The following Management's Discussion and Analysis ("MD&A") is intended to help the reader understand the results of operations and financial condition of TeraGo Inc. All references in this MD&A to "TeraGo", the "Company", "we", "us", "our" and "our company" refer to TeraGo Inc. and its subsidiaries, unless the context requires otherwise. This MD&A is dated August 11, 2016 and should be read in conjunction with our unaudited condensed interim consolidated financial statements for the three and six months ended June 30, 2016 and the notes thereto, our audited consolidated financial statements for the fiscal year ended December 31, 2015, including the notes thereto and our management's discussion and analysis for the year ended December 31, 2015. Additional information relating to TeraGo, including our most recently filed Annual Information Form ("AIF"), can be found on SEDAR at www.sedar.com and our website at www.terago.ca. For greater certainty, the information contained on our website is not incorporated by reference or otherwise into this MD&A. All dollar amounts included in this MD&A are in Canadian dollars unless otherwise indicated.

Certain information included herein is forward-looking and based upon assumptions and anticipated results that are subject to uncertainties. Should one or more of these uncertainties materialize or should the underlying assumptions prove incorrect, actual results may vary significantly from those expected. For a description of material factors that could cause our actual results to differ materially, see the "Forward-Looking Statements" section and the "Risk Factors" section in this MD&A. This MD&A also contains certain industry-related non-GAAP and additional GAAP measures that management uses to evaluate performance of the Company. These non-GAAP and additional GAAP measures are not standardized and the Company's calculation may differ from other issuers. See "Definitions – IFRS, Additional GAAP and Non-GAAP Measures".

FORWARD-LOOKING STATEMENTS

This MD&A includes certain forward-looking statements that are made as of the date hereof only and based upon current expectations, which involve risks and uncertainties associated with our business and the economic environment in which the business operates. All such statements are made pursuant to the 'safe harbour' provisions of, and are intended to be forward-looking statements under, applicable Canadian securities laws. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements. For example, the words *anticipate, believe, plan, estimate, expect, intend, should, may, could, objective* and similar expressions are intended to identify forward-looking statements. This MD&A includes, but is not limited to, forward looking statements regarding TeraGo's growth strategy, the growth in TeraGo's cloud and data centre businesses, retention campaign and initiatives to improve customer service, additional capital expenditures, investments in data centres and other IT services, expansion of network coverage, acquisitions and the integration of Codeninja Ltd. (doing business as "BoxFabric") and the hosting business assets acquired from AirVM Inc. into the Company. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. We caution readers of this document not to place undue reliance on our forward-looking statements as a number of factors could cause actual future results, conditions, actions or events to differ materially from the targets, expectations, estimates or intentions expressed with the forward-looking statements. When relying on forward-looking statements to make decisions with respect to the Company, you should carefully consider the risks, uncertainties and assumptions, including the risk that TeraGo's growth strategy will not generate the result intended by management, cross-selling of TeraGo's cloud services may not succeed, retention efforts decreasing profit margins, opportunities for expansion and acquisition not being available or at unfavourable terms, the Company not being able to realize the anticipated benefits and synergies from combining and integrating BoxFabric and the Hosting Business (as defined herein) into TeraGo's existing business and those risks set forth in or incorporated by reference into the "Risk Factors" section of this MD&A and other uncertainties and potential events. In particular, if any of the risks materialize, the expectations, and the predictions based on them, of the Company may need to be re-evaluated. Consequently, all of the forward-looking statements in this MD&A are expressly qualified by these cautionary statements and other cautionary statements or factors contained herein, and there can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences for the Company.

Except as may be required by applicable Canadian securities laws, we do not intend, and disclaim any obligation, to update or revise any forward-looking statements whether in words, oral or written as a result of new information, future events or otherwise.

OVERVIEW

Quarterly Financial Highlights

- Total revenue decreased 2.2% to \$14.8 million for the three months ended June 30, 2016 compared to \$15.1 million for the same period in 2015. The decrease in revenue is primarily driven by lower Network and Voice revenue, partially offset by growth in Cloud and Data Centre revenue. Cloud and Data Centre revenue grew by \$0.6 million or 15.2% over the period. Total revenue increased 8.7% to \$29.7 million for the six months ended June 30, 2016 compared to \$27.3 million for the same period in 2015. Growth in Cloud and Data Centre revenues were partially offset by a decline in Network and Voice revenues.
- Adjusted EBITDA increased 8.1% to \$4.9 million for the three months ended June 30, 2016 compared to \$4.5 million for the same period in 2015. The increase is primarily driven by synergies related to our March, 2015 acquisition of RackForce Networks Inc. ("RackForce") and reductions in personnel costs obtained from the Company's restructuring efforts in prior periods. For the six months ended June 30, 2016, Adjusted EBITDA increased 16.4% to \$9.6 million compared to \$8.2 million for the same period in 2015.
- Net loss was \$0.4 million for the three months ended June 30, 2016 compared to a net loss of \$2.2 million for the same period in 2015. The decrease in net loss was primarily driven by \$1.2 million less restructuring, acquisition-related and integration costs and \$0.3 million less finance costs. For the six months ended June 30, 2016, net loss was \$1.2 million compared to a net loss of \$2.2 million for the same period in 2015.

Key Developments

- On May 13, 2016, the Company announced it had entered into an asset purchase agreement to acquire the international hosting business (the "Hosting Business") of AirVM Inc. The Hosting Business expands TeraGo's Infrastructure as a Service (IaaS) offerings to the United States and the United Kingdom and adds new customers and channel partners. The acquisition of the Hosting Business closed on May 26, 2016.
- On May 30, 2016, the Company announced the launch of the Microsoft Azure Pack solution at its data centre located in Kelowna, British Columbia. TeraGo has added the Azure-based managed IaaS and Disaster Recovery as a Service (DRaaS) to its extensive suite of cloud solutions. The solution allows businesses to burst from TeraGo's private Azure platform to Microsoft's public Azure platform providing flexibility to the growing needs of businesses.
- On June 15, 2016 the Company was presented with the Canadian Telecommunications Employer of Choice (EOC) Recognition Award for 2016. This is the third consecutive year that TeraGo has been awarded this honour. The annual award is part of a national program dedicated to identifying, recognizing and promoting the best employers in the Canadian telecommunications industry.
- On June 23, 2016, the annual general meeting of shareholders of the Company was held. Each of Stewart Lyons, Jerry Grafstein, Michael Martin, Jim Nikopoulos and Nicole German were re-elected as directors, while Antonio (Tony) Ciciretto, Matthew Gerber and Gary Sherlock were elected as new directors of the Company by the common shareholders. Richard Brekka and James Sanger of Second Alpha Partners, LLC each continued on as directors of the Company, elected by the holder of the two (2) Class B Shares of the Company, Second Alpha Partners I(A), L.P. Mr. Nikopoulos and Mr. Sherlock were each subsequently announced as the new Chair of the Board and the Chair of the Audit Committee, respectively.

TERAGO OVERVIEW

TeraGo, operating through its wholly-owned subsidiaries TeraGo Networks, RackForce and BoxFabric, provides businesses across Canada, the United States, and the United Kingdom, with data and voice communications services, data centre colocation and hosting services through nine (9) data centres as well as cloud Infrastructure as a Service ("IaaS") computing and storage solutions. With respect to the Company's data and voice communications services, it owns and operates a carrier-grade, Multi-Protocol Label Switching ("MPLS") enabled fixed wireless, IP communications network in Canada targeting businesses that require Internet access and data connectivity services.

Subsequent to its acquisitions of RackForce and BoxFabric, the Company provides enterprise cloud services nationally and globally to multiple high value enterprise customers across a variety of verticals, including secondary and post-secondary education, hospitals, federal and provincial governments and non-profit organizations. The Company specializes in managing enterprise cloud services including IaaS and Platform as a Service ("PaaS") with network. It currently has strategic relationships with several technology partners that give it access to certain products and solutions to provide enterprise cloud services.

The Company's subscription-based business model generates stable and predictable recurring revenue from network services, data services, voice services, and cloud services. The Company offers its network and voice services across Canada and its data and cloud services globally. Once a customer is obtained, TeraGo's strategy is to generate incremental recurring revenue from that customer by: adding new customer locations, increasing service capacity supplied to existing locations, increasing data centre cabinet space and power and/or providing additional services, as applicable.

Cloud Services	Data Centre Services	Network and Voice Services
<ul style="list-style-type: none"> Private and hybrid cloud IaaS utility computing on virtual and dedicated compute platforms High performance and secure data storage and archiving Backup and recovery services for critical situations Multiple managed services related to hybrid cloud offerings 	<ul style="list-style-type: none"> Colocation services in partial, full, or customized cabinets Managed, Private Dedicated, and Co-location hosting services Private Vaults protected with biometrics for maximum security Other value added services 	<ul style="list-style-type: none"> National high performance, scalable Internet access principally via wireless with fibre optic in selected strategic areas Active redundancy capability with bundled connectivity solution Unified communications Managed network service

TERAGO'S BUSINESS MODEL

TeraGo's subscription-based business model generates stable and predictable recurring revenue from Internet, data, voice services, data centre services and cloud services.

TeraGo's customers typically sign one, two or three-year contracts. The majority of new customers sign contracts for three years or more. Services are billed monthly or quarterly over the term of the contract.

With its entry into data centre services and cloud services, TeraGo has built an operating platform to service the IT solutions sector. Cross selling opportunities to the customer base, while leveraging the Company's carrier grade network has augmented and diversified the Company's revenue base.

CLOUD SERVICES

TeraGo provides cloud services that seek to meet the complex and evolving IT needs of our customers. TeraGo provides IaaS for compute, storage, disaster recovery cloud solutions and other offerings either on a direct or indirect basis. These solutions allow the Company to compete in the cloud services market.

TeraGo offers customized cloud storage and compute offerings to customers across Canada. TeraGo cloud can offer a virtualized computing environment whereby customers can access on-demand computing power without the need to acquire and maintain expensive server equipment. TeraGo can also provide offsite cloud storage for key backup and

disaster recovery situations, including utilizing partnerships with software and hardware vendors such as Veeam and Solidfire. The Company has strategic relationships and partnerships with technology leaders such as IBM, Cisco, VMware, Microsoft, Mitel and others that gives it early access to intelligence, products and solutions to provide enterprise cloud services.

DATA CENTRE AND MANAGED SERVICES

TeraGo provides data centre services that protect and connect our customers' valuable information assets. Customers can provision computing equipment within shared partial cabinets or full, private cabinets, as well as customized caged space designed for their specific needs. TeraGo provides connectivity on redundant routes in and out of the facilities.

Hosting and colocation revenue is derived from set-up fees for new installations and monthly recurring charges based on the number of cabinets and/or the quantity of cage space, power requirements, managed services provided and Internet/data bandwidth requirements. Other services, such as disaster recovery services, are provided under custom contractual arrangements.

TeraGo also offers a variety of managed hosting solutions, which may require us to manage various aspects of a customer's hardware, software or operating systems in public or privately accessible environment. TeraGo offers disaster recovery services on a custom basis. This includes back-up office facilities that can be used in case of disaster. These facilities can be provisioned at the data centre location and provide customers with the capability to restore office functionality with direct access to their information located in the data centre.

Our network can provide these customers Internet and/or secure private virtual LAN connections between the data centre facility and the customer's office location(s).

Data centre services customers typically include national government agencies, financial services companies, cloud and data storage service providers, content and network service providers, and small and medium businesses which rely on TeraGo to store and manage their critical IT equipment and provide the ability to directly connect to the networks that enable our information-driven economy.

Data Centre Facilities

TeraGo's data centres provide data centre solutions, including colocation and disaster recovery, to a roster of small and medium-sized businesses, enterprises, public sector and technology service providers. TeraGo has approximately 60,000 square feet of data centre capacity in seven facilities across Canada, as well as facilities in the United States and the United Kingdom.

Mississauga, Ontario

TeraGo operates a 10,000 square foot AT 101 SOC2 Type 2 certified data centre facility in Mississauga, Ontario that was previously managed by BlackBerry Limited and built to a tier 3 standard. This facility predominantly serves the Greater Toronto Area.

Vaughan, Ontario

TeraGo operates a 16,000 square foot AT 101 SOC2 Type 2 certified data centre facility in Vaughan, Ontario, serving the Greater Toronto Area. This data centre and its operations were purchased in May 2013 when the Company acquired Data Centres Canada Inc.

Kelowna, British Columbia

TeraGo operates its 18,000 square feet AT 101 SOC2 Type 2 certified data centre in Kelowna named the GigaCenter. The GigaCenter is built to a tier 3 standard and the location in Kelowna is considered ideal for a data centre as the region is considered a seismically stable geographic location, has a temperate climate and has a lower probability of both natural and man-made events that may be a risk.

Vancouver, British Columbia

TeraGo operates two AT 101 SOC2 Type 2 certified data centre facilities in downtown Vancouver. Its first facility, acquired in December 2013, is 5,000 square feet and is expandable to 7,000 square feet. The facility has redundant fibre facilities between the data centre and the 'telco hotel', 555 West Hastings, in downtown Vancouver. The second facility which was acquired in April 2014 is 7,000 square feet and is served by TeraGo's fiber optic lines. Both facilities are used to service the Greater Vancouver Area.

Winnipeg, Manitoba

TeraGo provides data centre services to its customers in central Canada through a data centre in Winnipeg. Colocation services, via the data centre facility, are provided through an agreement that TeraGo has with a local operator.

Ottawa, Ontario

TeraGo provides data centre services to its customers in Ottawa, Ontario through a Tier III AT 101 SOC 1 Type 2 certified data centre. Colocation services, via the data centre facility, are provided through an agreement that TeraGo has with a local operator.

St. Louis, Missouri, United States

TeraGo provides cloud services to its customers through a SSAE 16 (formerly SAS70) SOC 2 certified data centre in St. Louis, Missouri, United States pursuant to an agreement TeraGo has with a local operator.

Newport, Wales, United Kingdom

TeraGo provides cloud services to its customers through a Tier 3 designed data centre in Newport, Wales, United Kingdom pursuant to an agreement TeraGo has with a local operator.

NETWORK SERVICES

TeraGo owns and operates a carrier-grade Multi-Protocol Label Switching ("MPLS") enabled wireline and fixed wireless, Internet Protocol ("IP") communications network in Canada, providing businesses with high performance, scalable, and secure access and data connectivity services.

TeraGo's carrier grade IP communication network serves an important and growing demand among Canadian businesses for network access diversity by offering wireless services that are redundant to their existing wireline broadband connections.

TeraGo's IP network has been designed to eliminate single points of failure and the Company backs its services with customer service level commitments, including 99.9% service availability, industry leading mean time to repair, 24 x 7 telephone and e-mail access to technical support specialists.

TeraGo offers Canadian businesses high performance unlimited and usage-based dedicated Internet access with upload and download speeds from 5 megabits per second ("Mbps") up to 1 gigabit per second ("Gbps"). Unlike asymmetrical DSL services offered by many of our competitors, TeraGo provides services that are symmetrical, hence customers can have the same high speed broadband performance whether uploading or downloading. TeraGo enhances service performance by minimizing the number of networks between our customers and their audiences, using peering arrangements with multiple tier-one carriers to connect to the Internet.

To deliver its services, the Company has built and operates a carrier-grade, IP network, using licensed and license-exempt spectrum and fibre-optic wireline infrastructure that supports commercially available equipment.

The Company owns and controls a national MPLS distribution network from Vancouver to Montreal that aggregates customer voice and data traffic and interconnects where necessary with carrier diverse leased fiber optic facilities. Major Internet peering and core locations are centralized in Vancouver, Toronto and Seattle, although Internet access is also available in all regional markets for further redundancy.

TeraGo offers a range of diverse Ethernet-based services over a secured wireless connection to customer locations up to 20 kilometres from a hub (provided line of sight or wireline networks exist) or through a fibre optic connection.

Quality of Service Capabilities

TeraGo's MPLS network, including key high traffic hub sites, is equipped with Quality of Service ("QoS") capabilities to improve performance and traffic management. All of TeraGo's major national markets are end-to-end QoS enabled providing the foundation to support voice traffic and other potential future applications.

Radio Spectrum

24-GHz and 38-GHz Wide-area Licences

The Company owns a national spectrum portfolio of 24-GHz and 38-GHz wide-area spectrum licences which covers regions across Canada, including 1,160 MHz in Canada's 6 largest cities. This spectrum is used for: point-to-point and point-to-multipoint microwave radio deployments; connecting core hubs together to create a wireless backbone where appropriate (often in a ring configuration to avoid points of failure); and in the access network or "last mile" to deliver high capacity (speeds of 10 to 1,000 Mbps) Ethernet-based links for business, government and cellular backhaul.

For further details on licensed spectrums, please refer to the Company's 2015 AIF.

VOICE SERVICES

TeraGo provides a number of unified communications services and is approved by the Canadian Radio-television and Telecommunications Commission ("CRTC") to offer voice services as a Type IV competitive local exchange carrier ("CLEC"). TeraGo provides businesses with a cost effective, flexible and high quality connection from their private branch exchange (PBX) to the public switched telephone network (PSTN). TeraGo's service provides features and capabilities generally consistent with those provided by incumbent local exchange carriers ("ILECs"), while offering greater value for our customers.

RESULTS OF OPERATIONS

Comparison of the three and six months ended June 30, 2016 and 2015
(in thousands of dollars, except with respect to gross profit margin and earnings per share)

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Financial				
Cloud and Data Center Revenue	\$ 4,436	\$ 3,852	\$ 8,870	\$ 4,751
Network and Voice Revenue	\$ 10,348	\$ 11,258	\$ 20,843	\$ 22,595
Total Revenue	\$ 14,784	\$ 15,110	\$ 29,713	\$ 27,346
Cost of Services ⁽¹⁾	\$ 3,358	\$ 3,540	\$ 6,827	\$ 6,121
Gross profit margin ⁽¹⁾	77.3%	76.6%	77.0%	77.6%
Adjusted EBITDA ^{(1) (2)}	\$ 4,895	\$ 4,529	\$ 9,571	\$ 8,225
Income tax recovery (expense)	\$ (11)	\$ -	\$ (11)	\$ 1,039
Net loss	\$ (395)	\$ (2,176)	\$ (1,215)	\$ (2,192)
Basic loss per share	\$ (0.03)	\$ (0.17)	\$ (0.09)	\$ (0.18)
Diluted loss per share	\$ (0.03)	\$ (0.17)	\$ (0.09)	\$ (0.18)

(1) See "Definitions - IFRS, Additional GAAP and NON-GAAP Measures"

(2) See "Adjusted EBITDA" for a reconciliation of net loss to Adjusted EBITDA

Refer to "Definitions – IFRS, Additional GAAP and Non-GAAP Measures" for a description of the components of relevant line items below.

Revenue

Total revenue decreased 2.2% to \$14.8 million for the three months ended June 30, 2016 compared to \$15.1 million for the same period in 2015. Total revenue increased 8.7% to \$29.7 for the six months ended June 30, 2016, million compared to \$27.3 million for the same period in 2015.

Cloud and Data Centre Revenue

For the three months ended June 30, 2016, cloud and data centre revenue increased 15.2% to \$4.4 million compared to \$3.9 million for the same period in 2015. The increase was driven by greater adoption of cloud services from new and existing customers as well as from the acquisitions of BoxFabric and the Hosting Business. For the six months ended June 30, 2016, cloud and data centre revenue increased 86.7% to \$8.9 million compared to \$4.8 million for the same period in 2015. The increase was driven by the factors described above, as well as the acquisition of RackForce in March 2015.

Network and Voice Revenue

Network and Voice revenues were impacted by a variety of factors, including regional economic difficulties, the company moving away from maintaining its lowest value customers, certain customers renewing long term contracts at lower current market rates and lower usage revenues as certain customers have shifted to unlimited usage plans.

Cost of services

For the three months ended June 30, 2016, cost of services decreased 5.1% to \$3.4 million compared to \$3.5 million for the same period in 2015. The decrease was primarily driven by RackForce synergies. For the six months ended June 30, 2016, cost of services increased to \$6.8 million compared to \$6.1 million for the same period in 2015. The

TERAGO INC.
Management's Discussion and Analysis
Quarter Ended June 30, 2016

increase is mainly due to introduction of costs associated with running the RackForce operations partially offset by the synergies noted above.

Salaries and related costs and other operating expenses ("SG&A")

For the three months ended June 30, 2016, SG&A decreased to \$7.4 million compared to \$9.1 million for the same period in 2015. The decrease was primarily driven by reduced restructuring, acquisition-related and integration costs following the RackForce acquisition as well as reductions in personnel costs obtained from the Company's restructuring efforts in the prior periods. For the six months ended June 30, 2016, SG&A decreased to \$15.2 million compared to \$15.9 million for the same period in 2015. The decrease was primarily driven by the factors described above, partially offset by the introduction of costs associated with the RackForce operations.

Adjusted EBITDA

For the three months ended June 30, 2016, Adjusted EBITDA increased 8.1% to \$4.9 million compared to \$4.5 million for the same period in 2015. The increase was primarily driven by synergies related to RackForce and reductions in personnel costs obtained from the Company's restructuring efforts in the prior periods. For the six months ended June 30, 2016, Adjusted EBITDA increased 16.4% to \$9.6 million compared to \$8.2 million for the same period in 2015. The increase was driven by the factors described above and the acquisition of RackForce, partially offset by the introduction of costs associated with owning RackForce.

The table below reconciles net loss to Adjusted EBITDA for the three and six months ended June 30, 2016 and 2015.

<i>(in thousands of dollars)</i>	Three months ended		Six months ended	
	June 30		June 30	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Net loss for the period	\$ (395)	\$ (2,176)	\$ (1,215)	\$ (2,192)
Foreign exchange loss (gain)	12	(19)	(20)	94
Finance costs	512	785	1,062	1,235
Finance income	(1)	(6)	(7)	(10)
Income tax (recovery) expense	11	-	11	(1,039)
Earnings (loss) from operations	139	(1,416)	(169)	(1,912)
Add:				
Depreciation of network assets, property and equipment and amortization of intangible assets	3,889	3,878	7,876	7,215
Loss (gain) on disposal of network assets	104	103	260	87
Stock-based compensation expense	330	332	617	670
Restructuring, acquisition-related, integration costs and other	433	1,632	987	2,165
Adjusted EBITDA⁽¹⁾	\$ <u>4,895</u>	\$ <u>4,529</u>	\$ <u>9,571</u>	\$ <u>8,225</u>

(1) See "Definitions - IFRS, Additional GAAP and NON-GAAP Measures"

Finance costs

For the three months ended June 30, 2016, finance costs decreased to \$0.5 million compared to \$0.8 million for the same period in 2015. For the six months ended June 30, 2016, finance costs decreased to \$1.1 million compared to \$1.2 million for the same period in 2015. The decrease in both periods was driven by the mark to market impact of revaluing the Company's interest rate swap contract on the drawn credit facility.

Income tax expense

For the three months ended June 30, 2016, income tax expense increased to \$0.01 million compared to \$nil for the same period in 2015. The increase was driven by taxable income within one of the Company's subsidiaries. For the six months ended June 30, 2016, income tax expense increased to \$0.01 million compared to a recovery of \$1.0 million for the same period in 2015. This increase was primarily driven by a tax benefit of \$1.0 million associated with expected utilization of deferred tax assets following the acquisition of RackForce that was recognized in the three months ended March 31, 2015.

Depreciation and amortization

For the three months ended June 30, 2016, depreciation of network assets, property and equipment and amortization of intangibles was consistent compared to the same period in 2015. For the six months ended June 30, 2016, depreciation of network assets, property and equipment and amortization of intangibles increased to \$7.9 million compared to \$7.2 million for the same period in 2015. The increase is mainly attributed to the depreciation and

TERAGO INC.
Management's Discussion and Analysis
Quarter Ended June 30, 2016

amortization of RackForce acquired intangibles and cloud and data centre infrastructure.

Net loss

For the three months ended June 30, 2016, net loss was \$0.4 million compared to a net loss of \$2.2 million for the same period in 2015. For the six months ended June 30, 2016, net loss was \$1.2 million compared to a net loss of \$2.2 million for the same period in 2015. Net loss in both periods was positively impacted compared to the prior period by revenue growth in the cloud and data centre services associated with the RackForce and BoxFabric acquisitions and lower one-time costs associated with the RackForce acquisition and the optimization of the network and voice business.

Summary of Quarterly Results

All financial results are in thousands, with the exception of earnings per share

	<u>Q2-16</u>	<u>Q1-16</u>	<u>Q4-15</u>	<u>Q3-15</u>	<u>Q2-15</u>	<u>Q1-15</u>	<u>Q4-14</u>	<u>Q3-14</u>
Revenue	\$ 14,784	14,929	15,102	15,272	15,110	12,236	12,629	12,545
Gross Profit Margin % ⁽¹⁾	77.3%	76.8%	77.4%	76.3%	76.6%	78.9%	79.3%	79.9%
Adjusted EBITDA ⁽¹⁾	\$ 4,895	4,676	4,863	5,313	4,529	3,696	3,954	4,081
Net loss	\$ (395)	(820)	(190)	(432)	(2,176)	(16)	(1,074)	(225)
Basic loss per share	\$ (0.03)	(0.06)	(0.01)	(0.03)	(0.17)	(0.00)	(0.09)	(0.02)
Diluted loss per share	\$ (0.03)	(0.06)	(0.01)	(0.03)	(0.17)	(0.00)	(0.09)	(0.02)
Basic weighted average number of shares outstanding	14,159	14,135	14,065	13,966	12,476	11,734	11,676	11,620
Diluted weighted average number of shares outstanding	14,159	14,135	14,065	13,966	12,476	11,734	11,676	11,620

(1) See "Definitions - IFRS, Additional GAAP and Non-GAAP Measures" for descriptions of Gross profit margin % and Adjusted EBITDA

Seasonality

The Company's net customer growth, with respect to its network business, is typically impacted adversely by weather conditions as the majority of new customer locations require the installation of rooftop equipment. Typically, harsher weather in the first quarter of the year results in a reduction of productive installation days.

The Company's cash flow and earnings are typically impacted in the first quarter of the year due to several annual agreements requiring payments in the first quarter including annual rate increases in long-term contracts and the restart on January 1st of payroll taxes and other levies related to employee compensation.

LIQUIDITY AND CAPITAL RESOURCES

TeraGo has historically financed its growth and operations through cash generated by operations, the issuance of equity securities and long-term debt.

The table below is a summary of cash inflows and outflows by activity.

<i>(in thousands of dollars)</i>	Three months ended June 30		Six months ended June 30	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Statement of Cash Flows Summary				
Cash inflows and (outflows) by activity:				
Operating activities	\$ 4,720	\$ 4,159	\$ 6,504	\$ 6,350
Investing activities	(3,059)	(2,529)	(5,629)	(35,959)
Financing activities	(1,718)	7,554	(3,513)	38,506
Net cash inflows (outflows)	(57)	9,184	(2,638)	8,897
Cash and cash equivalents, beginning of period	10,485	2,579	13,066	2,866
Cash and cash equivalents, end of period	\$ <u>10,428</u>	\$ <u>11,763</u>	\$ <u>10,428</u>	\$ <u>11,763</u>

Operating Activities

For the three months ended June 30, 2016, cash generated from operating activities was \$4.7 million compared to cash generated of \$4.2 million for the same period in 2015. For the six months ended June 30, 2016, cash generated from operating activities was \$6.5 million compared to cash generated of \$6.4 million for the same period in 2015. The increase in cash from operating activities in both periods is mainly due to a smaller net loss, partially offset by changes to non-cash working capital compared to the prior periods.

Investing Activities

For the three months ended June 30, 2016, cash used in investing activities was \$3.1 million compared to cash used of \$2.5 million for the same period in 2015. The increase was primarily driven by the acquisition of the Hosting Business, partially offset by lower purchase of network assets, property and equipment. For the six months ended June 30, 2016, cash used in investing activities was \$5.6 million compared to cash used of \$36.0 million for the same period in 2015. The six months ended June 30, 2015 included \$31.0 million for the acquisition of RackForce.

Financing Activities

For the three months ended June 30, 2016, cash used from financing activities was \$1.7 million compared to cash generated of \$7.6 million for the same period in 2015. For the six months ended June 30, 2016, cash used from financing activities was \$3.5 million compared to cash generated of \$38.5 million for the same period in 2015. The increase in cash used from financing activities for both periods is mainly due to higher cash proceeds generated for the same periods in 2015 from the amended credit facility and an equity offering.

Capital Resources

As at June 30, 2016, the Company had cash and cash equivalents of \$10.4 million and access to the \$35.0 million undrawn portion of its \$85 million credit facilities.

The Company anticipates incurring additional capital expenditures for the purchase and installation of network, data centre and cloud assets and customer premise equipment. As economic conditions warrant, the Company may expand its network coverage into new Canadian markets using wireless or fibre optics and making additional investments in data centres, cloud and other IT services through acquisitions or expansion.

Management believes the Company's current cash, anticipated cash from operations, access to the undrawn portion of debt facilities and its access to additional financing in the form of debt or equity will be sufficient to meet its working capital and capital expenditure requirements for the foreseeable future

Term Debt Facility

In June 2014, the Company entered into an agreement with a syndicate led by the National Bank of Canada ("NBC") to provide a \$50.0 million credit facility that is principally secured by a general security agreement over the Company's assets.

TERAGO INC.
Management's Discussion and Analysis
Quarter Ended June 30, 2016

In March 2015, the Company entered into an amended agreement with a syndicate led by NBC that increased the credit facility by \$35.0 million (\$30.0 million increase to the term debt facility and \$5.0 million increase to the revolving facility) and extended the term from June 6, 2017 to June 30, 2018. Other terms are substantially consistent with the existing credit facilities.

The total \$85.0 million facility that matures June 30, 2018 is made up of the following:

- \$10.0 million revolving facility which bears interest at prime plus a margin percent. As of June 30, 2016, \$nil amount is outstanding. Letters of credit outstanding under the facility totaled \$0.7 million as of June 30, 2016.
- \$50.0 million term facility which bears interest at prime or Banker's Acceptance (at the Company's option) plus a margin percent and is repayable in quarterly principal installments of \$1.3 million starting June 30, 2015. This facility was fully drawn upon signing the amended agreement.

On June 30, 2016, \$43.6 million of the term facility principal was in a Banker's Acceptance and the remaining \$0.2 million is at a floating rate. The Company has interest rate swap contracts on the Banker's Acceptance that mature June 29, 2018 that fix the interest rate at an average rate of 4.24%. The interest rate swap contract has not been designated as a hedge and will be marked-to-market each quarter. The fair value of the interest rate swap contract at June 30, 2016 was a liability of \$0.5 million (December 31, 2015 was a liability of \$0.6 million) and is recorded in other long-term liabilities, with a corresponding charge for the change in fair value recorded in finance costs.

As at June 30, 2016, the Company prepaid interest in the amount of \$0.4 million which represents the net settlement of the Banker's Acceptance and is recorded as a reduction in the carrying value of the debt.

- \$25.0 million available for funding acquisitions and will bear interest at prime or Banker's Acceptance (at the Company's option) plus a margin percent and is repayable in quarterly principal installments of 2.5% of the aggregate amount outstanding. As of June 30, 2016, this facility remains undrawn.

The financing fees have been deferred and amortized using the effective interest method over the term of the facility.

The NBC facility is subject to certain financial and non-financial covenants which the Company is in compliance with at June 30, 2016. Under this facility, the Company is also subject to a cash flow sweep that could accelerate principal repayments based on a detailed calculation outlined by NBC not later than 120 days after the end of each fiscal year.

Equity Offering

On June 11, 2015, the Company completed an equity offering to issue and sell 1,755 common shares for gross proceeds of \$10,004 (the "Offering"). Proceeds net of commissions, legal, accounting and listing fees were \$9,210. The Offering was carried out pursuant to an underwriting agreement with a syndicate of underwriters led by National Bank Financial Inc. and TD Securities Inc. and included Cormark Securities Inc., PI Financial Corp. and RBC Capital Markets.

The Company allocated \$9,210 of the intended use of net proceeds from the equity offering as follows:

Intended Use of Net Proceeds	Allocation	Use of Net Proceeds as at June 30, 2016
a) Fund its continued growth strategy, which is expected to include potential strategic acquisitions	\$4.0 million	\$2.3 million
b) Fund operational efficiency initiatives	\$3.2 million	\$0.3 million
c) Invest in new product development activities, specifically in the cloud and data centre segments	\$2.0 million	\$0.3 million

As of June 30, 2016, \$2.9 million of the net proceeds from the equity offering were used. The Company's intended use of these proceeds has not changed.

Transactions with Related Parties

Two former Directors of the Company, who retired effective June 23, 2016, also serve as Chairman of the Board and a Director of a customer of the Company. Revenue from this customer for the three months and six months ended June 30, 2016 was \$20 and \$40 (2015 - \$17 and \$34), respectively. Accounts receivable from this customer as at June 30, 2016 was \$5 (2015 - \$3), respectively.

The terms governing these related party transactions are consistent with those negotiated on an arm's length basis with non-related parties.

Share Capital

TeraGo's authorized share capital consists of an unlimited number of Common Shares, an unlimited number of Class A Non-Voting Shares and two Class B Shares. A detailed description of the rights, privileges, restrictions and conditions attached to the authorized shares is included in the Company's 2015 Annual Information Form, a copy of which can be found on SEDAR at www.sedar.com.

As of August 11, 2016, there were 14,187 Common Shares issued and outstanding and two Class B Shares issued and outstanding. In addition, as of August 11, 2016, there were 699 Common Shares issuable upon exercise of TeraGo stock options.

Restricted Cash

(a) Funds held in escrow

As at June 30, 2016, \$0.2 million is held in escrow by the Company pending finalization of working capital adjustments in the acquisition of BoxFabric.

RISK FACTORS

TeraGo is exposed to a number of risks and uncertainties that are common to other companies engaged in the same or similar businesses. The summary of the material risks that could significantly affect the financial condition, operating results or business of TeraGo, are set out in our management's discussion and analysis for the fiscal year ended December 31, 2015.

UPCOMING ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED

Certain new standards, interpretations, amendments and improvements to existing standards have been issued by the IASB. The standards impacted that may be applicable to the Company are as follows:

(a) IFRS 15 Revenue from Contracts with Customers

On May 28, 2014, the IASB issued IFRS 15 which supersedes existing standards and interpretations including IAS 18, Revenue and IFRIC 13, Customer Loyalty Programmes. IFRS 15 introduces a single model for recognizing revenue from contracts with customers with the exception of certain contracts under other IFRSs. The standard requires revenue to be recognized in a manner that depicts the transfer of promised goods or services to a customer and at an amount that reflects the expected consideration receivable in exchange for transferring those goods or services. This is achieved by applying the following five steps:

1. Identify the contract with a customer;
2. Identify the performance obligations in the contract;
3. Determine the transaction price;
4. Allocate the transaction price to the performance obligations in the contract; and
5. Recognize revenue when (or as) the entity satisfies a performance obligation.

IFRS 15 also provides guidance relating to the treatment of contract acquisition and contract fulfillment costs.

The standard is effective for annual periods beginning on or after January 1, 2018. The Company is assessing the impact of this standard on the consolidated financial statements. The extent of the impact has not yet been determined.

(b) IFRS 9 Financial Instruments

On July 24, 2014, the IASB issued the final publication of the IFRS 9 standard, superseding the current IAS 39, Financial Instruments: recognition and measurement ("IAS 39") standard. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on

financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39.

The standard is effective for annual periods beginning on or after January 1, 2018 with early adoption permitted. The Company is assessing the impact of this standard on the consolidated financial statements. The extent of the impact has not yet been determined.

(c) IFRS 16 Leases

On January 23, 2016, the IASB issued the final publication of the IFRS 16 standard, which will supersede the current IAS 17, Leases standard. Under IFRS 16, a lease will exist when a customer controls the right to use an identified asset as demonstrated by the customer having exclusive use of the asset for a period of time. IFRS 16 introduces a single accounting model for lessees and all leases will require an asset and liability to be recognized on the statement of financial position at inception.

The accounting treatment for lessors will remain largely the same as under IAS 17. The standard is effective for annual periods beginning on or after January 1, 2019 with early adoption permitted, but only if the entity is also applying IFRS 15. The extent of the impact of the adoption of this standard has not yet been determined.

CRITICAL ACCOUNTING ESTIMATES

The unaudited condensed interim consolidated financial statements are in compliance with International Accounting Standard 34 ("IAS 34"), Interim Financial Reporting. The preparation of financial statements in accordance with IAS 34 requires the use of certain critical accounting estimates. Estimates and assumptions are continuously evaluated and are based on management's best knowledge of the relevant facts and circumstances, having regard to previous experience. However, actual outcomes may differ from the amounts included in the consolidated financial statements.

The preparation of financial statements in accordance with IAS 34 also requires management to exercise judgement in applying the Company's accounting policies.

The Company's critical accounting estimates have been set out in Note 2 of the Company's 2015 Consolidated Financial Statements.

INTERNAL CONTROL OVER FINANCIAL REPORTING AND DISCLOSURE CONTROLS AND PROCEDURES

Our President and Chief Executive Officer and Chief Financial Officer designed or caused to be designed under their supervision, TeraGo's disclosure controls and procedures and internal control over financial reporting.

TeraGo's disclosure controls and procedures are designed to provide reasonable assurance that material information relating to TeraGo is made known to management by others, particularly during the period in which the interim filings are being prepared and that information required to be disclosed by TeraGo in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation. TeraGo's disclosure controls and procedures includes controls and procedures designed to ensure that information required to be disclosed by TeraGo in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to management, as appropriate to allow timely decisions regarding required disclosure.

TeraGo's internal control over financial reporting are designed to provide reasonable assurance regarding reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the Company's GAAP. TeraGo's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of TeraGo; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the Company's GAAP, and that receipts and expenditures of TeraGo are being made only in accordance with authorizations of management and directors of TeraGo; and (iii) are designed to provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of TeraGo's assets that could have a material effect on TeraGo's financial statements.

The control framework used to design TeraGo's internal control over financial reporting is based on the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO 2013).

Due to its inherent limitations, internal control over financial reporting may not prevent or detect all misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may change.

There were no changes in the Company's internal controls over financial reporting during the three months ended June 30, 2016 that have materially affected or are reasonably likely to materially affect internal controls over financial reporting. Management has concluded that there are no material weaknesses relating to the design of TeraGo's internal controls over financial reporting as of June 30, 2016.

DEFINITIONS – IFRS, ADDITIONAL GAAP AND NON-GAAP MEASURES

IFRS Measures

Cost of services

Cost of services consists of expenses related to delivering service to customers and servicing the operations of our networks. These expenses include costs for the lease of intercity facilities to connect our cities, internet transit and peering costs paid to other carriers, network real estate lease expense, spectrum lease expenses and lease and utility expenses for the data centres and salaries and related costs of staff directly associated with the cost of services.

Gross profit margin %

Gross profit margin % consists of gross profit margin divided by revenue where gross profit margin is revenue less cost of services.

Other operating expenses

Other operating expenses includes sales commission expense, advertising and marketing expenses, travel expenses, administrative expenses including insurance and professional fees, communication expenses, maintenance expenses and rent expenses for office facilities.

Foreign exchange gain (loss)

Foreign exchange gain (loss) relates to the translation of monetary assets and liabilities into Canadian dollars using the exchange rate in effect at that date. The resulting foreign exchange gains and losses are included in net income in the period.

Finance costs

Finance costs consist of interest charged on our short- and long-term debt, amortization of deferred financing costs including expenses associated with closing our long-term debt facility and accretion expense on the Company's decommissioning and restoration obligations. The deferred financing costs are amortized using the effective interest method over the term of the loan.

Finance income

Finance income consists of interest earned on our cash and cash equivalent and short-term investment balances.

Additional GAAP Measures

Earnings (loss) from operations

Earnings (loss) from operations exclude foreign exchange gain (loss), income taxes, finance costs and finance income. We include earnings (loss) from operations as an additional GAAP measure in our consolidated statement of earnings. We consider earnings (loss) from operations to be representative of the activities that would normally be regarded as operating for the Company. We believe this measure provides relevant information that can be used to assess the consolidated performance of the Company and therefore, provides meaningful information to investors.

Non-GAAP Measures

Adjusted EBITDA

The term "EBITDA" refers to earnings before deducting interest, taxes, depreciation and amortization. The Company believes that Adjusted EBITDA is useful additional information to management, the Board and investors as it provides an indication of the operational results generated by its business activities prior to taking into consideration how those activities are financed and taxed and also prior to taking into consideration asset depreciation and amortization and it excludes items that could affect the comparability of our operational results and could potentially alter the trends analysis in business performance. Excluding these items does not imply they are non-recurring. The Company calculates Adjusted EBITDA as earnings before deducting interest, taxes, depreciation and amortization, foreign exchange gain or loss, finance costs, finance income, gain or loss on disposal of network assets, property and equipment, stock-based compensation and restructuring, acquisition-related and integration costs. Investors are cautioned that Adjusted EBITDA should not be construed as an alternative to operating earnings or net earnings determined in accordance with IFRS as an indicator of our financial performance or as a measure of our liquidity and cash flows. Adjusted EBITDA does not take into account the impact of working capital changes, capital expenditures, debt principal reductions and other sources and uses of cash, which are disclosed in the consolidated statements of cash flows.

TeraGo's method of calculating Adjusted EBITDA may differ from other issuers and, accordingly, Adjusted EBITDA may not be comparable to similar measures presented by other issuers. See "Results of Operations – Adjusted EBITDA" for reconciliation of loss to Adjusted EBITDA.