

TERAGO INC.
Consolidated Financial Statements
Years ended December 31, 2016 and 2015

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MANAGEMENT’S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements of TeraGo Inc. and its subsidiaries and all the information in Management’s Discussion and Analysis are the responsibility of management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards. The consolidated financial statements include certain amounts that are based on the best estimates and judgments of management and in their opinion present fairly, in all material respects, TeraGo Inc.’s financial position, results of operations and cash flows. Management has prepared the financial information presented elsewhere in the Management’s Discussion and Analysis and has ensured that it is consistent with the consolidated financial statements, or has provided reconciliations where inconsistencies exist.

Management of TeraGo Inc., in furtherance of the integrity of the consolidated financial statements, has developed and maintains a system of internal controls. Management believes the internal controls provide reasonable assurance that transactions are properly authorized and recorded, financial records are reliable and form a proper basis for the preparation of consolidated financial statements and that TeraGo Inc.’s material assets are properly accounted for and safeguarded. The internal control processes include management’s communication to employees of policies that govern ethical business conduct.

The Board of Directors is responsible for overseeing management’s responsibility for financial reporting and is ultimately responsible for reviewing and approving the consolidated financial statements. The Board carries out this responsibility through its Audit Committee.

The Audit Committee meets periodically with management and the Company’s independent auditors to review the Company’s reported financial performance and to discuss audit, internal controls, accounting policies, and financial reporting matters; and to review Management’s Discussion and Analysis, the consolidated financial statements and the external auditors’ report. The Audit Committee reports its findings to the Board of Directors for consideration when approving the consolidated financial statements for issuance to the shareholders. The Audit Committee also considers, for review by the Board of Directors and approval by the shareholders, the engagement or re-appointment of the external auditors.

The consolidated financial statements have been audited by KPMG LLP, the external auditors, in accordance with Canadian generally accepted auditing standards on behalf of the shareholders. KPMG LLP has full and free access to the Audit Committee.

February 23, 2017

“Antonio Ciciretto”

President and Chief Executive Officer

“Joe Prodan”

Chief Financial Officer



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INDEPENDENT AUDITORS' REPORT

To the Shareholders of TeraGo Inc.

We have audited the accompanying consolidated financial statements of TeraGo Inc., which comprise the consolidated statements of financial position as at December 31, 2016 and 2015, the consolidated statements of comprehensive loss, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.



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Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of TeraGo Inc. as at December 31, 2016 and 2015, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

February 23, 2017
Vaughan, Canada

TERAGO INC.
Consolidated Statements of Financial Position
(In thousands)

	<i>Note</i>	December 31 2016	December 31 2015
Assets			
Cash and cash equivalents	6(a)	\$ 13,034	\$ 13,066
Accounts receivable	6(b)	3,673	3,306
Prepaid expenses and other assets		3,150	3,351
Total current assets		19,857	19,723
Network assets, property and equipment	7	44,161	48,520
Intangible assets	8	19,400	21,824
Goodwill	8	19,419	19,063
Deferred income taxes	13	-	700
Restricted cash	9	-	172
Total non-current assets		82,980	90,279
Total Assets		\$ 102,837	\$ 110,002
Liabilities			
Accounts payable and accrued liabilities		\$ 11,027	\$ 9,128
Current portion of deferred revenue		287	211
Current portion of long-term debt	10	5,170	6,123
Current portion of other long-term liabilities	11	774	186
Total current liabilities		17,258	15,648
Decommissioning and restoration obligations	12	207	234
Deferred revenue		323	270
Long-term debt	10	35,608	39,658
Other long-term liabilities	11	793	1,977
Total non-current liabilities		36,931	42,139
Total Liabilities		54,189	57,787
Shareholders' Equity			
Share capital	14	86,171	85,636
Contributed surplus		25,620	25,408
Deficit		(63,143)	(58,829)
Total Shareholders' Equity		\$ 48,648	\$ 52,215
Total Liabilities and Shareholders' Equity		\$ 102,837	\$ 110,002
Commitments	19		

On behalf of the Board:

(signed) "Jim Nikopoulos"

Director

(signed) "Gary Sherlock"

Director

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

TERAGO INC.
Consolidated Statements of Comprehensive Loss
(In thousands, except per share amounts)

	<i>Note</i>	Year ended December 31 2016	Year ended December 31 2015
Revenue	<i>17</i>	\$ 59,086	\$ 57,720
Expenses			
Cost of services		13,477	13,159
Salaries and related costs		21,195	20,587
Other operating expenses		10,845	10,062
Depreciation of network assets, property and equipment	<i>7</i>	11,796	11,400
Amortization of intangible assets	<i>8</i>	3,529	3,697
		<u>60,842</u>	<u>58,905</u>
Loss from operations		(1,756)	(1,185)
Foreign exchange gain (loss)		16	(171)
Finance costs		(1,882)	(2,624)
Finance income		8	37
Loss before income taxes		<u>\$ (3,614)</u>	<u>\$ (3,943)</u>
Income taxes			
Income tax recovery (expense)	<i>13</i>	(700)	1,133
Net loss and comprehensive loss		<u>\$ (4,314)</u>	<u>\$ (2,810)</u>
Deficit, beginning of year		<u>\$ (58,829)</u>	<u>\$ (56,019)</u>
Deficit, end of year		<u>\$ (63,143)</u>	<u>\$ (58,829)</u>
Basic loss per share	<i>16</i>	\$ (0.30)	\$ (0.22)
Diluted loss per share	<i>16</i>	\$ (0.30)	\$ (0.22)
Basic weighted average number of shares outstanding		14,177	13,069
Diluted weighted average number of shares outstanding		14,177	13,069

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

TERAGO INC.
Consolidated Statements of Cash Flows
(In thousands)

	Note	Year ended December 31 2016	Year ended December 31 2015
Operating Activities			
Net loss for the year		\$ (4,314)	\$ (2,810)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Severance, acquisition, and other costs		3,650	2,278
Depreciation of network assets, property and equipment	7	11,796	11,400
Amortization of intangible assets	8	3,529	3,697
Stock-based compensation expense	15	866	1,272
Finance costs		1,882	2,624
Finance income		(8)	(37)
Income tax expense (recovery)		700	(1,133)
Loss on adjustments and disposal of network assets	7	397	266
Severance, acquisition, and other costs paid		(1,943)	(2,153)
Changes in non-cash working capital items:			
Accounts receivable		(367)	1,001
Prepaid expenses		201	(689)
Accounts payable and accrued liabilities		(160)	480
Deferred revenue		129	(510)
Cash from Operating Activities		16,358	15,686
Investing Activities			
Acquisitions, net of cash acquired	5	(1,102)	(31,244)
Change in restricted cash		172	(172)
Purchase of network assets, property and equipment	7	(7,697)	(8,542)
Purchase of intangible assets	8	(496)	(892)
Change in non-cash working capital related to network assets, property and equipment and intangible assets		(442)	(239)
Cash used in Investing Activities		(9,565)	(41,089)
Financing Activities			
Proceeds from exercise of stock options		182	1,234
Proceeds from equity offering	14	-	10,004
Equity offering costs incurred	14	-	(794)
Interest paid, net of received		(1,746)	(1,904)
Proceeds from long term debt	10	-	31,500
Repayment of long-term debt	10	(5,261)	(4,058)
Financing costs incurred	10	-	(379)
Cash from (used in) Financing Activities		(6,825)	35,603
Net change in cash and cash equivalents, during the year		(32)	10,200
Cash and cash equivalents, beginning of year		13,066	2,866
Cash and cash equivalents, end of year		\$ 13,034	\$ 13,066
Supplemental cash flow disclosure			
Issuance of common shares in acquisition of RackForce Networks Inc.		\$ -	\$ 2,351

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

TERAGO INC.
Consolidated Statements of Changes in Equity
(In thousands)

	Share Capital		Contributed		Deficit	Total
	Number	Amount	Surplus			
Balance, January 1, 2016	14,133	\$ 85,636	\$ 25,408	\$ (58,829)	\$	52,215
Issuance of shares upon exercise of options	46	182	-	-		182
Stock-based compensation	-	-	212	-		212
Issuance of shares for directors' fees	71	353	-	-		353
Net loss and comprehensive loss	-	-	-	(4,314)		(4,314)
Balance, December 31, 2016	14,250	\$ 86,171	\$ 25,620	\$ (63,143)	\$	48,648

	Share Capital		Contributed		Deficit	Total
	Number	Amount	Surplus			
Balance, January 1, 2015	11,698	\$ 72,470	\$ 24,962	\$ (56,019)	\$	41,413
Issuance of shares upon exercise of options	287	1,234	-	-		1,234
Stock-based compensation	-	-	446	-		446
Issuance of shares for directors' fees	64	371	-	-		371
Issuance of shares for RackForce acquisition	329	2,351	-	-		2,351
Issuance of shares for equity offering – net of issuance costs	1,755	9,210	-	-		9,210
Net loss and comprehensive loss	-	-	-	(2,810)		(2,810)
Balance, December 31, 2015	14,133	85,636	25,408	(58,829)		52,215

See Note 14 – Share capital for classes of shares.

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

TERAGO INC.
Notes to the Consolidated Financial Statements
(In thousands, except for per share amounts)

1. Reporting Entity

TeraGo Inc. (the "Company") provides businesses across Canada and globally with connectivity services, colocation services and enterprise infrastructure cloud services. The Company's head office is located in Canada at Suite 800 – 55 Commerce Valley Drive West, Thornhill, Ontario. The Company was incorporated under the Canada Business Corporations Act on December 21, 2000 and owns and operates a carrier-grade, fixed wireless, fibre-based, IP communications network, as well as cloud and colocation facilities in Canada targeting enterprise customers that require cloud, colocation, and connectivity services. The Company's common shares are listed on the Toronto Stock Exchange (TSX) under the symbol TGO.

2. Basis of Preparation and Presentation

(a) Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted for the current year.

The Board of Directors authorized the consolidated financial statements for issue on February 23, 2017.

(b) Basis of Measurement

The consolidated financial statements have been prepared on a historical cost basis except for the following material items in the statement of financial position:

- financial instruments at fair value through profit (loss) ("FVTPL") are measured at fair value through net income or loss
- liabilities for cash-settled stock-based payment arrangements are measured at fair value

(c) Functional and Presentation Currency

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

(d) Use of Estimates and Judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Key areas of estimation and information about critical judgments in applying accounting policies that have the most significant effect on amounts recognized in the consolidated financial statements are:

- (i) *Estimates of useful lives of network assets, property and equipment and intangible assets:*
Management's judgment involves consideration of intended use, industry trends and other factors in determining the expected useful lives of depreciable assets, to determine depreciation methods, the asset's residual value and whether an asset is a qualifying asset for the purposes of capitalizing borrowing costs.
- (ii) *Capitalization of costs:*
Judgments and estimates are used in assessing the direct labour and other costs capitalized to network assets, property and equipment.
- (iii) *Cash generating units:*
Judgment is required to assess the Company's determination of cash generating units for the purpose of impairment testing.
- (iv) *Impairment of non-financial assets:*
The process to calculate the recoverable amount of our cash generating unit requires use of valuation methods such as the discounted cash flow method which uses assumptions of key variables including future cash flows, discount rate and terminal growth rates.

TERAGO INC.
Notes to the Consolidated Financial Statements
(In thousands, except for per share amounts)

- (v) *Allowance for doubtful accounts:*
In developing the estimates for an allowance against existing receivables, the Company considers general and industry economic and market conditions as well as credit information available for the customer and the aging of the account. Changes in the carrying amount due to changes in economic and market conditions could significantly affect the loss for the period.
- (vi) *Stock-based compensation:*
Estimating fair value for stock-based payments requires determining the most appropriate valuation model for a grant, which is dependent on the terms and conditions of the grant. In valuing stock options, the Company uses the Black-Scholes option pricing model. Several assumptions are used in the underlying calculation of fair values of the Company's stock options using the Black-Scholes option pricing model including the expected life of the option, risk-free interest rate and volatility of the underlying stock.
- (vii) *Business combination:*
The amount of goodwill initially recognized as a result of a business combination, the fair value estimate of any contingent consideration and the determination of the fair value of the identifiable assets acquired and the liabilities assumed is based, to a considerable extent, on management's estimate of future cash flows expected to be derived from the assets acquired.
- (viii) *Income taxes:*
A deferred tax asset is recognized for unused losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable income will be available against which they can be utilized. Significant estimates are required in evaluating the recoverability of deferred tax assets. The Company's assessment is based on existing tax laws, estimates of future profitability and tax planning strategies.
- (ix) *Provisions:*
Judgment is required to assess the likelihood of an outflow of the economic benefits to settle contingencies, such as litigations or decommissioning and restoration obligations, which may require a liability to be recognized. Significant judgments include assessing estimates of future cash flows, selection of discount rates and the probability of the occurrence of future events.

3. Significant Accounting Policies

(a) Revenue Recognition

The Company earns revenue by providing cloud, colocation, and connectivity services. Revenue is measured at the fair value of the consideration received or receivable for services, net of discounts and sales taxes. Revenue is recognized as the related services are provided to customers, if evidence of an arrangement exists, collection is deemed probable by management and revenue and costs are reliably measurable. The principal sources of revenue to the Company and recognition of these revenues are as follows:

- (i) Monthly recurring revenue from cloud, colocation, and connectivity are recognized as service revenue ratably over the number of months in the contract term as related services are provided to the customer.
- (ii) Revenue from installation services that do not have standalone value from the ongoing service are deferred and recognized over the term of the contract.
- (iii) Usage revenue is recorded as service revenue in the month the usage occurs.

Billings or payments received from customers in advance of revenue recognition are recorded in deferred revenue on the consolidated statement of financial position.

(b) Basis of Consolidation

The consolidated financial statements include the accounts of TeraGo Inc., TeraGo Networks Inc. and its wholly owned subsidiaries RackForce Networks Inc., RackForce Cloud Video Inc, and Codeninja Ltd. (collectively, the Company). A subsidiary is an entity that is controlled by another entity, known as the parent. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. All intercompany transactions between subsidiaries are eliminated on consolidation. On January 1, 2017, subsequent to year-end, TeraGo Networks Inc., RackForce Networks Inc., RackForce Cloud Video Inc., and Codeninja Ltd were amalgamated.

TERAGO INC.
Notes to the Consolidated Financial Statements
(In thousands, except for per share amounts)

(c) Financial Instruments

The Company initially measures financial instruments at fair value. Transaction costs that are directly attributable to the issuance of financial assets or liabilities are accounted for as part of the carrying value at inception (except for transaction costs related to financial instruments recorded as FVTPL financial assets which are expensed as incurred), and are recognized over the term of the assets or liabilities using the effective interest method.

Subsequent measurement and treatment of any gain or loss is recorded as follows:

- (i) Financial assets and financial liabilities at FVTPL are measured at fair value at the balance sheet date with any gain or loss recognized immediately in net loss. Interest and dividends earned from financial assets are also included in net loss for the period.
- (ii) Loans and receivables are measured at amortized cost using the effective interest method. Any gains or losses are recognized in net loss for the period.
- (iii) Other financial liabilities are measured at amortized cost using the effective interest method. Any gains or losses are recognized in net loss for the period.

Impairment of Financial Assets

A financial asset carried at amortized cost is considered impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flow of that asset that can be estimated reliably. An impairment loss is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate.

In assessing impairment, the Company uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends. Losses are recognized in the consolidated statements of loss and reflected in an allowance account against the financial asset.

The following is a summary of the Company's significant categories of financial instruments as at December 31, 2016:

Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets currently are comprised of cash and cash equivalents, accounts receivable and restricted cash.

(i) *Cash and Cash Equivalents and restricted cash*

Cash and cash equivalents consists of bank balances, cash on hand, demand deposits that can be withdrawn without penalty and short-term, highly liquid securities such as debt securities with an initial maturity date of not more than three months from the date of acquisition, that can readily be converted into known amounts of cash and are subject to an insignificant risk of change in value. Bank overdrafts that are repayable upon demand and form an integral part of the Company's cash management are included as a component of cash and cash equivalents. Cash and cash equivalents and restricted cash are carried at amortized cost.

(ii) *Accounts Receivable*

Accounts receivable are measured at the amount the item is initially recognized. The allowance for doubtful accounts is based on the Company's assessment of the collectability of outstanding trade receivables. The evaluation of collectability of customer accounts is done on an individual account basis. If, based on an evaluation of accounts, it is concluded that it is probable that a customer will not be able to pay all amounts due, an expected impairment loss is recognized. Recoveries are only recorded when objective verifiable evidence supports the change in the original allowance. Changes in the carrying amount of the allowance account are recognized in the statement of comprehensive loss for the period.

Other financial liabilities

The Company recognizes debt securities issues and subordinated liabilities on the date that they originated. All other financial liabilities are recognized initially on the date that the Company becomes a party to the contractual provisions. The Company has the following non-derivative financial liabilities: current and long-term debt, accounts payable and accrued liabilities, and current portion and long-term portion of other long term liabilities.

Such liabilities are recognized initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest method.

TERAGO INC.
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(In thousands, except for per share amounts)

Interest on loans and borrowings is expensed as incurred unless capitalized for qualifying assets in accordance with IAS 23, Borrowing Costs. Loans and borrowings are classified as a current liability unless the Company has an unconditional right to defer settlement for at least 12 months after the end of the year.

Derivative instruments

The Company uses an interest rate swap contract to manage the risk associated with the fluctuations of interest rates on its long-term debt. Management does not apply hedge accounting on the interest rate swap contract. As a result, the interest rate swap contract is marked to market each period, resulting in a gain or loss in net loss for the year.

(d) Network Assets, Property and Equipment

Network assets, property and equipment are recorded at cost less accumulated depreciation and impairment charges, if any. These costs include expenditures directly attributable to the acquisition of the asset. The cost of self-constructed network assets includes the cost of materials and direct labour and any other costs directly attributable to bringing the assets to a working condition for their intended purpose. This includes direct costs to design, acquire and build the asset and include directly attributable internally and externally generated engineering and construction costs and equipment on-hand. They also include the cost of dismantling and removing items and restoring the site on which they are located and specifically attributable borrowing costs on qualifying assets. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset only when it is probable that future economic benefits associated with the item will flow to the Company and the costs of the item can be reliably measured. All other expenditures are charged to operating expenses as incurred.

When major components of an item of network assets and property and equipment have different useful lives, they are accounted for as separate items. Depreciation of network assets and property and equipment is based on the estimated useful life of the assets as follows:

	<u>Estimated useful life/ Asset depreciation method</u>
Network assets	6 to 25 years straight line
Cloud and Data centre infrastructure	10 to 15 years straight line
Computer equipment	3 years straight line
Office furniture and equipment	5 years straight line
Leasehold improvements	over the term of lease
Vehicles	30% declining balance

Depreciation methods, useful lives and residual values are reviewed at least annually. Adjustments, if necessary, are recognized prospectively.

(e) Goodwill and Intangible Assets

Intangible assets include the following:

Radio Spectrum Licenses

Radio spectrum licenses are classified as indefinite life intangible assets and are not amortized but are tested for impairment on an annual basis. The licenses are granted with an auto-renewal policy and non-renewal of licenses by the regulatory body is considered remote unless license conditions are breached. As such, there is no foreseeable limit to the period over which these assets are expected to generate future net cash inflows to the Company and it is common industry practice for established telecommunications companies to treat these licenses as indefinite life.

Computer Software

Computer software is recorded at cost less accumulated amortization and amortized on a straight-line basis over 3 years or where there is a term license for the software, over the shorter of the term of the license or the useful life of the software.

Customer Relationships, Brand, Non-compete agreements, and Acquired Real Estate Leases

Customer relationships, brand, non-compete agreements and vendor's real estate leases are recorded at cost less accumulated amortization, initially measured at fair value on the acquisition date if acquired in a business combination. Customer relationships are amortized on a straight-line basis over a range of 5 to 10 years, brands are amortized over a period of 20 years, non-compete agreements are amortized on a straight-line basis in accordance with the term of the contracts and acquired real estate leases are amortized over the term of the lease.

Amortization methods, useful lives and residual values are reviewed at least annually. Adjustments, if necessary, are recognized prospectively.

TERAGO INC.
Notes to the Consolidated Financial Statements
(In thousands, except for per share amounts)

Goodwill

Goodwill is the amount that results when the fair value of consideration transferred for an acquired business exceeds the net fair value of the identifiable assets and liabilities acquired. When the Company enters into a business combination, the acquisition method of accounting is used. Goodwill is assigned, as of the date of the business combination, to cash generating units that are expected to benefit from the business combination.

(f) Impairment of non-financial assets

The Company monitors events and changes in circumstances that may require an assessment of the recoverability of its non-financial long-lived assets. When an impairment test is performed, the recoverable amount is assessed by reference to the higher of i) the net present value of the expected future cash flows (value-in-use) and ii) the fair value less cost to sell. If the recoverable amount is estimated to be less than the carrying amount, the carrying amount of the asset is reduced to its recoverable amount and an impairment loss is charged to operations in the period in which the impairment is identified. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows ("cash generating units" or "CGUs").

The carrying values of identifiable intangible assets with indefinite lives and goodwill are tested at minimum annually for impairment. Goodwill and indefinite life intangible assets are allocated to CGUs for the purpose of impairment testing based on the level at which management monitors it, which is not higher than an operating segment. The allocation is made to those CGUs that are expected to benefit from the business combination in which the goodwill arose. The Company currently has assessed that it has a single CGU.

The carrying values of non-financial assets with finite useful lives, such as network assets, property and equipment and intangible and other assets subject to amortization, are assessed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. If any such indication exists, the recoverable amount of the asset must be determined. Such assets are impaired if their recoverable amount is lower than their carrying amount. If it is not possible to estimate the recoverable amount of an individual asset, the recoverable amount of the CGU to which the asset belongs is tested for impairment.

(g) Subscriber acquisition costs

Subscriber acquisition costs are expensed as incurred.

(h) Business Combinations

Acquisitions of businesses are accounted for using the acquisition method. The consideration for each acquisition is measured at the aggregate of the fair values (at the date of exchange) of assets given, liabilities incurred or assumed, and equity instruments issued by the Company in exchange for control of the acquiree. Acquisition-related costs are recognized in loss in the period incurred.

Where applicable, the consideration for the acquisition includes any asset or liability resulting from a contingent consideration arrangement, measured at its acquisition-date fair value. Subsequent changes in such fair values are adjusted against the cost of acquisition where they qualify as measurement period adjustments. All other subsequent changes in the fair value of contingent consideration classified as an asset or liability are accounted for in accordance with relevant IFRS sections. Changes in the fair value of contingent consideration initially classified as equity are not recognized.

Where a business combination is achieved in stages, the Company's previously held interests in the acquired entity are remeasured to fair value at the acquisition date (i.e. the date the Company attains control) and the resulting gain or loss, if any, is recognized in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognized in other comprehensive income are reclassified to profit or loss, where such treatment would be appropriate if that interest were disposed.

The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 are recognized at their fair value at the acquisition date.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Company reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period or additional assets or liabilities are recognized, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognized as of that date.

TERAGO INC.
Notes to the Consolidated Financial Statements
(In thousands, except for per share amounts)

The measurement period is the period from the date of acquisition to the date the Company obtains complete information about facts and circumstances that existed as of the acquisition date and is subject to a maximum period of one year.

(i) Leases

Leases entered into by the Company as lessee that transfer substantially all the benefits and risks of ownership to the Company are recorded as finance leases and are included in property and equipment and obligations under finance leases. Obligations under finance leases are reduced by lease payments net of imputed interest. All other leases are classified as operating leases under which lease payments are expensed on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease cost, over the term of the lease. Contingent lease payments are accounted for in the period incurred.

(j) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where the impact is significant, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects the current market assessments of the time value of money and the risk specific to the liability. The unwinding of the discount is recognized as a finance cost.

Decommissioning and Restoration Obligations:

In the course of the Company's operations, network and other assets are utilized on leased premises. Often costs are expected to be incurred associated with decommissioning these assets and restoring the location where these assets are situated upon ceasing their use on those premises.

These decommissioning and restoration provisions are calculated on the basis of the identified costs for the current financial year, extrapolated into the future based on management's best estimates of future trends in prices, inflation, and other factors, and are discounted to present value at a risk-adjusted rate specifically applicable to the liability. Assumptions related to the amount and timing of cash flows required to satisfy the Company's future legal obligations include labour costs based on current marketplace wages and the rate of inflation over expected years to settlement; the length of facility lease renewal periods and probability of such renewals; and the appropriate discount rate to present value the future cash flows. Forecasts of estimated future provisions are reviewed periodically in light of future changes in business conditions or technological requirements.

The Company records these decommissioning and restoration costs as Network Assets, Property and Equipment, and subsequently allocates them to expense using a systematic and rational method over the asset's useful life. The Company records the accretion of the liability (unwinding of the discount) as a charge to finance costs.

(k) Foreign Currency Translation

Foreign currency accounts are translated into Canadian dollars as follows: At the transaction date, each asset, liability, revenue, and expense is translated into Canadian dollars using the exchange rate in effect at that date. At the year-end date, monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at that date. The resulting foreign exchange gains and losses are included in net loss in the current year.

(l) Finance income and finance costs

Finance income comprises interest income on funds invested, dividend income, gains on sale of available-for-sale financial assets, and changes in fair value of financial assets at FVTPL.

Finance costs comprise interest expense on borrowings, accretion of discounts on provisions, and changes in fair value of financial assets at FVTPL. Borrowing costs that are not directly attributable are recognized in loss for the year.

(m) Income Taxes

Income taxes on losses include current and deferred taxes. Income taxes are recognized in loss except to the extent that it relates to business combinations, or items recognized directly in equity or in other comprehensive income. Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is generally recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax assets and liabilities are measured, on an undiscounted basis, at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

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Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability in the consolidated statement of financial position differs from its tax base, except for differences arising on:

- the initial recognition of goodwill;
- the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting or taxable profit; and
- investments in subsidiaries, branches and associates, and interests in joint ventures where the Company is able to control the timing of the reversal of the difference and it is probable that the difference will not reverse in the foreseeable future.

A deferred tax asset is recognized to the extent it is probable that it will be realized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent it is no longer probable the related tax benefit will be realized.

(n) Government incentives

From time to time, the Company applies for government incentive programs such as investment tax credits. Government incentives are recognized when there is reasonable assurance of realization and reflected as a reduction of the expenditure to which the incentive relates. In the event the investment tax credits received differs from the amount claimed, the difference will be reflected in operations in the year in which it is determined.

(o) Stock-based Compensation Plans

The Company has equity-settled and cash-settled stock-based compensation plans.

The grant date fair values of equity settled stock-based payment awards to employees and directors are recognized as compensation cost, with a corresponding increase to equity, over the vesting period of the award. For cash-settled awards, the awards are classified as a liability and are re-measured to fair value at each reporting date. The Company accounts for the effects of service and non-market performance conditions in measuring the fair value of the liability in cash-settled awards by adjusting the number of rights to receive cash that are expected to satisfy any service and non-market performance conditions on a best estimate basis.

Awards with graded vesting are valued and recognized as compensation cost based on the respective vesting tranche. The amount of compensation cost recognized is adjusted to reflect the number of awards expected to vest based on continued employment vesting conditions, such that the amount ultimately recognized as compensation cost is based on the number of awards that vest.

The Employee share purchase plan allows employees to voluntarily participate in a share purchase plan. Under the terms of the plan, employees can contribute a specified percentage of their regular earnings through payroll deductions and the Company makes a contribution match which is recorded as compensation expense.

(p) Operating Segments

Management has determined that the Company operates in a single reportable operating segment. The Company provides cloud, colocation, and connectivity services and earns revenues primarily in Canada. As at December 31, 2016 substantially all of the Company's identifiable assets are located in Canada, with an immaterial amount of assets located in the United States and the United Kingdom.

(q) Loss Per Share

The basic loss per share has been computed by dividing the net loss for the year by the weighted average number of common shares outstanding during the year. Diluted loss per share is computed by adjusting the net loss attributable to common shareholders for the year and the weighted average number of common shares outstanding for the period for the effects of all potentially dilutive common shares including shares subject to the exercise of stock options, where dilutive. The Company uses the treasury stock method for calculating diluted loss per share.

4. Upcoming accounting pronouncements not yet adopted

The IASB has issued new standards and amendments to existing standards. These changes are not yet adopted as at December 31, 2016 and could have an impact on future periods.

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

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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 of IFRS 15 has not yet been determined.

IFRS 9 Financial Instruments

On 24 July 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.

IFRS 16 Leases

On January 13, 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.

5. Business Combinations**AirVM Hosting Business**

On May 26, 2016, the Company closed an asset purchase agreement to acquire the Hosting Business of Ottawa-based AirVM Inc for consideration of \$1,102. The acquisition brings expanded Infrastructure as a Service (IaaS) offerings to the Company from locations in the United States and the United Kingdom.

The acquisition was accounted for using the acquisition method in accordance with IFRS 3, Business Combinations, with the results of operations consolidated with those of the Company effective from the acquisition date. In connection with the acquisition, the Company recorded network assets, property and equipment of \$137, customer relationships and other intangible assets of \$609, and goodwill of \$356.

Goodwill recognized in the transaction represents the expected operational synergies with the acquiree including intangible assets that do not qualify for separate recognition. The goodwill and intangibles assets are tax deductible.

The identifiable intangible assets are being amortized over a period of 2 to 5 years.

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Acquisition of RackForce Networks Inc.

On March 27, 2015, the Company closed a share purchase agreement to acquire 100% of the shares of RackForce Networks Inc. ("RackForce"). The acquisition supports TeraGo's strategic plan to offer complementary services to business and enterprise customers. RackForce is one of Canada's largest enterprise cloud service providers. Its business involves the management of enterprise cloud services including Cloud Hosting Services (IaaS) and Application Hosting Services (SaaS) with network. RackForce has been in operation since 2001 and currently serves a variety of enterprise customers, including Fortune 100 companies, governments and education clients.

On March 27, 2015, the Company transferred \$33,351 (consisting of \$31,000 cash and issuance of \$2,351 common shares of the Company) with payment of cash and shares of \$24,132 to the vendors and cash of \$9,219 paid in escrow for the remaining balance, subject to among other things a working capital adjustment to be finalized within 90 days of closing. During 2015 the Company rendered a reduction in the purchase consideration of \$666 from the working capital adjustment, resulting in a net purchase consideration of \$32,685. The Company was repaid \$666 from the escrow account in 2015.

The acquisition was accounted for using the acquisition method in accordance with IFRS 3, Business Combinations, with the results of operations consolidated with those of the Company effective the acquisition date. Total acquisition related costs were \$656 and were included in other operating expenses for the year ended December 31, 2015.

The fair values of the assets acquired and liabilities assumed at the date of acquisition were as follows:

Net Working Capital	\$ (621)
Network Assets, Property and Equipment	9,824
Identifiable Intangible Assets:	
Customer Relationships	11,170
Brand	2,460
Non-Competition Agreements	490
Deferred tax liability	(3,039)
Goodwill	12,401
Purchase Price	<u>\$ 32,685</u>

Goodwill represents the expected operational synergies with the acquiree including intangible assets that do not qualify for separate recognition. The goodwill is not tax deductible.

The customer relationships are being amortized over a period of 10 years, brand is being amortized over a period of 20 years and the non-competition agreements are being amortized over a period of 3 years.

Acquisition of BoxFabric

On September 18, 2015, the Company closed a share purchase agreement to acquire 100% of the shares of Codeninja Ltd., which operates as BoxFabric ("BoxFabric") for consideration of \$1,100, subject to a working capital adjustment.

The acquisition was accounted for using the acquisition method in accordance with IFRS 3, Business Combinations, with the results of operations consolidated with those of the Company effective from the acquisition date.

Following settlement of the working capital adjustment, the Company paid total consideration of \$1,082, of which \$172 was held in escrow as restricted cash pending finalization of the escrow term at December 31, 2015.

The fair values of the assets acquired and liabilities assumed at the date of acquisition are determined to be as follows:

Net working capital	\$ 20
Network Assets, Property and Equipment	46
Identifiable Intangible Assets	356
Deferred tax liability	(94)
Goodwill	754
Purchase Price	<u>\$ 1,082</u>

Goodwill represents the expected operational synergies with the acquiree including intangible assets that do not qualify for separate recognition. The goodwill is not tax deductible.

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The identifiable intangible assets are being amortized over a period of 3 to 5 years.

Pro Forma Disclosure

The Company's acquisition of the Hosting Business of AirVM Inc. contributed revenue of \$395 and earnings from operations of \$19 since the date of acquisition. If the acquisition had occurred on January 1, 2016, consolidated revenue of the Company for the year ended December 31, 2016 would have been \$59,348 and loss from operations for the year would have been (\$1,743).

6. Current Assets

Details of selected current asset balances are as follows:

(a) Cash and cash equivalents

The Company's cash and cash equivalents are comprised of bank balances at major Canadian financial institutions.

(b) Accounts receivable

The Company's accounts receivable are comprised of the following:

	December 31	December 31
	2016	2015
Trade receivables	\$ 3,531	\$ 3,148
Allowance for doubtful accounts	(124)	(54)
Other	266	212
	\$ 3,673	\$ 3,306

7. Network Assets, Property and Equipment

Cost	Network assets	Cloud & Datacentre infrastructure	Computer equipment	Office furniture and equipment	Leasehold improvements	Vehicles	Total
Balance, January 1, 2016	\$ 114,869	\$ 13,752	\$ 2,173	\$ 2,211	\$ 1,602	\$ 49	\$ 134,656
Additions / reclassifications	6,530	645	355	121	46	-	7,697
Acquisitions	5	-	132	-	-	-	137
Disposals / Adjustments	(2,795)	(11)	-	-	-	-	(2,806)
Balance, December 31, 2016	\$ 118,609	\$ 14,386	\$ 2,660	\$ 2,332	\$ 1,648	\$ 49	\$ 139,684
Accumulated Depreciation							
Balance, January 1, 2016	\$ 80,080	\$ 888	\$ 2,133	\$ 2,132	\$ 854	\$ 49	\$ 86,136
Depreciation for the year	9,857	1,590	112	40	197	-	11,796
Disposals / Adjustments	(2,410)	1	-	-	-	-	(2,409)
Balance, December 31, 2016	\$ 87,527	\$ 2,479	\$ 2,245	\$ 2,172	\$ 1,051	\$ 49	\$ 95,523
Net Book Value, December 31, 2016	\$ 31,082	\$ 11,907	\$ 415	\$ 160	\$ 597	\$ -	\$ 44,161

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Cost	Network assets	Cloud & Datacentre infrastructure	Computer equipment	Office furniture and equipment	Leasehold improvements	Vehicles	Total
Balance, January 1, 2015	\$ 110,485	\$ 1,663	\$ 2,105	\$ 2,194	\$ 1,460	\$ 49	\$ 117,956
Additions / reclassifications	6,096	2,315	20	5	106	-	8,542
Acquisitions	-	\$ 9,774	\$ 48	\$ 12	\$ 36	-	\$ 9,870
Disposals / Adjustments	(1,712)	-	-	-	-	-	(1,712)
Balance, December 31, 2015	\$ 114,869	\$ 13,752	\$ 2,173	\$ 2,211	\$ 1,602	\$ 49	\$ 134,656
Accumulated Depreciation							
Balance, January 1, 2015	\$ 71,233	\$ 195	\$ 1,950	\$ 2,094	\$ 662	\$ 48	\$ 76,182
Depreciation for the year	10,294	692	183	38	192	1	11,400
Disposals / Adjustments	(1,447)	1	-	-	-	-	(1,446)
Balance, December 31, 2015	\$ 80,080	\$ 888	\$ 2,133	\$ 2,132	\$ 854	\$ 49	\$ 86,136
Net Book Value, December 31, 2015	\$ 34,789	\$ 12,864	\$ 40	\$ 79	\$ 748	\$ -	\$ 48,520

For the years ended December 31, 2016 and 2015, the Company had additions of capitalized wages and other directly attributable costs of \$2,097 and \$1,851, respectively, in network assets.

During 2016, the Company wrote off assets with a net book value of \$397 (Cost of \$2,806 less accumulated depreciation of \$2,409). During 2015, the Company wrote off assets with a net book value of \$266 (Cost of \$1,712 less accumulated depreciation of \$1,446). The corresponding loss on disposal of assets was included in other operating expenses.

8. Intangible Assets and Goodwill

Cost	Radio spectrum licenses	Computer Software	Customer relationships	Other	Total Intangibles	Goodwill	Total Intangibles and Goodwill
Balance, January 1, 2016	\$ 7,041	\$ 8,560	\$ 17,677	\$ 4,835	\$ 38,113	\$ 19,063	\$ 57,176
Additions	-	496	-	-	496	-	496
Acquisitions	-	-	564	45	609	356	965
Balance, December 31, 2016	\$ 7,041	\$ 9,056	\$ 18,241	\$ 4,880	\$ 39,218	\$ 19,419	\$ 58,637
Accumulated Depreciation							
Balance, January 1, 2016	\$ 2,371	\$ 7,178	\$ 5,385	\$ 1,355	\$ 16,289	\$ -	\$ 16,289
Amortization for the year	-	821	2,096	612	3,529	-	3,529
Balance December 31, 2016	\$ 2,371	\$ 7,999	\$ 7,481	\$ 1,967	\$ 19,818	\$ -	\$ 19,818
Net Book Value, December 31, 2016	\$ 4,670	\$ 1,057	\$ 10,760	\$ 2,913	\$ 19,400	\$ 19,419	\$ 38,819

Cost	Radio spectrum licenses	Computer Software	Customer relationships	Other	Total Intangibles	Goodwill	Total Intangibles and Goodwill
Balance, January 1, 2015	\$ 7,041	\$ 7,668	\$ 6,180	\$ 1,856	\$ 22,745	\$ 5,908	\$ 28,653
Additions	-	892	-	-	892	-	892
Acquisitions	-	-	11,497	2,979	14,476	13,155	27,631
Balance, December 31, 2015	\$ 7,041	\$ 8,560	\$ 17,677	\$ 4,835	\$ 38,113	\$ 19,063	\$ 57,176
Accumulated Depreciation							
Balance, January 1, 2015	\$ 2,371	\$ 6,157	\$ 3,293	\$ 771	\$ 12,592	\$ -	\$ 12,592
Amortization for the year	-	1,021	2,092	584	3,697	-	3,697
Balance December 31, 2015	\$ 2,371	\$ 7,178	\$ 5,385	\$ 1,355	\$ 16,289	\$ -	\$ 16,289
Net Book Value, December 31, 2015	\$ 4,670	\$ 1,382	\$ 12,292	\$ 3,480	\$ 21,824	\$ 19,063	\$ 40,887

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Impairment

The annual impairment test of goodwill and indefinite life intangible assets was performed on December 31, 2016 and December 31, 2015 and did not result in any impairment loss.

The recoverable amount is the higher of (i) an asset's or CGU's fair value less costs to sell and (ii) its value-in-use. In performing the annual impairment test for the Company's single CGU, the Company measured the value-in-use of the CGU using certain key management assumptions. Cash flow projections, which were made over a five-year period, were based primarily on the financial budget reviewed by the Board of Directors plus a terminal value using a 3% terminal growth rate. The Company discounted these estimates of future cash flows to their present value using an after-tax discount rate of 10.5% which reflects the entity's weighted average cost of capital. The fair value less costs to sell, primarily based on the Company's market capitalization as at December 31, 2016, also significantly exceeded the net carrying amount of the CGU.

9. Restricted Cash

Funds Held in escrow

During the year, the \$172 held back in escrow related to the acquisition of BoxFabric in 2015 (Note 5), was released by the Company pursuant to the terms of the share purchase agreement.

10. Long-term Debt

	December 31		December 31
	2016		2015
Term debt facility (a)	\$ 40,897	\$	45,833
Equipment loans (b)	170		431
less: financing fees	(289)		(483)
	<u>40,778</u>		<u>45,781</u>
less: current portion	(5,170)		(6,123)
	<u>\$ 35,608</u>	\$	<u>39,658</u>

(a) 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 \$50,000 credit facility that is principally secured by a general security agreement over the Company's assets.

In March 2015, the Company entered into an amended agreement with the syndicate led by NBC that increased the credit facility by \$35,000 (\$30,000 increase to the term debt facility and \$5,000 increase to the revolving facility) and extended the term from June 6, 2017 to June 30, 2018. Other terms were substantially consistent with the existing credit facilities.

The total \$85,000 facility that matures June 30, 2018 is made up of the following:

- \$10,000 revolving facility which bears interest at prime plus a margin percent. As of December 31, 2016, \$nil amount is outstanding (December 31, 2015 - \$nil). Letters of credit outstanding under the facility totaled \$655 as of December 31, 2016 (December 31, 2015 - \$655).
- \$50,000 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 \$1,250. This facility was fully drawn upon signing the amended agreement.

On December 31, 2016, \$41,100 of the term facility principal balance outstanding was in a Banker's Acceptance and the remaining \$150 was at a floating rate. In 2015, the Company entered into amended interest rate swap contracts that matures June 29, 2018. The interest rate on the Banker's Acceptance at December 31, 2016 was 3.99%. 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 December 31, 2016 was a liability of \$261 (December 31, 2015 - \$612) and is recorded in other long-term liabilities (Note 11), with a corresponding charge for the change in fair value recorded in finance costs.

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As at December 31, 2016, the Company prepaid interest in the amount of \$353 which represents the net settlement of the Banker's Acceptance and is recorded as a reduction in the carrying value of the debt.

- \$25,000 available for funding acquisitions and will bear interest at prime plus a margin percent and is repayable in quarterly principal installments of 2.5% of the aggregate amount outstanding. As of December 31, 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 December 31, 2016. Under this facility, the Company is subject to a cash flow sweep that could accelerate a certain amount of principal repayment based on a calculation outlined by the credit agreement not later than 120 days after the end of each fiscal year.

(b) Equipment loans

The Company has certain equipment loans with financing companies that are secured by the underlying equipment. These debt facilities, which bear interest at fixed rates ranging from 5.97% to 6.23% over the respective terms, have maturity dates between September 2017 and December 2017 and have total monthly installments of \$16.

11. Other Long-Term Liabilities

	December 31	December 31
	2016	2015
Performance based share units (Note 15 (c))	\$ 318	\$ 309
Restricted share units (Note 15 (b))	707	441
Fair value of interest rate swap contract (Note 10 (a))	261	612
Lease inducement liability	281	331
Assumed liabilities - Vancouver Data Centre	-	470
	<u>1,567</u>	<u>2,163</u>
less: current portion	(774)	(186)
	<u>\$ 793</u>	<u>\$ 1,977</u>

12. Decommissioning and Restoration Obligations

The Company's hub sites are established in leased or licensed premises. As part of these arrangements, the Company is liable for all restoration costs to ensure that the space is returned to its original state upon termination of the leases. The decommissioning and restoration obligations related to future site restoration costs related to these arrangements or licenses. The decommissioning and restoration obligations were determined using a discount rate of 10.5% over a range of periods from 2025 to 2045. As at December 31, 2016, the estimated amount of undiscounted cash flows required to settle this liability was \$1,163.

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the decommissioning and restoration obligations associated with the retirement of network assets:

	December 31	December 31
	2016	2015
Obligation, beginning of year	\$ 234	\$ 222
Accretion expense included in finance costs	17	12
Changes in assumptions	(44)	-
Obligation, end of year	<u>\$ 207</u>	<u>\$ 234</u>

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13. Income Taxes

Income tax expense (recovery)

	<u>December 31</u> <u>2016</u>	<u>December 31</u> <u>2015</u>
Current tax expense		
Current tax expense	\$ -	\$ -
	-	-
Deferred income tax (recovery)		
Movement in tax deductible temporary differences	700	(1,133)
	\$ 700	\$ (1,133)

Reconciliation of effective tax rate

	<u>December 31</u> <u>2016</u>		<u>December 31</u> <u>2015</u>	
	%		%	
Loss before Income taxes	\$ (3,614)		\$ (3,943)	
Income tax recovery at statutory rates	\$ (958)	(26.5)	\$ (1,031)	(26.1)
Permanent differences	150	4.2	410	10.4
Unrecognized (recognized) deferred tax assets	2,048	56.7	(512)	(13.0)
Other	(540)	(14.9)	-	-
Income tax expense (recovery)	\$ 700	19.4	\$ (1,133)	(28.7)

Unrecognized deferred tax assets and liabilities

Deferred tax assets have not been recognized in respect of the following items because they do not meet the criteria for recognition.

	<u>December 31</u> <u>2016</u>		<u>December 31</u> <u>2015</u>	
Excess of tax basis over book value	\$ 9,027		\$ 9,410	
Non-capital tax loss carryforwards	1,964		-	
Other deductible temporary differences	1,478		1,011	
	\$ 12,469		\$ 10,421	

Movement in deferred tax balances

	<u>Net Balance</u> <u>December 31,</u> <u>2015</u>	<u>Recognized</u> <u>in net loss</u>	<u>Net Balance,</u> <u>December 31,</u> <u>2016</u>
Excess UCC over NBV	\$ 2,021	\$ (2,021)	\$ -
SR&ED	872	(872)	-
Intangible Assets	(3,504)	3,504	-
Non-capital loss carryforwards	1,352	(1,352)	-
Other deductible temporary differences	(41)	41	-
	\$ 700	\$ (700)	\$ -

In 2016, the Company determined based on objective negative evidence in the form of cumulative net losses, that it was more likely than not that the Company would not have taxable profits with which to utilize recognized deferred income tax assets in the near term. As a result, the Company recorded a reduction of the deferred income tax asset of \$700 for the year ended December 31, 2016 with a corresponding charge to income tax expense.

Non-capital tax losses

The non-capital tax losses carried forward are available to reduce future taxable income and expire as follows:

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2030	\$	1,386
2031		1,356
2032		-
2033		718
2034		883
2035		1,695
2036		1,476
	\$	<u>7,514</u>

14. Share Capital

Authorized

Unlimited Common Shares
Two Class B Shares, non-transferable unless approved by the Board, non-participating and redeemable. Holder of Class B shares are entitled to nominate and elect one director for each Class B Share held.

	Number of Common Shares	In \$		
		Common Shares	Share Issue Costs	Total
Issued				
Balance, January 1, 2015	11,698	78,126	(5,656)	72,470
Issuance of common shares on exercise of stock options	287	1,234	-	1,234
Issuance of common shares for directors' fees	64	371	-	371
Issuance of common shares for Rackforce acquisition	329	2,351	-	2,351
Issuance of common shares for equity offering	1,755	10,004	(794)	9,210
Balance, December 31, 2015	<u>14,133</u>	<u>92,086</u>	<u>(6,450)</u>	<u>85,636</u>
Issuance of common shares on exercise of stock options	46	182	-	182
Issuance of common shares for directors' fees	71	353	-	353
Balance, December 31, 2016	<u>14,250</u>	<u>92,621</u>	<u>(6,450)</u>	<u>86,171</u>

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.

Dividends

Dividends are payable in an equal amount on each common share if declared by the Board of Directors of the Company. No dividends were declared for the years ended December 31, 2016 and 2015.

15. Stock-Based Compensation

(a) Stock Options

There are 986 common shares reserved for issuance under the Company's stock option plan. Upon closing of the Company's initial public offering on June 26, 2007, 799 options granted under the Company's original option plan (the "Old Plan") fully vested. Options granted under the Old Plan expire 10 years from date of vesting and as at December 31, 2016, there are 63 (2015 – 115) options outstanding under the Old Plan with a weighted average exercise price of \$4.00.

On June 18, 2007, the Company adopted a new option plan (the "2007 Option Plan") which is available to directors, officers, employees and other persons approved by the Board from time to time. On closing of the Company's initial public offering, 833 common shares were reserved for issuance under the 2007 Option Plan. The options granted under the

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2007 Option Plan expire 10 years from the date of grant and vest on a quarterly basis in 12 equal amounts over three years. All options under the 2007 Option Plan will vest immediately on a change of control of the Company. As of December 31, 2016, there are 609 options outstanding under the 2007 option plan.

For the years ended December 31, 2016 and 2015, the Company recorded stock-based compensation related to stock options of \$212 and \$446, respectively.

A summary of the status of the Company's stock option plan as at December 31, 2016 and 2015 is presented below.

	2016		2015	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding - January 1	684	\$5.89	1,318	\$7.03
Granted	40	\$5.12	12	\$6.25
Exercised	(46)	\$4.00	(287)	\$4.30
Forfeited / Expired	(6)	\$5.00	(359)	\$11.37
Outstanding - December 31	672	\$5.99	684	\$5.89
Exercisable	592	\$6.05	470	\$5.94

As at December 31, 2016, the range of exercise prices, the weighted average exercise price and the weighted average remaining contractual life are as follows:

Range of exercise prices	Options Outstanding			Options Exercisable	
	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
\$4.00	63	0.49	\$4.00	63	\$4.00
\$4.01 - \$5.50	50	7.90	\$5.11	17	\$5.08
\$5.51 - \$11.50	513	7.08	\$5.79	466	\$5.79
\$11.51 - \$11.75	46	0.46	\$11.75	46	\$11.75
	672	5.82	\$5.99	592	\$6.05

The fair value of stock option grants made to directors during the year is estimated using the Black-Scholes option pricing model, with the following weighted average assumptions: risk-free rate of 1.08% (2015 – 1.58%); dividend yield of nil; volatility of 46.60% (2015 – 48.80%); and expected lives of stock options of 7.9 years (2015 – 7.9). Expected volatility has been based on an evaluation of the historical period commensurate with the expected term. The expected term of the stock options has been based on historical experience and general option holder behavior. The fair value of the stock options is expensed over the vesting period of the options using the graded method.

(b) Restricted Share Units (RSUs)

On March 12, 2009, the Company established a RSU Plan which is available to the directors, officers, and full-time employees approved by the Board. The value of one RSU is equal to the value of one Common Share. Plan participants are granted a specific number of RSUs for a given period based on their position and level of contribution. At the end of the three-year vesting period, the RSUs vest if the plan participant is employed by the Company. Vested RSUs are expected to be paid in cash or Common Shares purchased on the open market, or a combination of both, as the Company chooses.

For the year ended December 31, 2016 and December 31, 2015, the Company recorded compensation expense of \$266 and \$244, respectively, related to the RSUs granted. As of December 31, 2016, a liability of \$707 (2015 - \$441) related to the RSUs granted is included in other long-term liabilities (Note 11).

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The following table is a summary of the number of outstanding RSU as at:

	<u>December 31</u> <u>2016</u>	<u>December 31</u> <u>2015</u>
Opening Balance, January 1	150	150
Granted	12	-
Vested	-	-
Ending Balance, December 31	<u>162</u>	<u>150</u>

(c) Performance-Based Share Units (PSUs)

Plan participants are granted a specific number of PSUs for a given period based on their role within the Company and level of performance. PSUs are also issued pursuant to the RSU Plan. At the end of the three-year vesting period, the PSUs vest if the plan participant is employed by the Company and certain non-market performance criteria are met. Vested PSUs are expected to be paid in cash or Common Shares purchased on the open market, or a combination of both, as the Company chooses. The PSUs are re-measured to fair value each reporting period. The value of one PSU is equal to the value of one Common Share.

In 2016, the Company granted 256 PSUs to certain executives (2015 – 153).

In 2016, 5 PSUs vested and the Company paid cash of \$25 (2015 – nil).

For the year ended December 31, 2016 and December 31, 2015, the Company recorded stock-based compensation expense of \$35 and \$211, respectively, related to the PSUs outstanding. As at December 31, 2016, a liability of \$318 (2015 - \$309) related to the PSUs granted is included in the other long-term liabilities (Note 11).

The following table is a summary of the number of outstanding PSUs as at:

	<u>December 31</u> <u>2016</u>	<u>December 31</u> <u>2015</u>
Opening Balance, January 1	252	119
Granted	256	153
Exercised/ Vested	(5)	-
Forfeited/ Expired	(308)	(20)
Ending Balance, December 31	<u>195</u>	<u>252</u>

(d) Stock-Based Compensation Summary

The following table is a summary of the stock-based compensation expense.

	<u>Year ended</u> <u>December 31</u> <u>2016</u>	<u>Year ended</u> <u>December 31</u> <u>2015</u>
Restricted share units	\$ 266	\$ 244
Performance-based share units	35	211
Stock options	212	446
Directors' fees paid in shares	353	371
	<u>\$ 866</u>	<u>\$ 1,272</u>

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16. Loss Per Share

The following table sets forth the calculation of basic and diluted loss per share.

	Year ended December 31 2016	Year ended December 31 2015
Numerator for basic and diluted loss per share:		
Net loss for the year	\$ (4,314)	\$ (2,810)
Denominator for basic and diluted loss per share:		
Basic weighted average number of shares outstanding	14,177	13,069
Effect of stock options, RSUs and PSUs	-	-
Diluted weighted average number of shares outstanding	14,177	13,069
Loss per share:		
Basic	\$ (0.30)	\$ (0.22)
Diluted	\$ (0.30)	\$ (0.22)

For the year ended December 31, 2016, the impact of all options, RSUs and PSUs totaling 1,223 (2015 – 1,086) were excluded in the calculation of diluted loss per share because they were antidilutive.

The comparative basic and diluted weighted average number of shares outstanding for the year ended December 31, 2015 have been corrected to 13,069 shares outstanding, due to an immaterial arithmetic error in the prior year financial statements. As a result, the basic and diluted earnings per share was adjusted from (\$0.23) to (\$0.22).

17. Revenue

The Company's revenue is comprised of the following:

	Year ended December 31 2016	Year ended December 31 2015
Cloud and Colocation Revenue	\$ 18,296	\$ 13,166
Connectivity Revenue	40,790	44,554
	\$ 59,086	\$ 57,720

18. Key Management Personnel Compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, including the directors of the Company.

Key management personnel compensation, including directors, is as follows:

	Year ended December 31 2016	Year ended December 31 2015
Salaries, fees and benefits	\$ 1,759	\$ 2,091
Termination expense	2,860	219
Share-based compensation expense	866	1,258
	\$ 5,485	\$ 3,568

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19. Commitments

The Company is committed to leases for premises, office equipment, network real estate access, automobiles, telecommunication facilities and radio spectrum licenses. Annual minimum payments over the next five years and thereafter are as follows:

	<u>Amount</u>
2017	\$ 11,297
2018	8,938
2019	7,281
2020	4,261
2021	3,541
Thereafter	<u>2,321</u>
	<u>\$ 37,639</u>

For the year ended December 31, 2016, the Company recorded rent expense of \$7,494 (2015 - \$7,032) relating to premises and network real estate access leases.

It is common practice for the Company to re-negotiate network real estate access lease or license arrangements as they become due for renewal. Included in the amounts above are estimates for the renewal of leases or licenses that are currently due for renewal or are due for renewal in 2017.

The Company is required to pay, under a CRTC-administered regime, a percentage (2016 - 0.53%, 2015 – 0.56%) of its adjusted Canadian telecommunications service revenue (as defined by CRTC and excluding retail Internet revenue) into a fund administered by CRTC.

20. Fair value of financial instruments

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies. Where quoted market values are not readily available, the Company may use considerable judgment to develop estimates of fair value. Accordingly, any estimated values are not necessarily indicative of the amounts the Company could realize in a current market exchange and could be materially affected by the use of different assumptions or methodologies. The Company classifies its fair value measurements within a fair value hierarchy, which reflects the significance of the inputs used in making the measurements as defined in IFRS 7 – Financial Instruments – Disclosures.

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 - Inputs other than quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly; and

Level 3 - Unobservable inputs for the asset or liability which are supported by little or no market activity

The fair values of cash and cash equivalents, short-term investments and restricted cash, which are primarily money market and fixed income securities, are based on quoted market values. The fair values of short-term financial assets and liabilities, including accounts receivable, accounts payable and accrued liabilities, as presented in the consolidated statements of financial position, approximate their carrying amounts due to their short-term maturities. The fair value of long-term debt approximates its carrying value because management believes the interest rates approximate the market interest rate for similar debt with similar security. The fair value of our interest rate swap contract is based on broker quotes and therefore, these contracts are measured using Level 2 inputs. Similar contracts are traded in an active market and the quotes reflect the actual transactions in similar instruments.

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The Company has classified its financial instruments as follows:

	December 31 2016		December 31 2015	
	Carrying amount	Fair Value	Carrying amount	Fair Value
Financial assets:				
Loans and receivables, measured at amortized cost				
Cash and cash equivalents	\$ 13,034	\$ 13,034	\$ 13,066	\$ 13,066
Accounts receivable	3,673	3,673	3,306	3,306
Restricted cash	-	-	172	172
Financial liabilities:				
Accounts payable and accrued liabilities, measured at amortized cost	\$ 11,027	\$ 11,027	\$ 9,128	\$ 9,128
Fair value of interest rate swap contract	261	261	612	612
Long-term debt, measured at amortized cost	40,778	40,778	45,781	45,781

Credit risk

The Company's cash and cash equivalents and restricted cash subject the Company to credit risk. The Company maintains cash and investment balances at Tier 1 Canadian financial institutions. The Company's maximum exposure to credit risk is limited to the amount of cash and cash equivalents.

Credit risk related to our interest rate swap contract arises from the possibility that the counter party to the agreement may default on their obligation. The Company assesses the creditworthiness of the counterparty to minimize the risk of counterparty default. The interest rate swap is held by National Bank Financial.

The Company, in the normal course of business, is exposed to credit risk from its customers and the accounts receivable are subject to normal industry risks. The Company attempts to manage these risks by dealing with credit worthy customers. If available, the Company reviews credit bureau ratings, bank accounts and industry references for all new customers. Customers that do not have this information available are typically placed on a pre-authorized payment plan for service or provide deposits to the Company. This risk is minimized as the Company has a diverse customer base located across various provinces in Canada.

As at December 31, 2016 and 2015, the Company had no material past due trade accounts receivable. The following table provides the aging of the trade accounts receivable:

	December 31 2016		December 31 2015	
	\$		\$	
Current	2,597		2,302	
31 to 60 days	650		769	
61 to 90 days	116		77	
over 90 days	168		-	
	\$ 3,531		\$ 3,148	

Interest rate risk

The Company is subject to interest rate risk on its cash and cash equivalents and long-term debt. The Company is exposed to interest rate risk on its operating line of credit since the interest rates applicable are variable and is, therefore, exposed to cash flow risks resulting from interest rate fluctuations. As at December 31, 2016, the operating line of credit balance was \$nil. The drawn term facility as at December 31, 2016 was \$41,250, \$41,100 of which was held in a Bankers Acceptance. In 2015, the Company entered into amended interest rate swap contracts that matures June 29, 2018. The interest rate on the Banker's Acceptance at December 31, 2016 was 3.99%. The remaining \$150 drawn under this facility bears interest for the period at prime rate plus a margin.

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Liquidity risk

The Company believes that its current cash and cash equivalents and anticipated cash from operations will be sufficient to meet its working capital and capital expenditure requirements for the foreseeable future. As at December 31, 2016, the Company had cash and cash equivalents of \$13,034. The Company has access to the \$34,345 undrawn portion of its \$85,000 credit facilities after consideration of outstanding letters of credit.

The Company's financial liabilities that have contractual maturities are summarized below:

	<u>Less than 1 year</u>	<u>2 - 3 years</u>	<u>Total</u>
Long-term debt	\$ 5,170	\$ 35,608	\$ 40,778
Accounts payable	3,025	-	3,025
Fair value of interest rate swap contract	-	261	261
Stock-based compensation ⁽¹⁾	723	302	1,025
Total	\$ 8,918	\$ 36,171	\$ 45,089

⁽¹⁾ Represents recognized amounts for cash-settled stock-based compensation arrangements (See Note 15). Settlement is subject to achievement of vesting criteria.

Currency risk

The Company has suppliers that are not based in Canada which gives rise to a risk that earnings and cash flows may be adversely affected by fluctuations in foreign currency exchange rates. The Company is primarily exposed to the fluctuations in the dollar. The Company believes this risk is minimal and does not use financial instruments to hedge these risks. A one cent appreciation in the U.S. dollar to Canadian dollar foreign exchange rate would have resulted in a decrease (increase) in income of \$6. Balances denominated in foreign currencies that are considered financial instruments are as follows:

	<u>Currency</u>	<u>December 31 2016</u>	<u>December 31 2015</u>
Cash and cash equivalents	USD	\$ 275	\$ 138
Accounts payable and accrued liabilities	USD	744	595

21. Capital Risk Management

The Company's objectives when managing capital are:

- (a) to ensure that the Company will continue as a going concern so that it can continue to provide services to its customers and offer a return on investment to its shareholders;
- (b) to maintain a capital structure which optimizes the cost of capital while providing flexibility and diversity of funding sources and timing of debt maturities along with adequate anticipated liquidity for future growth; and
- (c) to comply with debt covenants

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The Company defines capital that it manages as the aggregate of its cash and cash equivalents, short-term investments, debt facilities including finance leases and equity comprising of share capital, contributed surplus and deficit.

	<u>December 31</u> <u>2016</u>	<u>December 31</u> <u>2015</u>
Cash and cash equivalents	\$ (13,034)	\$ (13,066)
Long term debt	40,778	45,781
Share capital	86,171	85,636
Contributed surplus	25,620	25,408
Deficit	<u>(63,143)</u>	<u>(58,829)</u>
	<u>\$ 76,392</u>	<u>\$ 84,930</u>

The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its Board of Directors, will make changes to its capital structure as deemed appropriate under the specific circumstances.

The Company's overall strategy with respect to management of capital remains unchanged from the year ended December 31, 2016.

22. Related Party Transactions

Two former Directors of the Company, who retired effective June 23, 2016, also served as Chairman of the Board and a Director of a customer of the Company. Revenue from this customer for the year ended December 31, 2016 and 2015 was \$40 and \$79, respectively. Accounts receivable from this customer as at December 31, 2016 and 2015 was nil and \$3, respectively.

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