TERAGO INC.
Condensed Consolidated Financial Statements
Three months ended March 31, 2017 and 2016
(unaudited)

Contents

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

	Note		March 31 2017		December 31 2016
Assets					
Cash and cash equivalents	4(a)	$	9,171	$	13,034
Accounts receivable	4(b)		3,228		3,673
Prepaid expenses and other assets			2,697		3,150
Total current assets			15,096		19,857
Network assets, property and equipment	5		42,919		44,161
Intangible assets	6		18,606		19,400
Goodwill	6		19,419		19,419
Total non-current assets			80,944		82,980
Total Assets		$	96,040	$	102,837
Liabilities					
Accounts payable and accrued liabilities		$	7,350	$	11,027
Current portion of deferred revenue			343		287
Current portion of long-term debt	7		5,123		5,170
Current portion of other long-term liabilities	8		130		774
Total current liabilities			12,946		17,258
Decommissioning and restoration obligations			212		207
Deferred revenue			194		323
Long-term debt	7		34,417		35,608
Other long-term liabilities	8		560		793
Total non-current liabilities			35,383		36,931
Total Liabilities			48,329		54,189
Shareholders' Equity					
Share capital			86,266		86,171
Contributed surplus			25,643		25,620
Deficit			(64,198)		(63,143)
Total Shareholders' Equity		$	47,711	$	48,648
Total Liabilities and Shareholders' Equity		$	96,040	$	102,837

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.
Condensed Consolidated Statements of Comprehensive Loss
(In thousands, except per share amounts)
(unaudited)

	Note	Three months ended March 31 2017	Three months ended March 31 2016
Revenue		$ 14,277	$ 14,929
Expenses			
Cost of services		3,483	3,469
Salaries and related costs		5,321	5,095
Other operating expenses		2,393	2,686
Depreciation of network assets, property and equipment	5	2,875	2,988
Amortization of intangible assets	6	786	999
		14,858	15,237
Loss from operations		(581)	(308)
Foreign exchange gain (loss)		(7)	32
Finance costs		(471)	(550)
Finance income		4	6
Loss before income taxes		$ (1,055)	$ (820)
Income taxes			
Income tax recovery (expense)		-	-
Net loss and comprehensive loss		$ (1,055)	$ (820)
Deficit, beginning of period		$ (63,143)	$ (58,829)
Deficit, end of period		$ (64,198)	$ (59,649)
Basic loss per share	10	$ (0.07)	$ (0.06)
Diluted loss per share	10	$ (0.07)	$ (0.06)
Basic weighted average number of shares outstanding		14,258	14,135
Diluted weighted average number of shares outstanding		14,258	14,135

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

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

	Note	Three months ended March 31 2017	Three months ended March 31 2016
Operating Activities			
Net loss for the period		$ (1,055)	$ (820)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Severance, acquisition, and other costs		771	351
Depreciation of network assets, property and equipment	5	2,875	2,988
Amortization of intangible assets	6	786	999
Stock-based compensation expense (recovery)	9	(147)	287
Finance costs		471	550
Finance income		(4)	(6)
Loss on adjustments and disposal of network assets and intangible assets	5, 6	60	156
Severance, acquisition, and other costs paid		(847)	(519)
Stock-based compensation paid		(587)	(26)
Changes in non-cash working capital items:			
Accounts receivable		445	(372)
Prepaid expenses		453	(44)
Accounts payable and accrued liabilities		(4,713)	(1,877)
Deferred revenue		(73)	117
Cash from (used in) Operating Activities		(1,565)	1,784
Investing Activities			
Purchase of network assets, property and equipment	5	(1,685)	(1,661)
Purchase of intangible assets	6	-	(114)
Change in non-cash working capital related to network assets, property and equipment and intangible assets		1,109	(795)
Cash used in Investing Activities		(576)	(2,570)
Financing Activities			
Proceeds from exercise of stock options		31	20
Interest paid, net of received		(456)	(481)
Repayment of long-term debt	7	(1,297)	(1,334)
Cash used in Financing Activities		(1,722)	(1,795)
Net change in cash and cash equivalents, during the period		(3,863)	(2,581)
Cash and cash equivalents, beginning of period		13,034	13,066
Cash and cash equivalents, end of period		$ 9,171	$ 10,485

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

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

	Share Capital				Contributed				
	Number		Amount		Surplus		Deficit		Total
Balance, January 1, 2017	14,250	$	86,171	$	25,620	$	(63,143)	$	48,648
Issuance of shares upon exercise of options	8		31		-		-		31
Stock-based compensation	-		-		23		-		23
Issuance of shares for directors' fees	18		64		-		-		64
Net loss and comprehensive loss	-		-		-		(1,055)		(1,055)
Balance, March 31, 2017	14,276	$	86,266	$	25,643	$	(64,198)	$	47,711

	Share Capital				Contributed				
	Number		Amount		Surplus		Deficit		Total
Balance, January 1, 2016	14,133	$	85,636	$	25,408	$	(58,829)	$	52,215
Issuance of shares upon exercise of options	5		20		-		-		20
Stock-based compensation	-		-		63		-		63
Issuance of shares for directors' fees	17		82		-		-		82
Net loss and comprehensive loss	-		-		-		(820)		(820)
Balance, March 31, 2016	14,155		85,738		25,471		(59,649)		51,560

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

1. Reporting Entity

TeraGo Inc. (the "Company") provides businesses across Canada and globally with network and voice services, data centre 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 data centre facilities in Canada targeting enterprise customers that require broadband internet, data connectivity, voice, cloud and data centre 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

These unaudited condensed interim consolidated financial statements ("interim financial statements") were prepared using the same accounting policies and methods as those used in the Company's consolidated financial statements for the year ended December 31, 2016 (the "2016 Consolidated Financial Statements"). These interim financial statements are in compliance with International Accounting Standard 34, Interim Financial Reporting ("IAS 34"). Accordingly, certain information and footnote disclosure normally included in annual financial statements prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"), have been omitted or condensed.

The preparation of financial statements in accordance with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements have been set out in Note 2 of the Company's 2016 Consolidated Financial Statements. These interim financial statements should be read in conjunction with the Company's 2016 Consolidated Financial Statements.

The Company's operating results are subject to seasonal fluctuations that may materially impact quarter-to-quarter operating results and, thus, one quarter's operating results are not necessarily indicative of a subsequent quarter's operating results.

The policies applied in these interim financial statements are based on IFRS issued and outstanding as at March 31, 2017. The Board of Directors authorized the interim financial statements for issue on May 11, 2017.

These interim financial statements include the accounts of TeraGo Inc. and its wholly-owned subsidiary, TeraGo Networks Inc. (collectively the "Company"). Effective January 1, 2017, the Company's wholly-owned subsidiaries, TeraGo Networks Inc., RackForce Networks Inc., RackForce Cloud Video Inc. and Codeninja Ltd. completed a vertical short-form amalgamation.

The notes presented in these interim financial statements include only significant changes and transactions that have occurred since the last fiscal year end.

(b) Functional and Presentation Currency

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

3. Upcoming Accounting Pronouncements Not Yet Adopted

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 has a team focused on the adoption and compliance with IFRS 15. This team is responsible for determining existing policies, differences between existing policies and IFRS 15, ensuring the Company's data collection is appropriate, and communicating the upcoming changes with various stakeholders. In addition, this team is assisting with the development of processes and policies that will help ensure an effective transition and the related impacts are reliably assessed. As a result, the Company is continuing to assess the impact of this standard on its consolidated financial statements.

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.

4. 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.

(In thousands, except for per share amounts)

(b) Accounts receivable

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

	March 31 2017	December 31 2016
Trade receivables	$ 2,997	$ 3,531
Allowance for doubtful accounts	(58)	(124)
Other	289	266
	$ 3,228	$ 3,673

5. Network Assets, Property and Equipment

Cost	Network assets	Cloud & Datacentre infrastructure	Computer equipment	Office furniture and equipment	Leasehold improvements	Vehicles	Total
Balance, January 1, 2017	$ 118,609	$ 14,386	$ 2,660	$ 2,332	$ 1,648	$ 49	$ 139,684
Additions / reclassifications	1,563	49	28	20	25	-	1,685
Disposals / Adjustments	(448)	(2)	-	-	-	-	(450)
Balance, March 31, 2017	**$** 119,724	**$** 14,433	**$** 2,688	**$** 2,352	**$** 1,673	**$** 49	**$** 140,919
Accumulated Depreciation							
Balance, January 1, 2017	$ 87,527	$ 2,479	$ 2,245	$ 2,172	$ 1,051	$ 49	$ 95,523
Depreciation for the period	2,354	454	5	12	50	-	2,875
Disposals / Adjustments	(398)	-	-	-	-	-	(398)
Balance, March 31, 2017	**$** 89,483	**$** 2,933	**$** 2,250	**$** 2,184	**$** 1,101	**$** 49	**$** 98,000
Net Book Value, March 31, 2017	**$** 30,241	**$** 11,500	**$** 438	**$** 168	**$** 572	**$** -	**$** 42,919

6. Intangible Assets and Goodwill

Cost	Radio spectrum licenses	Computer Software	Customer relationships	Other	Total Intangibles	Goodwill	Total Intangibles and Goodwill
Balance, January 1, 2017	$ 7,041	$ 9,056	$ 18,241	$ 4,880	$ 39,218	$ 19,419	$ 58,637
Additions	-	-	-	-	-	-	-
Disposals / Adjustments	-	(7)	4	(5)	(8)	-	(8)
Balance, March 31, 2017	**$** 7,041	**$** 9,049	**$** 18,245	**$** 4,875	**$** 39,210	**$** 19,419	**$** 58,629
Accumulated Depreciation							
Balance, January 1, 2017	$ 2,371	$ 7,999	$ 7,481	$ 1,967	$ 19,818	$ -	$ 19,818
Amortization for the period	-	170	466	150	786	-	786
Balance March 31, 2017	**$** 2,371	**$** 8,169	**$** 7,947	**$** 2,117	**$** 20,604	**$** -	**$** 20,604
Net Book Value, March 31, 2017	**$** 4,670	**$** 880	**$** 10,298	**$** 2,758	**$** 18,606	**$** 19,419	**$** 38,025

(In thousands, except for per share amounts)

7. Long-term Debt

		March 31 2017		December 31 2016
Term debt facility (a)	$	39,658	$	40,897
Equipment loans (b)		123		170
less: financing fees		(241)		(289)
		39,540		40,778
less: current portion		(5,123)		(5,170)
	$	34,417	$	35,608

(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 March 31, 2017, $nil amount is outstanding. Letters of credit outstanding under the facility totaled $655 as of March 31, 2017.

- $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 March 31, 2017, $39,900 of the term facility principal balance outstanding was in a Banker's Acceptance and the remaining $100 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 March 31, 2017 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 March 31, 2017 was a liability of $219 (December 31, 2016 – $261) and is recorded in other long-term liabilities (Note 8), with a corresponding charge (recovery) for the change in fair value recorded in finance costs.

  As at March 31, 2017, the Company prepaid interest in the amount of $342 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 March 31, 2017, 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 March 31, 2017. 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.

(In thousands, except for per share amounts)

8. Other Long-Term Liabilities

		March 31 2017		December 31 2016
Performance based share units (Note 9 (c))	$	166	$	318
Restricted share units (Note 9 (b))		37		707
Fair value of interest rate swap contract (Note 7 (a))		219		261
Lease inducement liability		268		281
		690		1,567
less: current portion		(130)		(774)
	$	560	$	793

9. Stock-Based Compensation

(a) Stock Options

For the three month months ended March 31, 2017 and March 31, 2016, the Company recorded stock-based compensation related to stock options of $23 and $63, respectively.

A summary of the status of the Company's stock option plan as at March 31, 2017 is presented below.

	2017	
	Number of Options	Weighted Average Exercise Price
Outstanding - January 1, 2017	672	$5.99
Granted	-	-
Exercised	(8)	$4.00
Forfeited / Expired	(6)	$4.00
Outstanding – March 31, 2017	658	$6.03
Exercisable	623	$6.07

(b) Restricted Share Units (RSUs)

For the three months ended March 31, 2017 and March 31, 2016, the Company recorded compensation expense (recovery) of ($82) and $61, respectively, related to the RSUs granted and paid $587 and $nil, respectively, to the holders of RSUs that vested in the period. As of March 31, 2017, a liability of $37 (December 31, 2016 - $707) related to the RSUs outstanding is included in other long-term liabilities (Note 8).

	Number of RSUs
Opening Balance, January 1, 2017	162
Granted	130
Vested and paid	(150)
Ending Balance, March 31, 2017	142

(c) Performance Based Share Units (PSUs)

For the three months ended March 31, 2017 and March 31, 2016, the Company granted $nil and 237 PSUs, respectively, to certain key executives.

For the three months ended March 31, 2017 and March 31, 2016, the Company recorded stock-based compensation expense (recovery) of ($152) and $81, respectively, related to the PSUs outstanding. As at March 31, 2017, a liability of $166 (December 31, 2016 - $318) related to the PSUs outstanding is included in the other long-term liabilities (Note 8).

(In thousands, except for per share amounts)

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

	Number of PSUs
Opening Balance, January 1, 2017	195
Granted	-
Exercised	-
Forfeited/ Expired	(103)
Ending Balance, March 31, 2017	92

(d) Stock-Based Compensation Summary

The following table is a summary of the stock-based compensation expense (recovery):

	Three months ended March 31 2017	Three months ended March 31 2016
Restricted share units	$ (82)	$ 61
Performance-based share units	(152)	81
Stock options	23	63
Directors' fees paid in shares	64	82
	$ (147)	$ 287

10. Loss Per Share

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

	Three months ended March 31 2017	Three months ended March 31 2016
Numerator for basic and diluted loss per share:		
Net loss for the period	$ (1,055)	$ (820)
Denominator for basic and diluted loss per share:		
Basic weighted average number of shares outstanding	14,258	14,135
Effect of stock options, RSUs and PSUs	-	-
Diluted weighted average number of shares outstanding	14,258	14,135
Loss per share:		
Basic	$ (0.07)	$ (0.06)
Diluted	$ (0.07)	$ (0.06)

Due to the loss for the three months ended March 31, 2017, the impact of all options, RSUs and PSUs totaling 658 (March 31, 2016 – 1,311), were excluded in the calculation of diluted loss per share because they were antidilutive.

(In thousands, except for per share amounts)

11. Fair value of financial instruments

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies. These methodologies are described in Note 20 of the 2016 Consolidated Financial Statements.

The Company has classified its financial instruments as follows:

	March 31 2017		December 31 2016	
	Carrying amount	Fair Value	Carrying amount	Fair Value
Financial assets:				
Loans and receivables, measured at amortized cost				
Cash and cash equivalents	$ 9,171	$ 9,171	$ 13,034	$ 13,034
Accounts receivable	3,228	3,228	3,673	3,673
Financial liabilities:				
Accounts payable and accrued liabilities, measured at amortized cost	$ 7,350	$ 7,350	$ 11,027	$ 11,027
Fair value of interest rate swap contract	219	219	261	261
Long-term debt, measured at amortized cost	39,540	39,540	40,778	40,778

12. 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 three months ended March 31, 2017 and 2016 was $nil and $20, respectively. Accounts receivable from this customer as at March 31, 2017 and 2016 was $nil and $6, respectively.

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