TERAGO INC.
Condensed Consolidated Financial Statements
Three months ended March 31, 2016 and 2015
(unaudited)

Contents

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

		March 31 2016		December 31 2015
Assets				
Cash and cash equivalents (Note 4(a))	$	10,485	$	13,066
Accounts receivable (Note 4(b))		3,678		3,306
Prepaid expenses and other assets		3,395		3,351
Total current assets		17,558		19,723
Network assets, property and equipment (Note 5)		47,037		48,520
Intangible assets (Note 6)		20,939		21,824
Goodwill (Note 6)		19,063		19,063
Deferred income taxes		700		700
Restricted cash (Note 7)		172		172
Total non-current assets		87,911		90,279
Total Assets	$	105,469	$	110,002
Liabilities				
Accounts payable and accrued liabilities	$	6,385	$	9,128
Current portion of deferred revenue		274		211
Current portion of long-term debt (Note 8)		5,230		6,123
Current portion of other long-term liabilities (Note 9)		185		186
Total current liabilities		12,074		15,648
Decommissioning and restoration obligations		236		234
Deferred revenue		324		270
Long-term debt (Note 8)		39,280		39,658
Other long-term liabilities (Note 9)		1,995		1,977
Total non-current liabilities		41,835		42,139
Total Liabilities		53,909		57,787
Shareholders' Equity				
Share capital		85,738		85,636
Contributed surplus		25,471		25,408
Deficit		(59,649)		(58,829)
Total shareholders' equity		51,560		52,215
Total Liabilities and Shareholders' Equity	$	105,469	$	110,002

On behalf of the Board:

(signed) “Charles Allen”
Director

(signed) “Grant Ballantyne”
Director

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

		Three months ended March 31 2016		Three months ended March 31 2015
Revenue	$	14,929	$	12,236
Expenses				
Cost of services		3,469		2,581
Salaries and related costs		5,095		4,729
Other operating expenses		2,686		2,085
Depreciation of network assets, property and equipment (Note 5)		2,988		2,673
Amortization of intangible assets (Note 6)		999		664
		15,237		12,732
Loss from operations		(308)		(496)
Foreign exchange gain (loss)		32		(113)
Finance costs		(550)		(450)
Finance income		6		4
Loss before income taxes	$	(820)	$	(1,055)
Income taxes				
Income tax recovery		-		1,039
Net loss and comprehensive loss	$	(820)	$	(16)
Deficit, beginning of period	$	(58,829)	$	(56,019)
Deficit, end of period	$	(59,649)	$	(56,035)
Basic loss per share (Note 11)	$	(0.06)	$	(0.00)
Diluted loss per share (Note 11)	$	(0.06)	$	(0.00)
Basic weighted average number of shares outstanding		14,135		11,734
Diluted weighted average number of shares outstanding		14,135		11,734

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

	Three months ended March 31 2016	Three months ended March 31 2015
Operating Activities		
Net loss for the period	$ (820)	$ (16)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation of network assets, property and equipment (Note 5)	2,988	2,673
Amortization of intangible assets (Note 6)	999	664
Stock-based compensation expense (Note 10(d))	287	338
Finance costs	550	450
Finance income	(6)	(4)
Income tax recovery	-	(1,039)
Loss (gain) on adjustments and disposal of network assets (Note 5)	156	(16)
Changes in non-cash working capital items:		
Accounts receivable	(372)	26
Prepaid expenses	(44)	101
Accounts payable and accrued liabilities	(2,071)	(935)
Deferred revenue	117	(51)
Cash from Operating Activities	1,784	2,191
Investing Activities		
Acquisition of RackForce Networks Inc. – net of cash acquired	-	(30,942)
Purchase of network assets, property and equipment (Note 5)	(1,661)	(2,068)
Purchase of intangible assets (Note 6)	(114)	(272)
Change in non-cash working capital related to network assets, property and equipment and intangible assets	(795)	(148)
Cash used in Investing Activities	(2,570)	(33,430)
Financing Activities		
Proceeds from exercise of stock options	20	112
Interest paid	(481)	(212)
Interest received	-	4
Proceeds from long term debt (Note 8)	-	31,500
Repayment of long-term debt (Note 8)	(1,334)	(73)
Financing costs incurred (Note 8)	-	(379)
Cash from (used in) Financing Activities	(1,795)	30,952
Net change in cash and cash equivalents, during the period	(2,581)	(287)
Cash and cash equivalents, beginning of period	13,066	2,866
Cash and cash equivalents, end of period	$ 10,485	$ 2,579
Supplemental cash flow disclosure		
Issuance of common shares in acquisition of Rackforce Networks Inc.	$ -	$ 2,351

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

	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

	Share Capital		Contributed		
	Number	Amount	Surplus	Deficit	Total
Balance, January 1, 2015	11,698	$ 72,470	$ 24,962	$ (56,019)	$ 41,413
Issuance of shares upon exercise of options	36	142	-	-	142
Stock-based compensation	-	-	140	-	140
Issuance of shares for directors' fees	14	108	-	-	108
Issuance of shares for RackForce acquisition	329	2,351	-	-	2,351
Net loss and comprehensive loss	-	-	-	(16)	(16)
Balance, March 31, 2015	12,077	$ 75,071	$ 25,102	$ (56,035)	$ 44,138

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 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, 2015 (the “2015 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 2015 Consolidated Financial Statements. These interim financial statements should be read in conjunction with the Company’s 2015 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, 2016. The Board of Directors authorized the interim financial statements for issue on May 12, 2016.

These interim financial statements include the accounts of TeraGo Inc. and its wholly-owned subsidiaries, TeraGo Networks Inc., RackForce Networks Inc. and Codeninja Ltd. (collectively the “Company”). 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. Significant Accounting Policies and Upcoming Accounting Pronouncements Not Yet Adopted

(a) Significant Accounting Policies

These interim financial statements were prepared using the same accounting policies and methods as those used in the 2015 Consolidated Financial Statements. The Company adopted the following new accounting standards and amendments effective January 1, 2016. These standards or amendments did not have a material impact on the interim financial statements.

i) Clarification of Acceptable Methods of Depreciation and Amortization (Amendments to IAS 16 and IAS 38)

ii) Amendments to IAS 1 Presentation of Financial Statements

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

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

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.

(b) Accounts receivable

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

(In thousands, except for per share amounts)

	March 31 2016	December 31 2015
Trade receivables	$ 3,497	$ 3,148
Allowance for doubtful accounts	(19)	(54)
Other	200	212
	$ 3,678	$ 3,306

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, 2016	$ 114,869	$ 13,752	$ 2,173	$ 2,211	$ 1,602	$ 49	$ 134,656
Additions / reclassifications	1,193	307	144	-	25	-	1,669
Disposals / Adjustments	(1,149)	(5)	-	-	-	-	(1,154)
Balance, March 31, 2016	**$** 114,913	**$** 14,054	**$** 2,317	**$** 2,211	**$** 1,627	**$** 49	**$** 135,171
Accumulated Depreciation							
Balance, January 1, 2016	$ 80,080	$ 888	$ 2,133	$ 2,132	$ 854	$ 49	$ 86,136
Depreciation for the period	2,532	382	16	7	51	-	2,988
Disposals / Adjustments	(990)	-	-	-	-	-	(990)
Balance, March 31, 2016	**$** 81,622	**$** 1,270	**$** 2,149	**$** 2,139	**$** 905	**$** 49	**$** 88,134
Net Book Value, March 31, 2016	**$** 33,291	**$** 12,784	**$** 168	**$** 72	**$** 722	**$** -	**$** 47,037

6. Intangibles 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	-	114	-	-	114	-	114
Balance, March 31, 2016	**$** 7,041	**$** 8,674	**$** 17,677	**$** 4,835	**$** 38,227	**$** 19,063	**$** 57,290
Accumulated Depreciation							
Balance, January 1, 2016	$ 2,371	$ 7,178	$ 5,385	$ 1,355	$ 16,289	$ -	$ 16,289
Amortization for the period	-	236	605	158	999	-	999
Balance March 31, 2016	**$** 2,371	**$** 7,414	**$** 5,990	**$** 1,513	**$** 17,288	**$ -**	**$** 17,288
Net Book Value, March 31, 2016	**$** 4,670	**$** 1,260	**$** 11,687	**$** 3,322	**$** 20,939	**$** 19,063	**$** 40,002

7. Restricted Cash

Funds held in escrow

As at March 31, 2016, $172 is held in escrow by the Company pending finalization of working capital adjustments in the acquisition of BoxFabric.

(In thousands, except for per share amounts)

8. Long-term Debt

		March 31 2016		December 31 2015
Term debt facility (a)	$	44,592	$	45,833
Equipment loans (b)		353		431
less: financing fees		(435)		(483)
		44,510		45,781
less: current portion		(5,230)		(6,123)
	$	39,280	$	39,658

(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, 2016, $nil amount is outstanding. Letters of credit outstanding under the facility totaled $655 as of March 31, 2016.

- $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, 2016, $44,800 of the term facility principal was in a Banker's Acceptance and the remaining $200 is at a floating rate. The Company has interest rate swap contracts on the Banker's Acceptance that mature June 29, 2018 that fix the interest rate at an average rate of 4.24%. The interest rate swap contract has not been designated as a hedge and will be marked-to-market each quarter. The fair value of the interest rate swap contract at March 31, 2016 was a liability of $548 (December 31, 2015 – ($612)) and is recorded in other long-term liabilities (Note 9), with a corresponding charge for the change in fair value recorded in finance costs.

  As at March 31, 2016, the Company prepaid interest in the amount of $408 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, 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 March 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 5.91% to 6.23% over the respective terms, have maturity dates between July 2016 and December 2017 and have total monthly installments of $28.

(In thousands, except for per share amounts)

9. Other Long-Term Liabilities

		March 31 2016		December 31 2015
Performance based share units (Note 10 (c))	$	363	$	309
Restricted share units (Note 10 (b))		502		441
Fair value of interest rate swap contract (Note 8 (a))		548		612
Lease inducement liability		318		331
Assumed liabilities - Vancouver Data Centre		449		470
		2,180		2,163
less: current portion		(185)		(186)
	$	1,995	$	1,977

10. Stock-Based Compensation

(a) Stock Options

For the three months ended March 31, 2016 and March 31, 2015, the Company recorded stock-based compensation related to stock options of $63 and $140, respectively.

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

	2016	
	Number of Options	**Weighted Average Exercise Price**
Outstanding - January 1, 2016	684	$5.94
Granted	-	-
Exercised	(5)	$4.00
Forfeited / Expired	(2)	$7.72
Outstanding – March 31, 2016	677	$5.89
Exercisable	505	$5.94

(b) Restricted Share Units (RSUs)

For the three months ended March 31, 2016 and March 31, 2015, the Company recorded compensation expense of $61 and $60, respectively, related to the RSUs granted. As of March 31, 2016, a liability of $502 (December 31, 2015 - $441) related to the RSUs granted is included in other long-term liabilities (Note 9).

	Number of RSUs
Opening Balance, January 1, 2016	150
Granted	-
Vested	-
Ending Balance, March 31, 2016	150

(c) Performance Based Share Units (PSUs)

For the three months ended March 31, 2016, the Company granted 237 PSUs (2015 – 101) to certain key executives.

For the three months ended March 31, 2016 and March 31, 2015, the Company recorded stock-based compensation expense of $81 and $30, respectively, related to the PSUs outstanding. As at March 31, 2016, a liability of $363 (December 31, 2015 - $309) related to the PSUs granted is included in the other long-term liabilities (Note 9).

(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, 2016	252
Granted	237
Exercised	(5)
Forfeited/ Expired	-
Ending Balance, March 31, 2016	484

(d) Stock-Based Compensation Summary

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

		Three months ended March 31 2016		Three months ended March 31 2015
Restricted share units	$	61	$	60
Performance-based share units		81		30
Stock options		63		140
Directors' fees paid in shares		82		108
	$	287	$	338

11. Loss Per Share

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

		Three months ended March 31 2016		Three months ended March 31 2015
Numerator for basic and diluted loss per share:				
Net loss for the period	$	(820)	$	(16)
Denominator for basic and diluted loss per share:				
Basic weighted average number of shares outstanding		14,135		11,734
Effect of stock options, RSUs and PSUs		-		-
Diluted weighted average number of shares outstanding		14,135		11,734
Loss per share:				
Basic	$	(0.06)	$	(0.00)
Diluted	$	(0.06)	$	(0.00)

Due to the loss for the three months ended March 31, 2016, the impact of all options, RSUs and PSUs totaling 1,311 (March 31, 2015 – 1,614), were excluded from the calculation of diluted earnings per share because they were antidilutive.

(In thousands, except for per share amounts)

12. 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 21 of the 2015 Consolidated Financial Statements.

The Company has classified its financial instruments as follows:

	March 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	$ 10,485	$ 10,485	$ 13,066	$ 13,066
Accounts receivable	3,678	3,678	3,306	3,306
Restricted cash	172	172	172	172
Financial liabilities:				
Accounts payable and accrued liabilities, measured at amortized cost	$ 6,385	$ 6,385	$ 9,128	$ 9,128
Fair value of interest rate swap contract	548	548	612	612
Long-term debt, measured at amortized cost	44,510	44,510	45,781	45,781

13. Related Party Transactions

Two Directors of the Company also serve 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, 2016 and 2015 was $20 and $17, respectively. Accounts receivable from this customer as at March 31, 2016 and 2015 was $6 and $5, respectively.

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