

TERAGO INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL RESULTS FOR THE THREE MONTHS ENDED MARCH 31, 2019 AND 2018

The following Management's Discussion and Analysis ("MD&A") is intended to help the reader understand the results of operations and financial condition of TeraGo Inc. All references in this MD&A to "TeraGo", the "Company", "we", "us", "our" and "our company" refer to TeraGo Inc. and its subsidiaries, unless the context requires otherwise. This MD&A is dated May 8, 2019 and should be read in conjunction with our unaudited condensed interim consolidated financial statements for the three months ended March 31, 2019 and the notes thereto. Additional information relating to TeraGo, including our most recently filed Annual Information Form ("AIF"), can be found on SEDAR at www.sedar.com and our website at www.terago.ca. For greater certainty, the information contained on our website is not incorporated by reference or otherwise into this MD&A. All dollar amounts included in this MD&A are in Canadian dollars unless otherwise indicated.

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

FORWARD-LOOKING STATEMENTS

This MD&A includes certain forward-looking statements that are made as of the date hereof only and based upon current expectations, which involve risks and uncertainties associated with our business and the economic environment in which the business operates. All such statements are made pursuant to the 'safe harbour' provisions of, and are intended to be forward-looking statements under, applicable Canadian securities laws. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements. For example, the words *anticipate, believe, plan, estimate, expect, intend, should, may, could, objective* and similar expressions are intended to identify forward-looking statements. This MD&A includes, but is not limited to, forward looking statements regarding TeraGo's growth strategy, strategic plan, the growth in TeraGo's cloud and data centre businesses, retention campaign and initiatives to improve customer service, additional capital expenditures, investments in data centres, products and other IT services, and the Company's 5G technical trials and strategy. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. We caution readers of this document not to place undue reliance on our forward-looking statements as a number of factors could cause actual future results, conditions, actions or events to differ materially from the targets, expectations, estimates or intentions expressed with the forward-looking statements. When relying on forward-looking statements to make decisions with respect to the Company, you should carefully consider the risks, uncertainties and assumptions, including the risk that TeraGo's growth strategy and strategic plan will not generate the result intended by management, cross-selling of TeraGo's cloud services may not succeed, retention efforts decreasing profit margins, opportunities for expansion and acquisition not being available or at unfavourable terms, TeraGo's "go-to-market" strategy may not materialize, trends in the global cloud and data centre sectors may not be accurately projected, the outcome of the ISED 5G Consultation may not be favourable to the Company, the partnership with AWS not resulting in a favourable outcome, ISED decisions in the various Consultations that the Company has participated in being unfavourable to the Company, the technical 5G trial the Company is currently conducting may not generate the results intended, new market opportunities for 5G may not exist or require additional capital that may not be available to the Company, and those risks set forth in the "Risk Factors" section of this MD&A and other uncertainties and potential events. In particular, if any of the risks materialize, the expectations, and the predictions based on them, of the Company may need to be re-evaluated. Consequently, all of the forward-looking statements in this MD&A are expressly qualified by these cautionary statements and other cautionary statements or factors contained herein, and there can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences for the Company.

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

OVERVIEW

Financial Highlights

- Total revenue decreased 9.8% to \$12.4 million for the three months ended March 31, 2019 compared to \$13.7 million for the same period in 2018. The decrease in revenue is primarily driven by lower connectivity revenue which decreased 12.3% to \$7.9 million compared to \$9.0 million for the same period in 2018. In addition, cloud and colocation revenue decreased 5.0% to \$4.5 million compared to \$4.7 million for the same period in 2018. The decreases were attributable to churn exceeding provisioning as a result of lower sales volume.
- Net loss was \$1.2 million for the three months ended March 31, 2019 compared to a net loss of \$1.3 million for the same period in 2018. The decrease in net loss was driven by a number of factors: the reduction in headcount in the second half of 2018, lower cost of sales and other operating expenses due to cost reduction efforts, lower severance expenses, lower impairment charges, and lower depreciation & amortization from impaired assets and assets fully amortized in prior periods; partially offset by the decrease in revenue discussed above and the impact of the adoption of IFRS 16. With the adoption of IFRS 16, the Company now recognizes all leases on balance sheet with a right-of-use asset and a corresponding lease liability. This resulted in higher depreciation and finance costs that exceed the beneficial impact of lower cost of sales and operating costs for previously recognized operating leases. The net result was an increase to net loss.
- Adjusted EBITDA⁽¹⁾⁽²⁾ increased 46.7% to \$4.6 million for the three months ended March 31, 2019 compared to \$3.1 million for the same period in 2018. The increase was driven by the adoption of IFRS 16 which resulted in the reclassification of certain operating lease expenses to finance costs and depreciation which are excluded from the calculation of Adjusted EBITDA.

Key Developments

- TeraGo Networks was recognized in the Major Players Category of the IDC MarketScape for Canadian Datacenter Operations and Management Service Providers 2019 Vendor Assessment (IDC # CA44463419, April 2019) report which is prepared by International Data Corporation (IDC) Canada. The assessment profiles leading vendors in the Canadian data centres and managed services markets and covers their competencies for these two services.

⁽¹⁾ Adjusted EBITDA is a Non-GAAP measure. See "Definitions – Key Performance Indicator, IFRS, Additional GAAP and Non-GAAP Measures.

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

TERAGO OVERVIEW

TeraGo provides businesses across Canada with cloud, colocation and connectivity services. The Company provides cloud Infrastructure as a Service (“IaaS”) computing and storage solutions, data centre colocation solutions, and operates five (5) data centres across Canada. With respect to the Company’s connectivity services, it owns and operates a carrier-grade, Multi-Protocol Label Switching (“MPLS”) enabled fixed wireless, IP communications network in Canada targeting businesses that require Internet access, private interconnection, and data connectivity services.

The Company provides enterprise-class cloud services to multiple high value, mid-market and enterprise customers across a variety of industry verticals, federal, provincial and municipal governments and agencies, as well as non-profit organizations. The Company is focussed on providing customers with tailored hybrid IT solutions, running their IT workloads with the appropriate mix of on-premise, data centre colocation, private and public cloud environments. It currently has strategic relationships with several technology partners that give it access to certain products and solutions to provide enterprise cloud services. The Company has aligned with Amazon Web Services (“AWS”) in preparation to provide managed public cloud services and is an AWS Consulting Partner, part of the AWS APN partner network. TeraGo has since attained the Standard Partner tier in the AWS Partner Program.

The Company’s subscription-based business model generally generates stable and predictable recurring revenue from cloud, colocation and connectivity services. Once a customer is obtained, TeraGo’s strategy is to generate incremental recurring revenue from that customer by cross-selling to bundle customers with multiple services and up-selling within services provided.

Cloud Services	Colocation Services	Connectivity Services
<ul style="list-style-type: none"> Private and hybrid cloud IaaS utility computing on virtual and dedicated compute platforms High performance and secure data storage and archiving Business Continuity services for critical situations Managed Services for public and hybrid cloud offerings 	<ul style="list-style-type: none"> Colocation services in partial, full, or customized cabinets Managed, Private Dedicated, and Co-location hosting services Private Vaults protected with biometrics for maximum security Other value added services such as hybrid cloud 	<ul style="list-style-type: none"> National high performance, scalable Internet access principally via wireless and fibre optics Active redundancy capability with bundled connectivity solution Managed network service

TERAGO’S BUSINESS MODEL

TeraGo’s business strategy is to provide enterprise-class hybrid IT solutions tailored to the mid-market. The Company leverages its existing nationwide data centre footprint, VMware private/multi-tenant cloud and AWS, all underpinned by a resilient national carrier grade network infrastructure, to align with customers’ current IT landscape. This allows customers to operate on platforms best suited for their workloads – on-premise, data centre colocation, TeraGo private and multi-tenant cloud, and AWS public cloud – all securely interconnected.

TeraGo’s customers typically sign one, two or three-year contracts. Services are billed monthly over the term of the contract.

CONNECTIVITY SERVICES

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

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

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

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

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

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

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

Quality of Service Capabilities

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

Radio Spectrum

24-GHz and 38-GHz Wide-area Licences

The Company owns national spectrum portfolio of exclusive 24 GHz and 38 GHz wide-area spectrum licences which covers major regions throughout Canada including 2,120 MHz of spectrum across Canada's 6 largest cities. This spectrum is used to deploy point-to-point and point-to-multipoint microwave radio systems, interconnecting core hubs in ring architectures (where possible) to backhaul metro area network traffic and in the access network or "last mile" to deliver high capacity (speeds of 20Mbps to 1Gbps) IP-based services for business, government and mobile backhaul.

In June 2017, Innovation, Science and Economic Development Canada (ISED) issued the Consultation on Releasing Millimetre Wave Spectrum to Support 5G. This Consultation contemplates the future use of certain millimetre wave spectrum to support the deployment of 5th generation (5G) wireless networks and systems. The spectrum bands identified by ISED includes (amongst others) the 38 GHz band which TeraGo currently holds licences in. As of the date, hereof, the Company has submitted a comment letter and a subsequent reply comment letter in response to the Consultation and final decisions from ISED on this Consultation are yet to be released.

In June 2018, ISED published its overall approach and planned activities for spectrum over the next five years in a document titled *Spectrum Outlook 2018 to 2022*. In such document, ISED has confirmed that the 24 GHz band, among several others has been designated as Priority 2 for future release for commercial mobile use. A definitive timeline for the release of spectrum bands designated as Priority 2 and Priority 3 has not yet been confirmed by ISED. A timeline for the release of the 38 GHz band, which has been designated as a Priority 1 band has been set for the end of 2021.

For additional information on these Consultations and to review the response letter of the Company or other stakeholders, please refer to ISED's Consultation webpage: https://www.ic.gc.ca/eic/site/smt-gst.nsf/eng/h_sf11245.html.

On November 9, 2018, TeraGo completed its acquisition of MSI which is a holder of six 24 GHz spectrum licenses in Calgary, Edmonton, Montreal, Ottawa, Toronto, and Vancouver. Prior to the acquisition, TeraGo was a lessee to such spectrum of MSI and held subordinate licenses.

For further details on our licensed spectrums, please refer to the Company's 2018 AIF.

CLOUD SERVICES

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

TeraGo offers customized cloud storage and compute offerings to customers across Canada. TeraGo cloud can offer a virtualized computing environment whereby customers can access on-demand computing without the need to acquire and maintain expensive server equipment. TeraGo can also provide offsite cloud storage for key backup and disaster recovery situations, including utilizing partnerships with software and hardware vendors such as Veeam and Solidfire. The Company has strategic relationships and partnerships with technology leaders such as Amazon Web Services, IBM, Cisco, VMware, Microsoft, Mitel and others that gives it early access to intelligence, products and solutions to provide enterprise cloud services.

COLOCATION SERVICES

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

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

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

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

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

Data Centre Facilities

TeraGo's data centres provide IT solutions, including colocation and disaster recovery, to a roster of small and medium-sized businesses, enterprises, public sector and technology service providers. TeraGo has approximately 60,000 square feet of data centre capacity in the five (5) facilities it operates across Canada:

Mississauga, Ontario

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

Vaughan, Ontario

TeraGo operates a 16,000 square foot AT 101 SOC2 Type 2 certified data centre facility in Vaughan, Ontario, serving the Greater Toronto Area.

Kelowna, British Columbia

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

Vancouver, British Columbia

TeraGo operates two AT 101 SOC2 Type 2 certified data centre facilities in downtown Vancouver. Its first facility is approximately 7,000 square feet. The facility has redundant fibre facilities between the data centre and the 'telco hotel',

555 West Hastings, in downtown Vancouver. The second facility is 7,000 square feet and is served by TeraGo's fiber optic lines. Both facilities are used to service the Greater Vancouver Area.

RESULTS OF OPERATIONS

Comparison of the three months ended March 31, 2019 and 2018
(in thousands of dollars, except with respect to gross profit margin, earnings per share, Backlog MRR, and ARPU)

	Three months ended March 31	
	<u>2019</u>	<u>2018</u> ⁽³⁾
Financial		
Cloud and Colocation Revenue	\$ 4,494	4,731
Connectivity Revenue	\$ <u>7,903</u>	<u>9,009</u>
Total Revenue	\$ 12,397	13,740
Cost of Services ⁽¹⁾	\$ 2,261	3,555
Selling, General, & Administrative Costs	\$ 5,963	7,712
Gross profit margin ⁽¹⁾	81.8%	74.1%
Adjusted EBITDA ^{(1) (2)}	\$ 4,590	3,129
Net loss	\$ (1,188)	(1,312)
Basic loss per share	\$ (0.08)	(0.09)
Diluted loss per share	\$ (0.08)	(0.09)
Operating		
<u>Backlog MRR⁽¹⁾</u>		
Connectivity	\$ 71,624	58,336
Cloud & Colocation	\$ 37,094	133,687
<u>Churn Rate⁽¹⁾</u>		
Connectivity	1.5%	1.6%
Cloud & Colocation	1.1%	3.1%
<u>ARPU⁽¹⁾</u>		
Connectivity	\$ 1,033	1,041
Cloud & Colocation	\$ 3,221	3,084

(1) See "Definitions – Key Performance Indicators, IFRS, Additional GAAP and Non-GAAP Measures"

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

(3) The Company has applied IFRS 16 on January 1, 2019 using the modified retrospective approach. Under this method, the comparative information is not restated. See "Accounting Pronouncements Adopted in 2019" for further information.

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

Revenue

Total revenue decreased 9.8% to \$12.4 million for the three months ended March 31, 2019 compared to \$13.7 million for the same period in 2018. The decrease was attributable to churn exceeding provisioning.

Connectivity Revenue

For the three months ended March 31, 2019, connectivity revenue decreased 12.3% to \$7.9 million compared to \$9.0 million for the same period in 2018. Connectivity revenues were impacted by a variety of factors, including churn and certain customers renewing long term contracts at lower current market rates.

Cloud and Colocation Revenue

For the three months ended March 31, 2019, cloud and colocation revenue decreased 5.0% to \$4.5 million compared to \$4.7 million for the same period in 2018. The decrease was attributable to churn exceeding provisioning as a result of lower sales volume.

Cost of Services

For the three months ended March 31, 2019, cost of services decreased 36.4% to \$2.3 million compared to \$3.6 million for the same period in 2018. The decrease was primarily the result of the adoption of IFRS 16 which resulted in certain lease costs no longer being classified as cost of services and instead through depreciation and finance costs. Excluding the impact of IFRS 16, cost of services would have been \$3.4 million compared to \$3.6 million for the same period in 2018. The decrease would have been due to the decrease in revenue.

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

For the three months ended March 31, 2019, SG&A decreased 22.7% to \$6.0 million compared to \$7.7 million for the same period in 2018. The decrease was driven by lower cost of sales due to lower revenues, lower personnel costs due to a restructuring in late 2018, lower severance expenses, lower marketing costs, and lower maintenance costs due to cost reduction efforts. In addition, the Company recorded lower impairment charges recognized to adjust the carrying value of assets to their recoverable amount and lower depreciation & amortization expenses due to fully impaired assets and assets fully amortized in prior periods. Excluding the impact of IFRS 16, SG&A would have been \$6.6 million compared to \$7.7 million for the same period in 2018. The decrease would have been due to the factors mentioned above.

Net loss

Net loss was \$1.2 million for the three months ended March 31, 2019 compared to a net loss of \$1.3 million for the same period in 2018. The decrease in net loss was driven by a number of factors: the reduction in headcount in the second half of 2018, lower cost of sales and other operating expenses due to cost reduction efforts, lower severance expenses, lower impairment charges, and lower depreciation & amortization from impaired assets and assets fully amortized in prior periods; partially offset by the decrease in revenue discussed above and the impact of the adoption of IFRS 16. With the adoption of IFRS 16, the Company now recognizes all leases on balance sheet with a right-of-use asset and a corresponding lease liability. This resulted in higher depreciation and finance costs that exceed the beneficial impact of lower cost of sales and operating costs for previously recognized operating leases. The net result was an increase to net loss. Excluding the impact of IFRS 16, net loss would have been \$0.8 million for the three months ended March 31, 2019 compared to \$1.3 million in the same period in 2018. The decrease would have been due to the factors mentioned above.

Adjusted EBITDA⁽¹⁾

Adjusted EBITDA⁽³⁾⁽⁴⁾ increased 46.7% to \$4.6 million for the three months ended March 31, 2019 compared to \$3.1 million for the same period in 2018. The increase was driven by the adoption of IFRS 16 which resulted in the recognition of certain lease costs through finance costs and depreciation which are excluded from the calculation of Adjusted EBITDA and were previously recognized as cost of services and operating expenses. Excluding the impact of IFRS 16, Adjusted EBITDA would have been \$2.9 million compared to \$3.1 million for the same period in 2018 which is due primarily to lower revenue, partially offset by lower cost of sales and SG&A cost reductions.

The table below reconciles net loss to Adjusted EBITDA⁽¹⁾ for the three months March 31, 2019 and 2018.

⁽³⁾ Adjusted EBITDA is a Non-GAAP measure. See "Definitions – Key Performance Indicator, IFRS, Additional GAAP and Non-GAAP Measures.

⁽⁴⁾ See "Adjusted EBITDA" for a reconciliation of net loss to Adjusted EBITDA

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Management's Discussion and Analysis
Quarter Ended March 31, 2019

<i>(in thousands of dollars)</i>	Three months ended	
	March 31	
	2019	2018⁽²⁾
Net earnings (loss) for the period	\$ (1,188)	(1,312)
Foreign exchange loss (gain)	(6)	4
Finance costs	1,415	628
Finance income	(25)	-
Earnings (loss) from operations	196	(680)
Add:		
Depreciation of network assets, property and equipment and amortization of intangible assets	3,977	3,153
Loss on disposal of network assets	23	82
Impairment of Assets and Related Charges	82	236
Stock-based Compensation Expense (Recovery)	342	203
Restructuring, acquisition-related, integration costs and other	(30)	135
Adjusted EBITDA⁽¹⁾	\$ 4,590	3,129

(1) See "Definitions – Key Performance Indicators, IFRS, Additional GAAP and Non-GAAP Measures"

(2) The Company has initially applied IFRS 16 using the modified retrospective approach. Under this method, the comparative information is not restated.

Backlog MRR

Cloud and colocation backlog MRR was \$37,094 as at March 31, 2019 compared to \$133,687 as at March 31, 2018. The decrease is driven by the provisioning of large colocation customers which were in the backlog as of the prior year period.

Connectivity backlog MRR was \$71,624 as at March 31, 2019, compared to \$58,336 as at March 31, 2018. The increase in backlog MRR is driven primarily by growth in bookings and the timing of customer provisioning.

ARPU

For the three months ended March 31, 2019 cloud and colocation ARPU was \$3,221 compared to \$3,084 for the same period in 2018, representing a growth of 4.4% compared to the prior period. The increase was driven by the provisioning of large customers in the first half of 2018, as well as the churn of low value cloud customers.

For the three months ended March 31, 2019 Connectivity ARPU was \$1,033 compared to \$1,041 for the same period in 2018. The ARPU is consistent with prior year period as the Company continues to focus on acquiring and retaining small to medium sized business customers.

Churn

For the three months ended March 31, 2019, cloud and colocation churn was 1.1% compared to 3.1% for the same period in 2018. The decrease was the result of ongoing churn management efforts, as well as increased churn in the prior year period due to end of life services that the Company ceased in the prior year period.

For the three months ended March 31, 2019, connectivity churn was 1.5% compared to 1.6% for the same period in 2018. The decrease was driven by favourable impacts of the Company's investment in developing a robust customer experience framework.

Finance costs

For the three months ended March 31, 2019, finance costs increased 125.3% to \$1.4 million compared to \$0.6 million for the same period in 2018. The increase was primarily a result of the adoption of IFRS 16 where interest expenses on the Company's lease liabilities are now recognized in finance costs. Interest expenses on the Company's leases of \$0.7 million in the three months ended March 31, 2019 represents the financing component of its leases and are calculated using the Company's incremental borrowing rate. In addition, there was an unfavourable valuation of the Company's fixed interest rate swaps which resulted in higher finance costs. Excluding the impact of IFRS 16, finance costs would have been \$0.7 million for the three months ended March 31, 2019 compared to \$0.6 million for the same period in 2018. The increase would have been due to the unfavourable fixed interest rate swap valuation.

Depreciation and amortization

For the three months ended March 31, 2019, depreciation of network assets, property and equipment and amortization of intangibles increased 24.7% to \$3.9 million compared to \$3.2 million for the same period in 2018. The increase is

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Management's Discussion and Analysis
Quarter Ended March 31, 2019

the result of the adoption of IFRS 16 where the right to use an underlying asset in a lease contract is recognized on the balance sheet as a right-of-use asset. These assets are depreciated over the term of the underlying lease on a straight-line basis, of which the Company recorded additional depreciation of \$1.4 million in the three months ended March 31, 2019. This increase was partially offset by impaired and fully depreciated assets in prior periods. Excluding the impact of IFRS 16, depreciation and amortization would have been \$2.6 million compared to \$3.2 million for the same period in 2018. The decrease would have been due to impaired and fully depreciated assets in prior periods.

Summary of Quarterly Results

All financial results are in thousands, with the exception of earnings per share, Backlog MRR, and ARPU

	Q1-19	Q4-18 ⁽²⁾	Q3-18 ⁽²⁾	Q2-18 ⁽²⁾	Q1-18 ⁽²⁾	Q4-17 ⁽²⁾	Q3-17 ⁽²⁾	Q2-17 ⁽²⁾
Financial								
Revenue	\$ 12,397	12,868	14,004	13,683	13,740	13,543	13,680	13,892
Gross Profit Margin % ⁽¹⁾	81.8%	73.0%	75.1%	74.7%	74.1%	73.8%	74.3%	74.3%
Adjusted EBITDA ⁽¹⁾	\$ 4,590	3,119	3,593	3,123	3,129	2,937	3,213	3,003
Net income/(loss)	\$ (1,188)	(1,972)	(47)	(1,489)	(1,312)	(4,061)	(1,047)	(1,131)
Basic income/(loss) per share	\$ (0.08)	(0.13)	(0.00)	(0.10)	(0.09)	(0.28)	(0.07)	(0.08)
Diluted income/(loss) per share	\$ (0.08)	(0.13)	(0.00)	(0.10)	(0.09)	(0.28)	(0.07)	(0.08)
Basic weighted average number of shares outstanding	15,775	15,756	15,736	14,588	14,391	14,335	14,334	14,283
Diluted weighted average number of shares outstanding	15,775	15,756	15,736	14,588	14,391	14,335	14,334	14,283
Operating								
<u>Backlog MRR⁽¹⁾</u>								
Connectivity	\$ 71,624	64,659	71,659	60,750	58,336	84,191	98,345	76,254
Cloud & Colocation	\$ 37,094	31,742	30,172	67,747	133,687	291,698	134,283	39,977
<u>Churn Rate⁽¹⁾</u>								
Connectivity	1.5%	1.4%	1.4%	1.4%	1.6%	1.6%	1.5%	1.7%
Cloud & Colocation	1.1%	1.3%	1.0%	1.5%	3.1%	1.4%	1.5%	2.2%
<u>ARPU⁽¹⁾</u>								
Connectivity	\$ 1,033	1,054	1,071	1,062	1,041	996	984	972
Cloud & Colocation	\$ 3,221	3,138	3,049	3,336	3,084	3,027	3,112	3,124

(1) See "Definitions – Key Performance Indicators, IFRS, Additional GAAP and Non-GAAP Measures"

(2) The Company has initially applied IFRS 16 using the modified retrospective approach. Under this method, the comparative information is not restated.

Seasonality

The Company's net customer growth, with respect to its connectivity business, is typically impacted adversely by weather conditions as the majority of new customer locations require the installation of rooftop equipment. Typically, harsher weather in the first quarter of the year results in a reduction of productive installation days. In addition, certain customers using our cloud services may have higher usage during certain times of the year based on the seasonality of their respective businesses.

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

LIQUIDITY AND CAPITAL RESOURCES

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

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Management's Discussion and Analysis
Quarter Ended March 31, 2019

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

<i>(in thousands of dollars)</i>	Three months ended	
	March 31	
	2019	2018⁽¹⁾
Statement of Cash Flows Summary		
Cash inflows and (outflows) by activity:		
Operating activities	5,663	1,570
Investing activities	(3,228)	(3,613)
Financing activities	(3,247)	(1,302)
Net cash inflows (outflows)	(812)	(3,345)
Cash and cash equivalents, beginning of period	3,918	6,986
Cash and cash equivalents, end of period	3,106	3,641

(1) The Company has initially applied IFRS 16 using the modified retrospective approach. Under this method, the comparative information is not restated.

Operating Activities

For the three months ended March 31, 2019, cash generated from operating activities was \$5.7 million compared to cash from operations of \$1.6 million for the same period in 2018. The increase in cash from operating activities is mainly due to the reclassification of cash flows from operating activities to finance activities as a result of the adoption of IFRS 16. In addition, there was a significant beneficial impact of working capital timings compared to the same period in the prior year.

Investing Activities

For the three months ended March 31, 2019, cash used in investing activities was \$3.2 million compared to cash used of \$3.6 million for the same period in 2018. The increase in cash used in investing activities was due to lower operational capital expenditures during the period compared to the same period in the prior year.

Financing Activities

For the three months ended March 31, 2019 cash used in financing activities was \$3.2 million compared to cash used in financing activities of \$1.3 million for the same period in 2018. The increase was due to the reclassification of cash flows from operating activities to finance activities as a result of the adoption of IFRS 16. The increase represents payments made for lease liabilities.

Capital Resources

As at March 31, 2019, the Company had cash and cash equivalents of \$3.1 million and access to an undrawn revolving facility and acquisition funding capital as described in the subsequent section below, subject to the terms and conditions of the credit facilities.

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

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

Term Debt Facility

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

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

In June 2017, the Company entered into a second amended agreement with the syndicate led by NBC that reduced the term debt facility from \$50.0 million to \$40.0 million (as a result of principal previously repaid), reduced the quarterly principal installment from \$1.25 million to \$1.0 million and extended the term from June 30, 2018 to June 14, 2021. Other terms were substantially consistent with the existing credit facilities.

The total \$75,000 facility that matures June 14, 2021 is made up of the following:

- \$10.0 million revolving facility which bears interest at prime plus a margin percent. As of March 31, 2019, \$nil amount is outstanding (December 31, 2018 - \$nil). Letters of credit issued under the facility totaled \$0.7 million as of March 31, 2019 (December 31, 2018 - \$0.7 million).
- \$40.0 million term facility which bears interest at prime or Banker's Acceptance (at the Company's option) plus a margin percent and is repayable in quarterly principal installments of \$1.0 million. This facility was fully drawn upon signing the second amended agreement.

On March 31, 2019, \$31.8 million of the term facility principal balance outstanding was in a Banker's Acceptance and the remaining \$0.2 million was at a floating rate. During 2018, the Company entered into two amended interest rate swap contracts that mature June 29, 2021. The interest rate swap contracts have not been designated as a hedge and will be marked-to-market each quarter. The fair value of the interest rate swap contracts at March 31, 2019 was a liability of \$0.4 million (December 31, 2018 - \$0.2 million) and is recorded in other long-term assets/liabilities, with a corresponding charge (recovery) for the change in fair value recorded in finance costs. The effective interest rate on the Company's long-term debt at March 31, 2019 was 5.34% which represents the Company's interest on its Banker's Acceptance net of its interest swap contracts.

As at March 31, 2019, the Company prepaid interest in the amount of \$0.4 million which represents the net settlement of the Banker's Acceptance and is recorded as a reduction in the carrying value of the debt.

- \$25.0 million available for funding acquisitions and will bear interest at prime plus a margin percent and is repayable in quarterly principal installments of 2.5% of the aggregate amount outstanding. As of March 31, 2019, this facility remains undrawn.

Financing fees incurred as part of the Company's debt origination and modifications have been recorded as a reduction in the carrying amount of the debt and deferred and amortized using the effective interest method over the remaining 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, 2019. 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.

Share Capital

TeraGo's authorized share capital consists of an unlimited number of Common Shares, an unlimited number of Class A Non-Voting Shares and two Class B Shares. A detailed description of the rights, privileges, restrictions and conditions attached to the authorized shares is included in the Company's 2018 Annual Information Form, a copy of which can be found on SEDAR at www.sedar.com.

As of May 8, 2019, there were 15,790 Common Shares issued and outstanding and two Class B Shares issued and outstanding. In addition, as of May 8, 2019, there were 68 Common Shares issuable upon exercise of TeraGo stock options.

RISK FACTORS

TeraGo is exposed to a number of risks and uncertainties that are common to other companies engaged in the same or similar businesses. The summary of the material risks that could significantly affect the financial condition, operating results or business of TeraGo, are set out in our management's discussion and analysis for the fiscal year ended December 31, 2018.

ACCOUNTING PRONOUNCEMENTS ADOPTED IN 2019

a) IFRS 16 Leases

IFRS 16 introduced a single, on-balance sheet accounting approach for leases. Effective January 1, 2019, the Company adopted IFRS 16 using the modified retrospective approach by recognizing the cumulative effect of initially applying IFRS 16 as an adjustment to the opening balance of retained earnings at January 1, 2019. Comparative information has not been restated and continues to be reported under IAS 17.

Under the new standard, the Company assesses whether at contract inception, such contract contains a lease based on the new definition of a lease. Under IFRS 16, a contract is, or contains a lease if the contract conveys a right to control or use an identified asset for a period of time in exchange for consideration. The Company has also elected to apply the practical expedient to grandfather the assessment of which transactions were leases, as previously determined by IAS 17 and IFRIC 4. Therefore, the definition of a lease under IFRS 16 was only applied to contracts entered into or changed on or after January 1, 2019.

i) Significant Accounting Policies

The Company records a right-of-use asset and lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, and subsequently at cost less any accumulated depreciation and impairment losses, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of lease payments that are not paid at the commencement date, discounted using the Company's incremental borrowing rate. Payments included in the measurement of the liability include fixed payments and payments expected to be made where a renewal/extension option is reasonably certain to be exercised. The lease liability is subsequently increased by the interest cost and decreased by lease payments made. The liability is remeasured when there is a change in the future lease payments arising from the exercise of extension options, changes in the assessment of extension options reasonably expected to be exercised, renegotiations with lessors and contract amendments, changes in the scope of a lease due to certain contract rights being exercised, and changes in assessments of termination options reasonably expected to be exercised.

The Company elected to record the right-of-use assets based on the corresponding lease liability. In addition, the Company has elected to apply the practical expedient to account for leases for which the lease term ends within 12 months of the date of initial application as short term leases.

Judgments

The Company has applied judgment to determine the lease term for some lease contracts in which it is a lessee that includes renewal options. The assessment of whether the Company is reasonably certain to exercise such options will impact the lease term, which significantly impacts the amount of lease liabilities and right-of-use assets recognized.

A large portion of the Company's leases include renewal options that are exercisable by the Company and not the lessor. The Company typically exercises these options when they relate to rooftop locations that service its fixed wireless network. From time to time, the Company will reassess whether these options are reasonable expected to be exercised and remeasure the lease liability accordingly.

ii) Impacts on Financial Statements

On initial transition, the Company has recognized right-of-use assets representing its rights to use the underlying assets and lease liabilities representing its obligation to make lease payments. Right-of-use assets and lease liabilities of \$30,507 were recorded on January 1, 2019. In addition, the Company had previously recognized prepaid assets and deferred rent liabilities at December 31, 2018 for timing differences in contractual operating lease cash flows. Under the new standard, timing differences are recognized in the right-of-use asset and lease liability and as a result, these prepaid assets and deferred rent liabilities were adjusted through the January 1, 2019 right-of-use asset balance. There was no net impact on opening retained earnings on adoption.

The following is a table that reconciles the Company's operating lease obligations at December 31, 2018 as previously disclosed in the Company's 2018 Consolidated Financial Statements to the IFRS 16 lease liability recognized on January 1, 2019. A reconciliation of the lease liabilities during the 3 months ended March 31, 2019 is presented in Note 9 of the consolidated interim financial statements. The weighted average discount rate applied at January 1, 2019 was 9.29%.

vi) Impacts on Financial results

The following table highlights some of the key impacts on our financial metrics discussed in the MD&A:

	Three months ended March 31, 2019			
	Balances without adoption of IFRS 16	Effect of IFRS 16	Balances subsequent to transition	% Change
Financial				
Selling, General, & Admin Costs	\$ 6,627	(664)	5,963	-10%
Depreciation & Amortization	\$ 2,564	1,413	3,977	55%
Cost of Services	\$ 3,350	(1,089)	2,261	-33%
Finance Costs	\$ 698	717	1,415	103%
Gross Margin	\$ 9,047	1,089	10,136	12%
Adjusted EBITDA ^{(1) (2)}	\$ 2,837	1,753	4,590	62%
Net Income (Loss)	\$ (811)	(377)	(1,188)	46%
Total Assets	\$ 82,519	28,643	111,162	35%
Total Liabilities	\$ 38,491	29,020	67,511	75%
Total Shareholder's Equity	\$ 82,519	28,643	111,162	35%

(1) See "Definitions – Key Performance Indicators, IFRS, Additional GAAP and Non-GAAP Measures"

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

INTERNAL CONTROL OVER FINANCIAL REPORTING AND DISCLOSURE CONTROLS AND PROCEDURES

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

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

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

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

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

Given the material impacts of IFRS 16, the Company has implemented new key controls to ensure reporting accuracy. Management has concluded that there are no material weaknesses relating to the design of TeraGo's internal controls over financial reporting as of March 31, 2019. In accordance with Section 3.3 of National Instrument 52-109 – Certificate of Disclosure in Issuers' Annual and Interim Filings, the Company has limited the design of disclosure controls and procedures and internal controls over financial reporting to exclude controls, policies and procedures of MSI which was acquired not more than 365 days before the period ended March 31, 2019. The table below shows a summary of the financial information for MSI which is included in the three months ended financial statements of the Company as at March 31, 2019:

Non-current assets: \$5.6 million

EXECUTIVE MANAGEMENT CHANGES

Effective March 11, 2019, Geoff Kereluik was appointed as Vice President, Sales.

DEFINITIONS – KEY PERFORMANCE INDICATORS, IFRS, ADDITIONAL GAAP AND NON-GAAP MEASURES

IFRS Measures

Cost of services

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

Gross profit margin %

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

Other operating expenses

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

Foreign exchange gain (loss)

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

Finance costs

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

Finance income

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

Additional GAAP Measures

Earnings (loss) from operations

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

Non-GAAP Measures

Adjusted EBITDA

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

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

Key Performance Indicators

Backlog MRR

The term "Backlog MRR" is a measure of contracted monthly recurring revenue (MRR) from customers that have not yet been provisioned. The Company believes backlog MRR is useful additional information as it provides an indication of future revenue. Backlog MRR is not a recognized measure under IFRS and may not translate into future revenue, and accordingly, investors are cautioned in using it. The Company calculates backlog MRR by summing the MRR of new customer contracts and upgrades that are signed but not yet provisioned, as at the end of the period. TeraGo's method of calculating backlog MRR may differ from other issuers and, accordingly, backlog MRR may not be comparable to similar measures presented by other issuers.

ARPU

The term "ARPU" refers to the Company's average revenue per customer per month in the period. The Company believes that ARPU is useful supplemental information as it provides an indication of our revenue from an individual customer on a per month basis. ARPU is not a recognized measure under IFRS and, accordingly, investors are cautioned that ARPU should not be construed as an alternative to revenue determined in accordance with IFRS as an indicator of our financial performance. The Company calculates ARPU by dividing our total revenue before revenue from early terminations by the number of customers in service during the period and we express ARPU as a rate per month. TeraGo's method of calculating ARPU has changed from the Company's past disclosures to exclude revenue from early termination fees, where ARPU was previously calculated as revenue divided by the number of customers in service during the period. TeraGo's method may differ from other issuers, and accordingly, ARPU may not be comparable to similar measures presented by other issuers.

Churn

The term "churn" or "churn rate" is a measure, expressed as a percentage, of customer cancellations in a particular month. The Company calculates churn by dividing the number of customer cancellations during a month by the total number of customers at the end of the month before cancellations. The information is presented as the average monthly churn rate during the period. The Company believes that the churn rate is useful supplemental information as it provides an indication of future revenue decline and is a measure of how well the business is able to renew and keep existing customers on their existing service offerings. Churn and churn rate are not recognized measures under IFRS and, accordingly, investors are cautioned in using it. TeraGo's method of calculating churn and churn rate may differ from other issuers and, accordingly, churn may not be comparable to similar measures presented by other issuers.