

COGENT COMMUNICATIONS GROUP INC
Form 10-Q
August 08, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the Quarterly Period Ended June 30, 2007

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

Commission File No. 1-31227

COGENT COMMUNICATIONS GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Edgar Filing: COGENT COMMUNICATIONS GROUP INC - Form 10-Q

Delaware
(State of Incorporation)

52-2337274
(I.R.S. Employer
Identification Number)

1015 31st Street N.W.

Washington, D.C. 20007

(Address of Principal Executive Offices and Zip Code)

(202) 295-4200

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Securities Exchange Act. (Check one)

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$.001 par value 48,317,185 Shares Outstanding as of August 6, 2007

INDEX

**PART I
FINANCIAL INFORMATION**

<u>Item 1.</u>	<u>Condensed Consolidated Financial Statements (Unaudited)</u> <u>Condensed Consolidated Balance Sheets of Cogent Communications Group, Inc., and Subsidiaries as of December 31, 2006 and June 30, 2007 (Unaudited)</u> <u>Condensed Consolidated Statements of Operations of Cogent Communications Group, Inc., and Subsidiaries for the Three Months Ended June 30, 2006 and June 30, 2007 (Unaudited)</u> <u>Condensed Consolidated Statements of Operations of Cogent Communications Group, Inc., and Subsidiaries for the Six Months Ended June 30, 2006 and June 30, 2007 (Unaudited)</u> <u>Condensed Consolidated Statements of Cash Flows of Cogent Communications Group, Inc., and Subsidiaries for the Six Months Ended June 30, 2006 and June 30, 2007 (Unaudited)</u>
<u>Item 2.</u>	<u>Notes to Interim Condensed Consolidated Financial Statements (Unaudited)</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
<u>Item 4.</u>	<u>Controls and Procedures</u>

**PART II
OTHER INFORMATION**

<u>Item 1.</u>	<u>Legal Proceedings</u>
<u>Item 1A.</u>	<u>Risk Factors</u>
<u>Item 2.</u>	<u>Changes in Securities and Use of Proceeds</u>
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>
<u>Item 6.</u>	<u>Exhibits</u>

SIGNATURES
CERTIFICATIONS

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2006 AND JUNE 30, 2007
(IN THOUSANDS, EXCEPT SHARE DATA)

	December 31, 2006	June 30, 2007 (Unaudited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 42,642	\$ 181,754
Short term investments (\$0 and \$650 restricted, respectively)	80	650
Accounts receivable, net of allowance for doubtful accounts of \$1,233 and \$949, respectively	20,053	18,124
Prepaid expenses and other current assets	5,339	6,544
Total current assets	68,114	207,072
Property and equipment, net	263,268	252,251
Intangible assets, net	1,150	599
Deposits and other assets (\$1,118 and \$468 restricted, respectively)	4,344	3,745
Total assets	\$ 336,876	\$ 463,667
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	\$ 9,096	\$ 10,519
Accrued liabilities	12,614	15,193
Convertible subordinated notes, net of discount of \$1,213	8,978	
Current maturities, capital lease obligations	6,027	6,776
Total current liabilities	36,715	32,488
Convertible senior notes, net of discount of \$4,448 - due June 2027		195,552
Capital lease obligations, net of current maturities	82,019	81,243
Other long term liabilities	2,510	2,239
Total liabilities	121,244	311,522
Commitments and contingencies:		
Stockholders equity:		
Common stock, \$0.001 par value; 75,000,000 shares authorized; 48,928,108 and 48,270,730 shares issued and outstanding, respectively	49	48
Additional paid-in capital	478,140	432,607
Stock purchase warrants	764	764
Accumulated other comprehensive income foreign currency translation adjustment	1,638	2,281
Accumulated deficit	(264,959)	(283,555)
Total stockholders equity	215,632	152,145
Total liabilities and stockholders equity	\$ 336,876	\$ 463,667

The accompanying notes are an integral part of these condensed consolidated balance sheets.

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED JUNE 30, 2006 AND JUNE 30, 2007
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	Three Months Ended June 30, 2006 (Unaudited)	Three Months Ended June 30, 2007 (Unaudited)
Net service revenue	\$ 36,155	\$ 45,108
Operating expenses:		
Network operations (including \$101 and \$74 of equity-based compensation expense, respectively, exclusive of amounts shown separately)	20,177	21,502
Selling, general, and administrative (including \$3,271 and \$2,392 of equity-based compensation expense, respectively, and \$815 and \$707 of bad debt expense, net of recoveries, respectively)	14,865	15,017
Depreciation and amortization	14,658	16,332
Total operating expenses	49,700	52,851
Operating loss	(13,545)	(7,743)
Interest income and other, net	691	1,091
Interest expense	(2,637)	(2,540)
Net loss	\$ (15,491)	\$ (9,192)
Net loss per common share:		
Basic and diluted net loss per common share	\$ (0.34)	\$ (0.19)
Weighted-average common shares basic and diluted	45,099,826	48,378,853

The accompanying notes are an integral part of these condensed consolidated statements of operations.

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX MONTHS ENDED JUNE 30, 2006 AND JUNE 30, 2007
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	Six Months Ended June 30, 2006 (Unaudited)	Six Months Ended June 30, 2007 (Unaudited)
Net service revenue	\$ 70,602	\$ 88,729
Operating expenses:		
Network operations (including \$206 and \$123 of equity-based compensation expense, respectively, exclusive of amounts shown separately)	40,619	42,566
Selling, general, and administrative (including \$6,665 and \$3,961 of equity-based compensation expense, respectively, and \$1,147 and \$907 of bad debt expense, net of recoveries, respectively)	29,044	29,148
Depreciation and amortization	28,801	32,238
Total operating expenses	98,464	103,952
Operating loss	(27,862)	(15,223)
Interest income and other, net	1,183	1,880
Interest expense	(5,253)	(5,253)
Net loss	\$ (31,932)	\$ (18,596)
Net loss per common share:		
Basic and diluted net loss per common share	\$ (0.72)	\$ (0.38)
Weighted-average common shares basic and diluted	44,534,992	48,535,502

The accompanying notes are an integral part of these condensed consolidated statements of operations.

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2006 AND JUNE 30, 2007
(IN THOUSANDS)

	Six Months Ended June 30, 2006 (Unaudited)	Six Months Ended June 30, 2007 (Unaudited)
Cash flows from operating activities:		
Net cash provided by operating activities	\$ 3,327	\$ 23,913
Cash flows from investing activities:		
Purchases of property and equipment	(11,803)	(17,128)
Maturities (purchases) of short term investments	653	(570)
Proceeds from dispositions of assets	93	14
Net cash used in investing activities	(11,057)	(17,684)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	36,534	
Proceeds from issuance of senior convertible notes, net		195,500
Repayment of convertible notes		(10,187)
Purchase of common stock		(50,052)
Proceeds from exercises of stock options	85	435
Repayments of capital lease obligations	(4,945)	(3,205)
Net cash provided by financing activities	31,674	132,491
Effect of exchange rate changes on cash	355	392
Net increase in cash and cash equivalents	24,299	139,112
Cash and cash equivalents, beginning of period	29,883	42,642
Cash and cash equivalents, end of period	\$ 54,182	\$ 181,754

The accompanying notes are an integral part of these condensed consolidated statements of cash flows.

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2006 and 2007
(unaudited)

1. Description of the business and recent developments:

Description of business

Cogent Communications Group, Inc. (the Company) is a Delaware corporation and is headquartered in Washington, DC. The Company is a facilities-based provider of low-cost, high-speed Internet access and Internet Protocol (IP) communications services. The Company's network is specifically designed and optimized to transmit data using IP. The Company delivers its services to small and medium-sized businesses, communications service providers and other bandwidth-intensive organizations through over 13,780 customer connections in North America and Western Europe.

The Company offers on-net Internet access services exclusively through its own facilities, which run all the way to its customers' premises. Because of its integrated network architecture, the Company is not dependent on local telephone companies to serve its on-net customers. The Company provides on-net Internet access to certain bandwidth-intensive users such as universities, other Internet service providers, telephone companies, cable television companies and commercial content providers at speeds up to 10 Gigabits per second. These customers generally receive service in colocation facilities and the Company's data centers. The Company also offers Internet access services in multi-tenant office buildings typically serving law firms, financial services firms, advertising and marketing firms and other professional services businesses. The Company operates data centers throughout North America and Western Europe that allow customers to collocate their equipment and access the Company's network.

In addition to providing on-net services, the Company also provides Internet connectivity to customers that are not located in buildings directly connected to its network. The Company serves these off-net customers using other carriers' facilities to provide the "last mile" portion of the link from its customers' premises to the Company's network. The Company also provides certain non-core services that resulted from acquisitions. The Company continues to support but does not actively sell these non-core services.

The Company has created its network by acquiring optical fiber from underlying carriers and directly connecting Internet routers to this optical fiber. Through 2004, the Company expanded its network through several acquisitions of financially distressed companies or their assets. Since then, it has primarily focused on the growth of its on-net Internet access services.

7

Recent Developments

Convertible Senior Notes

In June 2007, the Company issued 1.00% Convertible Senior Notes (the "Notes") due June 15, 2027, for an aggregate principal amount of \$200.0 million in a private offering for resale to qualified institutional buyers pursuant to SEC Rule 144A. The Notes are unsecured and bear interest at 1.00% per annum. The Notes will rank equally with any future senior debt and senior to any future subordinated debt and will be effectively subordinated to all existing and future liabilities of the Company or its subsidiaries and to any secured debt the Company may issue, to the extent of the value of the collateral. Interest is payable in cash semiannually in arrears on June 15 and December 15, of each year, beginning on December 15, 2007. The Company received proceeds of approximately \$195.5 million, after deducting the original issue discount of 2.25%. The Company used \$10.6 million of the proceeds to repay principal and accrued interest on its existing convertible subordinated notes on June 15, 2007 and used approximately \$50.1 million of the net proceeds to repurchase approximately 1.8 million shares of its common stock concurrently with the Notes offering. These 1.8 million common shares were subsequently retired. The Company intends to use the remaining proceeds for general corporate purposes. The discount and other issuance costs are being amortized to interest expense using the effective interest method through June 15, 2014, which is the earliest put date.

Conversion Process and Other Terms of the Notes

The Notes are convertible into shares of the Company's common stock at an initial conversion price of \$49.18 per share, or 20.3355 shares for each \$1,000 principal amount of Notes, subject to adjustment for certain events as set forth in the indenture. Upon conversion of the Notes, the Company will have the right to deliver shares of its common stock, cash or a combination of cash and shares of its common stock. The Notes are convertible (i) during any fiscal quarter after the fiscal quarter ending September 30, 2007, if the closing sale price of the Company's common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter exceeds 130% of the conversion price in effect on the last trading day of the immediately preceding fiscal quarter, or (ii) specified corporate transactions occur, or (iii) the trading price of the Notes falls below a certain threshold, or (iv) if the Company calls the Notes for redemption, or (v) on or after April 15, 2027 until maturity. In addition, following specified corporate transactions, the Company will increase the conversion rate for holders who elect to convert notes in connection with such corporate transactions, provided that in no event may the shares issued upon conversion, as a result of adjustment or otherwise, result in the issuance of more than 35.5872 common shares per \$1,000 principal amount or approximately 7.1 million shares. The Notes include an Irrevocable Election of Settlement whereby the Company may choose, in its sole discretion, and without the consent of the holders of the Notes, to waive its right to settle the conversion feature in either cash or stock or in any combination at its option.

The Notes may be redeemed by the Company at any time after June 20, 2014 at a redemption price of 100% of the principal amount plus accrued interest. Holders of the Notes have the right to require the Company to repurchase for cash all or some of their notes on June 15, 2014, 2017 and 2022 and upon the occurrence of certain designated events at a redemption price of 100% of the principal amount plus accrued interest.

Registration Rights

Under the terms of the Notes, the Company is required to use reasonable efforts to file and maintain a shelf registration statement with the SEC covering the resale of the Notes and the common stock issuable on conversion of the Notes. If the Company fails to meet these terms, the Company will be required to pay special interest on the Notes in the amount of 0.25% for the first 90 days after the occurrence of the failure to meet and 0.50% thereafter. In addition to the special interest, additional interest of 0.25% per annum will accrue in the event of default, as defined in the indenture. The Company filed a shelf registration statement registering the Notes and common stock issuable on conversion of the Notes in July 2007.

Basis of presentation

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the unaudited condensed consolidated financial statements reflect all normal recurring adjustments that the Company considers necessary for the fair presentation of its results of operations and cash flows for the interim periods covered, and of the financial position of the Company at the date of the interim condensed consolidated balance sheet. Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The operating results for interim periods are not necessarily indicative of the operating results for the entire year. While the Company believes that the disclosures are adequate to not make the information misleading, these interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in its 2006 annual report on Form 10-K.

Edgar Filing: COGENT COMMUNICATIONS GROUP INC - Form 10-Q

The accompanying unaudited consolidated financial statements include all wholly-owned subsidiaries. All inter-company accounts and activity have been eliminated.

Use of estimates

The preparation of consolidated financial statements in conformity with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates.

8

Foreign currency translation adjustment and comprehensive loss

Statement of Financial Accounting Standard (SFAS) No. 130, Reporting of Comprehensive Income requires comprehensive income and the components of other comprehensive income to be reported in the financial statements and/or notes thereto. The Company's only components of other comprehensive income are currency translation adjustments for all periods presented (in thousands).

	Three months ended June 30, 2006		Three months ended June 30, 2007		Six months ended June 30, 2006		Six months ended June 30, 2007
Net loss	\$ (15,491 )	)	\$ (9,192 )	)	\$ (31,932 )	)	\$ (18,596)
Currency translation	633	)	449	)	736	)	643
Comprehensive loss	\$ (14,858 )	)	\$ (8,743 )	)	\$ (31,196 )	)	\$ (17,953)

Financial instruments

The Company was party to letters of credit totaling approximately \$1.0 million at December 31, 2006 and June 30, 2007. These letters of credit are secured by certificates of deposit of approximately \$1.1 million at December 31, 2006 and June 30, 2007, that are restricted and included in short term investments and deposits and other assets.

Basic and diluted net loss per common share

Basic loss per share is based upon the weighted-average number of common shares outstanding during the period. Diluted loss per share is computed using the weighted-average number of common shares outstanding during the period plus the dilutive effect of potentially future issuances of common stock. For the three and six months ended June 30, 2006 and June 30, 2007, options to purchase 1.2 million shares of common stock at weighted-average exercise prices of \$2.67 and \$5.16 per share, respectively, are not included in the computation of diluted loss per share as the effect would be anti-dilutive. As of June 30, 2006 and June 30, 2007, 0.1 million and 1.3 million unvested shares of restricted common stock, respectively, are not included in the computation of loss per share. These shares will be included in the computation as they vest.

In calculating diluted loss per share, the dilutive effect of stock options and warrants is computed using the average market price for the period in accordance with the treasury stock method. The effect of convertible securities on the calculation of diluted loss per share is calculated using the if-converted method. Using the if-converted method, the shares issuable upon conversion of the Notes were anti-dilutive for the three and six months ending June 30, 2007. Accordingly, their impact has been excluded from the computation of diluted loss per share. The Notes are convertible into shares of the Company's Common stock at an initial conversion price of \$49.18 per share, or 4.1 million common shares, subject to certain adjustments set forth in the indenture.

Recent accounting pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109. FIN No. 48 requires that management determine whether a tax position is more likely than not to be sustained upon examination based on the technical merits of the position. Once it is determined that a position meets this recognition threshold, the position is measured to determine the amount of benefit to be recognized in the financial statements. The Company adopted the provisions of FIN No. 48 on January 1, 2007. The adoption of FIN No. 48 did not have a material effect on the Company's results of operations or financial position.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The Company is subject to U.S. federal tax and state tax examinations for years from 2003 to 2006. Management does not believe there will be any material changes in its unrecognized tax positions over the next 12 months.

The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN No. 48, the Company did not have any accrued interest or penalties associated with any unrecognized tax positions, and there was no interest expense or expense associated with penalties recognized during the three or six months ended June 30, 2007.

2. Equity-based compensation:

Incentive award plan

In April 2007, the Company's board of directors and stockholders approved an increase in the number of shares available for grant under the 2004 Incentive Award Plan (the Award Plan) of 2.0 million shares of common stock. As of June 30, 2007, there were a total of approximately 1.0 million shares available for grant under the Award Plan.

In January 2007, the Company issued 51,250 common shares to its non-management directors. These grants were valued at the Company's closing price on the date of grant, were fully vested upon grant, and resulted in approximately \$0.9 million of compensation expense in January 2007. During the three months ended June 30, 2007, the Company issued approximately 1.0 million shares of restricted stock to its employees. These grants were valued at the Company's closing price on the date of grant and will vest over periods ranging from two to four years. These grants will result in approximately \$25.2 million of compensation expense to be recorded ratably over the service period.

3. Property and equipment:

Depreciation and amortization expense related to property and equipment and capital leases was \$14.2 million and \$16.0 million for the three months ended June 30, 2006 and 2007, respectively, and was \$27.9 million and \$31.6 million for the six months ended June 30, 2006 and 2007, respectively.

Capitalized network construction labor and related costs

The Company capitalized salaries and related benefits of employees working directly on the construction and build-out of its network of \$0.6 million and \$0.7 million for the three months ended June 30, 2006 and 2007, respectively, and \$1.2 million and \$1.3 million for the six months ended June 30, 2006 and 2007, respectively.

4. Accrued liabilities:

Acquired lease obligations

In December 2004, the Company accrued for the net present value of estimated cash flows for amounts related to leases of abandoned facilities acquired in an acquisition. A reconciliation of the amounts related to these contract termination costs is as follows (in thousands):

Lease accrual	
Assumed obligation balance December 31, 2006	\$ 1,754
Amortization of discount	55
Amounts paid	(303)
Balance June 30, 2007	1,506
Current portion (included in accrued liabilities)	(538)
Long term portion (included in other long term liabilities)	\$ 968

5. Long-term debt and credit facility:

Notes

As discussed in Note 1, in June 2007, the Company issued 1.00% Notes due June 15, 2027, for an aggregate principal amount of \$200.0 million.

Convertible Subordinated Notes Allied Riser

The Company's \$10.2 million 7.50% convertible subordinated notes were recorded at their fair value of approximately \$2.9 million at the merger date in 2002. The discount was amortized to interest expense through the maturity date. The notes and accrued interest were fully paid in June 2007.

Credit facility

Edgar Filing: COGENT COMMUNICATIONS GROUP INC - Form 10-Q

The Company's \$20.0 million credit facility expired on April 1, 2007. Since June 2005 there were no amounts outstanding under the credit facility.

10

6. Contingencies:

Current and potential litigation

The Company is involved in disputes with certain telephone companies that provide it local circuits or leased optical fibers. The total amount claimed by these vendors is \$3.0 million. The Company does not believe any of these amounts are owed to these providers and intends to vigorously defend its position and believes that it has adequately reserved for any potential liability.

The Company has been made aware of several other companies in its own and in other industries that use the word "Cogent" in their corporate names. One company has informed the Company that it believes the Company's use of the name "Cogent" infringes on its intellectual property rights in that name. If such a challenge is successful, the Company could be required to change its name and lose the value associated with the Cogent name in its markets. Management does not believe such a challenge, if successful, would have a material impact on the Company's business, financial condition or results of operations.

In December 2003, several former employees of Cogent Spain filed claims related to their termination of employment. One case has been resolved and the others are in various stages of appeal. The Company intends to continue to vigorously defend its position related to these charges and feels that it has adequately reserved for any potential liability.

In the normal course of business the Company is involved in other legal activities and claims. Because such matters are subject to many uncertainties and the outcomes are not predictable with assurance, the liability related to these legal actions and claims cannot be determined with certainty. Management does not believe that such claims and actions will have a material impact on the Company's financial condition or results of operations.

7. Related party transactions:

Office lease

The Company's headquarters is located in an office building owned by an entity controlled by the Company's Chief Executive Officer. The Company paid \$92,000 and \$211,000 in the three and six months ended June 30, 2006 and \$109,000 and \$274,000 in the three and six months ended June 30, 2007, respectively, in rent and related costs to this entity. The lease expires in August 2010.

LNG Holdings SA ("LNG")

In November 2003, approximately 90% of the stock of LNG, the then parent company of Cogent Europe was acquired by Symposium Inc. ("Symposium") a Delaware corporation. The Company's Chief Executive Officer owns 100% of Symposium. In the six months ended June 30, 2007 the Company paid approximately \$14,000 for professional services performed for LNG and the Company received reimbursement from LNG for approximately \$85,000 of professional fees paid for LNG in 2006.

8. Segment information:

The Company operates as one operating segment. Below are the Company's net service revenues and long lived assets by geographic region (in thousands):

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2007	Six Months Ended June 30, 2006	Six Months Ended June 30, 2007
Net Revenues				
North America	\$ 28,454	\$ 35,298	\$ 55,589	\$ 69,317
Europe	7,701	9,810	15,013	19,412
Total	\$ 36,155	\$ 45,108	\$ 70,602	\$ 88,729

	December 31, 2006	June 30, 2007
Long lived assets, net		
North America	\$ 221,942	\$ 211,322

Edgar Filing: COGENT COMMUNICATIONS GROUP INC - Form 10-Q

Europe	42,476	41,528
Total	\$ 264,418	\$ 252,850

11

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis together with our consolidated condensed financial statements and related notes included in this report. The discussion in this report contains forward-looking statements that involve risks and uncertainties, such as statements of our plans, objectives, expectations and intentions. The cautionary statements made in this report should be read as applying to all related forward-looking statements wherever they appear in this report. Our actual results could differ materially from those discussed here. Factors that could cause or contribute to these differences include those discussed in Item 1A Risk Factors in our annual report on Form 10-K for the fiscal year ended December 31, 2006.

General Overview

We are a leading facilities-based provider of low-cost, high-speed Internet access and IP communications services. Our network is specifically designed and optimized to transmit data using IP. IP networks are significantly less expensive to operate and are able to achieve higher performance levels than the traditional circuit-switched networks used by our competitors, thus giving us cost and performance advantages in our industry. We deliver our services to small and medium-sized businesses, communications service providers and other bandwidth-intensive organizations through over 13,780 customer connections in North America and Western Europe. Our primary on-net service is Internet access at a speed of 100 Megabits per second and greater. We offer this on-net service exclusively through our own facilities, which run all the way to our customers' premises.

Our network is comprised of in-building riser facilities, metropolitan optical fiber networks, metropolitan traffic aggregation points and inter-city transport facilities. The network is physically connected entirely through our facilities to over 1,150 buildings in which we provide our on-net services, including over 885 multi-tenant office buildings. We also provide on-net services in carrier-neutral colocation facilities, data centers and single-tenant office buildings. Because of our integrated network architecture, we are not dependent on local telephone companies to serve our on-net customers. We emphasize the sale of on-net services because we believe we have a competitive advantage in providing these services and our sales of these services generate higher gross profit margins than our off-net and non-core services.

We also provide Internet connectivity to customers that are not located in buildings directly connected to our network. We serve these off-net customers using other carriers' facilities to provide the last mile portion of the link from our customers' premises to our network. We also provide certain non-core services which are legacy services which we acquired and continue to support but do not actively sell.

We believe our key opportunity is provided by our high-capacity network, which provides us with the ability to add a significant number of customers to our network with minimal incremental costs. Our focus is to add customers to our network in a way that maximizes its use and at the same time provides us with a customer mix that produces strong profit margins. We are responding to this opportunity by increasing our sales and marketing efforts including increasing our number of sales representatives. In addition, we may add customers to our network through strategic acquisitions.

We plan to expand our network to locations that can be economically integrated and represent significant concentrations of Internet traffic. One of our keys to developing a profitable business will be to carefully match the expense of extending our network to reach new customers with the revenue generated by those customers.

We believe the two most important trends in our industry are the continued growth in Internet traffic and a decline in Internet access prices. As Internet traffic continues to grow and prices per unit of traffic continue to decline, we believe our ability to load our network and gain market share from less efficient network operators will expand. However, continued erosion in Internet access prices will likely have a negative impact on the rate at which we can increase our revenues and our profit margins.

Our on-net service consists of high-speed Internet access and IP connectivity ranging from 0.5 Megabits per second to 10 Gigabits per second of bandwidth. We offer our on-net services to customers located in buildings that are physically connected to our network. Off-net services are sold to businesses that are connected to our network primarily by means of T1, T3, E1 and E3 and Ethernet link lines obtained from other carriers. Our non-core services, which consist of legacy services of companies whose assets or businesses we have acquired, include managed modem services, email, retail dial-up Internet access, shared web hosting, managed web hosting, managed security, voice services (only provided in Toronto, Canada) and point to point private line services. We do not actively market these non-core services and expect the net service revenue associated with them to continue to decline.

Due to our strategic acquisitions of network assets and equipment, we believe we are positioned to grow our revenue base. We continue to deploy network equipment to parts of our network to maximize the utilization of our assets. Our future capital expenditures will be based

Edgar Filing: COGENT COMMUNICATIONS GROUP INC - Form 10-Q

primarily on our planned expansion of our network and on-net buildings and the concentration and growth of our customer base. We expect our 2007 capital expenditures to be approximately \$28.0 million. We plan to increase our number of on-net buildings by approximately 100 buildings by December 31, 2007 from 1,107 buildings at December 31, 2006.

12

Edgar Filing: COGENT COMMUNICATIONS GROUP INC - Form 10-Q

Historically, our operating expenses have exceeded our net service revenue resulting in operating losses. Our operating expenses consist primarily of the following:

- Network operations expenses, which consist primarily of the cost of leased circuits, sites and facilities; telecommunications license agreements, maintenance expenses, and salaries of, and expenses related to, employees who are directly involved with maintenance and operation of our network.
- Selling, general and administrative expenses, which consist primarily of salaries, commissions and related benefits paid to our employees and related selling and administrative costs including professional fees and bad debt expenses.
- Depreciation and amortization expenses, which result from the depreciation of our property and equipment, including the assets associated with our network and the amortization of our intangible assets.
- Equity-based compensation expenses that result from the grants of stock options and restricted stock.

Results of Operations

Our management reviews and analyzes several key performance indicators in order to manage our business. These key performance indicators include:

- net service revenues, which are an indicator of our overall business growth and the success of our sales and marketing efforts and sales representative productivity;
- gross profit, which is an indicator of our service offering mix, competitive pricing pressures and the cost of our network operations;
- growth in our on-net customer base and revenues, which is an indicator of the success of our on-net focused sales efforts and sales representative productivity;
- growth in the number of on-net buildings; and
- the distribution of revenue across our service offerings.

Three Months Ended June 30, 2006 Compared to the Three Months Ended June 30, 2007

The following summary table presents a comparison of our results of operations for the three months ended June 30, 2006 and 2007 with respect to certain key financial measures. The comparisons illustrated in the table are discussed in greater detail below.

	Three months ended		Percent Change	
	June 30, 2006	2007		
	(in thousands)			
Net service revenue	\$ 36,155	\$ 45,108	24.8	%
Network operations expenses (1)	20,076	21,428	6.7	%
Gross profit (2)	16,079	23,680	47.3	%
Selling, general, and administrative expenses (3)	11,594	12,625	8.9	%
Equity-based compensation expense	3,372	2,466	(26.9))%
Depreciation and amortization expenses	14,658	16,332	11.4	%
Net loss	(15,491	) (9,192	) (40.7)%

(1) Excludes equity-based compensation expenses of \$101 and \$74 in the three months ended June 30, 2006 and

2007, respectively, which, if included would have resulted in a period-to-period change of 6.6%.

(2) Excludes equity-based compensation expenses of \$101 and \$74 in the three months ended June 30, 2006 and 2007, respectively, which if included would have resulted in a period-to-period change of 47.7%.

(3) Excludes equity-based compensation expenses of \$3,271 and \$2,392 in the three months ended June 30, 2006 and 2007, respectively, which, if included would have resulted in a period-to-period change of 1.0%.

13

Net Service Revenue. Our net service revenue increased 24.8% from \$36.2 million for the three months ended June 30, 2006 to \$45.1 million for the three months ended June 30, 2007. The impact of exchange rates resulted in approximately \$0.7 million of this increase in revenues. For the three months ended June 30, 2006 and 2007, on-net, off-net and non-core revenues represented 69.6%, 23.7% and 6.7% and 78.2%, 17.6% and 4.2% of our net service revenues, respectively.

Our on-net revenues increased 40.4% from \$25.1 million for the three months ended June 30, 2006 to \$35.3 million for the three months ended June 30, 2007. Our on-net revenues increased as we increased the number of our on-net customer connections by 61.5% from approximately 6,100 at June 30, 2006 to approximately 9,800 at June 30, 2007. On-net customer connections increased at a greater rate than on-net revenues due to a decline in the revenue per on-net customer connection, which we expect to continue. This decline is partly attributed to a shift in the customer connection mix. Due to the increase in the size of our sales force, we are now able to focus not only on customers who purchase high-bandwidth connections, as we have done historically, but also on customers who purchase lower-bandwidth connections. We expect to continue to focus our sales efforts on a broad mix of customers. Additionally, on-net customers who cancel their service, in general, have greater revenue per connection than new customers. These trends result in lower revenue per on-net connection. We believe that our on-net revenues as a percentage of total revenues will continue to increase as we are allocating the majority of our sales and marketing resources toward obtaining additional on-net customers.

Our off-net revenues decreased 7.5% from \$8.6 million for the three months ended June 30, 2006 to \$7.9 million for the three months ended June 30, 2007. Our off-net customer connections declined from approximately 3,500 at June 30, 2006 to approximately 3,100 at June 30, 2007. We expect that the net loss of off-net customer connections will continue. Our non-core revenues decreased 22.8% from \$2.4 million for the three months ended June 30, 2006 to \$1.9 million for the three months ending June 30, 2007. The number of our non-core customer connections declined from approximately 1,100 at June 30, 2006 to approximately 900 at June 30, 2007. We do not actively market these acquired non-core services and expect that the net service revenue associated with them will continue to decline.

Network Operations Expenses. Our network operations expenses, excluding equity-based compensation expense, increased 6.7% from \$20.1 million for the three months ended June 30, 2006 to \$21.4 million for the three months ended June 30, 2007. The increase is primarily attributable to an increase in facilities-related costs related to our expansion activities partly offset by a decline in leased circuit costs related to the decline in off-net revenues. We provide Internet connectivity to our off-net customers using other carriers' facilities to provide the last mile portion of the link from our customers' premises to our network and incur leased circuit costs to provide these services.

Gross Profit. Our gross profit, excluding equity-based compensation expense, increased 47.3% from \$16.1 million for the three months ended June 30, 2006 to \$23.7 million for the three months ended June 30, 2007. We determine gross profit by subtracting network operation expenses from our net service revenue (excluding equity-based compensation expense) and do not allocate depreciation and amortization expense to our network operations expense. The increase is primarily attributed to the increase in higher gross margin on-net revenues as a percentage of net service revenue. Our gross profit margin expanded from 44.5% for the three months ended June 30, 2006 to 52.5% for the three months ended June 30, 2007. Our gross profit has benefited from the limited incremental expenses associated with providing service to an increasing number of on-net customers and the decline in off-net revenues which carry a lower gross margin due to the associated leased circuit required to provide this service. Our gross profit margin may be impacted by the timing and amounts of disputed circuit costs and the additional costs of expanding our network. We generally record disputed circuit costs amounts when billed by the vendor and reverse these amounts when the vendor credit has been received or the dispute has been otherwise resolved. We believe that our gross profit margin will continue to increase as we are allocating the majority of our sales and marketing resources toward obtaining additional on-net customers and as sales of these services generate higher gross profit margins than our off-net and non-core services.

Selling, General, and Administrative Expenses. Our SG&A expenses, excluding equity-based compensation expense, increased 8.9% from \$11.6 million for the three months ended June 30, 2006 to \$12.6 million for the three months ended June 30, 2007. SG&A expenses increased primarily from the increase in salaries and related costs required to support our expanding sales and marketing efforts.

Equity-based Compensation Expense. Equity-based compensation expense is related to restricted stock and stock options. The total equity-based compensation expense decreased 26.9% from \$3.4 million for the three months ended June 30, 2006 to \$2.5 million for the three months ending June 30, 2007. The decrease is primarily attributed to a \$2.5 million decrease in equity-based compensation expense associated with the amortization of compensation expense for certain 2003 restricted stock grants which ended in August 2006 when these shares became fully vested. The decrease was partly offset by compensation expense from the issuances of restricted stock to our employees in the three months ended June 30, 2007. During the three months ended June 30, 2007, we issued approximately 1.0 million shares of restricted stock to our employees. These grants were valued at our closing stock price on the date of grant and will vest over periods ranging from two to four years. These grants resulted in approximately \$1.8 million in equity based compensation expense for the three months ended June 30, 2007.

Depreciation and Amortization Expenses. Our depreciation and amortization expense increased 11.4% from \$14.7 million for the three months ended June 30, 2006 to \$16.3 million for the three months ended June 30, 2007 primarily due to an increase in fixed assets.

Net Loss. Our net loss was \$15.5 million for the three months ended June 30, 2006 as compared to a net loss of \$9.2 million for the three months ended June 30, 2007. Our net loss decreased by \$6.3 million as a result of a \$7.6 million increase in our gross margin and \$0.9 million reduction in equity based compensation expense partly offset by a \$1.0 million increase in SG&A expenses and a \$1.7 million increase in depreciation and amortization expenses.

Buildings On-net. As of June 30, 2006 and 2007 we had a total of 1,076 and 1,159 on-net buildings connected to our network, respectively.

Six Months Ended June 30, 2006 Compared to the Six Months Ended June 30, 2007

The following summary table presents a comparison of our results of operations for the six months ended June 30, 2006 and 2007 with respect to certain key financial measures. The comparisons illustrated in the table are discussed in greater detail below.

	Six months ended		Percent Change	
	June 30, 2006	2007		
	(in thousands)			
Net service revenue	\$ 70,602	\$ 88,729	25.7	%
Network operations expenses (1)	40,413	42,443	5.0	%
Gross profit (2)	30,189	46,286	53.3	%
Selling, general, and administrative expenses (3)	22,379	25,187	12.5	%
Equity-based compensation expense	6,871	4,084	(40.6))%
Depreciation and amortization expenses	28,801	32,238	11.9	%
Net loss	(31,932)	(18,596)	(41.8))%

(1) Excludes equity-based compensation expenses of \$206 and \$123 in the six months ended June 30, 2006 and 2007, respectively, which, if included would have resulted in a period-to-period change of 4.8%.

(2) Excludes equity-based compensation expenses of \$206 and \$123 in the six months ended June 30, 2006 and 2007, respectively, which if included would have resulted in a period-to-period change of 54.0%.

(3) Excludes equity-based compensation expenses of \$6,665 and \$3,961 in the six months ended June 30, 2006 and 2007, respectively, which, if included would have resulted in a period-to-period change of 0.4%.

Net Service Revenue. Our net service revenue increased 25.7% from \$70.6 million for the six months ended June 30, 2006 to \$88.7 million for the six months ended June 30, 2007. The impact of exchange rates resulted in approximately \$1.5 million of this increase in revenues. For the six months ended June 30, 2006 and 2007, on-net, off-net and non-core revenues represented 67.7%, 25.1% and 7.2% and 77.1%, 18.5% and 4.4% of our net service revenues, respectively.

Our on-net revenues increased 43.1% from \$47.8 million for the six months ended June 30, 2006 to \$68.4 million for the six months ended June 30, 2007. Our on-net revenues increased as we increased the number of our on-net customer connections by 61.5% from approximately 6,100 at June 30, 2006 to approximately 9,800 at June 30, 2007. On-net customer connections increased at a greater rate than on-net revenues due to a decline in the revenue per on-net customer connection, which we expect to continue. This decline is partly attributed to a shift in the customer connection mix. Due to the increase in the size of our sales force, we are now able to focus not only on customers who purchase high-bandwidth connections, as we have done historically, but also on customers who purchase lower-bandwidth connections. We expect to continue to focus our sales efforts on a broad mix of customers. Additionally, on-net customers who cancel their service, in general, have greater revenue per connection than new customers. These trends result in lower revenue per on-net connection. We believe that our on-net revenues as a percentage of total revenues will continue to increase as we are allocating the majority of our sales and marketing resources toward obtaining additional on-net customers.

Our off-net revenues decreased 7.3% from \$17.7 million for the six months ended June 30, 2006 to \$16.4 million for the six months ended June 30, 2007. Our off-net customer connections declined from approximately 3,500 at June 30, 2006 to approximately 3,100 at June 30, 2007. We expect that the net loss of off-net customer connections will continue. Our non-core revenues decreased 23.4% from \$5.1 million for the six months ended June 30, 2006 to \$3.9 million for the six months ending June 30, 2007. The number of our non-core customer connections declined from approximately 1,100 at June 30, 2006 to approximately 900 at June 30, 2007. We do not actively market these acquired non-core services and expect that the net service revenue associated with them will continue to decline.

Network Operations Expenses. Our network operations expenses, excluding equity-based compensation expense, increased 5.0% from \$40.4 million for the six months ended June 30, 2006 to \$42.4 million for the six months ended June 30,

2007. The increase is primarily attributable to an increase in facilities related costs related to our expansion activities partly offset by a decline in leased circuit costs related to the decline in off-net revenues. We provide Internet connectivity to our off-net customers using other carriers' facilities to provide the last mile portion of the link from our customers' premises to our network and incur leased circuit costs to provide these services.

15

Gross Profit. Our gross profit, excluding equity-based compensation expense, increased 53.3% from \$30.2 million for the six months ended June 30, 2006 to \$46.3 million for the six months ended June 30, 2007. We determine gross profit by subtracting network operation expenses from our net service revenue (excluding equity-based compensation expense) and do not allocate depreciation and amortization expense to our network operations expense. The increase is primarily attributed to the increase in higher gross margin on-net revenues as a percentage of net service revenue. Our gross profit margin expanded from 42.8% for the six months ended June 30, 2006 to 52.2% for the six months ended June 30, 2007. Our gross profit has benefited from the limited incremental expenses associated with providing service to an increasing number of on-net customers and the decline in off-net revenues which carry a lower gross margin due to the associated leased circuit required to provide this service. Our gross profit margin may be impacted by the timing and amounts of disputed circuit costs and the additional costs of expanding our network. We generally record disputed circuit costs amounts when billed by the vendor and reverse these amounts when the vendor credit has been received or the dispute has been otherwise resolved. We believe that our gross profit margin will continue to increase as we are allocating the majority of our sales and marketing resources toward obtaining additional on-net customers and as sales of these services generate higher gross profit margins than our off-net and non-core services.

Selling, General, and Administrative Expenses. Our SG&A expenses, excluding equity-based compensation expense, increased 12.5% from \$22.4 million for the six months ended June 30, 2006 to \$25.2 million for the six months ended June 30, 2007. SG&A expenses increased primarily from the increase in salaries and related costs required to support our expanding sales and marketing efforts.

Equity-based Compensation Expense. Equity-based compensation expense is related to restricted stock and stock options. The total equity-based compensation expense decreased 40.6% from \$6.9 million for the six months ended June 30, 2006 to \$4.1 million for the six months ending June 30, 2007. The decrease is primarily attributed to a \$5.1 million decrease in equity-based compensation expense associated with the amortization of compensation expense for certain 2003 restricted stock grants which ended in August 2006 when these shares became fully vested. The decrease was partly offset by compensation expense from grants of restricted stock made in the in the six months ended June 30, 2007. In January 2007 we granted 51,250 shares of restricted stock to our non-management directors. These grants were valued at our closing price on the date of grant, were fully vested upon grant, and resulted in approximately \$0.9 million of compensation expense during the six months ended June 30, 2007. During the three months ended June 30, 2007, we issued approximately 1.0 million shares of restricted stock to our employees. These grants were valued at our closing stock price on the date of grant and will vest over periods ranging from two to four years. These grants resulted in approximately \$1.8 million in equity based compensation expense for the six months ended June 30, 2007.

Depreciation and Amortization Expenses. Our depreciation and amortization expense increased 11.9% from \$28.8 million for the six months ended June 30, 2006 to \$32.2 million for the six months ended June 30, 2007 primarily due to an increase in fixed assets.

Net Loss. Our net loss was \$31.9 million for the six months ended June 30, 2006 as compared to a net loss of \$18.6 million for the six months ended June 30, 2007. Our net loss decreased by \$13.3 million as a result of a \$16.1 million increase in our gross margin and \$2.8 million reduction in equity based compensation expense partly offset by a \$2.8 million increase in SG&A expenses and a \$3.4 million increase in depreciation and amortization expenses.

Buildings On-net. As of June 30, 2006 and 2007 we had a total of 1,076 and 1,159 on-net buildings connected to our network, respectively.

Liquidity and Capital Resources

In assessing our liquidity, management reviews and analyzes our current cash balances on-hand, short-term investments, accounts receivable, accounts payable, capital expenditure commitments, and required capital lease and debt payments and other obligations.

Cash Flows

The following table sets forth our consolidated cash flows for the six months ended June 30, 2006 and six months ended June 30, 2007.

	Six months ended June 30,	
	2006	2007
	(in thousands)	
Net cash provided by operating activities	\$ 3,327	\$ 23,913
Net cash used in investing activities	(11,057)	(17,684)
Net cash provided by financing activities	31,674	132,491
Effect of exchange rates on cash	355	392
Net increase in cash and cash equivalents during period	\$ 24,299	\$ 139,112

Net Cash Provided by Operating Activities. Our primary sources of operating cash are receipts from our customers who are billed on a monthly basis for our services. Our primary uses of operating cash are payments made to our vendors and employees. Net cash provided by operating activities was \$3.3 million for the six months ended June 30, 2006 compared to net cash provided by operating activities of

\$23.9 million for the six months ended June 30, 2007. The increase in cash provided by operating activities is due to an increase in our gross profit and an improvement in the changes in operating assets and liabilities from a use of cash of \$1.4 million for the six months ended June 30, 2006 to an increase of cash of \$5.1 million for the six months ended June 30, 2007.

Net Cash Used In Investing Activities. Net cash used in investing activities was \$11.1 million for the six months ended June 30, 2006 and \$17.7 million for the six months ended June 30, 2007. Our primary use of investing cash for the six months ended June 30, 2006 was \$11.8 million for the purchases of property and equipment. Our primary source of investing cash for the six months ended June 30, 2006 was \$0.7 million from the maturities of short-term investments. Our primary use of investing cash for the six months ended June 30, 2007 was \$17.1 million for the purchases of property and equipment and \$0.6 million for the purchase of short-term investments. The increase in purchases of property and equipment from the six months ended June 30, 2006 to the six months ended June 30, 2007 is primarily due to our network expansion activities.

Net Cash Used In Financing Activities. Net cash provided by financing activities was \$31.7 million for the six months June 30, 2006. Net cash provided by financing activities was \$132.5 million for the six months June 30, 2007. Our primary use of financing cash for the six months ended June 30, 2006 was \$4.9 million of principal payments under our capital lease obligations. Our primary use of financing cash for the six months ended June 30, 2007 was \$50.1 million for the purchase of 1.8 million shares of our common stock, \$10.2 million for the repayment of our convertible subordinated notes on their June 15, 2007 maturity date and \$3.2 million of principal payments under our capital lease obligations. Our primary source of financing cash for the six months ended June 30, 2006 was \$36.5 million of net proceeds from a public offering of common stock. Our primary source of financing cash for the six months ended June 30, 2007 was \$195.5 million of proceeds from the issuance of our 1.00% Convertible Senior Notes.

Cash Position and Indebtedness

Our total cash and cash equivalents and short-term investments were \$182.4 million at June 30, 2007. Our total indebtedness, net of discount, at June 30, 2007 was \$283.6 million. Our total indebtedness includes \$88.0 million of capital lease obligations for dark fiber primarily under 15-25 year IRUs, of which approximately \$6.8 million is considered a current liability. These capital lease obligations will be paid over a weighted average remaining term of approximately twelve years.

Convertible Senior Notes

In June 2007, we issued 1.00% Convertible Senior Notes (the *Notes*) due June 15, 2027, for an aggregate principal amount of \$200.0 million in a private offering for resale to qualified institutional buyers pursuant to SEC Rule 144A. The Notes are unsecured and bear interest at 1.00% per annum. The Notes will rank equally with any future senior debt and senior to any future subordinated debt and will be effectively subordinated to all of our existing and future liabilities and to any secured debt we may issue to the extent of the value of the collateral. Interest is payable in cash semiannually in arrears on June 15 and December 15, of each year, beginning on December 15, 2007. We received proceeds of approximately \$195.5 million after deducting the original issue discount of 2.25%. We used \$10.6 million of the proceeds to repay principal and accrued interest on our existing convertible subordinated notes on June 15, 2007 and approximately \$50.1 million to repurchase approximately 1.8 million shares of our common stock. These 1.8 million common shares were subsequently retired. We intend to use the remaining proceeds for general corporate purposes.

The Notes are convertible into shares of our common stock at an initial conversion price of \$49.18 per share, or 20.3355 shares for each \$1,000 principal amount of Notes, subject to adjustment for certain events as set forth in the indenture. Upon conversion of the Notes, we will have the right to deliver shares of our common stock, cash or a combination of cash and shares of our common stock. The Notes are convertible (i) during any fiscal quarter after the fiscal quarter ending September 30, 2007, if the closing sale price of our common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter exceeds 130% of the conversion price in effect on the last trading day of the immediately preceding fiscal quarter, or (ii) specified corporate transactions occur, or (iii) the trading price of the Notes falls below a certain threshold, or (iv) if we call the Notes for redemption, or (v) on or after April 15, 2027 until maturity. In addition, following specified corporate transactions, we will increase the conversion rate for holders who elect to convert Notes in connection with such corporate transactions, provided that in no event may the shares issued upon conversion, as a result of adjustment or otherwise, result in the issuance of more than 35.5872 common shares per \$1,000 principal amount, or approximately 7.1 million shares. The Notes include an Irrevocable Election of Settlement whereby we may choose, in our sole discretion, and without the consent of the holders of the Notes, to waive our right to settle the conversion feature in either cash or stock or in any combination at our option.

Edgar Filing: COGENT COMMUNICATIONS GROUP INC - Form 10-Q

The Notes may be redeemed by us at any time after June 20, 2014 at a redemption price of 100% of the principal amount plus accrued interest. Holders of the Notes have the right to require us to repurchase for cash all or some of their Notes on June 15, 2014, 2017 and 2022 and upon the occurrence of certain designated events at a redemption price of 100% of the principal amount plus accrued interest.

Under the terms of the Notes, we are required to use reasonable efforts to file and maintain a shelf registration statement with the SEC covering the resale of the Notes and the common stock issuable on the conversion of the Notes. If we fail to meet these terms, we will be required to pay special interest on the Notes in the amount of 0.25% for the first 90 days after the occurrence of the failure to meet and 0.50% thereafter. In addition to the special interest, additional interest of 0.25% per annum will accrue in the event of default as defined in the indenture. We filed a shelf registration statement registering the Notes and common stock issuable on conversion of the Notes in July 2007.

17

Convertible Subordinated Notes.

Our \$10.2 million 7.50% convertible subordinated notes were due on June 15, 2007. These notes and accrued interest were paid on June 15, 2007 with part of the proceeds from the Notes.

Credit Facility

On March 9, 2005, we entered into a \$20 million credit facility with a commercial bank. The credit facility expired on April 1, 2007.

Contractual Obligations and Commitments

For our contractual obligations and commitments see Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations of our annual report on Form 10-K for the year ended December 31, 2006. The long-term debt component of our contractual obligations and commitments has changed materially since December 31, 2006 due to the issuance of our Convertible Senior Notes. The terms of our Convertible Senior Notes are described above.

Future Capital Requirements

We believe that our cash on hand and cash generated from our operating activities will be adequate to meet our working capital, capital expenditure, debt service and other cash requirements if we execute our business plan. Our business plan for 2007 includes increasing our number of on-net buildings by approximately 100 buildings by December 31, 2007 from 1,107 buildings at December 31, 2006 and continuing to increase our number of sales representatives and our marketing efforts. We expect our capital expenditures for 2007 to be approximately \$28.0 million.

Our business plan also assumes, among other things, the following:

- our ability to continue to increase the size of our on-net customer base;
- our ability to maintain our recent sales productivity performance and incremental sales product mix;
- our ability to locate and hire sales representatives according to our plan;
- no material changes to the conversion rate between the Euro and the U.S. dollar and the Canadian dollar and the U.S. dollar;
- no material increases in our revenue churn rate;
- no material decline in our product pricing;
- no material increases in our customer bad debt;
- our capital expenditures including the costs of our expansion plan will not materially differ from our plan;
- no material losses from contingencies; and
- our ability to add revenue generating buildings to our network.

Any future acquisitions or other significant unplanned costs or cash requirements may require that we raise additional funds through the issuance of debt or equity. We cannot assure you that such financing will be available on terms acceptable to us or our stockholders, or at all. Insufficient funds may require us to delay or scale back the number of buildings that we serve, reduce our planned increase in our sales and marketing efforts, or require us to otherwise alter our business plan or take other actions that could have a material adverse effect on our business, results of operations and financial condition. If issuing equity securities raises additional funds, substantial dilution to existing stockholders may result.

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

18

Critical Accounting Policies and Significant Estimates

Management believes that as of June 30, 2007, there have been no material changes to our critical accounting policies and significant estimates from those listed in Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations of our annual report on Form 10-K for the year ended December 31, 2006, except as noted below

- We evaluated the embedded conversion option of our 1.00% Convertible Senior Notes (the Notes) in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, EITF Issue No. 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in a Company's Own Stock and EITF Issue No. 01-6 The Meaning of Indexed to a Company's Own Stock, and concluded that the embedded conversion option contained within the Notes should not be accounted for separately because the conversion option is indexed to our common stock and would be classified within stockholders' equity, if issued on a standalone basis.
- We evaluated the terms of the Notes for a beneficial conversion feature in accordance with EITF No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios and EITF No. 00-27, Application of Issue 98-5 to Certain Convertible Instruments and concluded that there was no beneficial conversion feature at the commitment date based on the conversion rate of the Notes relative to the commitment date stock price. We will continue to evaluate potential future beneficial conversion charges based upon potential future triggering conversion events.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

For quantitative and qualitative disclosures about market risk see Item 7A Quantitative and Qualitative Disclosures About Market Risk, of our annual report on Form 10-K for the year ended December 31, 2006. Our exposures to market risk have not changed materially since December 31, 2006.

ITEM 4. CONTROLS AND PROCEDURES.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), an evaluation was performed under the supervision and with the participation of our management, including our principal executive officer and our principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, our management, including our principal executive officer and our principal financial officer, concluded that the design and operation of these disclosure controls and procedures were effective at the reasonable assurance level.

There has been no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

We are involved in legal proceedings in the normal course of our business that we do not expect to have a material impact on our operations or results of operations. The more significant of these proceedings are discussed in Note 6 of our interim condensed consolidated financial statements.

ITEM 1A. RISK FACTORS

We need to retain existing customers and continue to add new customers in order to become profitable and remain cash flow positive.

In order to become profitable and remain consistently cash flow positive, we need to both retain existing customers and continue to add a large number of new customers. The precise number of additional customers required to become profitable and remain consistently cash flow positive is dependent on a number of factors, including the turnover of existing customers and the revenue mix among customers. We may not succeed in adding customers if our sales and marketing plan is unsuccessful. In addition, many of our target customers are existing businesses that are already purchasing Internet access services from one or more providers, often under a contractual commitment, and it has been our experience that such target customers are often reluctant to switch providers due to costs associated with switching providers. Further, as some of our customers grow larger they may decide to build or otherwise acquire their own Internet networks. While no single customer accounted for more than approximately 3.0% of our revenues for the six months ended June 30, 2007, a migration of a few very large Internet users to their own networks could impair our growth.

We have historically incurred operating losses and these losses may continue for the foreseeable future.

Since we initiated operations in 2000, we have generated operating losses and these losses may continue for the foreseeable future. In 2005 we had an operating loss of \$62.1 million, in 2006 we had an operating loss of \$46.6 million and in the six months ended June 30, 2007 we had an operating loss of \$15.2 million. As of June 30, 2007, we had an accumulated deficit of \$283.6 million. Continued losses may prevent us from pursuing our strategies for growth or may require us to seek unplanned additional capital and could cause us to be unable to meet our debt service obligations, capital expenditure requirements or working capital needs.

We are experiencing rapid growth of our business and operations and we may not be able to efficiently manage our growth.

We have rapidly grown our company through acquisitions of companies, assets and customers as well as implementation of our own network expansion and the acquisition of new customers through our own sales efforts. Our expansion places significant strains on our management, operational and financial infrastructure. Our ability to manage our growth will be particularly dependent upon our ability to:

- expand, develop and retain an effective sales force and qualified personnel;
- maintain the quality of our operations and our service offerings;
- maintain and enhance our system of internal controls to ensure timely and accurate compliance with our regulatory reporting requirements; and
- expand our accounting and operational information systems in order to support our growth.

If we fail to implement these measures successfully, our ability to manage our growth will be impaired.

We may experience delays and additional costs in expanding our on-net buildings.

Currently, we plan to increase our carrier-neutral facilities and other on-net buildings from 1,159 at June 30, 2007 to approximately 1,200 buildings by December 31, 2007 for an approximate additional 100 additional buildings for the year ended December 31, 2007. We may be unsuccessful at identifying appropriate buildings or negotiating favorable terms for acquiring access to such buildings, and consequently, may experience difficulty in adding customers to our network and fully using the network's capacity.

We may not successfully make or integrate acquisitions or enter into strategic alliances.

As part of our growth strategy, we intend to pursue selected acquisitions and strategic alliances. To date, we have completed 13 acquisitions. We compete with other companies for acquisition opportunities and we cannot assure you that we will be able to effect future acquisitions or strategic alliances on commercially reasonable terms or at all. Even if we enter into these transactions, we may experience:

- delays in realizing or a failure to realize the benefits we anticipate;

- difficulties or higher-than-anticipated costs associated with integrating any acquired companies, products or services into our existing business;
- attrition of key personnel from acquired businesses;
- unexpected costs or charges; or
- unforeseen operating difficulties that require significant financial and managerial resources that would otherwise be available for the ongoing development or expansion of our existing operations.

In the past, our acquisitions have often included assets, service offerings and financial obligations that are not compatible with our core business strategy. We have expended management attention and other resources to the divestiture of assets, modification of products and systems as well as restructuring financial obligations of acquired operations. In most acquisitions, we have been successful in renegotiating long-term agreements that we have acquired relating to long distance and local transport of data and IP traffic. If we are unable to satisfactorily renegotiate such agreements in the future or with respect to future acquisitions, we may be exposed to large claims for payment for services and facilities we do not need.

Consummating these transactions could also result in the incurrence of additional debt and related interest expense, as well as unforeseen contingent liabilities, all of which could have a material adverse effect on our business, financial condition and results of operations. Because we have purchased financially distressed companies or their assets, and may continue to do so in the future, we have not had, and may not have, the opportunity to perform extensive due diligence or obtain contractual protections and indemnifications that are customarily provided in corporate acquisitions. As a result, we may face unexpected contingent liabilities arising from these acquisitions. We may also issue additional equity in connection with these transactions, which would dilute our existing shareholders.

Revenues generated by the customer contracts that we have acquired have accounted for a substantial portion of our historical growth in net service revenue. However, following an acquisition, we have experienced a decline in revenue attributable to acquired customers as these customers' contracts have expired and they have entered into standard Cogent customer contracts at generally lower rates or have chosen not to renew service with us. We anticipate that we will experience similar declines with respect to customers we have acquired or will acquire.

We depend upon our key employees and may be unable to attract or retain sufficient qualified personnel.

Our future performance depends upon the continued contribution of our executive management team and other key employees, in particular, our Chairman and Chief Executive Officer, Dave Schaeffer. As founder of our company, Mr. Schaeffer's knowledge of our business combined with his engineering background and industry experience make him particularly well-suited to lead our company.

Our connections to the Internet require us to establish and maintain relationships with other providers, which we may not be able to maintain.

The Internet is composed of various public and private network providers who operate their own networks and interconnect them at public and private interconnection points. Our network is one such network. In order to obtain Internet connectivity for our network, we must establish and maintain relationships with other providers and incur the necessary capital costs to locate our equipment and connect our network at these various interconnection points.

By entering into what are known as settlement-free peering arrangements, providers agree to exchange traffic between their respective networks without charging each other. Our ability to avoid the higher costs of acquiring dedicated network capacity and to maintain high network performance is dependent upon our ability to establish and maintain peering relationships. The terms and conditions of our peering relationships may also be subject to adverse changes, which we may not be able to control. For example, several network operators with large numbers of individual users are arguing that they should be able to charge or charge more to network operators and businesses that send traffic to those users. If we are not able to maintain or increase our peering relationships in all of our markets on favorable terms, we may not be able to provide our customers with high performance or affordable services, which could have a material adverse effect on our business. We have in the past encountered some disputes with certain of our providers regarding our peering arrangements, but we have generally been able to route our traffic through alternative peering arrangements, resolve such disputes, or terminate such peering arrangements with a minimal adverse impact on our business. In the past we had two such disputes that resulted in a temporary disruption of the exchange of traffic between our network and the network of the other carrier. We continue to experience resistance from certain incumbent telephone companies, especially in Europe, to the upgrade of settlement free peering connections necessary to accommodate the growth of traffic we send to such carriers. We cannot assure you that we will be able to continue to establish and maintain relationships with providers or favorably resolve disputes with providers.

We make some of our connections to other Internet networks pursuant to agreements through carriers that make data transmission capacity available to us at negotiated rates. In some instances these agreements have minimum and maximum volume commitments. If we fail to meet the minimum, or exceed the maximum, volume commitments, our costs may rise.

We have substantial debt which we may not be able to repay when due.

We have \$200.0 million of senior convertible notes outstanding. The holders of the notes have the right to compel us to repurchase for cash on June 15, 2014, June 15, 2017 and June 15, 2022, all or some of their notes. They also have the right to be paid the principal upon default and upon certain designated events, such as certain changes of control. We may not have sufficient funds to pay the principal at the time we are obligated to do so, which could result in bankruptcy, or we may only be able to raise the funds on unfavorable terms.

The holders of our senior convertible notes have the right to convert their notes to common stock.

The holders of our senior convertible notes are under certain circumstances able to convert their notes into common stock at a conversion price of \$49.18 per share of common stock and to obtain additional shares of common stock. If our share price exceeds \$49.18 and the conversion right is exercised by the holders of the notes the number of our shares of common stock outstanding will increase which could reduce further appreciation in our stock price and impact our per share earnings. Rather than issue the stock we are permitted to pay the cash equivalent in value to the stock to be issued. We might not have sufficient funds to do this or doing so might have other detrimental impacts on us.

Our operations outside of the United States expose us to economic, regulatory and other risks.

The nature of our operations outside of the U.S. involves a number of risks, including:

- fluctuations in currency exchange rates;

- exposure to additional regulatory requirements, including import restrictions and controls, exchange controls, tariffs and other trade barriers;

21

- difficulties in staffing and managing our foreign operations;
- changes in political and economic conditions; and
- exposure to additional and potentially adverse tax regimes.

As we continue to expand our European and Canadian business, our success will depend, in part, on our ability to anticipate and effectively manage these and other risks. Our failure to manage these risks and grow our European and Canadian operations may have a material adverse effect on our business and results of operations.

Fluctuations in foreign exchange rates may adversely affect our financial position and results of operations.

Our operations outside of the U.S. expose us to currency fluctuations and exchange rate risk. For example, while we record revenues and financial results from our European operations in euros, these results are reflected in our consolidated financial statements in U.S. dollars. Therefore, our reported results are exposed to fluctuations in the exchange rates between the U.S. dollar and the Euro. In particular, we fund the Euro-based operating expenses and associated cash flow requirements of our European operations, including IRU obligations, in U.S. dollars. Accordingly, in the event that the Euro strengthens versus the dollar to a greater extent than we anticipate, the expenses and cash flow requirements associated with our European operations may be significantly higher in U.S. dollar terms than planned.

Our business could suffer delays and problems due to the actions of network providers on whom we are partially dependent.

Our off-net customers are connected to our network by means of communications lines that are provided as services by local telephone companies and others. We may experience problems with the installation, maintenance and pricing of these lines and other communications links, which could adversely affect our results of operations and our plans to add additional customers to our network using such services. We have historically experienced installation and maintenance delays when the network provider is devoting resources to other services, such as traditional telephony. We have also experienced pricing problems when a lack of alternatives allows a provider to charge high prices for services in an area. We attempt to reduce this problem by using many different providers so that we have alternatives for linking a customer to our network. Competition among the providers tends to improve installation, maintenance and pricing.

If the information systems that we depend on to support our customers, network operations, sales and billing do not perform as expected, our operations and our financial results may be adversely affected.

We rely on complex information systems to operate our network and support our other business functions. Our ability to track sales leads, close sales opportunities, provision services and bill our customers for those services depends upon the effective integration of our various information systems. If our systems, individually or collectively, fail or do not perform as expected, our ability to process and provision orders, to make timely payments to vendors and to ensure that we collect revenue owed to us would be adversely affected. Such failures or delays could result in increased capital expenditures, customer and vendor dissatisfaction, loss of business or the inability to add new customers or additional services, all of which would adversely affect our business and results of operations.

We may have difficulty implementing the ability to intercept communications as required by the U.S. Communications Assistance for Law Enforcement Act.

In 2006, we began the process of implementing the requirements of the U.S. Communications Assistance for Law Enforcement Act. This law requires that we are able to intercept communications when required to do so by law enforcement agencies. We may experience difficulties and significant costs in implementing the operations procedures and installing the equipment and software necessary to comply with the law. If we are unable to comply with the laws we could be subject to fines of up to \$1 million per event and other penalties.

Our business could suffer from an interruption of service from our fiber providers.

The carriers from whom we have obtained our inter-city and intra-city dark fiber maintain that fiber. If these carriers fail to maintain the fiber or disrupt our fiber connections for other reasons, such as business disputes with us and governmental takings, our ability to provide service in the affected markets or parts of markets would be impaired. The companies that maintain our inter-city dark fiber and many of the companies that maintain our intra-city dark fiber are also competitors of ours. Consequently, they may have incentives to act in ways unfavorable to us. While we have successfully mitigated the effects of prior service interruptions and business disputes in the past, we may incur significant delays and costs in restoring service to our customers in connection with future service interruptions, and we may lose customers if delays are substantial.

Our business depends on agreements with colocation operators, which we could fail to obtain or maintain.

Our business depends upon access to customers in carrier neutral colocation centers, which are facilities in which many large users of the Internet house the computer servers that deliver content and applications to users by means of the Internet and provide access to multiple Internet access networks. Most colocation centers with which we deal allow any carrier to operate within the facility (for a standard fee). We expect to enter into additional colocation agreements as part of our growth plan. Current government regulations do not require colocation operators to allow all carriers access on terms that are reasonable or nondiscriminatory. We have been successful in obtaining agreements with these operators in the past and have generally found that the operators want to have us in their colocation facilities because we offer low-cost, high capacity Internet service to their other customers. Any deterioration in our existing relationships with these colocation center operators could harm our marketing efforts and could substantially reduce our potential customer base.

Our business depends on license agreements with building owners and managers, which we could fail to obtain or maintain.

Our business depends upon our in-building networks. Our in-building networks depend on access agreements with building owners or managers allowing us to install our in-building networks and provide our services in the buildings. These agreements typically have terms of five to ten years, with one or more renewal options. Any deterioration in our existing relationships with building owners or managers could harm our marketing efforts and could substantially reduce our potential customer base. We expect to enter into additional access agreements as part of our growth plan. Current federal and state regulations do not require building owners to make space available to us or to do so on terms that are reasonable or nondiscriminatory. While the FCC has adopted regulations that prohibit common carriers under its jurisdiction from entering into exclusive arrangements with owners of multi-tenant commercial office buildings, these regulations do not require building owners to offer us access to their buildings. Building owners or managers may decide not to permit us to install our networks in their buildings or may elect not to renew or amend our access agreements. The initial term of most of our access agreements will conclude in the next several years. Most of these agreements have one or more automatic renewal periods and others may be renewed at the option of the landlord. While we have historically been successful in renewing these agreements and no single building access agreement is material to our success, the failure to obtain or maintain a number of these agreements would reduce our revenue, and we might not recover our costs of procuring building access and installing our in-building networks.

We may not be able to obtain or construct additional building laterals to connect new buildings to our network.

In order to connect a new building to our network we need to obtain or construct a lateral from our metropolitan network to the building. We may not be able to obtain fiber in an existing lateral at an attractive price from a provider and may not be able to construct our own lateral due to the cost of construction or municipal regulatory restrictions. Failure to obtain fiber in an existing lateral or to construct a new lateral could keep us from adding new buildings to our network and from increasing our revenues.

Impairment of our intellectual property rights and our alleged infringement on other companies' intellectual property rights could harm our business.

We are aware of several other companies in our and other industries that use the word "Cogent" in their corporate names. One company has informed us that it believes our use of the name "Cogent" infringes on their intellectual property rights in that name. If such a challenge is successful, we could be required to change our name and lose the goodwill associated with the Cogent name in our markets.

The sector in which we operate is highly competitive, and we may not be able to compete effectively.

We face significant competition from incumbent carriers, Internet service providers and facilities-based network operators. Relative to us, many of these providers have significantly greater financial resources, more well-established brand names, larger customer bases, and more diverse strategic plans and service offerings.

Intense competition from these traditional and new communications companies has led to declining prices and margins for many communications services, and we expect this trend to continue as competition intensifies in the future. Decreasing prices for high-speed Internet services have somewhat diminished the competitive advantage that we have enjoyed as a result of our service pricing.

Our competitors may also introduce new technology or services that make our services less attractive to potential customers. For example, some providers are introducing a new version of the Internet protocol (Ipv6) that we do not plan to introduce at this time. If this becomes important to Internet users our ability to compete may be lessened or we may have to incur additional costs in order to accommodate this technology.

Network failure or delays and errors in transmissions expose us to potential liability.

Our network uses a collection of communications equipment, software, operating protocols and proprietary applications for the high-speed transportation of large quantities of data among multiple locations. Given the complexity of our network, it is possible that data will be lost or distorted. Delays in data delivery may cause significant losses to one or more customers using our network. Our network may also contain undetected design faults and software bugs that, despite our testing, may not be discovered in time to prevent harm to our network or to the data transmitted over it. The failure of any equipment or facility on the network could result in the interruption of customer service until we effect necessary repairs or install replacement equipment. Network failures, delays and errors could also result from natural disasters, power losses, security breaches, computer viruses, denial of service attacks and other natural or man-made events. Our off-net services are dependent on the network of other providers or on local telephone companies. Network failures, faults or errors could cause delays or service interruptions, expose us to customer liability or require expensive modifications that could have a material adverse effect on our business.

As an Internet access provider, we may incur liability for information disseminated through our network.

Edgar Filing: COGENT COMMUNICATIONS GROUP INC - Form 10-Q

The law relating to the liability of Internet access providers and on-line services companies for information carried on or disseminated through their networks is unsettled. As the law in this area develops and as we expand our international operations, the potential imposition of liability upon us for information carried on and disseminated through our network could require us to implement measures to reduce our exposure to such liability, which may require the expenditure of substantial resources or the discontinuation of certain products or service offerings. Any costs that are incurred as a result of such measures or the imposition of liability could harm our business.

Legislation and government regulation could adversely affect us.

As an enhanced service provider, we are not subject to substantial regulation by the FCC or the state public utilities commissions in the United States. Internet service is also subject to minimal regulation in Europe and in Canada. If we decide to offer traditional voice services or otherwise expand our service offerings to include services that would cause us to be deemed a common carrier, we will become subject to additional regulation. Additionally, if we offer voice service using IP (voice over IP) or offer certain other types of data services using IP we may become subject to additional regulation. This regulation could impact our business because of the costs and time required to obtain necessary authorizations, the

additional taxes than we may become subject to or may have to collect from our customers, and the additional administrative costs of providing voice services, and other costs. Even if we do not decide to offer additional services, governmental authorities may decide to impose additional regulation and taxes upon providers of Internet service. All of these could inhibit our ability to remain a low cost carrier.

Much of the law related to the liability of Internet service providers remains unsettled. For example, many jurisdictions have adopted laws related to unsolicited commercial email or spam in the last several years. Other legal issues, such as the sharing of copyrighted information, transborder data flow, universal service, and liability for software viruses could become subjects of additional legislation and legal development. We cannot predict the impact of these changes on us. Regulatory changes could have a material adverse effect on our business, financial condition or results of operations.

Terrorist activity throughout the world and military action to counter terrorism could adversely impact our business.

The September 11, 2001 terrorist attacks in the United States and the continued threat of terrorist activity and other acts of war or hostility have had, and may continue to have, an adverse effect on business, financial and general economic conditions internationally. Effects from these events and any future terrorist activity, including cyber terrorism, may, in turn, increase our costs due to the need to provide enhanced security, which would adversely affect our business and results of operations. These circumstances may also damage or destroy the Internet infrastructure and may adversely affect our ability to attract and retain customers, our ability to raise capital and the operation and maintenance of our network access points. We are particularly vulnerable to acts of terrorism because our largest customer concentration is located in New York, our headquarters is in Washington, D.C., and we have significant operations in Paris and Madrid, cities that have historically been targets for terrorist attacks.

We issue projected results and estimates for future periods from time to time, and such projections and estimates are subject to inherent uncertainties and may prove to be inaccurate.

Financial information, results of operations and other projections that we may issue from time to time are based upon our assumptions and estimates. While we believe these assumptions and estimates to be reasonable, they are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. You should understand that certain unpredictable factors could cause our actual results to differ from our expectations and those differences may be material. No independent expert participates in the preparation of these estimates. These estimates should not be regarded as a representation by us as to our results of operations during such periods as there can be no assurance that any of these estimates will be realized. In light of the foregoing, we caution you not to place undue reliance on these estimates. These estimates constitute forward-looking statements.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

On June 6, 2007 in conjunction with our sale of \$200.0 million of senior convertible notes we repurchased 1.8 million shares of our common stock at a per share price of \$28.10. This was a one-time repurchase and not part of planned series of repurchases.

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plan or Programs
June 6, 2007	1,800,000	\$ 28.10	1,800,000	0

The share repurchase depicted above was a one-time repurchase and not part of planned series of repurchases. At this time we have no plans for further repurchases.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

On April 30, 2007, we held our 2007 Annual Meeting of Stockholders in Washington, D.C. Stockholders representing 45,330,476 shares entitled to vote at the Annual Meeting were present in person or by proxy. This represents 93.3%, and a majority, of the 48,645,707 total shares authorized to vote at the Annual Meeting as of the record date of March 9, 2007.

The following nominees were elected to our board of directors, each to hold office until his or her successor is elected and qualified, by the vote set forth below:

Name	For	Withheld
David Schaeffer	44,378,164	952,312
Steven Brooks	25,122,010	20,208,466
Lewis H. Ferguson, III	45,160,525	169,951
Erel Margalit	33,571,765	11,758,711
Timothy Weingarten	24,648,657	20,681,819
Richard R. Liebhaber	43,567,838	1,762,638
D. Blake Bath	45,078,970	251,506

In addition, the stockholders approved the increase of shares available for grant under the 2004 Incentive Award Plan by 2.0 million shares of common stock. The vote on this proposal number 2 was as follows: FOR: 28,729,374; AGAINST: 10,423,048; ABSTAIN: 774,726; BROKER NON-VOTE: 5,403,328. Accordingly, the number of shares available for grant under the 2004 Incentive Award Plan was increased from 9,318 to 2,009,318 shares of common stock.

ITEM 6. EXHIBITS.

(a) Exhibits

Exhibit Number	Description
4.1	Indenture related to the Convertible Senior Notes due 2027, dated as June 11, 2007, between Cogent Communications Group, Inc. and Wells Fargo Bank, N.A., as trustee (including form of 1.00% Convertible Senior Notes due 2027) (incorporated by reference to Exhibit 4.1 of our Current Report on Form 8-K filed on June 12, 2007).
4.2	Form of 1.00% Convertible Senior Notes due 2027 (incorporated by reference to Exhibit 4.2 of our Current Report on Form 8-K filed on June 12, 2007).
4.3	Registration Rights Agreement dated as of June 11, 2007, by and among Cogent Communications Group, Inc. and Bear, Stearns & Co. Inc., UBS Securities LLC, RBC Capital Markets Corporation and Cowen and Company, LLC (incorporated by reference to Exhibit 4.3 of our Current Report on Form 8-K filed on June 12, 2007.).
10.1	Purchase Agreement, dated as of June 11, 2007, by and among Cogent Communications Group, Inc., Cogent Communications, Inc. and Bear, Stearns & Co. Inc., UBS Securities LLC, RBC Capital Markets Corporation and Cowen and Company, LLC (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on June 12, 2007.).
10.2	Amendment No. 3 to Employment Agreement of Dave Schaeffer, dated as of August 7, 2007 (filed herewith).
31.1	Certification of Chief Executive Officer pursuant of Section 302 of the Sarbanes Oxley Act of 2002 (filed herewith)
31.2	Certification of Chief Financial Officer pursuant of Section 302 of the Sarbanes Oxley Act of 2002 (filed herewith)
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes Oxley Act of 2002 (filed herewith)
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes Oxley Act of 2002 (filed herewith)

Edgar Filing: COGENT COMMUNICATIONS GROUP INC - Form 10-Q

(b) Reports on Form 8-K.

During the three months ended June 30, 2007, the Company filed four reports on Form 8-K containing the following information and filed on the following dates:

Date	Description
May 7, 2007	We issued a press release summarizing our financial results for the quarter ended March 31, 2007.
June 6, 2007	We filed a press release dated June 5, 2007 announcing pricing of our convertible note offering and concurrent share repurchase.
June 12, 2007	We announced the completion of an offering of \$200.0 million principal amount of our 1.00% Convertible Senior Notes due 2027, and filing the related transaction documents.
June 22, 2007	We announced the adoption of certain amendments to the Cogent Communications Group, Inc. 2004 Incentive Award Plan approved at a meeting of our board of directors on June 20, 2007, which amendments shall apply only to awards made to employees under the Plan after June 20, 2007.

26

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 8, 2007

COGENT COMMUNICATIONS GROUP, INC.

By:

/s/ David Schaeffer
Name: David Schaeffer
Title: Chairman of the Board and Chief
Executive
Officer

Date: August 8, 2007

By:

/s/ Thaddeus G. Weed
Name: Thaddeus G. Weed
Title: Chief Financial Officer (Principal
Accounting
Officer)