

COGENT COMMUNICATIONS GROUP INC
Form 10-Q
August 05, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x

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

For the Quarterly Period Ended June 30, 2010

OR

o

**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)

Delaware

(State or other jurisdiction of incorporation or organization)

52-2337274

(I.R.S. Employer
Identification Number)

1015 31st Street N.W.

Washington, D.C. 20007

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

(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 (or for such shorter period that the registrant was required to submit and post such files), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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 45,829,888 Shares Outstanding as of July 31, 2010

Table of Contents

INDEX

**PART I
FINANCIAL INFORMATION**

Item 1.	<u>Condensed Consolidated Financial Statements (Unaudited)</u> <u>Condensed Consolidated Balance Sheets of Cogent Communications</u> <u>Group, Inc., and Subsidiaries as of December 31, 2009 and June 30, 2010</u> <u>(Unaudited)</u> <u>Condensed Consolidated Statements of Operations of Cogent</u> <u>Communications Group, Inc., and Subsidiaries for the Three Months Ended</u> <u>June 30, 2009 and June 30, 2010 (Unaudited)</u> <u>Condensed Consolidated Statements of Operations of Cogent</u> <u>Communications Group, Inc., and Subsidiaries for the Six Months Ended</u> <u>June 30, 2009 and June 30, 2010 (Unaudited)</u> <u>Condensed Consolidated Statements of Cash Flows of Cogent</u> <u>Communications Group, Inc., and Subsidiaries for the Six months Ended</u> <u>June 30, 2009 and June 30, 2010 (Unaudited)</u> <u>Notes to Interim Condensed Consolidated Financial Statements (Unaudited)</u>
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of</u> <u>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 6.</u>	<u>Exhibits</u>

SIGNATURES
CERTIFICATIONS

Table of Contents

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 2009 AND JUNE 30, 2010

(IN THOUSANDS, EXCEPT SHARE DATA)

	December 31, 2009	June 30, 2010 (Unaudited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 55,929	\$ 52,435
Accounts receivable, net of allowance for doubtful accounts of \$2,516 and \$3,132 respectively	22,877	22,620
Prepaid expenses and other current assets	8,045	10,499
Total current assets	86,851	85,554
Property and equipment, net	263,784	267,403
Deposits and other assets - \$469 and \$448 restricted, respectively	4,360	5,016
Total assets	\$ 354,995	\$ 357,973
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	\$ 12,781	\$ 16,992
Accrued liabilities	17,609	16,556
Current maturities, capital lease obligations	5,643	9,562
Total current liabilities	36,033	43,110
Capital lease obligations, net of current maturities	104,021	99,816
Convertible senior notes, net of discount of \$25,708 and \$23,286, respectively	66,270	68,692
Other long term liabilities	4,187	4,092
Total liabilities	210,511	215,710
Commitments and contingencies:		
Stockholders equity:		
Common stock, \$0.001 par value; 75,000,000 shares authorized; 44,853,974 and 45,829,888 shares issued and outstanding, respectively	45	46
Additional paid-in capital	475,158	478,445
Accumulated other comprehensive income (loss)	1,976	(2,080)
Accumulated deficit	(332,695)	(334,148)
Total stockholders equity	144,484	142,263
Total liabilities and stockholders equity	\$ 354,995	\$ 357,973

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

Table of Contents

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED JUNE 30, 2009 AND JUNE 30, 2010

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	Three Months Ended June 30, 2009 (Unaudited)	Three Months Ended June 30, 2010 (Unaudited)
Service revenue	\$ 57,991	\$ 64,395
Operating expenses:		
Network operations (including \$47 and \$95 of equity-based compensation expense, respectively, exclusive of amounts shown separately)	24,558	29,224
Selling, general, and administrative (including \$2,303 and \$1,701 of equity-based compensation expense, respectively)	19,265	18,091
Depreciation and amortization	15,271	14,099
Total operating expenses	59,094	61,414
Operating (loss) income	(1,103)	2,981
Interest income and other, net	454	383
Interest expense	(3,888)	(4,148)
Loss before income taxes	(4,537)	(784)
Income tax benefit (provision)	84	(99)
Net loss	\$ (4,453)	\$ (883)
Net loss per common share:		
Basic and diluted net loss per common share	\$ (0.10)	\$ (0.02)
Weighted-average common shares basic and diluted	43,689,747	44,525,633

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

Table of Contents

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE SIX MONTHS ENDED JUNE 30, 2009 AND JUNE 30, 2010

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	Six Months Ended June 30, 2009 (Unaudited)	Six Months Ended June 30, 2010 (Unaudited)
Service revenue	\$ 113,066	\$ 127,170
Operating expenses:		
Network operations (including \$123 and \$142 of equity-based compensation expense, respectively, exclusive of amounts shown separately)	48,752	57,323
Selling, general, and administrative (including \$6,041 and \$2,818 of equity-based compensation expense, respectively)	40,072	36,608
Depreciation and amortization (Note 2)	29,847	27,569
Total operating expenses	118,671	121,500
Operating (loss) income	(5,605)	5,670
Interest income and other, net	704	762
Interest expense	(7,633)	(8,241)
Loss before income taxes	(12,534)	(1,809)
Income tax (provision) benefit	(79)	356
Net loss	\$ (12,613)	\$ (1,453)
Net loss per common share:		
Basic and diluted net loss per common share	\$ (0.29)	\$ (0.03)
Weighted-average common shares basic and diluted	43,678,822	44,521,667

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

Table of Contents

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2009 AND JUNE 30, 2010

(IN THOUSANDS)

	Six months Ended June 30, 2009 (Unaudited)	Six months Ended June 30, 2010 (Unaudited)
Cash flows from operating activities:		
Net cash provided by operating activities	\$ 25,847	\$ 30,510
Cash flows from investing activities:		
Purchases of property and equipment	(25,124)	(24,521)
Maturities of short term investments	62	
Purchase of other assets	(246)	
Proceeds from dispositions of assets	95	234
Net cash used in investing activities	(25,213)	(24,287)
Cash flows from financing activities:		
Purchases of common stock	(730)	
Proceeds from exercises of stock options	19	77
Repayments of capital lease obligations	(11,352)	(8,517)
Net cash used in financing activities	(12,063)	(8,440)
Effect of exchange rate changes on cash	210	(1,277)
Net decrease in cash and cash equivalents	(11,219)	(3,494)
Cash and cash equivalents, beginning of period	71,291	55,929
Cash and cash equivalents, end of period	\$ 60,072	\$ 52,435
Supplemental disclosure of cash flow information:		
Capital lease obligations incurred	\$ 18,219	\$ 15,113

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

Table of Contents

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2009 and 2010
(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 in North America and 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 its net centric customers which include 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 to its corporate customers 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 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 corporate 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.

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

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

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 2009 annual report on Form 10-K.

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.

Foreign currency translation adjustment and comprehensive income (loss)

The Company's only component of other comprehensive income (loss) is the currency translation adjustment for all periods presented.

	Three months ended June 30, 2009	Three months ended June 30, 2010	Six months ended June 30, 2009	Six months ended June 30, 2010
Net loss	\$ (4,453)	\$ (883)	\$ (12,613)	\$ (1,453)
Currency translation	1,849	(2,905)	232	(4,056)
Comprehensive loss	\$ (2,604)	\$ (3,788)	\$ (12,381)	\$ (5,509)

Table of Contents

Financial instruments

At December 31, 2009 and June 30, 2010, the carrying amount of cash and cash equivalents, accounts receivable, prepaid and other current assets, accounts payable, and accrued expenses approximated fair value because of the short-term nature of these instruments. The Company measures its cash equivalents at fair value based upon quoted (Level 1) market prices and at amortized cost, which approximates fair value. Based upon the quoted (Level 1) market price at June 30, 2010, the fair value of the Company's \$92.0 million convertible senior notes was approximately \$70.1 million.

The Company was party to letters of credit totaling approximately \$0.4 million as of December 31, 2009 and June 30, 2010. These letters of credit are secured by investments totaling approximately \$0.5 million at December 31, 2009 and \$0.4 million at June 30, 2010 that are restricted and included in other assets.

Basic and diluted net (loss) income per common share

Basic earnings per share (EPS) excludes dilution for common stock equivalents and is computed by dividing net income or (loss) available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is based on the weighted-average number of shares of common stock outstanding during each period, adjusted for the effect of common stock equivalents, if dilutive.

Shares of restricted stock are included in the computation of basic EPS as they vest and are included in diluted EPS, to the extent they are dilutive, determined using the treasury stock method. As of June 30, 2009 and June 30, 2010, 0.7 million and 1.3 million unvested shares of restricted common stock, respectively, are not included in the computation of diluted (loss) income per share, as the effect would be anti-dilutive.

Using the if-converted method, the shares issuable upon conversion of the Company's 1.00% Convertible Senior Notes (the Notes) were anti-dilutive for the three and six months ended June 30, 2009 and 2010. Accordingly, the impact has been excluded from the computation of diluted income or (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, yielding 1.9 million shares at June 30, 2009 and June 30, 2010, subject to certain adjustments set forth in the indenture.

The Company computes the dilutive effect of outstanding options using the treasury stock method. For the three and six months ended June 30, 2009 and 2010, options to purchase 0.9 million and 0.4 million shares of common stock, respectively, at weighted-average exercise prices of \$6.70 and \$12.71 per share, respectively, are not included in the computation of diluted (loss) per share as the effect would be anti-dilutive. For the three and six months ended June 30, 2009 and 2010, the Company's employees exercised options for approximately 103,000, 205,000, 11,000 and 13,000 common shares, respectively.

2. Property and equipment:

Depreciation and amortization expense related to property and equipment and capital leases was \$15.2 million and \$14.1 million for the three months ended June 30, 2009 and 2010, respectively, and was \$29.7 million and \$27.5 million for the six months ended June 30, 2009 and 2010, respectively. In the three months ended March 31, 2010, the Company recorded an impairment charge for certain property and equipment totaling \$0.6 million that is included in depreciation and amortization expense. There were no such charges in the three months ended June 30, 2010 or the three or six months ended June 30, 2009.

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 \$1.5 million and \$1.4 million for the three months ended June 30, 2009 and 2010, respectively, and \$2.6 million and \$2.9 million for the six months ended June 30, 2009 and 2010, respectively.

Asset Retirement Obligations

In the first quarter of 2010, the Company determined that its estimates of restoration costs for its leased facility asset retirement obligations were too high based on current costs to restore and changes in the expected timing of the payment of those costs due to the extensions of lease terms. As a result, in the first quarter of 2010, the Company revised its estimates of the cash flows that it believes will be required to settle its leased facility asset retirement obligations at the end of the respective lease terms, which resulted in a reduction to the Company's asset retirement obligation liability. As a result of the revisions in the estimated amount and timing of cash flows for its asset retirement obligations, in the three months ended March 31, 2010, the Company reduced its asset retirement obligation liability by \$0.9 million with an offsetting reduction to depreciation and amortization of \$0.7 million and selling, general and administrative expenses of \$0.2 million.

Table of Contents**3. Long -term debt:***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. 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 \$195.1 million, after deducting the original issue discount of 2.25% and issuance costs. In 2008, the Company purchased an aggregate of \$108.0 million of face value of the Notes for \$48.6 million in cash in a series of transactions.

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 has the right to deliver shares of the Company's common stock, cash or a combination of cash and shares of the Company's 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. 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 the Company's right to settle the conversion feature in either cash or stock or in any combination. 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.

The debt and equity components for the Notes were as follows (in thousands):

	December 31, 2009	June 30, 2010
Principal amount of convertible senior notes	\$ 91,978	\$ 91,978
Unamortized discount	(25,708)	(23,286)
Net carrying amount	66,270	68,692
Additional paid-in capital	74,933	74,933

At June 30, 2010, the unamortized discount had a remaining recognition period of 4.0 years. The amount of interest expense recognized and effective interest rate for the three and six months ended June 30 was as follows (in thousands):

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

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2010	Six Months Ended June 30, 2009	Six Months Ended June 30, 2010
Contractual coupon interest	\$ 230	\$ 230	\$ 460	\$ 460
Amortization of discount and costs on Notes	1,128	1,228	2,231	2,429
Interest expense	\$ 1,358	\$ 1,458	\$ 2,691	\$ 2,889
Effective interest rate	8.7%	8.7%	8.7%	8.7%

Table of Contents

4. Contingencies:

Current and potential litigation

The Company is involved in disputes with certain telecommunications companies. The total amount claimed by these vendors is approximately \$0.3 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.

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.

Revolving line of credit

In October 2009, the Company entered into a \$20.0 million revolving line of credit facility with a bank. Borrowings under the facility may be used for general corporate purposes, acquisitions, purchases of the Company's common stock, and purchases of the Company's convertible notes. The facility expires and all amounts must be repaid on October 14, 2010. The Company's ability to draw under the revolving facility is conditioned upon, among other things, (i) the size of the Company's borrowing base, which is comprised of the Company's accounts receivable in the United States and Canada, and amounts the Company has on deposit with the bank; (ii) the Company's ability to make the representations and warranties contained in the loan documents on the date of such borrowing; and (iii) the absence of any default or event of default under its loan documents. The revolving facility has a floating interest rate of one month LIBOR plus 2.5% per annum, subject to a minimum interest rate of 3.0% and has a commitment fee of 0.3% per annum.

The Company's obligations under the revolving facility are secured by a lien on the accounts receivable, general intangibles and certain other assets of the Company and its U.S. and Canadian operating subsidiaries. The revolving facility contains customary covenants, including, but not limited to, restrictions on the Company and its U.S. and Canadian operating subsidiaries' ability to grant liens or security interests on assets subject to the bank's security interest and pay dividends. The revolving facility requires the maintenance of a trailing four quarter ratio of the Company's funded debt to adjusted EBITDA (as defined) and a ratio of the Company's adjusted EBITDA (as defined) less dividends and capital expenditures to its debt constituting current maturities (excluding any amounts due under the revolving credit facility). The covenants also require the Company to maintain a minimum of \$10.0 million to be deposited with the bank. There have been no borrowings under the revolving facility and the Company was in compliance with these covenants.

Incentive Award Plan

The Company has an award plan, the 2004 Incentive Award Plan, as amended (the "Award Plan"), under which grants of stock and options are made. On April 15, 2010, the Company's shareholders approved increasing the authorized shares by 1.3 million shares. In the second quarter of

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

2010, the Company granted approximately 1.0 million restricted shares to certain of its employees that will vest over a three year period. These restricted shares were valued at approximately \$9.8 million and will be recognized as equity-based compensation expense on a straight line basis over the service period. The Company also granted an additional 0.2 million restricted shares that are subject to certain performance conditions not considered probable. The targets for the performance awards include the combined achievement of designated revenue growth, EBITDA margin, as adjusted, and capital expenditures.

5. Related party transactions:

Office lease

The Company's headquarters is located in an office building owned by a partnership (6715 Kenilworth Avenue Partnership). The two owners of the partnership are the Company's Chief Executive Officer, who has a 51% interest in the partnership and his wife, Ruth Schaeffer, who has a 49% interest in the partnership. The Company paid \$0.3 million for the six months ended June 30, 2009 and 2010 in rent and related costs (including taxes and utilities) to this partnership under a lease that expires in August 2012. The dollar value of the Company's Chief Executive Officer's interest in the lease payments for the six months ended June 30, 2009 and 2010 was \$0.15 million. The dollar value of his wife's interest in the lease payment for the six months ended June 30, 2009 and 2010 was \$0.15 million. If the Company's Chief Executive Officer's interest is combined with that of his wife then the total dollar value of his interest in the lease payments for the six months ended June 30, 2009 and 2010 was \$0.3 million.

In the six months ended June 30, 2010, the Company purchased approximately \$52,000 of equipment from an equipment vendor. One of the Company's directors is also a director of the equipment vendor.

6. Segment information:

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

Table of Contents

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2010	Six Months Ended June 30, 2009	Six Months Ended June 30, 2010
Revenues				
North America	\$ 45,374	\$ 50,432	\$ 88,339	\$ 98,662
Europe	12,617	13,963	24,727	28,508
Total	\$ 57,991	\$ 64,395	\$ 113,066	\$ 127,170

	December 31, 2009	June 30, 2010
Long lived assets, net		
North America	\$ 215,681	\$ 220,349
Europe	48,281	47,178
Total	\$ 263,962	\$ 267,527

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, but are not limited to:

Future economic instability in the global economy which could affect spending on Internet services; the impact of changing foreign exchange rates (in particular the Euro-USD exchange rate) on the translation of our non-USD denominated revenues, expenses, assets and liabilities; legal and operational difficulties in new markets; the imposition of a requirement that we contribute to the Universal Service Fund; changes in government policy and/or regulation, including pending net neutrality rules by the United States Federal Communications Commission and in the area of data protection; increasing competition leading to lower prices for our services; our ability to attract new customers and to increase and maintain the volume of traffic on our network; the ability to maintain our Internet peering arrangements on favorable terms; our reliance on an equipment vendor, Cisco Systems Inc., and the potential for hardware or software problems associated with such equipment; the dependence of our network on the quality and dependability of third-party fiber providers; our ability to retain certain customers that comprise a significant portion of our revenue base; the management of network failures and/or disruptions; and outcomes in litigation as well as other risks discussed from time to time in our filings with the Securities and Exchange Commission, including, without limitation, ours annual report on Form 10-K for the fiscal year ended December 31, 2009.

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 many of our competitors when providing Internet access services, thus, we believe, giving us cost and performance advantages. We deliver our services to small and medium-sized businesses, communications service providers and other bandwidth-intensive organizations through approximately 23,400 customer connections in North America and Europe.

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

We provide on-net Internet access to our net centric customers, which include 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 in our data centers. We also provide Internet access services to our corporate customers in multi-tenant office buildings typically serving law firms, financial services firms, advertising and marketing firms and other professional services businesses.

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 "last mile" access service lines obtained from other carriers, primarily in the form of point-to-point TDM, POS, SDH and/or Carrier Ethernet circuits. Our non-core services, which consist primarily of legacy services of companies whose assets or businesses we have acquired primarily include dial-up Internet access services and voice services (only provided in Toronto, Canada). We do not actively market these non-core services and expect the service revenue associated with them to continue to decline.

Our network is comprised of in-building riser facilities, metropolitan optical fiber networks, metropolitan traffic aggregation points and inter-city transport facilities. Our network is physically connected entirely through our facilities to 1,503 buildings in which we provide our

Table of Contents

on-net services, including 1,071 multi-tenant office buildings. We also provide on-net services in carrier-neutral colocation facilities, Cogent controlled 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 greater 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 (local loop) 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 growth 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 direct 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 profitable customer mix. 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 are expanding our network to locations that we believe 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 expected to be generated by those customers.

We believe two of the most important trends in our industry are the continued long-term growth in Internet traffic and a decline in Internet access prices within carrier neutral data centers. 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 continue to 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 profitability. Our revenue may also be negatively affected if we are unable to grow our Internet traffic or if the rate of growth of Internet traffic does not offset the expected decline in per unit pricing. We do not know if Internet traffic will increase or decrease, or the rate at which it will grow or decrease. Changes in Internet traffic will be a function of the number of users, the applications for which the Internet is used, the pricing of Internet services, and other factors.

The growth in Internet traffic has a more significant impact on our net-centric customers who represent the majority of the traffic on our network and who tend to consume the majority of their allocated bandwidth on their connections. Net-centric customers tend to purchase their service on a price per megabit basis. Our corporate customers tend to utilize a small portion of their allocated bandwidth on their connections and tend to purchase their service on a per connection basis.

Due to our strategic acquisitions of network assets and equipment, we believe we are positioned to grow our revenue base. We continue to purchase and deploy network equipment to parts of our network to maximize the utilization of our assets and to expand our network. Our future capital expenditures will be based primarily on our planned expansion of our network, the addition of on-net buildings and the concentration and growth of our customer base. We plan to continue to expand our network and to increase our number of on-net buildings by approximately 120 buildings by December 31, 2010 from 1,451 buildings at December 31, 2009. Many factors can affect our ability to add buildings to our network. These factors include the willingness of building owners to grant us access rights, the availability of optical fiber networks to serve those buildings, and equipment availability.

Results of Operations

Three Months Ended June 30, 2009 Compared to the Three Months Ended June 30, 2010

Our management reviews and analyzes several key financial measures in order to manage our business and assess the quality of and potential variability of our service revenues and cash flows. The following summary table presents a comparison of our results of operations for the three months ended June 30, 2009 and 2010 with respect to certain key financial measures. The comparisons illustrated in the table are discussed in greater detail below.

	Three months ended June 30,		Percent Change
	2009	2010	
	(in thousands)		
Service revenue	\$ 57,991	\$ 64,395	11.0%
On-net revenue	46,453	50,253	8.2%
Off-net revenue	10,562	13,370	26.6%
Non-core revenue	976	772	(20.9)%
Network operations expenses (1)	24,511	29,129	18.8%
Selling, general, and administrative expenses (2)	16,962	16,390	(3.4)%
Equity-based compensation expense	2,350	1,796	(23.6)%
Depreciation and amortization expenses	15,271	14,099	(7.7)%
Income tax benefit (provision)	84	(99)	(217.9)%

Table of Contents

(1) Excludes equity-based compensation expenses of \$47 and \$95 in the three months ended June 30, 2009 and 2010, respectively, which, if included would have resulted in a period-to-period change of 19.0%.

(2) Excludes equity-based compensation expenses of \$2,303 and \$1,701 in the three months ended June 30, 2009 and 2010, respectively, which, if included would have resulted in a period-to-period change of (6.1)%.

Service Revenue. Our service revenue increased 11.0% from \$58.0 million for the three months ended June 30, 2009 to \$64.4 million for the three months ended June 30, 2010. The impact of exchange rates resulted in a decrease of revenues for the three months ended June 30, 2010 of approximately \$0.4 million. All foreign currency comparisons herein reflect our second quarter 2010 results translated at the average foreign currency exchange rates for the second quarter of 2009. For the three months ended June 30, 2009 and 2010, on-net, off-net and non-core revenues represented 80.1%, 18.2% and 1.7% and 78.0%, 20.8% and 1.2% of our service revenues, respectively.

Revenues from our corporate and net centric customers represented 47.9% and 52.1%, respectively, for the three months ended June 30, 2009 and represented 49.3% and 50.7%, respectively, for the three months ended June 30, 2010. Revenues from corporate customers increased 14.2% from \$27.8 million for the three months ended June 30, 2009 to \$31.7 million for the three months ended June 30, 2010. Revenues from our net-centric customers increased 8.1% from \$30.2 million for the three months ended June 30, 2009 to \$32.7 million for the three months ending June 30, 2010.

Our on-net revenues increased 8.2% from \$46.5 million for the three months ended June 30, 2009 to \$50.3 million for the three months ended June 30, 2010. Our on-net revenues increased as we increased the number of our on-net customer connections by 20.0% from approximately 16,000 at June 30, 2009 to approximately 19,200 at June 30, 2010. On-net customer connections increased at a greater rate than on-net revenues due to a decline in the average revenue per on-net customer connection, primarily from our net centric customers. This decline is partly attributed to volume and term based pricing discounts. Additionally, on-net customers who cancel their service from our installed base of customers, in general, have greater average revenue per connection than new customers. These trends resulted in a reduction to our average revenue per on-net connection.

Our off-net revenues increased 26.6% from \$10.6 million for the three months ended June 30, 2009 to \$13.4 million for the three months ended June 30, 2010. Our off-net revenues increased as we increased the number of our off-net customer connections by 3.6% from approximately 3,300 at June 30, 2009 to approximately 3,400 at June 30, 2010. Off-net revenues increased at a greater rate than off-net customer connections due to an increase in the average revenue per off-net customer connection. Off-net customers who cancel their service, in general, have an average revenue per connection that is less than new off-net customers who generally purchase higher-bandwidth connections.

Our non-core revenues decreased 20.9% from \$1.0 million for the three months ended June 30, 2009 to \$0.8 million for the three months ending June 30, 2010. The number of our non-core customer connections decreased 32.6% from approximately 1,150 at June 30, 2009 to approximately 780 at June 30, 2010. We do not actively market these acquired non-core services and expect that the associated service revenue will continue to decline.

Network Operations Expenses. Our network operations expenses, excluding equity-based compensation expense, increased 18.8% from \$24.5 million for the three months ended June 30, 2009 to \$29.1 million for the three months ended June 30, 2010. The impact of exchange rates

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

resulted in a decrease of network operations expenses for the three months ended June 30, 2010 of approximately \$0.3 million. The increase is primarily attributable to an increase in costs related to our network and facilities expansion activities and increase in our off-net revenues partly offset by the decline in network operations expenses associated with the decline in our non-core revenues.

Selling, General, and Administrative (SG&A) Expenses. Our SG&A expenses, excluding equity-based compensation expense, decreased 3.4% from \$17.0 million for the three months ended June 30, 2009 to \$16.4 million for the three months ended June 30, 2010. The impact of exchange rates resulted in a decrease of SG&A expenses for the three months ended June 30, 2010 of approximately \$0.2 million. SG&A expenses decreased primarily from a decrease in professional fees and bad debt expense.

Equity-based Compensation Expense. Equity-based compensation expense results from grants of restricted stock and stock options. Equity-based compensation expense decreased 23.6% from \$2.4 million for the three months ended June 30, 2009 to \$1.8 million for the three months ending June 30, 2010. The decrease is primarily due to the completion of the service period in April 2009 of certain restricted stock grants made to our employees in April 2007 partly offset by the impact of grants of restricted shares to certain of our employees in the second quarter of 2010.

In the second quarter of 2010, we granted approximately 1.0 million restricted shares to certain of our employees that will vest over a three year period. These restricted shares were valued at approximately \$9.8 million and will be recognized as equity-based compensation expense on a straight line basis over the service period.

Table of Contents

Depreciation and Amortization Expenses. Our depreciation and amortization expense decreased 7.7% from \$15.3 million for the three months ended June 30, 2009 to \$14.1 million for the three months ended June 30, 2010. The decrease is primarily due to the decline in depreciation expense from fully depreciated fixed assets. The impact of exchange rates resulted in a decrease of depreciation and amortization expenses for the three months ended June 30, 2010 of approximately \$0.1 million.

Income tax (provision) benefit. For the three months ended June 30, 2009, our income tax benefit was \$0.1 million and composed primarily of U.S. state income taxes. For the three months ended June 30, 2010, our income tax provision was \$0.1 million also composed primarily of U.S. state income taxes.

Buildings On-net. As of June 30, 2009 and 2010, we had a total of 1,389 and 1,503 on-net buildings connected to our network, respectively.

Six Months Ended June 30, 2009 Compared to the Six Months Ended June 30, 2010

The following summary table presents a comparison of our results of operations for the six months ended June 30, 2009 and 2010 with respect to certain key financial measures. The comparisons illustrated in the table are discussed in greater detail below.

	2009	Six months ended June 30, (in thousands)	2010	Percent Change
Service revenue	\$	113,066	\$ 127,170	12.5%
On-net revenue		90,746	99,888	10.1%
Off-net revenue		20,429	25,686	25.7%
Non-core revenue		1,891	1,596	(15.6)%
Network operations expenses (1)		48,629	57,181	17.6%
Selling, general, and administrative expenses (2)		34,031	33,790	(0.7)%
Equity-based compensation expense		6,164	2,960	(52.0)%
Depreciation and amortization expenses		29,847	27,569	(7.6)%
Income tax (provision) benefit		(79)	356	550.6%

(1) Excludes equity-based compensation expenses of \$123 and \$142 in the six months ended June 30, 2009 and 2010, respectively, which, if included would have resulted in a period-to-period change of 17.6%.

(2) Excludes equity-based compensation expenses of \$6,041 and \$2,818 in the six months ended June 30, 2009 and 2010, respectively, which, if included would have resulted in a period-to-period change of (8.6)%.

Service Revenue. Our service revenue increased 12.5% from \$113.1 million for the six months ended June 30, 2009 to \$127.2 million for the six months ended June 30, 2010. The impact of exchange rates resulted in an increase of revenues for the six months ended June 30, 2010 of

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

approximately \$1.1 million. All foreign currency comparisons herein reflect our results for the six months ended June 30, 2010 translated at the average foreign currency exchange rates for the six months ended June 30, 2009. For the six months ended June 30, 2009 and 2010, on-net, off-net and non-core revenues represented 80.3%, 18.0% and 1.7% and 78.5%, 20.2% and 1.3% of our service revenues, respectively.

Revenues from our corporate and net centric customers represented 47.9% and 52.1%, respectively, for the six months ended June 30, 2009 and represented 48.4% and 51.6%, respectively, for the six months ended June 30, 2010. Revenues from corporate customers increased 13.7% from \$54.1 million for the six months ended June 30, 2009 to \$61.5 million for the six months ended June 30, 2010. Revenues from our net-centric customers increased 11.4% from \$58.9 million for the six months ended June 30, 2009 to \$65.6 million for the six months ending June 30, 2010.

Our on-net revenues increased 10.1% from \$90.7 million for the six months ended June 30, 2009 to \$99.9 million for the six months ended June 30, 2010. Our on-net revenues increased as we increased the number of our on-net customer connections by 20.0% from approximately 16,000 at June 30, 2009 to approximately 19,200 at June 30, 2010. On-net customer connections increased at a greater rate than on-net revenues due to a decline in the average revenue per on-net customer connection, primarily from our net centric customers. This decline is partly attributed to volume and term based pricing discounts. Additionally, on-net customers who cancel their service from our installed base of customers, in general, have greater average revenue per connection than new customers. These trends resulted in a reduction to our average revenue per on-net connection.

Our off-net revenues increased 25.7% from \$20.4 million for the six months ended June 30, 2009 to \$25.7 million for the six months ended June 30, 2010. Our off-net revenues increased as we increased the number of our off-net customer connections by 3.6% from approximately 3,300 at June 30, 2009 to approximately 3,400 at June 30, 2010. Off-net revenues increased at a greater rate than off-net customer connections

Table of Contents

due to an increase in the average revenue per off-net customer connection. Off-net customers who cancel their service, in general, have an average revenue per connection that is less than new off-net customers who generally purchase higher-bandwidth connections

Our non-core revenues decreased 15.6% from \$1.9 million for the six months ended June 30, 2009 to \$1.6 million for the six months ending June 30, 2010. The number of our non-core customer connections decreased 32.6% from approximately 1,150 at June 30, 2009 to approximately 780 at June 30, 2010. We do not actively market these acquired non-core services and expect that the associated service revenue will continue to decline.

Network Operations Expenses. Our network operations expenses, excluding equity-based compensation expense, increased 17.6% from \$48.6 million for the six months ended June 30, 2009 to \$57.2 million for the six months ended June 30, 2010. The impact of exchange rates resulted in an increase of network operations expenses for the six months ended June 30, 2010 of approximately \$0.2 million. The increase is primarily attributable to an increase in costs related to our network and facilities expansion activities and increase in our off-net revenues partly offset by the decline in network operations expenses associated with the decline in our non-core revenues.

Selling, General, and Administrative (SG&A) Expenses. Our SG&A expenses, excluding equity-based compensation expense, decreased 0.7% from \$34.0 million for the six months ended June 30, 2009 to \$33.8 million for the six months ended June 30, 2010. The impact of exchange rates resulted in an increase of SG&A expenses for the six months ended June 30, 2010 of approximately \$0.2 million. SG&A expenses decreased primarily from the increase in salaries and related costs required to support our expanding sales and marketing efforts being more than offset by a reduction in bad debt expense, a reduction to our leased facility asset retirement obligations (discussed below) and a reduction in professional fees.

Equity-based Compensation Expense. Equity-based compensation expense results from grants of restricted stock and stock options. Equity-based compensation expense decreased 52.0% from \$6.2 million for the six months ended June 30, 2009 to \$3.0 million for the six months ending June 30, 2010. The decrease is primarily due to the completion of the service period in April 2009 of certain restricted stock grants made to our employees in April 2007 partly offset by the impact of grants of restricted shares to certain of our employees in the second quarter of 2010.

In the second quarter of 2010, we granted approximately 1.0 million restricted shares to certain of our employees that will vest over a three year period. These restricted shares were valued at approximately \$9.8 million and will be recognized as equity-based compensation expense on a straight line basis over the service period.

Depreciation and Amortization Expenses. Our depreciation and amortization expense decreased 7.6% from \$29.8 million for the six months ended June 30, 2009 to \$27.6 million for the six months ended June 30, 2010. The decrease is primarily due to the decline in depreciation expense from fully depreciated fixed assets and an adjustment to our asset retirement obligations, discussed below, more than offsetting depreciation expense associated with the increase in deployed fixed assets and the impact of an \$0.6 million impairment charge for certain property and equipment that was recorded in the six months ended June 30, 2010. There were no such impairment charges or adjustments to our asset retirement obligations recorded in the six months ended June 30, 2009. The impact of exchange rates resulted in an increase of depreciation and amortization expenses for the six months ended June 30, 2010 of approximately \$0.1 million.

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

In the first quarter of 2010, we determined that our estimates of restoration costs for our leased facility asset retirement obligations were too high based on current costs to restore and changes in the expected timing of the payment of those costs due to the extensions of lease terms. As a result, in the first quarter of 2010, we revised our estimates of the cash flows that we believed will be required to settle our leased facility asset retirement obligations at the end of the respective lease terms, which resulted in a reduction to our asset retirement obligation liability. These revisions in the estimated amount and timing of cash flows for asset retirement obligations reduced our asset retirement obligation liability by \$0.9 million with an offsetting reduction to depreciation and amortization of \$0.7 million and selling, general and administrative expenses of \$0.2 million.

Income tax (provision) benefit. For the six months ended June 30, 2009, our income tax provision was \$0.1 million composed primarily of penalties and interest on an uncertain tax position. For the six months ended June 30, 2010, our income tax benefit was \$0.4 million which includes approximately \$0.2 million for U.S. state income taxes offset by a tax benefit of \$0.6 million from the recognition of a receivable for refunds of federal alternative minimum tax amounts paid in prior years.

Buildings On-net. As of June 30, 2009 and 2010, we had a total of 1,389 and 1,503 on-net buildings connected to our network, respectively.

Liquidity and Capital Resources

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

Table of Contents**Cash Flows**

The following table sets forth our consolidated cash flows for the six months ended June 30, 2009 and six months ended June 30, 2010.

(in thousands)	Six months ended June 30,	
	2009	2010
Net cash provided by operating activities	\$ 25,847	\$ 30,510
Net cash used in investing activities	(25,213)	(24,287)
Net cash used in financing activities	(12,063)	(8,440)
Effect of exchange rates on cash	210	(1,277)
Net decrease in cash and cash equivalents during period	\$ (11,219)	\$ (3,494)

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 \$25.8 million for the six months ended June 30, 2009 compared to net cash provided by operating activities of \$30.5 million for the six months ended June 30, 2010. The increase in cash provided by operating activities is due to an increase in our operating profit partly offset by changes in operating assets and liabilities of \$1.2 million.

Net Cash Used In Investing Activities. Net cash used in investing activities was \$25.2 million for the six months ended June 30, 2009 and \$24.3 million for the six months ended June 30, 2010. Our primary use of investing cash for the six months ended June 30, 2009 and six months ended June 30, 2010 was \$25.1 million and \$24.5 million, respectively, for the purchases of property and equipment.

Net Cash Used In Financing Activities. Net cash used in financing activities was \$12.1 million for the six months June 30, 2009 and \$8.4 million for the six months June 30, 2010. Our primary uses of financing cash for the six months ended June 30, 2009 were \$11.4 million of principal payments under our capital lease obligations and \$0.7 million for the purchases of shares of our common stock. Our primary use of financing cash for the six months ended June 30, 2010 was \$8.5 million of principal payments under our capital lease obligations.

Cash Position and Indebtedness

Our total indebtedness, net of discount, at June 30, 2010 was \$178.1 million and our total cash and cash equivalents were \$52.4 million. Our total indebtedness, net of discount, at June 30, 2010 includes \$109.4 million of capital lease obligations for dark fiber primarily under 15-25 year indefeasible right of use lease agreements (IRU s), of which approximately \$9.6 million is considered a current liability.

Convertible Senior Notes

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

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 subsidiary's existing and future liabilities and to any secured debt that 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 \$195.1 million after deducting the original issue discount of 2.25% and issuance costs.

In the fourth quarter of 2008, we purchased an aggregate of \$108.0 million of face value of the Notes for \$48.6 million in cash in a series of transactions. These transactions resulted in a gain of \$23.1 million for the year ended December 31, 2008. After these transactions, there is \$92.0 million of face value of the Notes outstanding. We may purchase additional Notes.

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. 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.

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.

Table of Contents

Revolving line of credit

In October 2009, we entered into a \$20.0 million revolving line of credit facility with a commercial bank. Borrowings under the credit facility may be used for general corporate purposes, acquisitions, purchases of our common stock, and purchases of our Notes. The credit facility expires and all amounts must be repaid on October 14, 2010. Our ability to draw under the credit facility is conditioned upon, among other things, (i) the size of our borrowing base, which is comprised of our accounts receivable in the United States and Canada and amounts we have on deposit with the bank; (ii) our ability to make the representations and warranties contained in the loan documents on the date of such borrowing; and (iii) the absence of any default or event of default under its loan documents. The credit facility has a floating interest rate of one month LIBOR plus 2.5% per annum, subject to a minimum interest rate of 3.0% and has a commitment fee of 0.3% per annum.

Our obligations under the credit facility are secured by a lien on the accounts, general intangibles and certain of our other assets and our U.S. and Canadian operating subsidiaries. The credit facility contains customary covenants, including, but not limited to, restrictions on us and our U.S. and Canadian operating subsidiaries' ability to grant liens or security interests on assets subject to the banks security interest and pay dividends. The credit facility requires the maintenance of a trailing four quarter ratio of our funded debt to adjusted EBITDA (as defined) and a ratio of our adjusted EBITDA (as defined) less dividends and capital expenditures to its debt constituting current maturities (excluding amounts due under this revolving credit facility). The covenants also require us to maintain a minimum of \$10.0 million to be deposited with the commercial bank. There have been no borrowings under the revolving facility and we have been in compliance with the covenants.

Contractual Obligations and Commitments

There have been no material changes to our contractual obligations and commitments included 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, 2009.

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.

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. Such financing may not 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 and markets that we add to our network, 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

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

We do not have 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.

Income taxes

Due to the uncertainty surrounding the realization of our net deferred tax asset, we have recorded a valuation allowance for the substantial majority of our net deferred tax asset. As of December 31, 2009, we have worldwide net operating loss carry-forwards of approximately \$1.1 billion. This amount includes U.S. federal and state, Canadian and European net operating loss carry-forwards of approximately \$400 million, \$4 million and \$680 million, respectively. Section 382 of the Internal Revenue Code in the United States limits the utilization of net operating losses when ownership changes, as defined by that section, occur. We have performed an analysis of our Section 382 ownership changes and have determined that the utilization of certain of our net operating loss carryforwards in the United States may be limited. This restricted amount includes the limitation on annual utilization related to the remaining \$183 million of federal and state net operating loss carry-forwards of Allied Riser Communications Corporation that were acquired by us via a 2002 merger. The net operating loss carryforwards in the United States will expire, if unused, between 2024 and 2030. The net operating loss carry-forwards related to our Canadian operations expire in 2027. The net operating loss carry-forwards related to our European operations include \$527 million that do not expire and \$153 million that expire between 2010 and 2016.

We are subject to income taxes in the United States and numerous foreign jurisdictions. Our effective income tax rate in the future could be adversely affected by a number of factors, including: changes in the mix of earnings in countries with differing statutory tax rates, changes in tax laws, the outcome of income tax audits in various jurisdictions around the world, and any repatriation of non-U.S. earnings for which we have not previously provided for U.S. taxes. We regularly assess all of these matters to determine the adequacy of our tax provision, which is subject to significant discretion.

Table of Contents

Critical Accounting Policies and Significant Estimates

Management believes that as of June 30, 2010, 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, 2009 except for our estimates related to our asset retirement obligations discussed in Note 2 to these interim condensed consolidated financial statements.

Recent Accounting Pronouncements to be adopted

In September 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, Multiple Element Arrangements. ASU 2009-13 addresses the determination of when the individual deliverables included in a multiple arrangement may be treated as separate units of accounting. ASU 2009-13 also modifies the manner in which the transaction consideration is allocated across separately identified deliverables and establishes definitions for determining fair value of elements in an arrangement. This standard must be adopted by us no later than January 1, 2011 with earlier adoption permitted. We are currently evaluating the impact, if any, that this standard update will have on our consolidated financial statements.

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, 2009. Our exposures to market risk have not changed materially since December 31, 2009. Based upon the quoted market price at June 30, 2010, the fair value of our 1.00% \$92.0 million Convertible Senior Notes was approximately \$70.1 million.

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. Note 4 of our interim condensed consolidated financial statements includes information on these proceedings and other disputes.

ITEM 6. EXHIBITS.

(a) Exhibits

Exhibit Number	Description
31.1	Certification of Chief Executive Officer (filed herewith)
31.2	Certification of Chief Financial Officer (filed herewith)
32.1	Certification of Chief Executive Officer (filed herewith)
32.2	Certification of Chief Financial Officer (filed herewith)

Table of Contents

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 5, 2010

COGENT COMMUNICATIONS GROUP, INC.

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

Date: August 5, 2010

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

Table of Contents

Exhibit Index

Exhibit Number	Description
31.1	Certification of Chief Executive Officer (filed herewith)
31.2	Certification of Chief Financial Officer (filed herewith)
32.1	Certification of Chief Executive Officer (filed herewith)
32.2	Certification of Chief Financial Officer (filed herewith)