

COGENT COMMUNICATIONS GROUP INC
Form 10-K
March 14, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006

OR

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

For the transition period from _____ to _____

Commission file number 1-31227

COGENT COMMUNICATIONS GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)
1015 31st Street N.W.
Washington, D.C.
(Address of Principal Executive Offices)

52-2337274
(I.R.S. Employer
Identification No.)

20007
(Zip Code)

(202) 295-4200

Registrant's Telephone Number, Including Area Code

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value \$0.001 per share

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x

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 file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 o Accelerated filer x Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The number of shares outstanding of the issuer's common stock, par value \$0.001 per share, as of March 1, 2007 was 49,005,223.

The aggregate market value of the Common Stock held by non-affiliates of the registrant, based on the closing price of \$9.37 per share on June 30, 2006 as reported by the NASDAQ National Market was approximately \$263.6 million.

**COGENT COMMUNICATIONS GROUP, INC.
FORM 10-K ANNUAL REPORT**

FOR THE YEAR ENDED DECEMBER 31, 2006

TABLE OF CONTENTS

		Page
	<u>Part I Financial Information</u>	
<u>Item 1</u>	<u>Business</u>	3
<u>Item 1A</u>	<u>Risk Factors</u>	10
<u>Item 2</u>	<u>Description of Properties</u>	17
<u>Item 3</u>	<u>Legal Proceedings</u>	17
<u>Item 4</u>	<u>Submission of Matters to a Vote of Security Holders</u>	17
	<u>Part II Other Information</u>	
<u>Item 5</u>	<u>Market for the Registrant's Common Equity and Related Stockholder Matters</u>	18
<u>Item 6</u>	<u>Selected Consolidated Financial Data</u>	20
<u>Item 7</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 7A</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	37
<u>Item 8</u>	<u>Financial Statements and Supplementary Data</u>	38
<u>Item 9</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	65
<u>Item 9A</u>	<u>Controls and Procedures</u>	65
<u>Item 9B</u>	<u>Other Information</u>	68
	<u>Part III</u>	
<u>Item 10</u>	<u>Directors and Executive Officers of the Registrant</u>	68
<u>Item 11</u>	<u>Executive Compensation</u>	68
<u>Item 12</u>	<u>Security Ownership of Certain Beneficial Owners and Management</u>	68
<u>Item 13</u>	<u>Certain Relationships and Related Transactions</u>	68
<u>Item 14</u>	<u>Principal Accountant Fees and Services</u>	68
	<u>Part IV</u>	
<u>Item 15</u>	<u>Exhibits and Financial Statement Schedules</u>	68
<u>Signatures</u>		73

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for the registrant's 2007 annual shareholders meeting are incorporated by reference in Part III of this Form 10-K.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report may contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are not statements of historical facts, but rather reflect our current expectations concerning future results and events. You can identify these forward-looking statements by our use of words such as "anticipates," "believes," "continues," "expects," "intends," "likely," "opportunity," "plans," "potential," "project," "will," and similar expressions to identify forward-looking statements, whether in the negative or the affirmative. We cannot guarantee that we actually will achieve these plans, intentions or expectations. These forward-looking statements are subject to risks, uncertainties and other factors, some of which are beyond our control, which could cause actual results to differ materially from those forecast or anticipated in such forward-looking statements.

You should not place undue reliance on these forward-looking statements, which reflect our view only as of the date of this report. We undertake no obligation to update these statements or publicly release the result of any revisions to these statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.

PART I

ITEM 1. BUSINESS

Overview

We are a leading facilities-based provider of low-cost, high-speed Internet access and Internet Protocol, or IP, communications services. Our network is specifically designed and optimized to transmit data using IP. We deliver our services to small and medium-sized businesses, communications service providers and other bandwidth-intensive organizations through approximately 12,300 customer connections in North America and Europe.

Our primary on-net service is Internet access at a speed of 100 Megabits per second, much faster than typical Internet access currently offered to businesses. We offer this on-net service exclusively through our own facilities, which run all the way to our customers' premises. Because of our integrated network architecture, we are not dependent on local telephone companies to serve our on-net customers. Our typical customers in multi-tenant office buildings are law firms, financial services firms, advertising and marketing firms and other professional services businesses. We also provide on-net Internet access to certain bandwidth-intensive users such as universities, other ISPs and commercial content providers at speeds of up to ten Gigabits per second. For the years ended December 31, 2006, 2005 and 2004 our on-net customers generated 70.6%, 57.9% and 63.5%, respectively, of our total net service revenue.

In addition to providing our on-net 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. For the years ended December 31, 2006, 2005 and 2004, our off-net customers generated 23.1%, 33.0%, and 24.4%, respectively, of our total net service revenue.

Non-core services are those services we acquired and continue to support but do not actively sell. For the years ended December 31, 2006, 2005 and 2004, non-core services generated 6.3% and 9.1% and 12.1%, respectively, of our total net service revenue.

We also operate 28 data centers comprising over 250,000 square feet throughout North America and Europe that allow customers to co-locate their equipment and access our network.

Competitive Advantages

We believe we address many of the IP data communications needs of small and medium-sized businesses, communications service providers and other bandwidth-intensive organizations by offering them high-quality Internet service at attractive prices.

Low Cost of Operation. We offer a streamlined set of products on an integrated network that operates on a single protocol. Our network design allows us to avoid many of the costs associated with circuit-switched networks related to provisioning, monitoring and maintaining multiple transport protocols. Our low cost of operation gives us greater pricing flexibility and an advantage in a competitive environment characterized by falling Internet access prices.

Independent Network. Our on-net service does not rely on infrastructure controlled by local incumbent telephone companies. We provide the entire network, including the last mile and the in-building wiring to the customer's suite. This gives us more control over our service, quality and pricing and allows us to provision services more quickly and efficiently. We are typically able to activate customer services in one of our on-net buildings in fewer than twelve days.

High Quality, Reliable Service. We are able to offer high-quality Internet service due to our network, which was designed solely to transmit IP data, and dedicated intra-city bandwidth for each customer. This

design increases the speed and throughput of our network and reduces the number of data packets dropped during transmission.

Low Capital Cost to Grow Our Business. We have incurred relatively minimal indebtedness in growing our business because of our network design of using Internet routers without additional legacy equipment and our strategy of acquiring optical fiber from the excess capacity in existing networks.

Experienced Management Team. Our senior management team is composed of seasoned executives with extensive expertise in the telecommunications industry as well as knowledge of the markets in which we operate. The members of our senior management team have an average of 20 years of experience in the telecommunications industry. Our senior management team has designed and built our network and led the integration of our network assets, customers and service offerings we acquired through 13 acquisitions.

Convergence. There is a clear industry and market trend for legacy products (e.g., TDM voice, Private Line, Frame Relay, and Asynchronous Transfer Mode) to converge on IP. Many of our competitors will have to migrate their existing customers and products to IP. This migration can be costly, lengthy, and risky. We do not face this challenge because our network and products are IP.

Our Strategy

We intend to become the leading provider of high quality Internet access and IP communications services and to continue to improve our profitability and cash flow. The principal elements of our strategy include:

Focus on Providing Low-Cost, High-Speed Internet Access and IP Connectivity. We intend to further load our high-capacity network to respond to the growing demand for high-speed Internet service generated by bandwidth-intensive applications such as streaming media, online gaming, voice over IP (VOIP), remote data storage, distributed computing and virtual private networks. We intend to do so by continuing to offer our high-speed and high capacity services at competitive prices.

Pursuing On-Net Customer Growth. We intend to increase usage of our network and operational infrastructure by adding customers in our existing on-net buildings, as well as adding buildings to our network.

Selectively Pursuing Acquisition Opportunities. In addition to adding customers through our sales and marketing efforts, we will continue to seek out acquisition opportunities that increase our customer base, allowing us to take advantage of the unused capacity of our network and add revenues with minimal incremental costs. We may also make additional acquisitions to add network assets at attractive prices.

Our Network

Our network is comprised of in-building riser facilities, metropolitan optical networks, metropolitan traffic aggregation points and inter-city transport facilities. We deliver a high level of technical performance because our network is optimized for IP traffic. Our network is more reliable and delivers IP traffic at lower cost than networks built as overlays to traditional circuit-switched telephone networks.

Our network serves 90 metropolitan markets in North America and Europe and encompasses:

- over 850 multi-tenant office buildings strategically located in commercial business districts;
- over 240 carrier-neutral Internet aggregation facilities, data centers and single-tenant buildings;
- over 200 intra-city networks consisting of over 9,800 fiber miles;

- an inter-city network of more than 23,000 fiber route miles; and
- multiple leased high-capacity transatlantic circuits connecting the North American and European portions of our network.

4

We have created our network by acquiring optical fiber from carriers with large amounts of unused fiber and directly connecting Internet routers to the existing optical fiber national backbone. We have expanded our network through key acquisitions of financially distressed companies or their assets at a significant discount to their original cost. Due to our network design and acquisition strategy, we believe we are positioned to grow our revenue and increase profitability with limited incremental capital expenditures. We expect our 2007 capital expenditure rate to be similar to the rate we experienced in 2006.

Inter-city Networks

Our inter-city network consists of optical fiber connecting major cities in North America and Europe. The North American and European portions of our network are connected by transatlantic circuits. Our network was built by acquiring from various owners of fiber optic networks the right to use one or two strands of optical fiber out of the multiple fibers owned by the carrier. We have installed the optical and electronic equipment necessary to amplify, regenerate, and route the optical signals along these networks. We have the right to use the fiber under long term agreements. We pay these providers fees for the maintenance of the optical fiber and provide our own equipment maintenance. The larger providers of our inter-city optical fiber are WiTel (now part of Level 3) in the United States, LDCOM (now part of Neuf Cegetel in France, MTI in Germany, Telia Sonera in Europe, and RENFE (adif) in Spain.

Intra-city Networks

In each metropolitan area in which we provide high-speed on-net Internet access service, our backbone network is connected to a router connected to one or more of our metropolitan optical networks. We create our intra-city networks by obtaining the right to use optical fiber from carriers with large amounts of unused capacity. These metropolitan networks consist of optical fiber that runs from the central router in a market into routers located in on-net buildings. In most cases the metropolitan fiber runs in a ring architecture, which provides redundancy so that if the fiber is cut, data can still be transmitted to the central router by directing traffic in the opposite direction around the ring. The router in the building provides a connection to each on-net customer.

Within the cities where we offer off-net Internet access service, we lease circuits from telecommunications carriers, primarily local telephone companies, to provide the last mile connection to the customer's premises. Typically, these circuits are aggregated at various locations in those cities onto higher-capacity leased circuits that ultimately connect the local aggregation route to our network.

In-Building Networks

In office buildings where we provide service to multiple tenants we connect our routers to a cable containing 12 to 288 optical fiber strands that typically run from our equipment in the basement of the building through the building riser to the customer location. Service for customers is initiated by connecting a fiber optic cable from a customer's local area network to the infrastructure in the building riser. The customer then has dedicated and secure access to our network using an Ethernet connection. Ethernet is the lowest cost network connection technology and is used almost universally for the local area networks that businesses operate.

Internetworking

The Internet is an aggregation of interconnected networks. We interconnect our network with most major and hundreds of minor Internet Service Providers, or ISPs, at approximately 70 locations. We interconnect our network through public and private peering arrangements. Public peering is the means by which ISPs have traditionally connected to each other at central, public facilities. Larger ISPs also

exchange traffic and interconnect their networks by means of direct private connections referred to as private peering.

Peering agreements between ISPs are necessary in order for them to exchange traffic. Without peering agreements, each ISP would have to buy Internet access from every other ISP in order for its customer's traffic, such as email, to reach and be received from customers of other ISPs. We are considered a Tier 1 ISP and, as a result, have settlement-free peering arrangements with most other providers. This allows us to exchange traffic with those ISPs without payment by either party. In such arrangements, each party exchanging traffic bears its own cost of delivering traffic to the point at which it is handed off to the other party. We also engage in public peering arrangements in which each party also pays a fee to the owner of routing equipment that operates as the central exchange for all the participants. We do not treat our settlement-free peering arrangements as generating revenue or expense related to the traffic exchanged. Where we do not have settlement-free peering connection with an ISP, we exchange traffic through an intermediary, whereby such intermediary receives payment from us. Approximately 3% of our traffic is handled this way.

Network Management and Control

Our primary network operations centers are located in Washington, D.C and Madrid, Spain. These facilities provide continuous operational support in both North America and Europe. Our network operations centers are designed to immediately respond to any problems in our network. To ensure the quick replacement of faulty equipment in the intra-city and long-haul networks, we have deployed field engineers across North America and Europe. In addition, we have maintenance contracts with third party vendors that specialize in optical and routed networks.

Our Services

We offer high-speed Internet access and IP connectivity to small and medium-sized businesses, communications providers and other bandwidth-intensive organizations located in North America and Europe.

The table below shows our primary service offerings:

On-Net Services	Bandwidth (Mbps)
Fiber500	0.5
Two Meg	2.0
Fast Ethernet	100
Gigabit Ethernet	1,000
10 Gigabit Ethernet	10,000
Colocation with Internet Access	2 to 10,000
Point-to-Point	1.5 to 10,000
Off-Net Services	
T1 or E1	1.5 or 2.0
T3 or E3	45 or 34
Ethernet	10, 100 or 1,000

We offer on-net services in 79 metropolitan markets. We serve over 1,100 buildings of which more than 960 are located in North America with the remainder located in Europe. Our most popular on-net service in North America is our Fast Ethernet service, which provides Internet access at 100 megabits per second. We typically offer our Fast Ethernet (Internet access) service to our small and medium-sized business customers at \$1,000 a month for month-to-month service. We offer lower prices for longer term

commitments typically \$900 per month for a one year term and \$800 per month for a two year term. We also offer Internet access services at higher speeds of up to ten Gigabits per second. These services are generally used by customers that have businesses, such as web hosting, that are Internet based and are generally delivered at data centers and carrier hotels. We believe that, on a per-Megabit basis, this service offering is one of the lowest priced in the marketplace. We also offer colocation services in 28 locations in North America and Europe. This service offers Internet access combined with rack space and power in a Cogent facility, allowing the customer to locate a server or other equipment at that location and connect to our Internet service. Our final on-net service offering is our Point-to-Point or Layer 2 service. These point-to-point connections span North America and Europe and allow customers to connect geographically dispersed local area networks in a seamless manner. We emphasize the sale of on-net services because we believe that we have a competitive advantage in providing these services and our sales of these services generate higher gross profit margins.

We offer off-net services to customers not located in our on-net buildings. These services are provided in the metropolitan markets in North America and Europe in which we offer on-net services and in approximately 10 additional markets. These services are generally provided to small and medium-sized businesses. A significant amount of our off-net revenues were acquired revenues, which have historically churned at a greater rate than our on-net revenues. As a result, we expect the revenue from these off-net services to continue to decline. We expect the growth of our on-net Internet services to compensate for this loss.

We support a number of non-core services assumed with certain of our acquisitions. These services include our managed modem service, email service, dial-up Internet, shared web hosting and voice services in Toronto, Canada, managed web hosting, managed security and legacy point-to-point services. Our managed modem service is offered to larger businesses and other Internet service providers that serve individuals that dial in to the Internet. The business or ISP is our customer for this service. Individuals make use of the dial-in access through arrangements with the business or ISP. We expect the revenue from these non-core services to decline. We expect the growth of our on-net Internet services to compensate for this loss.

Sales and Marketing

Sales. We employ a relationship-based sales and marketing approach. As of March 1, 2007, our sales force included 143 full-time employees focused solely on acquiring and retaining customers. Our outside direct sales personnel work through direct face-to-face contact with potential customers in, or intending to locate in, on-net buildings. Through agreements with building owners, we are able to initiate and maintain personal contact with our customers by staging various promotional and social events in our on-net buildings. Direct sales personnel are compensated with a base salary plus quota-based commissions and incentives. We use a customer relationship management system to efficiently track activity levels and sales productivity.

Agent Program. We also have an agent program used as an alternate channel to distribute our products and services. The agent program consists of value-added resellers, IT consultants, and smaller telecom agents, who are managed by our direct sales personnel, and larger national or regional companies whose primary business is to sell telecommunications, data, and Internet services. The agent program includes over 110 agents.

Marketing. Because of our focus on a direct sales force, we have not spent funds on television, radio or print advertising. Our marketing efforts are designed to drive awareness of our products and services, identify qualified leads through various direct marketing campaigns and provide our sales force with product brochures, collateral materials and relevant sales tools to improve the overall effectiveness of our sales organization. In addition, we conduct public relations efforts focused on cultivating industry analyst

and media relationships with the goal of securing media coverage and public recognition of our Internet communications services. Our marketing organization is responsible for our product strategy and direction based upon primary and secondary market research and the advancement of new technologies.

Competition

We face competition from incumbent carriers, Internet service providers and facilities-based network operators, many of whom are much bigger than us, have significantly greater financial resources, better-established brand names and large, existing installed customer bases in the markets in which we compete. We also face competition from other new entrants to the communications services market. Many of these companies offer products and services that are similar to our products and services, and we expect the level of competition to intensify in the future. Unlike some of our competitors, we do not have title to most of the dark fiber that makes up our network. Our interests in that dark fiber are in the form of long-term leases or IRUs obtained from their titleholders. We rely on the maintenance of such dark fiber to provide our on-net services to customers. We are also dependent on third-party providers, some of whom are our competitors, for the provision of lines to our off-net customers.

We believe that competition is based on many factors, including price, transmission speed, ease of access and use, breadth of service availability, reliability of service, customer support and brand recognition. Because our fiber optic networks have been recently installed compared to those of the incumbent carriers, our state-of-the-art technology may provide us with cost, capacity, and service quality advantages over some existing incumbent carrier networks; however, our network may not support some of the services supported by these legacy networks, such as circuit-switched voice and frame relay. While the Internet access speeds offered by traditional ISPs typically do not match our on-net offerings, these slower services are usually priced lower than our offerings and thus provide competitive pressure on pricing, particularly for more price-sensitive customers. Additionally, some of our competitors have recently emerged from bankruptcy. Because the bankruptcy process allows for the discharge of debts and rejection of certain obligations, we may have less of an advantage with respect to these competitors. These and other downward pricing pressures have diminished, and may further diminish, the competitive advantages that we have enjoyed as the result of our service pricing.

Regulation

In the United States, the Federal Communications Commission (FCC) regulates common carriers interstate services and state public utilities commissions exercise jurisdiction over intrastate basic telecommunications services. Our Internet service offerings are not currently regulated by the FCC or any state public utility commission. However, as we expand our offerings we may become subject to regulation in the U.S. at the federal and state levels and in other countries. The offerings of many of our competitors and vendors, especially incumbent local telephone companies, are subject to direct federal and state regulations. These regulations change from time to time in ways that are difficult for us to predict.

In the United States, we are subject to the obligations set forth in the Communications Assistance for Law Enforcement Act, which is administered by the FCC. That law requires that we be able to intercept communications when required to do so by law enforcement agencies. We are required to comply or we may face significant fines and penalties.

There is no current legal requirement that owners or managers of commercial office buildings give access to competitive providers of telecommunications services, although the FCC does prohibit carriers from entering contracts that restrict the right of commercial multiunit property owners to permit any other common carrier to access and serve the property's commercial tenants.

Our subsidiary, Cogent Canada, offers voice and Internet services in Canada. Generally, the regulation of Internet access services and competitive voice services has been similar in Canada to that in

the U.S. in that providers of such services face fewer regulatory requirements than the incumbent local telephone company. This may change. Also, the Canadian government has requirements limiting foreign ownership of certain telecommunications facilities in Canada. We are not subject to these restrictions today. We will have to comply with these regulations to the extent they change and to the extent we begin using facilities in a manner that subjects us to these restrictions.

Our European subsidiaries operate in a more highly regulated environment for the types of services they provide. In many Western European countries, a national license or a notice filed with a regulatory authority is required for the provision of data and Internet services. In addition, our subsidiaries operating in member countries of the European Union are subject to the directives and jurisdiction of the European Union. We believe that each of our subsidiaries has the necessary licenses to provide its services in the markets where it operates today. To the extent we expand our operations or service offerings in Europe or other new markets, we may face new regulatory requirements.

The laws related to Internet telecommunications are unsettled and there may be new legislation and court decisions that may affect our services and expose us to liability.

Employees

As of March 1, 2007, we had 377 employees. A union represents twenty-two of our employees in France. We believe that we have a satisfactory relationship with our employees.

Available Information

We make available free of charge through our Internet website our annual report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act. The reports are made available through a link to the SEC's Internet website at www.sec.gov. You can find these reports and request a copy of our Code of Conduct on our website at www.cogentco.com under the Investor Relations link.

ITEM 1A. RISK FACTORS

If our operations do not consistently produce positive cash flow to pay for our growth or meet our operating and financing obligations, and we are unable to otherwise raise additional capital to meet these needs, our ability to implement our business plan will be materially and adversely affected.

Until we can consistently generate positive cash flow from our operations, we will continue to rely on our cash reserves and, potentially, additional equity and debt financings to meet our cash needs. Our future capital requirements likely will increase if we acquire or invest in additional businesses, assets, services or technologies. We may also face unforeseen capital requirements for new technology required to remain competitive or to comply with new regulatory requirements, for unforeseen maintenance of our network and facilities, and for other unanticipated expenses associated with running our business. In addition, if we do not retain existing customers or add new customers, we may be required to raise additional funds through the issuance of debt or equity. We cannot assure you that we will have access to necessary capital, nor can we assure you that any such financing will be available on terms that are acceptable to our stockholders or us. If issuing equity securities raises additional funds, substantial dilution to existing stockholders may result.

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 their own Internet networks. While no single customer accounted for more than 1.7% of our 2006 revenues, 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 2004 we had an operating loss of \$84.1 million, in 2005 we had an operating loss of \$62.1 million and in 2006 we had an operating loss of \$46.6 million. As of December 31, 2006, we had an accumulated deficit of \$265.0 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 difficulties in implementing our business plan in Europe and may incur related unexpected costs.

During the first quarter of 2004, we began operations in Europe through our acquisition of Firstmark, the parent holding company of LambdaNet Communications France SAS, or LambdaNet France, and LambdaNet Communications Espana SA, or LambdaNet Spain, and have obtained the rights to certain dark fiber and other network assets that were once part of Carrier 1 International S.A. in Germany. Prior to these transactions, we had only minimal European operations. We are expanding our operations in Europe. If we are not successful in developing our market presence in Europe, our operating results could be adversely affected.

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 1,107 at December 31, 2006 to approximately 1,160 at 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.

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.

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

The nature of our European and Canadian business 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;
- 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 European and Canadian operations 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 be 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.

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.

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.

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 that 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.

ITEM 2. DESCRIPTION OF PROPERTIES

We lease and own space for offices, data centers, colocation facilities, and points-of-presence.

Our headquarters facilities consist of approximately 15,370 square feet located in Washington, D.C. The lease for our headquarters is with an entity controlled by our Chief Executive Officer. The lease expires on August 31, 2010.

We also lease approximately 376,000 square feet of space in 58 locations to house our colocation facilities, regional offices and operations centers. The remaining term of these leases ranges from 6 months to 9 years with, in many cases, options to renew.

We believe that these facilities are generally in good condition and suitable for our operations.

ITEM 3. LEGAL PROCEEDINGS

We are involved in legal proceedings in the normal course of our business that we do not expect to have a material adverse affect on our business, financial condition or results of operations. For a discussion of the significant proceedings in which we are involved, see Note 7 to our consolidated financial statements.

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

No matters were submitted to a vote of our security holders during the quarter ended December 31, 2006.

PART II**ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS**

Our sole class of common equity is our common stock, par value \$0.001, which is currently traded on the NASDAQ Global Market under the symbol CCOI. Prior to March 6, 2006, our common stock traded on the American Stock Exchange under the symbol COI. Prior to February 5, 2002 no established public trading market for our common stock existed.

As of March 1, 2007, there were approximately 135 holders of record of shares of our common stock holding 49,005,223 shares of our common stock.

The table below shows, for the quarters indicated, the reported high and low trading prices of our common stock.

	High	Low
<i>Calendar Year 2005</i>		
First Quarter	\$ 25.40	\$ 8.11
Second Quarter	28.30	6.29
Third Quarter	8.37	4.56
Fourth Quarter	6.16	4.18
<i>Calendar Year 2006</i>		
First Quarter	\$ 9.77	\$ 5.13
Second Quarter	12.41	7.79
Third Quarter	11.77	7.78
Fourth Quarter	17.00	11.14

We have not paid any dividends on our common stock since our inception and do not anticipate paying any dividends in the foreseeable future. Our line of credit prohibits the payment of dividends. Any future determination to pay dividends will be at the discretion of our board of directors and will be dependent upon then-existing conditions, including our financial condition, results of operations, contractual restrictions, capital requirements, business prospects and other factors our board of directors deems relevant.

Performance Graph

The Company, in connection with its merger with Allied Riser Communications Corporation, began trading shares of its common stock on the American Stock Exchange in February 2002. On March 6, 2006, the Company's shares of Common Stock began trading on the Nasdaq National Market. The chart below compares the relative changes in the cumulative total return of the Company's Common Stock for the period February 5, 2002 - December 31, 2006, against the cumulative total return for the same period of the (1) The Standard & Poors 500 (S&P 500) Index and (2) an industry peer group consisting of Savvis Communications Corporation (NASDAQ: SVVS); Internap Network Services Corporation (AMEX: IIP); and Time Warner Telecom Inc. (NASDAQ: TWTC). The comparison assumes \$100 was invested on February 5, 2002 in the Company's common stock, the S&P 500 Index and the industry peer group, with dividends, if any, reinvested.

**COMPARISON OF 59 MONTH CUMULATIVE TOTAL RETURN*
AMONG COGENT COMMUNICATIONS GROUP, THE S & P INDEX
AND A PEER GROUP**

Value of \$100 Invested on February 5, 2002.

	2/02	12/02	12/03	12/04	12/05	12/06
Cogent Communications Group	100.00	7.52	23.17	21.39	5.44	16.06
S&P 500	100.00	79.05	101.73	112.80	118.34	137.03
Peer Group	100.00	24.89	127.76	56.33	58.70	159.07

* \$100 invested on 2/5/02 in stock or on 1/31/02 in index including reinvestment of dividends. Fiscal year ending December 31.

Copyright © 2006, Standard & Poor's, a division of The McGraw-Hill Companies, Inc. All rights reserved. www.researchdatagroup.com/S&P.htm

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The annual financial information set forth below has been derived from our audited consolidated financial statements. The information should be read in connection with, and is qualified in its entirety by reference to, Management's Discussion and Analysis, the consolidated financial statements and notes included elsewhere in this report and in our SEC filings.

	Years Ended December 31,				
	2002	2003	2004	2005	2006
	(dollars in thousands)				
CONSOLIDATED STATEMENT OF OPERATIONS DATA:					
Service revenue, net	\$ 51,913	\$ 59,422	\$ 91,286	\$ 135,213	\$ 149,071
Operating expenses:					
Network operations	49,091	47,017	63,466	85,794	80,106
Equity-based compensation expense network operations	233	1,307	858	399	315
Selling, general, and administrative	33,495	26,570	40,382	41,344	46,593
Equity-based compensation expense SG&A	3,098	17,368	11,404	12,906	10,194
Gain on settlement of vendor litigation	(5,721))			
Terminated public offering costs			779		
Restructuring charges			1,821	1,319	
Depreciation and amortization	33,990	48,387	56,645	55,600	58,414
Total operating expenses	114,186	140,649	175,355	197,362	195,622
Operating loss	(62,273)	(81,227)	(84,069)	(62,149)	(46,551)
Settlement of note holder litigation	(3,468))			
Gains lease obligation restructurings			5,292	844	255
Gain Allied Riser note exchange		24,802			
Gains Cisco credit facility		215,432		842	
Gains dispositions of assets				3,372	254
Interest income (expense) and other, net	(34,545)	(18,264)	(10,883)	(10,427)	(7,715)
(Loss) income before extraordinary gain	(100,286)	140,743	(89,660)	(67,518)	(53,757)
Extraordinary gain Allied Riser merger	8,443				
Net (loss) income	(91,843)	140,743	(89,660)	(67,518)	(53,757)
Beneficial conversion charges		(52,000)	(43,986)		
Net (loss) income applicable to common shareholders	\$ (91,843)	\$ 88,743	\$ (133,646)	\$ (67,518)	\$ (53,757)
Net (loss) income per common share available to common shareholders basic	\$ (564.45)	\$ 11.18	\$ (175.03)	\$ (1.96)	\$ (1.16)
Net (loss) income per common share available common shareholders diluted	\$ (564.45)	\$ 11.18	\$ (175.03)	\$ (1.96)	\$ (1.16)
Weighted-average common shares basic	162,712	7,935,831	763,540	34,439,937	46,343,372
Weighted-average common shares diluted	162,712	7,938,838	763,540	34,439,937	46,343,372
CONSOLIDATED BALANCE SHEET DATA					
(AT PERIOD END):					
Cash and cash equivalents	\$ 39,314	\$ 7,875	\$ 13,844	\$ 29,883	\$ 42,642
Total assets	407,677	344,440	378,586	351,373	336,876
Long-term debt (including capital leases and current portion) (net of unamortized discount of \$6,084 in 2003, \$5,026 in 2004, \$3,478 in 2005 and \$1,213 in 2006)	347,930	83,702	126,382	99,105	97,024
Preferred stock	175,246	97,681	139,825		
Stockholders' equity	32,626	244,754	212,490	221,001	215,632
OTHER OPERATING DATA:					
Net cash (used in) provided by operating activities	(41,567)	(27,357)	(26,425)	(9,062)	5,285
Net cash used in investing activities	(19,786)	(25,316)	(2,701)	(14,055)	(19,478)
Net cash provided by financing activities	51,694	20,562	34,486	39,824	27,045

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis together with Selected Consolidated Financial and Other Data and our consolidated 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 Risk Factors, as well as those discussed elsewhere. You should read Risk Factors and Special Note Regarding Forward-Looking Statements.

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 approximately 12,300 customer connections in North America and Western Europe. Our primary on-net service is Internet access at a speed of 100 Megabits per second, much faster than typical Internet access currently offered to businesses. 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 1,100 buildings in which we provide our on-net services, including over 850 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.

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. We may identify locations that we desire to serve with our on-net product but cannot be cost effectively added to our network. 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.

We have grown our net service revenue from \$91.3 million for the year ended December 31, 2004 to \$149.1 million for the year ended December 31, 2006. We have generated our revenue growth through the strategic acquisitions of communications network assets and customers, primarily from financially distressed companies, the continued expansion of our network of on-net buildings and the increase in customers generated by our sales and marketing efforts.

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 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.

Our on-net, off-net and non-core services comprised 57.9%, 33.0% and 9.1% of our net service revenue, respectively, for the year ended December 31, 2005 and 70.6%, 23.1% and 6.3% for the year ended December 31, 2006. While we target our sales and marketing efforts at increasing on-net customers, customers we add through acquisitions will also affect the mix of on-net and off-net revenues. For example, off-net service revenue increased as a percentage of total revenue in 2005 as compared to 2004 due to the inclusion of a full year of revenue from customers we added through our December 2004 acquisition of the off-net Internet access customers of Verio, Inc. We expect the percentage of on-net revenues to continue to increase as a percentage of total revenues in 2007.

We have grown our gross profit from \$27.8 million for the year ended December 31, 2004 to \$69.0 million for the year ended December 31, 2006. Our gross profit margin has expanded from 30.5% in 2004 to 46.3% for the year ended December 31, 2006. We determine gross profit by subtracting network operation expenses (excluding equity-based compensation expense) from our net service revenue. Equity-based compensation expense classified as cost of network services was \$0.9 million, \$0.4 million and \$0.3 million for the years ended December 31, 2004, 2005 and 2006, respectively. We believe that our gross profit will benefit and continue to expand as we are allocating the majority of our sales 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. We believe that as we add on-net customers we incur limited incremental expenses. We have not allocated depreciation and amortization expense to our network operations expense.

Due to our strategic acquisitions of network assets and equipment, we believe we are positioned to grow our revenue base and profitability without significant additional capital investments. We continue to deploy network equipment to other parts of our network to maximize the utilization of our assets. As a result, our future capital expenditures will be based primarily on our planned expansion of on-net buildings and the concentration and growth of our customer base. We expect our 2007 capital expenditure rate to be similar to the rate we experienced for 2006. We plan to increase our number of on-net buildings to approximately 1,160 by December 31, 2007 from 1,107 at December 31, 2006.

Historically, our operating expenses have exceeded our net service revenue resulting in operating losses of \$84.1 million, \$62.1 million and \$46.6 million in 2004, 2005 and 2006, respectively. In each of these periods, our operating expenses consisted primarily of the following:

- Network operations expenses which consist primarily of the cost of leased circuits, sites and facilities; tenant license agreements, network 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 bad debt expense and professional fees.
- 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 expense that results from the expense related to certain stock options and our restricted stock granted to our employees.
- Restructuring charges that resulted from the termination of our Paris office lease.

Acquisitions

Since our inception, we have consummated 13 acquisitions through which we have generated revenue growth, expanded our network and customer base and added strategic assets to our business. We have accomplished this primarily by acquiring financially distressed companies or their assets at a significant discount to their original cost. The overall impact of these acquisitions on the operation of our business has been to extend the physical reach of our network in both North America and Western Europe, expand the breadth of our service offerings, and increase the number of customers to whom we provide our services. The overall impact of these acquisitions on our balance sheet and cash flows has been to significantly increase the assets on our balance sheet, including cash in the case of the Allied Riser merger, increase our indebtedness and increase our cash flows from operations due to our increased customer base. A substantial portion of our historical growth in net service revenue and specifically off-net and non-core revenues has been generated by the customer contracts we have acquired. Following an acquisition, we have historically 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.

Acquisition of Verio

In December 2004, we acquired most of the off-net Internet access customers of Verio Inc., a leading global IP provider and subsidiary of NTT Communications Corp. The acquired assets included over 3,700 primarily off-net customer connections located in 23 of our U.S. markets, customer accounts receivable and certain network equipment. We also assumed the liabilities associated with providing services to these customers including vendor relationships, accounts payable, and accrued liabilities.

Acquisition of Aleron

In October 2004, we acquired certain assets of Aleron Broadband Services, formally known as AGIS Internet, and \$18.5 million in cash, in exchange for 3,700 shares of our Series M preferred stock, which converted into approximately 5.7 million shares of our common stock in February 2005. We acquired Aleron's customer base and network, as well as Aleron's Internet access and managed modem services.

Acquisition of Global Access

In September 2004, we acquired the majority of the assets of Global Access Telecommunications, Inc. in exchange for 185 shares of our Series L preferred stock. The Series L preferred stock issued in the transaction converted into approximately 0.3 million shares of our common stock in February 2005. Global Access provided Internet access and other data services in Germany. We acquired over 350 customer connections in Germany as a result of the acquisition.

Acquisition of UFO

In August 2004, we acquired certain assets of Unlimited Fiber Optics, Inc., or UFO, for 2,600 shares of our Series K preferred stock. The preferred stock issued in the merger converted into approximately 0.8 million shares of our common stock in February 2005. Among these assets were UFO's customer base, which was comprised of data service customers located in San Francisco and Los Angeles. The acquired assets also included net cash of approximately \$1.9 million and customer accounts receivable.

Acquisition of European Networks

In 2004 we expanded our operations into Europe through a series of acquisitions in which we acquired customers and extended our network, primarily in France, Spain, and Germany. We began operating in France and Spain through the acquisition of subsidiaries of LNG Holdings SA, or LNG, an operator of a European telecommunications network that was on the verge of insolvency. In March 2004, we acquired network assets in Germany formerly operated as part of the Carrier 1 network.

Results of Operations

Our management reviews and analyzes several key performance indicators in order to manage our business and assess the quality of and potential variability of our net service revenues and cash flows. 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;
- gross profit, which is an indicator of both our service offering mix, competitive pricing pressures and the cost of our network operations;
- growth in our on-net customer base, which is an indicator of the success of our on net focused sales efforts;
- growth in our on-net buildings; and
- distribution of revenue across our service offerings.

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

Year Ended December 31, 2005 Compared to the Year Ended December 31, 2006

The following summary table presents a comparison of our results of operations for the year ended December 31, 2005 and 2006 with respect to certain key financial measures. The comparisons illustrated in the table are discussed in greater detail below.

	Year Ended December 31, 2005	2006	Percent Change	
	(in thousands)			
Net service revenue	\$ 135,213	\$ 149,071	10.2	%
Network operations expenses(1)	85,794	80,106	(6.6)%
Gross profit(2)	49,419	68,965	39.6	%
Selling, general, and administrative expenses(3)	41,344	46,593	12.7	%
Restructuring charges	1,319		(100.0)%
Depreciation and amortization expenses	55,600	58,414	5.1	%
Gains lease obligations, debt restructurings and asset sales	5,058	509	(89.9)%
Net loss	(67,518	(53,757	(20.4)%

(1) Excludes equity-based compensation expense of \$399 and \$315 in the years ended December 31, 2005 and 2006, respectively, which, if included would have resulted in a period-to-period change of (6.7)%.

(2) Excludes equity-based compensation expense of \$399 and \$315 in the years ended December 31, 2005 and 2006, respectively, which if included would have resulted in a period-to-period change of 40.0%.

(3) Excludes equity-based compensation expense of \$12,906 and \$10,194 in the years ended December 31, 2005 and 2006, respectively, which, if included would have resulted in a period-to-period change of 4.7%.

Net Service Revenue. Our net service revenue increased 10.2% from \$135.2 million for the year ended December 31, 2005 to \$149.1 million for the year ended December 31, 2006. For the years ended December 31, 2005 and 2006, on-net, off-net and non-core revenues represented 57.9%, 33.0% and 9.1% and 70.6%, 23.1% and 6.3% of our net service revenues, respectively.

Our on-net revenues increased 34.4% from \$78.3 million for the year ended December 31, 2005 to \$105.3 million for the year ended December 31, 2006. Our on-net revenues increased as we increased the number of our on-net customer connections from approximately 4,700 at December 31, 2005 to approximately 7,800 at December 31, 2006. 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 such a broad mix of customers. Additionally, on-net customers who cancel their service from our installed base of customers, in general, have a greater revenue per connection than new customers. These trends result in a 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 22.9% from \$44.6 million for the year ended December 31, 2005 to \$34.4 million for the year ended December 31, 2006 primarily because our December 2004 acquisition of off-net customers from Verio resulted in a substantial increase in the number of our off-net customers in 2005 and many of these acquired customers have either cancelled service or re-priced their contracts at lower rates. Our off-net customer connections declined from approximately 4,000 at December 31, 2005 to approximately 3,500 at December 31, 2006. We expect that the net loss of off-net customer connections will continue. Our non-core revenues decreased 23.4% from \$12.2 million for the year ended December 31, 2005 to \$9.4 million for the year ending December 31, 2006. The number of our non-core customer connections declined from approximately 1,300 at December 31,

2005 to approximately 1,000 at December 31, 2006. 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, decreased 6.6% from \$85.8 million for the year ended December 31, 2005 to \$80.1 million for the year ended December 31, 2006. The decrease is primarily attributable to 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 39.6% from \$49.4 million for the year ended December 31, 2005 to \$69.0 million for the year ended December 31, 2006. We determine gross profit by subtracting network operations 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 36.5% for the year ended December 31, 2005 to 46.3% for the year ended December 31, 2006. 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. We generally record these disputed 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 (SG&A). Our SG&A expenses, excluding equity-based compensation expense, increased 12.7% from \$41.3 million for the year ended December 31, 2005 to \$46.6 million for the year ended December 31, 2006. 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 21.0% from \$13.3 million for the year ended December 31, 2005 to \$10.5 million for the year ending December 31, 2006. The decrease is primarily attributed to a \$3.4 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. Equity-based compensation expense for the year ended December 31, 2006 includes \$0.7 million in compensation costs associated with the adoption of Statement No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)) on January 1, 2006 using the modified-prospective-transition method. As of December 31, 2006 there was approximately \$5.5 million of total unrecognized compensation cost related to non-vested equity-based compensation awards. That cost is expected to be recognized over a weighted average period of approximately twenty-seven months.

Depreciation and Amortization Expenses. Our depreciation and amortization expense increased 5.1% from \$55.6 million for the year ended December 31, 2005 to \$58.4 million for the year ended December 31, 2006 due to an increase in deployed fixed assets. In the fourth quarter of 2005, we revised the number of lease renewal periods used in determining the lease term for purposes of amortizing certain of our leasehold improvements. This resulted in a net increase in depreciation expense of approximately \$3.0 million.

Restructuring charges. In 2004, we abandoned the Paris office obtained in the Cogent Europe acquisition and located these operations in another Cogent Europe facility. We recorded a restructuring charge of approximately \$1.8 million

related to the discounted remaining commitment on the lease, net of estimated sublease income. In the third quarter of 2005, we revised our estimate for sublease income, and recorded an additional \$1.3 million restructuring charge.

26

Gains- lease obligations, asset sales and debt restructurings. In September 2005, Cogent Spain negotiated modifications to an IRU capital lease that reduced its quarterly IRU lease payments and extended the lease term. The modification to the IRU capital lease resulted in a gain of approximately \$0.8 million. In June 2005, we repaid our \$17.0 million amended and restated Cisco note. The repayment resulted in a gain of \$0.8 million representing the amount of the estimated future interest payments that was not required to be paid. In 2005, we sold a building and land for net proceeds of \$5.1 million. This sale resulted in a gain of approximately \$3.9 million.

In September 2006, Cogent Spain negotiated modifications to an IRU capital lease that reduced its quarterly IRU lease payments and extended the lease term. The modification to this IRU capital lease resulted in a gain of approximately \$0.3 million. In 2006, we sold another building and land for net proceeds of \$0.8 million. This sale resulted in a gain of approximately \$0.3 million.

Net Loss. Our net loss was \$67.5 million for the year ended December 31, 2005 as compared to a net loss of \$53.8 million for the year ended December 31, 2006. Our net loss decreased by \$13.8 million primarily due to a \$19.5 million increase in our gross profit partially offset by a \$5.2 million increase in SG&A, and a \$2.8 million increase in depreciation and amortization expense. Included in net loss for the year ended December 31, 2005 is a \$1.3 million restructuring charge and gains of approximately \$5.1 million. Included in net loss for the year ended December 31, 2006 are gains of approximately \$0.5 million.

Buildings On-net. As of December 31, 2005 and 2006 we had a total of 1,040 and 1,107 on-net buildings connected to our network, respectively.

Year Ended December 31, 2004 Compared to the Year Ended December 31, 2005

The following summary table presents a comparison of our results of operations for the year ended December 31, 2004 and 2005 with respect to certain key financial measures. The comparisons illustrated in the table are discussed in greater detail below.

	Year Ended December 31, 2004 (in thousands)	2005	Percent Change	
Net service revenue	\$ 91,286	\$ 135,213	48.1	%
Network operations expenses(1)	63,466	85,794	35.2	%
Gross profit(2)	27,820	49,419	77.6	%
Selling, general, and administrative expenses(3)	40,382	41,344	2.4	%
Restructuring charges	1,821	1,319	(27.6))%
Terminated public offering costs	779		(100.0))%
Depreciation and amortization expenses	56,645	55,600	(1.8))%
Gains lease obligations, asset sales and debt restructurings	5,292	5,058	(4.4))%
Net loss	(89,660)	(67,518)	(24.7))%

(1) Excludes equity-based compensation expense of \$858 and \$399 in the years ended December 31, 2004 and 2005, respectively, which, if included would have resulted in a period-to-period change of 34.0%.

(2) Excludes equity-based compensation expense of \$858 and \$399 in the years ended December 31, 2004 and 2005, respectively, which if included would have resulted in a period-to-period change of 81.8%.

(3) Excludes equity-based compensation expense of \$11,404 and \$12,906 in the years ended December 31, 2004 and 2005, respectively, which, if included would have resulted in a period-to-period change of 4.8%.

Net Service Revenue. Our net service revenue increased 48.1% from \$91.3 million for the year ended December 31, 2004 to \$135.2 million for the year ended December 31, 2005. For the years ended December 31, 2004 and 2005, on-net, off-net and non-core revenues represented 63.5%, 24.4% and 12.1% and 57.9%, 33.0% and 9.1% of our net service revenues, respectively. Off-net service revenue increased as a percentage of total revenue in 2005 as compared to 2004 primarily due to the inclusion of a full year of revenue from customers we added through our December 2004 acquisition of the off-net Internet access customers of Verio.

Our on-net revenues increased 35.2% from \$57.9 million for the year ended December 31, 2004 to \$78.3 million for the year ended December 31, 2005. Our on-net revenues increased as we increased the number of our on-net customer connections from approximately 2,800 at December 31, 2004 to approximately 4,700 at December 31, 2005. Notwithstanding the increase in on-net revenues, the percentage of on-net revenues of total revenues decreased from 2004 to 2005 due to the increase in off-net revenues from the acquisition of the off-net Internet access customers of Verio. We believe that our on-net revenues as a percentage of total revenues will increase as we are allocating the majority of our sales resources toward obtaining additional on-net customers. Our off-net revenues increased 100.4% from \$22.3 million for the year ended December 31, 2004 to \$44.6 million for the year ended December 31, 2005. Our off-net revenues increased as we increased the number of our off-net customer connections during 2005 primarily from the December 2004 Verio acquisition. Due primarily to the churn of these acquired customers during 2005, however, our off-net customer connections declined from approximately 4,500 at December 31, 2004 to approximately 4,000 at December 31, 2005. We expect that this loss of our off-net customer connections will continue. Our non-core revenues increased 10.5% from \$11.1 million for the year ended December 31, 2004 to \$12.2 million for the year ending December 31, 2005. Our non-core revenues increased as we added non-core managed modem customer connections from our October 2004 Aleron acquisition and certain non-core Verio customers in that December 2004 acquisition. The number of our non-core customer connections declined from approximately 1,800 at December 31, 2004 to approximately 1,300 at December 31, 2005. We do not actively market these acquired non-core services and expect that the net service revenue associated with them will decline.

Our net service revenue related to our acquisitions is included in our statements of operations from the acquisition dates. Acquired net service revenues from our UFO, Global Access, Aleron and Verio acquisitions, which occurred in August 2004, September 2004, October 2004 and December 2004, respectively, totaled \$6.9 million for the year ended December 31, 2004 and \$35.5 million for the year ended December 31, 2005, respectively. This increase is primarily due to the \$21.7 million increase in acquired revenues from the December 2004 Verio acquisition. Approximately \$2.0 million of our non-core Cogent Europe net service revenue during 2004 was derived from network sharing services rendered to LambdaNet Communications Deutschland AG, or LambdaNet Germany. LambdaNet Germany was majority-owned by LNG Holdings until April 2004 when it was sold to an unrelated third party. In the first quarter of 2005, this network sharing arrangement was terminated and there was no such revenue in 2005.

Network Operations Expenses. Our network operations expenses, excluding equity-based compensation expense, increased 35.2% from \$63.5 million for the year ended December 31, 2004 to \$85.8 million for the year ended December 31, 2005. The increase is primarily attributable to leased circuits and facilities costs incurred in connection with our 2004 acquisitions. We provide Internet connectivity to the acquired customers that are not located in buildings directly connected to our network. As a result 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 and incur leased circuit costs to provide these services. Additionally, for the year ended December 31, 2004, Cogent Europe recorded \$1.8 million of costs associated with using the LambdaNet Germany network. In 2005 this network sharing arrangement was terminated and there were no such costs in 2005.

Gross profit. Our gross profit, excluding equity-based compensation expense, increased 77.6% from \$27.8 million for the year ended December 31, 2004 to \$49.4 million for the year ended December 31, 2005. The \$21.6 million increase is primarily attributed to our increase in net service revenue. Our gross profit margin expanded from 30.5% in 2004 to 36.5% for the year ended December 31, 2005. We determine gross profit by subtracting network operation expenses from our net service revenue (excluding equity-based compensation expense). Our gross profit has benefited from the limited incremental expenses associated with providing service to an increasing number of on-net customers. We have not allocated depreciation and amortization expense to our network operations expense. Our gross profit margin may be impacted by the timing and amounts of disputed circuit costs. We generally record these disputed 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 increase as we are allocating the majority of our sales 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 2.4% from \$40.4 million for the year ended December 31, 2004 to \$41.3 million for the year ended December 31, 2005. SG&A expenses increased primarily from the \$2.8 million increase in salaries and related costs required to support our sales effort and an increase of approximately \$0.5 million of auditor fees associated with our Sarbanes-Oxley Section 404 compliance requirements.

Equity-based Compensation Expense. Equity-based compensation expense is primarily related to restricted stock granted to our employees. Equity-based compensation expense increased from \$12.3 million for the year ended December 31, 2004 to \$13.3 million for the year ending December 31, 2005. The increase is primarily attributed to approximately \$0.6 million of deferred compensation expense recorded in 2005 from the grant of additional restricted shares in 2005 and the amortization expense related to \$4.7 million of deferred compensation related to options for restricted stock. These options were granted to certain of our employees in the third quarter of 2004 with an exercise price below the trading price of our common stock on the grant date. Compensation costs are recorded on a straight-line basis over the service period.

Restructuring charges. In 2004, Cogent France re-located its Paris headquarters. The estimated net present value of the remaining lease obligation, net of estimated sublease income, was approximately \$1.8 million and was recorded as a restructuring charge in 2004. In the third quarter of 2005, we revised our estimate for sublease income and estimated that the net present value of the remaining lease obligation increased by approximately \$1.3 million and recorded an additional restructuring charge.

Withdrawal of Public Offering. In May 2004, we filed a registration statement to sell shares of common stock in a public offering. In October 2004, we withdrew this registration statement and expensed the associated deferred costs of approximately \$0.8 million.

Depreciation and Amortization Expenses. Our depreciation and amortization expense decreased 1.8% from \$56.6 million for the year ended December 31, 2004 to \$55.6 million for the year ended December 31, 2005. The decrease is primarily attributed to a \$6.3 million decrease in the amortization expense of intangible assets that were fully amortized in 2005. In addition, in the fourth quarter of 2005, we revised the number of lease renewal periods used in determining the lease term for purposes of amortizing certain of our leasehold improvements. This resulted in a net increase in depreciation expense of approximately \$3.0 million.

Gains Lease Obligations, Asset Sales and Debt Restructurings. In 2004, we renegotiated several capital lease obligations for our intra-city fiber in France and Spain. These transactions resulted in gains of approximately \$5.3 million recorded as gains on lease obligation restructurings for the year ended December 31, 2004.

In March 2005, we sold our building and land located in Lyon, France for net proceeds of \$5.1 million. These assets were acquired in the Cogent Europe acquisition. This transaction resulted in a gain of approximately \$3.9 million. In June 2005, we used a portion of the proceeds from our public offering to repay our \$17.0 million Amended and Restated Cisco Note. The repayment of the Amended and Restated Cisco Note resulted in a gain of \$0.8 million representing the amount of the estimated future interest payments that was not required to be paid. In September 2005, we re-negotiated a capital lease obligation for our intra-city fiber in Spain. The modification to the IRU capital lease resulted in a gain of approximately \$0.8 million.

Net Loss. Our net loss was \$89.7 million for the year ended December 31, 2004 as compared to a net loss of \$67.5 million for the year ended December 31, 2005. The \$22.2 million reduction in our net loss occurred primarily due to the \$21.6 million increase in our gross margin.

Buildings On-net. As of December 31, 2004 and 2005 we had a total of 989 and 1,040 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, 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 years ended December 31, 2004, 2005, and 2006.

	Year Ended December 31,		
	2004	2005	2006
	(in thousands)		
Net cash (used in) provided by operating activities	\$ (26,425)	\$ (9,062)	\$ 5,285
Net cash used in investing activities	(2,701)	(14,055)	(19,478)
Net cash provided by financing activities	34,486	39,824	27,045
Effect of exchange rates on cash	609	(668)	(93)
Net increase in cash and cash equivalents during period	\$ 5,969	\$ 16,039	\$ 12,759

Net Cash (Used in) Provided By Operating Activities. Net cash used in operating activities was \$9.1 million for the year ended December 31, 2005 compared to net cash provided by operating activities of \$5.3 million for 2006. The change is primarily due to the increase in gross margin dollars generated from our increase in revenues. 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. Our net loss was \$67.5 million for the year ended December 31, 2005 compared to a net loss of \$53.8 million for the year ended December 31, 2006. Net loss for the year ended December 31, 2005 included non-cash gains of \$4.8 million related to our restructuring of certain lease obligations, repayment of our Cisco note obligation and net gains on asset sales. Net loss for the year ended December 31, 2006 included non-cash gains of \$0.5 million related to our restructuring of a lease obligation and asset sales. Depreciation and amortization, including the amortization of deferred compensation and the debt discount on the Allied Riser notes was \$70.5 million for the year ended December 31, 2005, and \$71.2 million for the year ended December 31, 2006. Net changes in operating assets and liabilities resulted in a decrease to operating cash of \$7.2 million for the year ended December 31, 2005 and a decrease in operating cash of \$11.6 million for the year ended December 31, 2006.

Net cash used in operating activities was \$26.4 million for the year ended December 31, 2004 compared to \$9.1 million for 2005. The reduction is primarily due to the increase in gross margin dollars generated from our increase in revenues. Our net loss was \$89.7 million for the year ended December 31, 2004 compared to a net loss of \$67.5 million for the year ended December 31, 2005. Net loss for the year ended December 31, 2004 included non-cash gains of \$6.1 million related to our restructuring of certain lease obligations. Net loss for the year ended December 31, 2005 included non-cash gains of \$4.8 million related to our restructuring of certain lease obligations, repayment of our Cisco note obligation and net gains on asset sales. Depreciation and amortization, including the amortization of deferred compensation and the debt discount on the Allied Riser notes was \$70.0 million for the year ended December 31, 2004, and \$70.5 million for the year ended December 31, 2005. Net changes in operating assets and liabilities resulted in a decrease to operating cash of \$0.6 million for the year ended December 31, 2004 and a decrease in operating cash of \$7.2 million for the year ended December 31, 2005.

Net Cash Used In Investing Activities. Net cash used in investing activities was \$2.7 million for the year ended December 31, 2004, \$14.1 million for the year ended December 31, 2005 and \$19.5 million for the year ended December 31, 2006. Our primary uses of investing cash during 2004 were \$10.1 million for the purchase of property and equipment and \$1.9 million for the purchase of a network in Germany. Our primary uses of investing cash during 2005 were \$17.3 million for the purchase of property and equipment, \$0.9 million for the final payment on the purchase of a network in Germany and \$0.8 million for the net purchases of short-term investments. Our primary uses of investing cash during 2006 were \$21.5 million for the purchase of property and equipment. Our primary sources of investing cash in 2004 were \$2.3 million of cash acquired from our acquisitions of Cogent Europe and Global Access and \$7.4 million from the proceeds of the sale of assets and proceeds of short-term investments. Our primary source of investing cash in 2005 was \$5.1 million from the proceeds of the sales of assets. Our primary sources of investing cash in 2006 were \$1.2 million from the proceeds of short-term investments and \$0.9 million from the proceeds of the sales of assets.

Net Cash Provided by Financing Activities. Financing activities provided net cash of \$34.5 million for the year ended December 31, 2004, \$39.8 million for the year ended December 31, 2005 and \$27.0 million for the year ended December 31, 2006. Net cash from financing activities during 2004 resulted from \$42.4 million of acquired cash related to our mergers with Symposium Gamma, Symposium Omega, UFO Group, and Cogent Potomac. Net cash used in financing activities for 2004 included a \$1.2 million payment to LNG Holdings and \$6.6 million in principal payments under our capital leases. Net cash from financing activities during 2005 resulted from \$63.7 million of net proceeds from our June 2005 public offering, \$10.0 million from the issuance of our subordinated note and \$10.0 million borrowed under our credit facility. Net cash used in financing activities for 2005 included \$17.0 million for the repayment of our Cisco note, \$10.0 million for the repayment of our subordinated note, \$10.0 million for the repayment of the amount outstanding under our credit facility and \$6.9 million in principal payments under our capital leases. Net cash from financing activities during 2006 resulted from \$36.5 million of net proceeds from our June 2006 public offering and \$0.4 million from the proceeds from the exercises of stock options. Net cash used in financing activities for 2006 included \$9.9 million in principal payments under our capital leases.

Cash Position and Indebtedness

Our total indebtedness, net of discount, at December 31, 2006 was \$97.0 million and our total cash and cash equivalents and short-term investments were \$42.7 million. Our total indebtedness at December 31, 2006 includes \$88.0 million of capital lease obligations for dark fiber primarily under 15-25 year IRUs, of which approximately \$6.0 million is considered a current liability. These capital lease obligations will be paid over a weighted average remaining term of approximately thirteen years.

Subordinated Note

On February 24, 2005, we issued a subordinated note in the principal amount of \$10.0 million to Columbia Ventures Corporation in exchange for \$10 million in cash. Columbia Ventures Corporation is owned by one of the Company's directors and shareholders. The terms of the subordinated note required the payment of all principal and accrued interest upon the occurrence of a liquidity event, which was defined as an equity offering of at least \$30.0 million in net proceeds. Our June 2005 public offering was considered a liquidity event and in June 2005 we repaid the \$10.0 million subordinated note, plus accrued interest of \$0.3 million.

Credit Facility

On March 9, 2005, we entered into a \$10.0 million credit facility with a commercial bank. The credit facility is secured by our accounts receivable and our other assets. In December 2005, we modified the credit facility, which increased the available borrowings to up to \$20.0 million and removed a \$4.0 million restricted cash covenant, among other revisions. The borrowing base is determined primarily by the aging characteristics related to our accounts receivable. In March 2005, we borrowed \$10.0 million under the credit facility for working capital purposes. In June 2005, we repaid the \$10.0 million with part of the proceeds of our June 2005 public offering. Borrowings under the credit facility accrue interest at the prime rate plus 1.5% and may, in certain circumstances, be reduced to the prime rate plus 0.5%. Our obligations under the credit facility are guaranteed by our material domestic subsidiaries. As of December 31, 2006, and since June 2005 there were no amounts outstanding under the credit facility. The credit facility expires on April 1, 2007. We do not plan to renew the credit facility.

Amended and Restated Cisco Note

We used a portion of the proceeds from our June 2005 public offering to repay in full the indebtedness under our \$17.0 million amended and restated Cisco note. The Cisco recapitalization was considered a troubled debt restructuring under Statement of Financial Accounting Standards (SFAS) No. 15, *Accounting by Debtors and Creditors of Troubled Debt Restructurings*. Under SFAS No. 15, the note was recorded at its principal amount of \$17.0 million plus the estimated future interest payments of \$0.8 million. The estimated future interest was not required to be paid, so the payment of the note resulted in a gain of \$0.8 million.

Allied Riser Convertible Subordinated Notes

Our 7.50% convertible subordinated notes are due on June 15, 2007. The \$10.2 million of notes were recorded at their fair value of approximately \$2.9 million at the merger date in 2002. The discount is amortized to interest expense through the maturity date. Interest is payable semiannually on June 15 and December 15.

Contractual Obligations and Commitments

The following table summarizes our contractual cash obligations and other commercial commitments as of December 31, 2006.

	Payments due by period				
	Total (in thousands)	Less than 1 year	1-3 years	3-5 years	After 5 years
Long term debt	\$ 10,573	10,573			
Capital lease obligations	146,381	12,694	21,622	24,885	87,180
Operating leases(1)	152,642	28,319	39,373	24,184	60,766
Unconditional purchase obligations	1,163	1,163			
Total contractual cash obligations	\$ 310,759	\$ 52,749	\$ 60,995	\$ 49,069	\$ 147,946

(1) These amounts include \$153.7 million of operating lease, maintenance and tenant license agreement obligations, reduced by sublease agreements of \$1.0 million.

Capital Lease Obligations. The capital lease obligations above were incurred in connection with IRUs for inter-city and intra-city dark fiber underlying substantial portions of our network. These capital leases are presented on our balance sheet at the net present value of the future minimum lease payments, or \$88.0 million at December 31, 2006. These leases generally have terms of 15 to 25 years.

Letters of Credit. We are also party to letters of credit totaling \$1.0 million at December 31, 2006. These obligations are fully secured by our restricted investments, and as a result, are excluded from the contractual cash obligations above.

Future Capital Requirements

We believe that our cash on hand and cash from operations 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 includes increasing our number of on-net buildings to approximately 1,160 by December 31, 2007 from 1,107 at December 31, 2006 and continuing to substantially increase our number of sales representatives and our marketing efforts in 2007. 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;
- our capital expenditure rate for 2007 will continue at a rate similar to the rate we experienced in 2006;
- 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; and
- our ability to add additional productive 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 we issue equity securities, substantial dilution to existing stockholders may result.

We may elect to purchase or otherwise retire the remaining \$10.2 million face value of Allied Riser notes with cash, stock or assets from time to time in open market or privately negotiated transactions, either directly or through intermediaries where we believe that market conditions are favorable to do so. Such purchases may have a material effect on our liquidity, financial condition and results of operations.

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.

Critical Accounting Policies and Significant Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates including those related to allowances for doubtful accounts, revenue allowances, long-lived assets, accruals, contingencies and litigation, and the carrying values of assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We historically have not experienced significant revisions to our estimates except to the extent that they result from (1) changes in estimated litigation accruals, (2) changes in estimated leased circuit obligations, (3) changes in the number of option renewal periods used in determining the lease term for purposes of determining the amortization period for our leasehold improvements, (4) changes in our estimates of the percentage of time our employees were involved in our construction activities and (5) changes in estimated sub-lease income which has caused us to revise our lease accruals for abandoned facilities.

The accounting policies we believe to be most critical to understanding our financial results and condition and that require complex, significant and subjective management judgments are discussed below.

Revenue Recognition

We recognize service revenue when the services are performed, evidence of an arrangement exists, the fee is fixed and determinable and collection is probable. Service discounts and incentives offered to certain customers are recorded as a reduction of revenue when granted. Fees billed in connection with customer installations are deferred and recognized ratably over the estimated customer life. We determine the

estimated customer life using a historical analysis of customer retention. If our estimated customer life increases, we will recognize installation revenue over a longer period. We expense direct costs associated with sales as incurred.

Allowances for Sales Credits and Unfulfilled Customer Purchase Obligations

We have established allowances to account for sales credits and unfulfilled contractual purchase obligations.

- Our allowance for sales credits is recorded as a reduction to our service revenue to provide for situations when customers are granted a service termination adjustment for amounts billed in advance or a service level agreement credit or discount. This allowance is determined by actual credits granted during the period and an estimate of unprocessed credits.
- Our allowance for unfulfilled contractual customer purchase obligations is designed to account for the possible non-payment of amounts under agreements that we have with certain of our customers that place minimum purchase obligations on them. Although we vigorously seek payments due pursuant to these purchase obligations, we have historically collected only a small portion of these billed obligations. In order to allow for this, we reduce our gross service revenue by the amount that has been invoiced to these customers. We reduce this allowance and recognize the related service revenue only upon the receipt of cash payments in respect of these invoices. This allowance is determined by the amount of unfulfilled contractual purchase obligations invoiced to our customers and with respect to which we are continuing to seek payment.

Valuation Allowances for Doubtful Accounts Receivable and Deferred Tax Assets

We have established allowances associated with uncollectible accounts receivable and our deferred tax assets.

- Our valuation allowance for uncollectible accounts receivable is designed to account for the expense associated with accounts receivable that we estimate will not be collected. We assess the adequacy of this allowance by evaluating general factors, such as the length of time individual receivables are past due, historical collection experience, and changes in the credit-worthiness of our customers. We also assess the ability of specific customers to meet their financial obligations to us and establish specific allowances based on the amount we expect to collect from these customers.
- Our valuation allowance for our net deferred tax asset reflects the uncertainty surrounding the realization of our net operating losses and our other deferred tax assets. For federal and state tax purposes, our net operating loss carry-forwards, including those that we have generated through our operations and those acquired in the Allied Riser merger could be subject to significant limitations on annual use. To reflect for this uncertainty and the uncertainty of future taxable income we have recorded a valuation allowance for the full amount of our net deferred tax asset.

Impairment of Long-Lived Assets

We review our long-lived assets, including property and equipment, and intangible assets with definite useful lives for impairment whenever events or changes in circumstances indicate that the carrying amount should be addressed pursuant to the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Pursuant to SFAS No. 144, impairment is determined by comparing the carrying value of these long-lived assets to our estimate of future undiscounted cash flows expected to result from the use of the assets. In the event that there are changes in the planned use of our long-lived assets, or our expected future undiscounted cash flows are reduced significantly, our assessment of our ability to recover the carrying value of these assets under SFAS No. 144 could change. No impairment pursuant to SFAS No. 144 existed at December 31, 2005 or 2006.

Business Combinations

We account for our business combinations pursuant to SFAS No. 141, *Business Combinations*. Under SFAS No. 141 we allocate the cost of an acquired entity to the assets acquired and liabilities assumed based upon their estimated fair values at the date of acquisition. Intangible assets are recognized when they arise from contractual or other legal rights or if they are separable. We determine estimated fair values using quoted market prices, when available, or by present values of future cash flows discounted at appropriate interest rates. Consideration not in the form of cash is measured based upon the estimated fair value of the consideration given. We amortize our intangible assets on a straight-line basis or using an accelerated method consistent with expected cash flows. We presently have no intangible assets that are not subject to amortization.

Equity-based Compensation

Effective January 1, 2006, we adopted FASB Statement No. 123(R), *Share-Based Payment* (Statement 123(R)), using the modified-prospective-transition method. The adoption of Statement 123(R) requires us to make additional estimates and judgments that affect our financial statements. These estimates include the following which impact the amount of compensation expense recorded under Statement 123(R).

Expected Dividend Yield We have never declared or paid dividends and have no plans to do so in the foreseeable future. Additionally, our credit facility prohibits us from paying cash dividends.

Expected Volatility We use the historical volatility since our June 2005 public offering to estimate expected volatility because less than 3% of our fully diluted shares were publicly traded before that date.

Risk-Free Interest Rate We use the zero coupon U.S. Treasury rate during the quarter having a term that most closely resembles the expected term of the option.

Expected Term of the Option We estimate the expected life of the option term by analyzing historical stock option exercises and other relevant data.

Forfeiture Rates We estimate the forfeiture rate based on historical data with further consideration given to the class of employees to whom the options were granted.

Other Accounting Policies

We record assets and liabilities under capital leases at the lesser of the present value of the aggregate future minimum lease payments or the fair value of the assets under lease.

We capitalize the direct costs incurred prior to an asset being ready for service. These costs include costs under the related construction contract and the salaries and benefits of employees directly involved with construction activities. Our capitalization of these costs is based upon estimates of time for our employees involved in construction activities.

We estimate our litigation accruals based upon our estimate of the expected outcome after consultation with legal counsel.

We estimate our accruals for disputed leased circuit obligations based upon the nature and age of the dispute. Our network costs are impacted by the timing and amounts of disputed circuit costs. We generally record these disputed amounts when billed by the vendor and reverse these amounts when the vendor credit has been received or the dispute has otherwise been resolved.

We estimate the useful lives of our property and equipment based upon historical usage with consideration given to technological changes and trends in the industry that could impact the asset utilization.

We establish the number of renewal option periods used in determining the lease term for amortizing leasehold improvements based upon our assessment at the inception of the lease of the number of option periods that are reasonably assured in accordance with SFAS No. 13 *Accounting for Leases*.

We estimate our restructuring and abandoned lease facilities accruals based upon our estimate of the net present value of cash flows expected from these obligations including expected sub-lease income after consideration of market conditions for these and similar properties and the terms of the related lease agreement.

Recent Accounting Pronouncements

Prior to January 1, 2006, we accounted for our equity-based compensation plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (Opinion 25), and related Interpretations, as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation* (Statement 123). Effective January 1, 2006, we adopted FASB Statement No. 123(R), *Share-Based Payment* (Statement 123(R)), using the modified-prospective transition method. Under the modified-prospective transition method, compensation cost recognized in 2006 includes: (a) compensation cost for all share-based payments granted prior to but not yet vested as of January 1, 2006, based on the grant date fair value, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value. Results for prior periods have not been restated. As a result of adopting Statement 123(R), our net loss for the year ended December 31, 2006, was approximately \$0.7 million greater than if it had continued to account for share-based compensation under Opinion 25. Upon the adoption of Statement 123(R), \$9.7 million of deferred compensation was offset against additional paid-in-capital.

In June 2006, the FASB issued FIN No. 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, including resolution of any related appeals or litigation processes, 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. We will adopt the provisions of FIN No. 48 beginning in the first quarter of 2007. We are currently evaluating the effect, if any, the adoption of FIN No. 48 will have on our financial statements. Based upon our analysis performed to date, we do not believe that the adoption of FIN No. 48 will have a material effect on our financial position.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest income and expense are sensitive to changes in the general level of interest rates. However, based upon the nature and current level of our investments, which are primarily cash and cash equivalents, we believe that there is no material risk of interest rate exposure.

Our European and Canadian operations expose us to currency fluctuations and exchange rate risk. For example, while we record financial results from our European and Canadian operations in euros and the Canadian dollar, respectively, these results are reflected in our consolidated financial statements in U.S. dollars. The assets and liabilities associated with our European and Canadian operations are translated into U.S. dollars and 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 and the Canadian dollar. In addition, 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, the expenses and cash flow requirements associated with our European operations may be significantly higher in U.S.-dollar terms than planned.

ITEM 8. INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
<u>Report of Independent Registered Public Accounting Firm</u>	39
<u>Consolidated Balance Sheets as of December 31, 2005 and 2006</u>	40
<u>Consolidated Statements of Operations for the Years Ended December 31, 2004, December 31, 2005 and December 31, 2006</u>	41
<u>Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2004, December 31, 2005 and December 31, 2006</u>	42
<u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2004, December 31, 2005 and December 31, 2006</u>	44
<u>Notes to Consolidated Financial Statements</u>	46

38

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Cogent Communications Group, Inc.

We have audited the accompanying consolidated balance sheets of Cogent Communications Group, Inc. and subsidiaries (the Company) as of December 31, 2005 and 2006, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule listed in the index at Item 15(a)2. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Cogent Communications Group, Inc. and subsidiaries at December 31, 2005 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, in 2006, the Company adopted Statement of Financial Accounting Standards No. 123(R), Share Based Payment.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Cogent Communications Group, Inc. and subsidiaries internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 13, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

*McLean, VA
March 13, 2007*

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 2005 AND 2006
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	2005	2006
Assets		
Current assets:		
Cash and cash equivalents	\$ 29,883	\$ 42,642
Short term investments (\$1,283 and \$0 restricted, respectively)	1,283	80
Accounts receivable, net of allowance for doubtful accounts of \$1,437 and \$1,233, respectively	16,452	20,053
Prepaid expenses and other current assets	3,959	5,339
Total current assets	51,577	68,114
Property and equipment:		
Property and equipment	488,142	512,321
Accumulated depreciation and amortization	(195,355)	(249,053)
Total property and equipment, net	292,787	263,268
Intangible assets, net	2,554	1,150
Deposits and other assets (\$1,118 restricted)	4,455	4,344
Total assets	\$ 351,373	\$ 336,876
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	\$ 11,521	\$ 9,096
Accrued liabilities	16,275	12,614
Convertible subordinated notes, net of discount of \$1,213 due June 2007		8,978
Current maturities, capital lease obligations	6,698	6,027
Total current liabilities	34,494	36,715
Capital lease obligations, net of current maturities	85,694	82,019
Convertible subordinated notes, net of discount of \$3,478	6,713	
Other long term liabilities	3,471	2,510
Total liabilities	130,372	121,244
Commitments and contingencies:		
Stockholders equity:		
Common stock, \$0.001 par value; 75,000,000 shares authorized; 44,092,652 and 48,928,108 shares issued and outstanding, respectively	44	49
Additional paid-in capital	440,500	478,140
Deferred compensation	(9,680)	
Stock purchase warrants	764	764
Treasury stock, 61,462 and no shares, respectively	(90)	
Accumulated other comprehensive income foreign currency translation adjustment	665	1,638
Accumulated deficit	(211,202)	(264,959)
Total stockholders equity	221,001	215,632
Total liabilities and stockholders equity	\$ 351,373	\$ 336,876

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

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2004, DECEMBER 31, 2005 AND DECEMBER 31, 2006
(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

	2004	2005	2006
Service revenue, net	\$ 91,286	\$ 135,213	\$ 149,071
Operating expenses:			
Network operations (including \$858, \$399 and \$315 of equity-based compensation expense, respectively, exclusive of amounts shown separately)	64,324	86,193	80,421
Selling, general, and administrative (including \$11,404, \$12,906 and \$10,194 of equity-based compensation expense, and \$3,995, \$4,574 and \$2,584 of bad debt expense, respectively)	51,786	54,250	56,787
Restructuring charges	1,821	1,319	
Terminated public offering costs	779		
Depreciation and amortization	56,645	55,600	58,414
Total operating expenses	175,355	197,362	195,622
Operating loss	(84,069)	(62,149)	(46,551)
Gain Cisco credit facility		842	
Gains capital lease obligation restructurings	5,292	844	255
Gains disposition of assets		3,372	254
Interest income and other	2,119	1,320	2,969
Interest expense	(13,002)	(11,747)	(10,684)
Net loss	\$ (89,660)	\$ (67,518)	\$ (53,757)
Beneficial conversion charges	(43,986)		
Net loss available to common shareholders	\$ (133,646)	\$ (67,518)	\$ (53,757)
Net loss per common share:			
Basic and diluted net loss per common share	\$ (117.43)	\$ (1.96)	\$ (1.16)
Beneficial conversion charge	\$ (57.61)	\$	\$
Basic and diluted net loss per common share available to common shareholders	\$ (175.03)	\$ (1.96)	\$ (1.16)
Weighted-average common shares basic and diluted	763,540	34,439,937	46,343,372

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

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2004 DECEMBER 31, 2005 AND DECEMBER 31, 2006
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	Common Shares	Stock Amount	Additional Paid-in Capital	Deferred Compensation	Treasury Stock	Stock Purchase Warrants	Preferred Stock F Shares	Preferred Stock F Amount	Preferred Stock G Shares	Preferred Stock G Amount	Preferred Stock H Shares	Preferred Stock H Amount	Preferred Stock I Shares	Preferred Stock I Amount
Balance at														
December 31, 2003	653,567	\$	\$ 232,475	\$ (32,680)	\$ (90)	\$ 764	11,000	\$ 10,904	\$ 41,030	\$ 40,787	53,373	\$ 45,990		\$
Total, December 31, 2003														
Forfeitures of shares granted to employees				4,966							(5,127)	(4,965)		
Equity-based compensation expense				12,262										
Foreign currency translation														
Issuances of preferred stock, net				(2,370)							1,913	2,370	2,575	2,545
Issuances of options for preferred stock				(4,711)							4,711			
Conversion of preferred stock into common stock	173,920		3,808						(9)	(9)	(4,338)	(3,797)		
Beneficial conversion charge				43,896										
Reclassification of beneficial conversion charge to additional paid in capital				(43,896)										
Contribution of capital LNG related party				410										
Net loss														
Balance at														
December 31, 2004	827,487	1	236,692	(22,533)	(90)	764	11,000	10,904	41,021	40,778	45,821	44,309	2,575	2,545
Total, December 31, 2004														
Forfeitures of shares granted to employees	(23,069)		(686)	697							(14)	(11)		
Equity-based compensation expense				13,306										
Foreign currency translation														
Issuances of common stock, net	11,719,231	11	64,712	(1,150)										
Conversion of preferred stock into common stock	31,569,003	32	139,782				(11,000)	(10,904)	(41,021)	(40,778)	(45,807)	(44,298)	(2,575)	(2,545)
Net loss														
Balance at														
December 31, 2005	44,092,652	44	440,500	(9,680)	(90)	764								
Total, December 31, 2005														
Forfeitures of shares granted to employees	(646)													
Adoption of SFAS 123(R) reclassification of deferred compensation				(9,680)	9,680									
Equity-based compensation expense				10,509										
Foreign currency translation														
Issuances of common stock, net	4,732,500	5	36,474											

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

Exercises of options for common stock	103,602		427						
Treasury stock retirement			(90)		90				
Net loss									
Balance at									
December 31, 2006	48,928,108	\$ 49	\$ 478,140	\$	\$	\$ 764	\$	\$	\$
Total, December 31, 2006									

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

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2004 DECEMBER 31, 2005 AND DECEMBER 31, 2006
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	Preferred Stock J		Preferred Stock K		Preferred Stock L		Preferred Stock M		Foreign Currency Translation	Accumulated Deficit	Total Stockholder Equity	Comprehensive Income (Loss)
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Adjustmen			
Balance at December 31, 2003		\$		\$		\$		\$	\$ 628	\$ (54,024)	\$ 244,754	\$
Cancellations of shares granted to employees											1	
Equity-based compensation expense											12,262	
Foreign currency translation									887		887	887
Issuances of preferred stock, net	3,891	19,421	2,600	2,588	185	927					25,481	
Issuances of options for preferred stock												
Conversion of preferred stock into common stock							3,701	18,353			18,355	
Beneficial conversion charge										(43,896)		
Reclassification of beneficial conversion charge to additional paid in capital										43,896		
Contribution of capital - LNG related party											410	
Net loss										(89,660)	(89,660)	(89,660)
Balance at December 31, 2004	3,891	19,421	2,600	2,588	185	927	3,701	18,353	1,515	(143,684)	212,490	
Total, Year Ended December 31, 2004												(88,773)
Cancellations of shares granted to employees												
Equity-based compensation expense											13,306	
Foreign currency translation									(850)		(850)	(850)
Issuances of common stock, net											63,573	
Conversion of preferred stock into common stock	(3,891)	(19,421)	(2,600)	(2,588)	(185)	(927)	(3,701)	(18,353)				
Net loss										(67,518)	(67,518)	(67,518)
Balance at December 31, 2005									665	(211,202)	221,001	
Total, Year Ended December 31, 2005												(68,368)
Cancellations of shares granted to employees												
Adoption of SFAS 123(R) reclassification of deferred compensation												
Equity-based compensation expense											10,509	
Foreign currency translation									973		973	973
Issuances of common stock, net											36,479	
Exercises of options for common stock											427	
Treasury stock retirement												
Net loss		\$		\$		\$		\$		(53,757)	(53,757)	(53,757)
		\$		\$		\$		\$	1,638	(264,959)	\$ 215,632	

Balance at December 31,
2006
Total, Year Ended
December 31, 2006

\$ (52,784)

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

43

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2004, DECEMBER 31, 2005 AND DECEMBER 31, 2006
(IN THOUSANDS)

	2004	2005	2006
Cash flows from operating activities:			
Net loss	\$ (89,660)	\$ (67,518)	\$ (53,757)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Depreciation and amortization	56,645	55,600	58,414
Amortization of debt discount convertible notes	1,058	1,548	2,265
Equity-based compensation expense	12,262	13,305	10,509
Gains Cisco credit facility related party		(842)	
Gains capital lease obligation restructurings and dispositions of assets, net	(6,124)	(3,983)	(540)
Changes in assets and liabilities:			
Accounts receivable	2,274	(3,645)	(2,758)
Prepaid expenses and other current assets	2,256	34	(1,321)
Other assets	1,565	(3,700)	563
Accounts payable and accrued liabilities	(6,701)	139	(8,090)
Net cash (used in) provided by operating activities	(26,425)	(9,062)	5,285
Cash flows from investing activities:			
Purchases of property and equipment	(10,135)	(17,342)	(21,526)
Purchases of intangible assets	(317)	(129)	(100)
(Purchases) maturities of short term investments, net	3,026	(774)	1,203
Cash acquired acquisitions	2,336		
Purchase of fiber optic network in Germany	(1,949)	(932)	
Proceeds from asset sales	4,338	5,122	945
Net cash used in investing activities	(2,701)	(14,055)	(19,478)
Cash flows from financing activities:			
Repayment of capital lease obligations	(6,630)	(6,899)	(9,861)
Repayment of advance from LNG Holdings related party	(1,242)		
Cash acquired mergers	42,358		
Proceeds from sales of common stock, net		63,723	36,479
Proceeds from exercises of common stock options			427
Proceeds from issuance of subordinated note related party		10,000	
Repayment of subordinated note related party		(10,000)	
Repayment of Cisco note		(17,000)	
Borrowings under credit facility		10,000	
Repayments under credit facility		(10,000)	
Net cash provided by financing activities	34,486	39,824	27,045
Effect of exchange rate changes on cash	609	(668)	(93)
Net increase in cash and cash equivalents	5,969	16,039	12,759
Cash and cash equivalents, beginning of year	7,875	13,844	29,883
Cash and cash equivalents, end of year	\$ 13,844	\$ 29,883	\$ 42,642
Supplemental disclosures of cash flow information:			
Cash paid for interest	\$ 10,960	\$ 12,598	\$ 12,235
Non-cash financing activities			
Capital lease obligations incurred	968	1,213	2,087

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

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2004, DECEMBER 31, 2005 AND DECEMBER 31, 2006
(IN THOUSANDS)

	2004
Issuance of Series I preferred stock for Symposium Gamma common stock	\$ 2,575
Issuance of Series J preferred stock for Symposium Omega common stock	19,454
Issuance of Series K preferred stock for UFO Group common stock	2,600
Issuance of Series L preferred stock for Global Access assets	927
Issuance of Series M preferred stock for Cogent Potomac common stock	18,352
<i>Symposium Gamma (Cogent Europe) Acquisition</i>	
Fair value of assets acquired	\$ 155,468
Negative goodwill	(77,232)
Less: valuation of preferred stock	(2,575)
Fair value of liabilities assumed	\$ 75,661
<i>Symposium Omega Acquisition</i>	
Fair value of assets acquired	\$ 19,454
Less: valuation of preferred stock	\$ (19,454)
Fair value of liabilities assumed	
<i>UFO Group Acquisition</i>	
Fair value of assets acquired	\$ 3,326
Less: valuation of preferred stock	(2,600)
Fair value of liabilities assumed	\$ 726
<i>Global Access Acquisition</i>	
Fair value of assets acquired	\$ 1,931
Less: valuation of preferred stock	(927)
Fair value of liabilities assumed	\$ 1,004
<i>Cogent Potomac (Aleron) Acquisition</i>	
Fair value of assets acquired	\$ 20,622
Less: valuation of preferred stock	(18,352)
Fair value of liabilities assumed	\$ 2,270
<i>Verio Acquisition</i>	
Fair value of assets acquired	\$ 4,493
Fair value of liabilities assumed	\$ 4,493

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

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2004, 2005 and 2006

1. Description of the business and summary of significant accounting policies:

Description of business

Cogent Communications, Inc. (Cogent) was formed on August 9, 1999, as a Delaware corporation and is headquartered in Washington, DC. In 2001, Cogent formed Cogent Communications Group, Inc., (the Company), a Delaware corporation. Effective on March 14, 2001, Cogent's stockholders exchanged all of their outstanding common and preferred shares for an equal number of shares of the Company, and Cogent became a wholly owned subsidiary of the Company. This was a tax-free exchange that was accounted for by the Company at Cogent's historical cost.

The Company is a leading 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 12,300 customer connections in North America and Western Europe.

The Company's primary on-net service is Internet access at a speed of 100 Megabits per second, much faster than typical Internet access currently offered to businesses. The Company offers this on-net service 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's typical customers in multi-tenant office buildings are law firms, financial services firms, advertising and marketing firms and other professional services businesses. The Company also 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.

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 operates data centers throughout North America and Western Europe that allow customers to collocate their equipment and access 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 carriers with large amounts of unused fiber and directly connecting Internet routers to the existing optical fiber national backbone. The Company has expanded its network through several acquisitions of financially distressed companies or their assets. The overall impact of these acquisitions on the operation of its business has been to extend the physical reach of the Company's network in both North America and Europe, expand the breadth of its service offerings, and increase the number of customers to whom the Company provides its services.

Management's plans, liquidity and business risks

The Company has experienced losses since its inception in 1999 and as of December 31, 2006 had an accumulated deficit of \$265.0 million. The Company operates in the rapidly evolving Internet services industry, which is subject to intense competition and rapid technological change, among other factors. The successful execution of the Company's business plan is dependent upon the Company's ability to increase and retain its customers, the Company's ability to retain and attract key employees, and the Company's ability to manage its growth including its increased sales and marketing efforts and geographic expansion,

among other factors. Although management believes that the Company will successfully mitigate its risks, management cannot give any assurance that it will be able to do so or that the Company will ever operate profitably.

On June 7, 2006 the Company sold 4.35 million shares of common stock at \$9.00 per share in a public offering. This public offering resulted in net proceeds to the Company of approximately \$36.5 million. Management believes that cash on hand, cash from this public offering and cash generated from the Company's operations will be adequate to meet the Company's future funding requirements.

Any future acquisitions, other significant unplanned costs or cash requirements may require the Company to raise additional funds through the issuance of debt or equity. Such financing may not be available on terms acceptable to the Company or its stockholders, or at all. Insufficient funds may require the Company to delay or scale back the number of buildings that it serves, scale back its planned sales and marketing efforts, or require the Company to restructure its business. If the Company issues equity securities, substantial dilution to existing stockholders may result.

Summary of Significant Accounting Policies

Principles of consolidation

The consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles and include the accounts of the Company and all of its wholly owned and majority-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

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.

Revenue recognition and allowance for doubtful accounts

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition. The Company's service offerings consist of telecommunications services provided under month-to-month or annual contracts billed monthly in advance. Net revenues from telecommunication services are recognized when the services are performed, evidence of an arrangement exists, the fee is fixed and determinable and collection is probable. The probability of collection is determined by an analysis of a new customer's credit history and historical payment patterns for existing customers. Service discounts and incentives related to telecommunication services are recorded as a reduction of revenue when granted. Fees billed in connection with customer installations are deferred and recognized ratably over the estimated customer life determined by a historical analysis of customer retention.

The Company invoices certain customers for amounts contractually due for unfulfilled minimum contractual obligations and recognizes a corresponding sales allowance equal to this revenue resulting in the recognition of no net revenue at the time the customer is billed. The Company recognizes net revenue as these billings are collected in cash. The Company vigorously seeks payment of these amounts.

The Company establishes a valuation allowance for collection of doubtful accounts and other sales credit adjustments. Valuation allowances for sales credits are established through a reduction of revenue, while valuation allowances for doubtful accounts are established through a charge to selling, general and administrative expenses. The Company assesses the adequacy of these reserves by evaluating general

factors, such as the length of time individual receivables are past due, historical collection experience, and changes in the credit worthiness of its customers. The Company believes that its established valuation allowances were adequate as of December 31, 2005 and 2006. If circumstances relating to specific customers change or economic conditions change such that the Company's past collection experience and assessment of the economic environment are no longer relevant, the Company's estimate of the recoverability of its trade receivables could be impacted.

Network operations

Network operations include costs associated with service delivery, network management, and customer support. This includes the costs of personnel and related operating expenses associated with these activities, network facilities costs, fiber and equipment maintenance fees, leased circuit costs, and access fees paid to building owners. The Company estimates its accruals for any disputed leased circuit obligations based upon the nature and age of the dispute. Network operations costs are impacted by the timing and amounts of disputed circuit costs. The Company generally records these disputed amounts when billed by the vendor and reverses these amounts when the vendor credit has been received or the dispute has otherwise been resolved. The Company does not allocate depreciation and amortization expense to its network operations expense.

International operations

Revenue for Cogent Canada for the years ended December 31, 2004, 2005 and 2006 was \$6.2 million, \$8.0 million and \$10.7 million, respectively. The net income (loss) for Cogent Canada for the years ended December 31, 2004, 2005 and 2006, was \$0.3 million, \$1.8 million and \$(1.6) million, respectively. Cogent Canada's total assets were \$12.0 million at December 31, 2005 and \$12.6 million at December 31, 2006.

Revenue for the Company's European operations for the years ended December 31, 2004, 2005 and 2006 was \$23.3 million, \$27.0 million and \$31.6 million, respectively. The net loss for Cogent Europe for the years ended December 31, 2004, 2005 and 2006, was \$14.4 million, \$11.0 million and \$11.0 million, respectively. Cogent Europe's total consolidated assets were \$57.1 million at December 31, 2005 and \$57.2 million at December 31, 2006.

Foreign currency translation adjustment and comprehensive income (loss)

The functional currency of Cogent Canada is the Canadian dollar. The functional currency of Cogent Europe is the euro. The consolidated financial statements of Cogent Canada, and Cogent Europe, are translated into U.S. dollars using the period-end foreign currency exchange rates for assets and liabilities and the average foreign currency exchange rates for revenues and expenses. Gains and losses on translation of the accounts of the Company's non-U.S. operations are accumulated and reported as a component of other comprehensive income (loss) in stockholders' equity.

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.

Financial instruments

The Company considers all highly liquid investments with an original maturity of three months or less at purchase to be cash equivalents. The Company determines the appropriate classification of its investments at the time of purchase and evaluates such designation at each balance sheet date. At December 31, 2005 and 2006, the Company's investments consisted of money market accounts and certificates of deposit.

At December 31, 2005 and 2006, the carrying amount of cash and cash equivalents, short-term investments, accounts receivable, prepaid and other current assets, accounts payable, and accrued expenses approximated fair value because of the short maturity of these instruments. Based upon the borrowing rates for debt arrangements with similar terms the Company estimates the fair value of the Allied Riser convertible subordinated notes at \$10.2 million using a discounted cash flows method and using an interest rate for obligations of similar characteristics. The Allied Riser convertible subordinated notes due in June 2007 have a face value of \$10.2 million. The notes were recorded at their fair value of approximately \$2.9 million at the Allied Riser merger date. The resulting discount is being amortized to interest expense through the maturity date using the effective interest rate method.

Short-term investments

Short-term investments consist of certificates of deposit with original maturities beyond three months, but less than 12 months. Such short-term investments are carried at cost, which approximates fair value due to the short period of time to maturity. Investments underlying our cash equivalents and short-term investments are classified as held-to-maturity in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities.

The Company was party to letters of credit totaling approximately \$2.2 million as of December 31, 2005 and \$1.0 million at December 31, 2006. These letters of credit are secured by certificates of deposit of approximately \$2.4 million at December 31, 2005 and \$1.1 million at December 31, 2006 that are restricted and included in short-term investments and other assets.

Credit risk

The Company's assets that are exposed to credit risk consist of its cash equivalents, short-term investments, other assets and accounts receivable. The Company places its cash equivalents and short-term investments in instruments that meet high-quality credit standards as specified in the Company's investment policy guidelines. Accounts receivable are due from customers located in major metropolitan areas in the United States, Western Europe and Ontario, Canada. Receivables from the Company's net centric (wholesale) customers and customers obtained through business combinations are subject to a higher degree of credit risk than other customers.

Property and equipment

Property and equipment are recorded at cost and depreciated once deployed using the straight-line method over the estimated useful lives of the assets. Useful lives are determined based on historical usage with consideration given to technological changes and trends in the industry that could impact the asset utilization. System infrastructure costs include capitalized interest, the capitalized salaries and benefits of employees directly involved with construction activities and costs incurred by third party contractors. Assets and liabilities under capital leases are recorded at the lesser of the present value of the aggregate future minimum lease payments or the fair value of the assets under lease. Leasehold improvements include costs associated with building improvements. The Company determines the number of renewal option periods included in the lease term for purposes of amortizing leasehold improvements based upon its assessment at the inception of the lease of the number of option periods that are reasonably assured in accordance with SFAS No. 13 Accounting for Leases. Expenditures for maintenance and repairs are expensed as incurred.

Depreciation and amortization periods are as follows:

Type of asset	Depreciation or amortization period
Indefeasible rights of use (IRUs)	Shorter of useful life or IRU lease agreement; generally 15 to 20 years, beginning when the IRU is ready for use
Network equipment	3 to 8 years
Leasehold improvements	Shorter of lease term with reasonably assured renewal term or useful life; generally 8 to 15 years
Software	2 to 5 years
Owned buildings	40 years
Office and other equipment	1 to 10 years
System infrastructure	5 to 10 years

Long-lived assets

The Company's long-lived assets include property and equipment and identifiable intangible asset. These long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount should be addressed pursuant to Statement of Financial Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Pursuant to SFAS No. 144, impairment is determined by comparing the carrying value of these long-lived assets to management's probability weighted estimate of the future undiscounted cash flows expected to result from the use of the assets and their eventual disposition. The cash flow projections used to make this assessment are consistent with the cash flow projections that management uses internally to assist in making key decisions. In the event an impairment exists, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the asset, which is generally determined by using quoted market prices or valuation techniques such as the discounted present value of expected future cash flows, appraisals, or other pricing models. Management believes that no such impairment existed as of December 31, 2005 or 2006. In the event there are changes in the planned use of the Company's long-term assets or the Company's expected future undiscounted cash flows are reduced significantly, the Company's assessment of its ability to recover the carrying value of these assets under SFAS No. 144 could change.

Asset retirement obligations

In accordance with SFAS No. 143, Accounting for Asset Retirement Obligations, the fair value of a liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. The Company measures changes in the liability for an asset retirement obligation due to passage of time using the effective interest rate method. The interest rate used to measure that change is the credit-adjusted risk-free rate that existed when the liability was initially measured.

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

Income taxes

The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. Under SFAS No. 109, deferred tax assets or liabilities are computed based upon the differences between financial statement and income tax bases of assets and liabilities using the enacted marginal tax rate. Deferred income tax expense or benefits are based upon the changes in the assets or liability from period to period.

Equity-based compensation

Prior to January 1, 2006, the Company accounted for its equity-based compensation plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (*Opinion 25*), and related Interpretations, as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation* (*Statement 123*). Effective January 1, 2006, the Company adopted FASB Statement No. 123(R), *Share-Based Payment* (*Statement 123(R)*), using the modified-prospective transition method.

Under the modified-prospective transition method, compensation cost recognized in 2006 includes: (a) compensation cost for all equity-based payments granted prior to but not yet vested as of January 1, 2006, based on the grant date fair value, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value. Results for prior periods have not been restated. As a result of adopting Statement 123(R), the Company's net loss for the year ended December 31, 2006, was approximately \$0.7 million greater than if it had continued to account for share-based compensation under Opinion 25. Upon the adoption of Statement 123(R), \$9.7 million of deferred compensation was offset against additional paid-in-capital.

The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of Statement 123 for the years ended December 31, 2004 and December 31, 2005 (in thousands except per share amounts):

	Year Ended December 31, 2004	Year Ended December 31, 2005
Net loss available to common shareholders, as reported	\$ (133,646)	\$ (67,518)
Add: stock-based employee compensation expense included in reported net loss, net of related tax effects	12,262	13,305
Deduct: total stock-based employee compensation expense determined under fair value based method, net of related tax effects	(12,523)	(13,918)
Pro forma net loss available to common shareholders	\$ (133,907)	\$ (68,131)
Loss per share available to common shareholders, as reported basic and diluted	\$ (175.03)	\$ (1.96)
Pro forma loss per share available to common shareholders, basic and diluted	\$ (175.38)	\$ (1.98)

Pro forma information regarding net loss and net loss per share is required by Statement 123 and, in periods prior to January 1, 2006, had been determined as if the Company had accounted for its employee stock options under the fair value method. The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model. The Company determines the fair value of grants of its restricted common stock by the closing trading price of its common stock on the grant date. The weighted-average per share grant date fair value of options for common stock was \$6.21 in 2004, \$4.95 in 2005 and \$6.16 in 2006.

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

The following assumptions were used for determining the fair value of options granted in the three years ended December 31, 2006:

	Year Ended December 31, 2004		Year Ended December 31, 2005		Year Ended December 31, 2006	
Dividend yield	0.0	%	0.0	%	0.0	%
Expected volatility average	151.0	%	159.8	%	58.2	%
Risk-free interest rate average	4.0	%	4.1	%	4.8	%
Expected life of the option term (in years)	5.0		5.0		5.0	

Basic and diluted net loss per common share

Net loss per share is presented in accordance with the provisions of SFAS No. 128 Earnings per Share. SFAS No. 128 requires a presentation of basic EPS and diluted EPS. Basic 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, adjusted, using the if-converted method, for the effect of common stock equivalents arising from the assumed conversion of participating convertible securities, if dilutive. Diluted net loss per common share is based on the weighted-average number of shares of common stock outstanding during each period, adjusted for the effect of common stock equivalents arising from the assumed exercise of stock options, warrants, the conversion of preferred stock and conversion of participating convertible securities, if dilutive. Common stock equivalents have been excluded from the net loss per share calculations for all periods presented because their effect would be anti-dilutive.

For the years ended December 31, 2004, 2005 and 2006 options to purchase 1.1 million, 1.2 million shares and 1.2 million shares of common stock at weighted-average exercise prices of \$2.30, \$2.68 and \$2.73 per share, respectively, are not included in the computation of diluted earnings per share as they are anti-dilutive. Unvested restricted stock is not included in the computation of earnings per share until vested. For the years ended December 31, 2005 and 2006, 0.3 million shares and 0.4 million shares of unvested restricted stock, respectively, are not included in the computation of basic earnings per share and will be included as this stock vests. For the year ended December 31, 2004, preferred stock, which was convertible into 31.6 million shares of common stock was not included in the computation of diluted earnings per share as a result of its anti-dilutive effect. For each of the three years ended December 31, 2006 approximately 6,300 shares, of common stock issuable on the conversion of the Allied Riser convertible subordinated notes and warrants were not included in the computation of diluted earnings per share as a result of their anti-dilutive effect.

The weighted-average basic and diluted common shares outstanding increased from 34.4 million for the year ended December 31, 2005 to 46.3 million for the year ended December 31, 2006 primarily due to the effect of the conversion of the Company's shares of preferred stock into 31.6 million shares of common stock on February 14, 2005, the Company's public offering of 11.5 million shares of common stock which closed in June 2005 and the Company's public offering of 4.35 million shares of common stock which closed in June 2006.

The weighted-average basic and diluted common shares outstanding increased from 0.8 million for the year ended December 31, 2004 to 34.4 million for the year ended December 31, 2005 primarily due to the effect of the conversion of the Company's shares of preferred stock into 31.6 million shares of common stock on February 14, 2005 and the Company's public offering of 11.5 million shares of common stock which closed in June 2005.

Cash flows from financing activities

In connection with the acquisitions of Cogent Europe, Symposium Omega, UFO and Cogent Potomac, certain of the Company's shareholders invested in the entities that were used by the Company to

acquire the operating assets and liabilities of the businesses acquired. As a result, these amounts are included in cash flows from financing activities in the accompanying consolidated statement of cash flows for 2004.

Recent accounting pronouncements

In June 2006, the FASB issued FIN No. 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, including resolution of any related appeals or litigation processes, 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 will adopt the provisions of FIN No. 48 beginning in the first quarter of 2007. The Company is currently evaluating the effect, if any, the adoption of FIN No. 48 will have on its financial statements. Based upon the analysis performed to date, the Company does not believe that the adoption of FIN No. 48 will have a material effect on its financial position.

2. Property and equipment:

Property and equipment consisted of the following (in thousands):

	December 31, 2005	2006
Owned assets:		
Network equipment	\$ 233,275	\$ 244,688
Leasehold improvements	63,327	68,452
System infrastructure	36,549	38,670
Software	7,688	7,800
Office and other equipment	5,973	7,395
Buildings	1,435	1,418
Land	226	125
	348,473	368,548
Less Accumulated depreciation and amortization	(167,768)	(213,625)
	180,705	154,923
Assets under capital leases:		
IRUs	139,669	143,773
Less Accumulated depreciation and amortization	(27,587)	(35,428)
	112,082	108,345
Property and equipment, net	\$ 292,787	\$ 263,268

Depreciation and amortization expense related to property and equipment and capital leases was \$48.3 million, \$53.7 million and \$56.8 million for the years ended December 31, 2004, 2005 and 2006, respectively.

Asset sales

In 2005, the Company sold a building and land for net proceeds of \$5.1 million. This transaction resulted in a gain of approximately \$3.9 million. In 2006, the Company sold another building and land for net proceeds of \$0.8 million. This transaction resulted in a gain of approximately \$0.3 million.

Capitalized labor and related costs

The Company capitalizes the salaries and related benefits of employees directly involved with its construction activities. In 2004, 2005 and 2006, the Company capitalized salaries and related benefits of

\$1.7 million, \$2.2 million and \$2.1 million, respectively. These amounts are included in system infrastructure costs.

3. Accrued liabilities:

Paris office lease restructuring charges

In 2004, the French subsidiary of Cogent Europe re-located its Paris headquarters. The estimated net present value of the remaining lease obligation, net of estimated sublease income, was approximately \$1.8 million and was recorded as a restructuring charge in 2004. In 2005, the Company revised its estimate for sublease income and estimated that the net present value of the remaining lease obligation had increased by approximately \$1.3 million and recorded an additional restructuring charge. A reconciliation of the amounts related to these contract termination costs is as follows (in thousands):

Restructuring accrual	
Charged to costs 2004	\$1,821
Amortization of discount	145
Amounts paid	(355)
Balance December 31, 2004	1,611
Amortization of discount	144
Charged to costs - 2005	1,319
Effect of exchange rates	(236)
Amounts paid	(1,286)
Balance December 31, 2005	1,552
Effect of exchange rates	40
Amortization of discount	114
Amounts paid	(1,313)
Balance December 31, 2006 (included in accrued liabilities)	\$393

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 its Verio acquisition. In 2005, the Company revised its estimate for sublease income and estimated that the net present value of the remaining lease obligation increased by approximately \$1.6 million and recorded a corresponding increase to the acquired intangible assets. In August 2006, the Company placed one of these facilities into service and reversed the associated liability resulting in an increase to other income of approximately \$0.4 million. A reconciliation of the amounts related to these contract termination costs is as follows (in thousands):

Lease accrual	
Assumed obligation balance December 31, 2004	\$ 1,894
Increase to obligation 2005	1,563
Amortization of discount	105
Amounts paid	(842)
Balance December 31, 2005	2,720
Amortization of discount	154
Facility placed into service included in other income	(395)
Amounts paid	(725)
Balance December 31, 2006	1,754
Current portion (included in accrued liabilities)	(512)
Long term portion (included in other long term liabilities)	\$ 1,242

Asset retirement obligations

The Company provides for asset retirement obligations for certain points of presence in its networks. A reconciliation of the amounts related to these obligations as follows (in thousands):

Asset Retirement Obligations

Beginning balance	\$
Acquired balance Cogent Europe	1,226
Amortization of discount	40
Amounts paid	(64)
Balance December 31, 2004	1,202
Effect of exchange rates	(128)
Amortization of discount	45
Amounts paid	(274)
Balance December 31, 2005	845
Effect of exchange rates	101
Amortization of discount	40
Balance December 31, 2006 (recorded as other long term liabilities)	\$ 986

Accrued liabilities as of December 31 consist of the following (in thousands):

	2005	2006
General operating expenditures	\$ 7,890	\$ 6,828
Restructuring accrual	1,198	393
Due to LNG related party (Note 10)	24	
Acquired lease accruals Verio acquisition	657	512
Deferred revenue	1,302	1,265
Payroll and benefits	1,271	1,465
Taxes non income based	817	585
Interest	3,116	1,566
Total	\$ 16,275	\$ 12,614

4. Intangible assets:

Intangible assets as of December 31 consist of the following (in thousands):

	2005	2006
Peering arrangements	\$ 16,440	\$ 16,440
Customer contracts	12,350	12,435
Trade name	1,764	1,764
Non-compete agreements	431	431
Licenses	465	615
Total	31,450	31,685
Less accumulated amortization	(28,896)	(30,535)
Intangible assets, net	\$ 2,554	\$ 1,150

Intangible assets are being amortized over periods ranging from 12 to 60 months. Intangible assets are amortized on a straight-line basis or using an accelerated method consistent with expected cash flows. Amortization expense for the years ended December 31, 2004, 2005 and 2006 was approximately \$8.3 million, \$2.0 million and \$1.6 million, respectively. Future amortization expense related to intangible assets is expected to be \$1.0 million, \$0.1 million and \$0.1 million, for the years ending December 31, 2007, 2008 and 2009, respectively.

5. Long-term debt and credit facility:

Subordinated note

On February 24, 2005, the Company issued a subordinated note in the principal amount of \$10.0 million to Columbia Ventures Corporation, a stockholder, in exchange for \$10.0 million in cash. The note had an initial interest rate of 10.0% per annum. The Company could prepay the note in whole or in part at any time without penalty. The terms of the note required the payment of all principal and accrued interest upon the occurrence of a liquidity event, which was defined as an equity offering of at least \$30.0 million in net proceeds. The Company's June 2005 public offering was considered a liquidity event and in June 2005 the Company repaid the \$10.0 million subordinated note, plus accrued interest of \$0.3 million.

Credit facility

The Company has a credit facility with a commercial bank that provides for borrowings up to \$20.0 million. The credit facility matures on April 1, 2007 and is secured by a first priority lien on the Company's accounts receivable and on a majority of the Company's other assets. The borrowing base is determined primarily by the aging characteristics related to the Company's accounts receivable and the amount of the Company's cash held at the commercial bank. In March 2005, the Company borrowed \$10.0 million that was repaid in June 2005. Borrowings under the credit facility accrue interest at the prime rate plus 1.5% and may, in certain circumstances, be reduced to the prime rate plus 0.5%. Interest is paid monthly. The line includes an unused facility fee of 0.375% and a 0.75% prepayment penalty. The agreements governing the credit facility contain certain customary representations and warranties, covenants, notice provisions and events of default including a requirement to maintain a certain percentage of the Company's unrestricted cash with the commercial bank and financial covenants based upon the Company's operating performance and capital expenditures. There have been no amounts borrowed since June 2005 and there were no amounts outstanding under the credit facility at December 31, 2006. The Company does not plan to renew the credit facility when it expires on April 1, 2007.

Cisco note

In June 2005, the Company used a portion of the proceeds from its public offering to repay its \$17.0 million amended and restated Cisco note. The note was subject to mandatory prepayment in full, without prepayment penalty, upon the completion of any equity financing or receipt of loan proceeds in excess of \$30.0 million. The repayment of the note resulted in a gain of \$0.8 million representing the amount of the estimated future interest payments.

Allied Riser convertible subordinated notes

The Company's 7.50% convertible subordinated notes are due on June 15, 2007. The \$10.2 million of notes were recorded at their fair value of approximately \$2.9 million at the Allied Riser merger date. The discount is amortized to interest expense through the maturity date. The notes are convertible at the option of the holders into approximately 1,050 shares of the Company's common stock. Interest is payable semiannually on June 15 and December 15, and is payable, at the election of the Company, in either cash or registered shares of the Company's common stock. The Company has paid interest in cash.

6. Income taxes:

The net deferred tax asset is comprised of the following (in thousands):

	December 31	
	2005	2006
Net operating loss carry-forwards	\$ 275,283	\$ 319,768
Depreciation	(47,764)	(38,370)
Start-up expenditures	3,724	2,838
Accrued liabilities	3,407	(497)
Deferred compensation	4,760	4,783
Other	4	15
Valuation allowance	(239,414)	(288,537)
Net deferred tax asset	\$	\$

Due to the uncertainty surrounding the realization of its net deferred tax asset, the Company has recorded a valuation allowance for the full amount of its net deferred tax asset. Should the Company achieve taxable income, its deferred tax assets may be available to offset future income tax liabilities. The Company has combined net operating loss carry-forwards of approximately \$927 million. The federal and state net operating loss carry-forwards for the United States of approximately \$426 million expire from 2023 to 2027. The Company has net operating loss carry forwards related to its European operations of approximately \$501 million, which do not expire. The federal and state net operating loss carry-forwards of Allied Riser Communications Corporation of approximately \$183 million are subject to certain limitations on annual utilization due to the change in ownership as a result of the merger as prescribed by federal and state tax laws. The Company's net operating loss carry-forwards could also be subject to certain additional limitations on annual utilization if certain changes in ownership have occurred or were to occur as prescribed by the laws in the respective jurisdictions.

The following is a reconciliation of the Federal statutory income tax rate to the effective rate reported in the financial statements.

	2004	2005	2006
Federal income tax (benefit) at statutory rates	34.0 %	34.0 %	34.0 %
State income tax (benefit) at statutory rates, net of Federal benefit	4.0	4.0	4.0
Impact of foreign operations	(0.4)	(0.4)	(0.6)
Impact of permanent differences	0.1	0.1	7.5
Change in valuation allowance	(37.7)	(37.7)	(44.9)
Effective income tax rate	%	%	%

7. Commitments and contingencies:*Capital leases fiber lease agreements*

The Company has entered into lease agreements with several providers for intra-city and inter-city dark fiber primarily under 15-25 year IRUs with additional renewal terms. These IRUs connect the Company's international backbone fibers with the multi-tenant office buildings and the customers served by the Company. Once the Company has accepted the related fiber route, leases of intra-city and inter-city fiber-optic rings that meet the criteria for treatment as capital leases are recorded as a capital lease obligation and IRU asset. The future minimum commitments under these agreements are as follows (in thousands):

For the year ending December 31,	
2007	\$ 12,694
2008	10,811
2009	10,811
2010	15,171
2011	9,714
Thereafter	87,180
Total minimum lease obligations	146,381
Less amounts representing interest	(58,335)
Present value of minimum lease obligations	88,046
Current maturities	(6,027)
Capital lease obligations, net of current maturities	\$ 82,019

Capital lease obligation amendments

Cogent Spain has negotiated modifications to certain of its IRU capital lease obligations. These modifications have generally reduced IRU lease payments and extended the lease terms. A 2004 lease modification resulted in a gain of approximately \$5.2 million. A 2005 lease modification resulted in a gain of approximately \$0.8 million. A 2006 lease modification resulted in a gain of approximately \$0.3 million. These transactions resulted in gains since the differences between the carrying values of the old IRU obligations and the net present values of the new IRU obligations were greater than the carrying values of the related IRU assets.

In March 2004, Cogent France paid approximately \$0.3 million and settled amounts due from and due to a vendor. The vendor leased Cogent France its office facility and an intra-city IRU. The settlement agreement also restructured the IRU capital lease by reducing the lease payments. This transaction resulted in a reduction to the capital lease obligation and IRU asset of approximately \$1.9 million in 2004.

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 \$1.5 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.

Operating leases, maintenance and tenant license agreements

The Company leases office space, network equipment sites, and facilities under operating leases. The Company also enters into building access agreements with the landlords of its targeted multi-tenant office buildings. The Company pays fees for the maintenance of its intra-city and inter-city leased fiber and in certain cases the Company connects its customers to its network under operating lease commitments for fiber. Future minimum annual commitments under these arrangements are as follows (in thousands):

2007	\$ 28,960
2008	22,073
2009	17,699
2010	14,203
2011	9,981
Thereafter	60,766
	\$ 153,682

Expense related to these arrangements was \$33.7 million in 2004, \$36.8 million in 2005 and \$33.8 million in 2006. The Company has sublet certain office space and facilities. Future minimum payments under these sub-lease agreements are approximately \$0.6 million, \$0.3 million, and \$0.1 million for the years ending December 31, 2007 through December 31, 2009, respectively.

Unconditional purchase obligations

Unconditional purchase obligations for equipment and services totaled approximately \$1.2 million at December 31, 2006 and are expected to be fulfilled within one year.

8. Stockholders equity:

Treasury stock retirement

In September 2006, the Company retired its 61,462 shares of treasury stock. As a result, \$0.1 million of treasury stock was offset against additional paid-in-capital.

Equity conversion

In February 2005, holders of the Company's preferred stock elected to convert all of their shares of preferred stock into 31.6 million shares of the Company's common stock. As a result, the Company no longer has outstanding shares of preferred stock. The accounting for this transaction resulted in the

elimination of the balances of the Series F through M preferred stock and an increase of approximately \$139.7 million to additional paid-in-capital.

Public offerings

On June 13, 2005 the Company sold 10.0 million shares of common stock at \$6.00 per share in a public offering. On June 16, 2005 the underwriters exercised their option to purchase an additional 1.5 million shares of common stock at \$6.00 per share. This public offering resulted in net proceeds to the Company of \$63.7 million, after underwriting, legal, accounting and printing costs.

On June 7, 2006 the Company sold 4.35 million shares of common stock at \$9.00 per share and certain selling shareholders sold 6.0 million shares of common stock at the same price in a public offering. This public offering resulted in net proceeds to the Company, after underwriting, legal, accounting and printing costs of approximately \$36.5 million.

In May 2004, the Company filed a registration statement to sell shares of common stock in a public offering. In October 2004, the Company withdrew the public offering and expensed the associated costs of approximately \$0.8 million.

Warrants

In connection with the February 2002 merger with Allied Riser, the Company assumed warrants that convert into approximately 5,000 shares of the Company's common stock. All of the warrants are exercisable at exercise prices ranging from \$0 to \$9,500 per share.

Dividends

The Company's line of credit prohibits the Company from paying cash dividends and restricts the Company's ability to make other distributions to its stockholders.

Beneficial conversion charges

Beneficial conversion charges of \$2.5 million, \$19.5 million, \$2.6 million, \$0.9 million and \$18.5 million were recorded on January 5, 2004, March 30, 2004, August 12, 2004, September 15, 2004, and October 26, 2004 respectively, since the price per common share at which the Series I, Series J, Series K, Series L and Series M preferred stock were convertible into were less than the quoted trading price of the Company's common stock on that date.

9. Stock option and award plan:

Incentive Award Plan

In September 2003, the Compensation Committee of the board of directors adopted and the stockholders approved, the Company's Incentive Award Plan (the "Award Plan"). Stock options granted under the Award Plan generally vest over a four-year period and have a term of ten years. Grants of shares of restricted stock granted under the Award Plan vest over periods ranging from immediate vesting to over a four-year period. Certain option and share grants provide for accelerated vesting if there is a change in control, as defined. For grants of restricted stock, when an employee terminates prior to full vesting the employee retains their vested shares and the employee's unvested shares are returned to the plan. For grants of options for common stock, when an employee terminates prior to full vesting the employee may elect to exercise their vested options for a period of ninety days and any unvested options are returned to the plan. Compensation expense for all awards is recognized ratably over the service period. Shares issued to satisfy awards are provided from the Company's authorized shares. As of December 31, 2006, of the 3.8 million authorized shares under the Award Plan there were a total of 0.2 million shares available for grant.

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

Stock options exercised, granted, and canceled under the Company's Award Plan during the period from December 31, 2003 to December 31, 2006, was as follows:

	Number of Options	Weighted-average exercise price
Outstanding at December 31, 2003		
Granted	1,057,667	\$ 2.27
Cancellations	(2,347)	\$ 6.17
Outstanding at December 31, 2004	1,055,320	\$ 2.26
Granted	216,053	\$ 5.59
Cancellations	(36,733)	\$ 7.66
Outstanding at December 31, 2005	1,234,640	\$ 2.68
Granted 13,840 granted below market value	82,220	\$ 8.13
Cancellations	(60,282)	\$ 6.73
Exercised intrinsic value \$0.8 million; cash received \$0.4 million	(103,602)	\$ 4.11
Outstanding at December 31, 2006 - \$15.6 million intrinsic value and 7.9 years weighted-average remaining contractual term	1,152,976	\$ 2.73
Exercisable at December 31, 2006 - \$12.0 million intrinsic value and 7.7 years weighted-average remaining contractual term	810,127	\$ 1.46
Expected to vest - \$14.6 million intrinsic value and 7.8 years weighted-average remaining contractual term	1,056,246	\$ 2.45

Stock options outstanding and exercisable under the Award Plan by price range at December 31, 2006 were as follows:

Range of Exercise Prices	Number Outstanding 12/31/2006	Weighted Average Remaining Contractual Life (years)	Weighted-Average Exercise Price	Number Exercisable As of 12/31/2006	Weighted-Average Exercise Price
\$0.00 to \$0.01 (granted below market value)	658,014	7.72	\$ 0.00	616,823	\$ 0.00
\$0.02 to \$5.94	129,489	8.75	\$ 4.90	25,922	\$ 4.95
\$5.95 to \$6.00	286,233	7.50	\$ 6.00	157,896	\$ 6.00
\$6.01 to \$32.00	79,240	9.13	\$ 10.04	9,486	\$ 11.09
\$0.00 to \$32.00	1,152,976	7.88	\$ 2.73	810,127	\$ 1.46

Compensation expense related to stock options and restricted stock was approximately \$12.3 million, \$13.3 million and \$10.5 million for the years ended December 31, 2004, December 31, 2005 and December 31, 2006, respectively. As of December 31, 2006 there was approximately \$5.5 million of total unrecognized compensation cost related to non-vested equity-based compensation awards. That cost is expected to be recognized over a weighted average period of approximately twenty-seven months. In January 2007, the Company granted approximately 51,000 vested shares of common stock to its non-management Directors resulting in approximately \$0.9 million of equity-based compensation expense.

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

A summary of the status of the Company's non-vested restricted stock awards as of December 31, 2006 and the changes during the year ended December 31, 2006 is as follows:

Non-vested awards	Shares	Weighted-Average Grant Date Fair Value
Non-vested at December 31, 2005	407,991	\$ 20.57
Granted	382,500	\$ 18.63
Vested	(419,365)	\$ 17.11
Forfeited	(646)	\$ 38.73
Non-vested at December 31, 2006	370,480	\$ 17.66

The weighted- average per share grant date fair value of restricted stock granted to employees was \$32.31 in 2004 (92,808 shares), \$4.93 in 2005 (200,000 shares) and \$18.63 in 2006 (382,500 shares). The fair value was determined using the trading price of the Company's common stock on the date of grant. The fair value of shares of restricted stock vested in the years ending December 31, 2004, 2005 and 2006 was approximately \$8.5 million, \$6.0 million and \$4.1 million, respectively.

10. 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 \$409,000 in 2004, \$417,000 in 2005 and \$464,000 in 2006 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 January 2004, LNG transferred its interest in Cogent Europe to Symposium Gamma, Inc. (Gamma), a Delaware corporation. Symposium continues to own approximately 90% of the stock of LNG. LNG operates as a holding company. Its subsidiaries that have not been sold hold assets related to their former telecommunications operations (which operations have been terminated). Prior to the Company's January 2004 merger with Gamma, and advanced as part of the Gamma merger, LNG transferred \$1.2 million to Cogent France. Cogent France repaid the \$1.2 million to LNG in March 2004.

In 2005, the Company reimbursed LNG for the approximate \$200,000 of salaries paid to two employees of LNG that were providing Cogent Europe accounting and management services during 2004. In November 2004, these two employees became employees of Cogent Europe. In 2006, the Company paid approximately \$208,000 for professional services performed for LNG.

Vendor settlement

In 2004, Cogent Spain and LNG settled a number of disputes between those entities and Iberbanda, a Spanish entity from whom Cogent Spain had been leasing space and obtaining services. In the settlement, LNG released to Iberbanda a \$0.4 million bond that had been put in place by LNG with the Spanish government as part of a bid for the right to construct a wireless network. LNG's release of the bond has been recorded as a contribution of capital from a shareholder as a result of the Company's Chief Executive Officer's ownership of LNG.

Customers

Certain of the Company's directors are either directors or owners of customers of the Company. The Company has billed and recorded revenue of approximately \$15,000 per month to these companies.

Transactions with One Communications, Hibernia Atlantic, and Pacwest

The Company purchases local loops from a subsidiary of One Communications Corp. and Pacwest Telecomm Inc.; and it obtains transatlantic circuits from Hibernia Atlantic U.S. LLC. A Company director and a shareholder through his wholly-owned company, Columbia Ventures Corporation has a substantial interest in each of these companies. In 2006, the Company paid these companies approximately \$1.1 million for these services. Each service was acquired after the Company considered alternative suppliers and the Company believes that the terms under which these circuits were acquired are at least as advantageous as those the Company could have received from an unaffiliated party. None of the leases of these circuits have a term of service in excess of twelve months.

11. Segment information:

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company has one operating segment. Below are the Company's net revenues and long lived assets by geographic region (in thousands):

	Years Ended December 31,		
	2004	2005	2006
<i>Service Revenue, net</i>			
North America	\$ 68,009	\$ 108,260	\$ 117,475
Europe	23,277	26,953	31,596
Total	\$ 91,286	\$ 135,213	\$ 149,071

	December 31, 2005	December 31, 2006
<i>Long lived assets, net</i>		
North America	\$ 252,343	\$ 221,942
Europe	42,998	42,476
Total	\$ 295,341	\$ 264,418

12. Quarterly financial information (unaudited):

	Three months ended			
	March 31, 2005	June 30, 2005	September 30, 2005	December 31, 2005
	(in thousands, except share and per share amounts)			
Service revenue, net	\$ 34,414	\$ 33,806	\$ 33,772	\$ 33,222
Network operations, including equity-based compensation expense	23,033	21,494	21,590	20,077
Operating loss	(15,694)	(13,659)	(14,814)	(17,981)
Gains - asset sales, lease and debt obligations	3,372	842	844	
Net loss	(14,973)	(16,151)	(16,106)	(20,288)
Net loss per common share - basic and diluted	(0.96)	(0.48)	(0.37)	(0.47)
Weighted-average number of shares outstanding - basic and diluted	15,610,722	33,963,566	43,474,555	43,619,506

In the fourth quarter of 2005, the Company revised the number of lease renewal periods used in determining the lease term for purposes of amortizing certain of its leasehold improvements resulting in a net increase in depreciation expense of approximately \$3.0 million.

	Three months ended			
	March 31, 2006	June 30, 2006	September 30, 2006	December 31, 2006
	(in thousands, except share and per share amounts)			
Service revenue, net	\$ 34,447	\$ 36,155	\$ 37,954	\$ 40,515
Network operations, including equity-based compensation expense	20,442	20,177	19,432	20,371
Operating loss	(14,318)	(13,545)	(10,645)	(8,044)
Gains asset sales and lease obligations			255	254
Net loss	(16,441)	(15,491)	(11,854)	(9,971)
Net loss per common share basic and diluted	(0.38)	(0.34)	(0.24)	(0.21)
Weighted-average number of shares outstanding basic and diluted	43,841,837	45,099,826	48,463,130	48,510,716

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. 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 disclosure. In designing and evaluating the disclosure controls and procedures, management recognized 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 controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

65

**MANAGEMENT'S REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING**

We are responsible for the preparation and integrity of our published financial statements. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and, accordingly, include amounts based on judgments and estimates made by our management. We also prepared the other information included in the annual report and are responsible for its accuracy and consistency with the financial statements.

We are responsible for establishing and maintaining a system of internal control over financial reporting, which is intended to provide reasonable assurance to our management and Board of Directors regarding the reliability of our financial statements. The system includes but is not limited to:

- a documented organizational structure and division of responsibility;
- established policies and procedures, including a code of conduct to foster a strong ethical climate which is communicated throughout the company;
- Regular reviews of our financial statements by qualified individuals; and
- the careful selection, training and development of our people.

There are inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and the circumvention or overriding of controls. Also, the effectiveness of an internal control system may change over time. We have implemented a system of internal control that was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles.

We have assessed our internal control system in relation to criteria for effective internal control over financial reporting described in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based upon these criteria, we believe that, as of December 31, 2006, our system of internal control over financial reporting was effective.

The independent registered public accounting firm, Ernst & Young LLP, has audited our 2006 financial statements. Ernst & Young LLP was given unrestricted access to all financial records and related data, including minutes of all meetings of stockholders, the Board of Directors and committees of the Board. Ernst & Young LLP has issued an unqualified audit opinion on our 2006 financial statements as a result of the audit and also has issued an attestation report on management's assessment of its internal control over financial reporting which is attached hereto.

Cogent Communications Group, Inc.

March 13, 2007

By:

/s/ DAVID SCHAEFFER

David Schaeffer

Chief Executive Officer

/s/ THADDEUS WEED

Thaddeus Weed

Chief Financial Officer

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Board of Directors and Stockholders
Cogent Communications Group, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Cogent Communications Group, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Cogent Communications Group, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, management's assessment that Cogent Communications Group, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Cogent Communications Group, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2006 consolidated financial statements of Cogent Communications Group Inc. and our report dated March 13, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

McLean, Virginia
March 13, 2007

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this Item 10 is incorporated in this report by reference to the information set forth under the captions entitled Election of Directors, The Board of Directors and Committees, and Section 16(a) Beneficial Ownership Reporting Compliance in the 2007 Proxy Statement for the 2007 Annual Meeting of Stockholders, which is expected to be filed with the Commission within 120 days after the close of our fiscal year.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item 11 is incorporated in this report by reference to the information set forth under the captions entitled The Board of Directors and Committees, Executive Compensation, Employment Agreements, Compensation Committee Report on Executive Compensation, and Compensation Committee Interlocks and Insider Participation in the 2007 Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this Item 12 is incorporated in this report by reference to the information set forth under the caption Security Ownership of Certain Beneficial Owners and Management in the 2007 Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item 13 is incorporated in this report by reference to the information set forth under the caption Certain Transactions in the 2007 Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item 14 is incorporated in this report by reference to the information set forth under the caption Relationship With Independent Public Accountants in the 2007 Proxy Statement.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

- (a)
1. Financial Statements. A list of financial statements included herein is set forth in the Index to Financial Statements appearing in ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.
 2. Financial Statement Schedules. The Financial Statement Schedule described below is filed as part of the report.
Description
Schedule II Valuation and Qualifying Accounts.
All other financial statement schedules are not required under the relevant instructions or are inapplicable and therefore have been omitted.

(b) Exhibits.

Exhibit	Description
2.1	Agreement and Plan of Merger, dated as of January 2, 2004, among Cogent Communications Group, Inc., Lux Merger Sub, Inc. and Symposium Gamma, Inc. (previously filed as Exhibit 2.1 to our Periodic Report on Form 8-K, filed on January 8, 2004, and incorporated herein by reference)
2.2	Agreement and Plan of Merger, dated as of March 30, 2004, among Cogent Communications Group, Inc., DE Merger Sub, Inc. and Symposium Omega, Inc. (incorporated by reference to Exhibits 2.6 of our Annual Report on Form 10-K for the year ended December 31, 2003, filed on March 30, 2004)
2.3	Agreement and Plan of Merger, dated as of August 12, 2004, among Cogent Communications Group, Inc., Marvin Internet, Inc., and UFO Group, Inc. (previously filed as Exhibit 2.6 to our Annual Report on Form 10-K, filed on March 31, 2005, and incorporated herein by reference)
2.4	Asset Purchase Agreement, dated as of September 15, 2004, between Global Access telecommunications Inc., Symposium Gamma, Inc. and Cogent Communications Group, Inc. (previously filed as Exhibit 2.7 to our Annual Report on Form 10-K, filed on March 31, 2005, and incorporated herein by reference)
2.5	Agreement and Plan of Merger, dated as of October 26, 2004, among Cogent Communications Group, Inc., Cogent Potomac, Inc. and NVA Acquisition, Inc. (previously filed as Exhibit 2.8 to our Annual Report on Form 10-K, filed on March 31, 2005, and incorporated herein by reference)
2.6	Agreement for the Purchase and Sale of Assets, dated December 1, 2004, among Cogent Communications Group, Inc., SFX Acquisition, Inc. and Verio Inc. (previously filed as Exhibit 2.9 to our Annual Report on Form 10-K, filed on March 31, 2005, and incorporated herein by reference)
3.1	Fifth Amended and Restated Certificate of Incorporation (previously filed as Exhibit 3.1 to our Annual Report on Form 10-K, filed on March 31, 2005, and incorporated herein by reference)
3.2	Amended and Restated Bylaws of Cogent Communications Group, Inc. (previously filed as Exhibit 3.2 to our Quarterly Report on Form 10-Q, filed on May 6, 2005, and incorporated herein by reference)
4.1	First Supplemental Indenture, among Allied Riser Communications Corporation, as issuer, Cogent Communications Group, Inc., as co-obligor, and Wilmington Trust Company, as trustee (incorporated by reference to Exhibit 4.4 to our Registration Statement on Form S-4, as amended by a Form POS AM (Post-Effective Amendment No. 2), Commission File No. 333-71684, filed February 4, 2002)
4.2	Indenture, dated as of July 28, 2000 by and between Allied Riser Communications Corporation and Wilmington Trust Company, as trustee, relating to Allied Riser's 7.50% Convertible Subordinated Notes due 2007 (incorporated by reference to Exhibit 4.5 to our Registration Statement on Form S-4, as amended by a Form POS AM (Post-Effective Amendment No. 1), Commission File No. 333-71684, filed January 25, 2002)
4.3	Subordinated Note in the principal amount of \$10.0 million issued by the Company to Columbia Ventures Corporation, pursuant to a Note Purchase Agreement (previously filed as Exhibit 4.1 to our Periodic Report on Form 8-K, filed on February 28, 2005, and incorporated herein by reference)

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

- 10.1 Seventh Amended and Restated Registration Rights Agreement of Cogent Communications Group, Inc., dated October 26, 2004 (previously filed as Exhibit 10.2 to our Annual Report on Form 10-K, filed on March 31, 2005, and incorporated herein by reference)
- 10.2 Fiber Optic Network Leased Fiber Agreement, dated February 7, 2000, by and between Cogent Communications, Inc. and Metromedia Fiber Network Services, Inc., as amended July 19, 2001 (incorporated by reference to Exhibit 10.1 to our Registration Statement on Form S-4, Commission File No. 333-71684, filed on October 16, 2001) *
- 10.3 Dark Fiber IRU Agreement, dated April 14, 2000, between WilTel Communications, Inc. and Cogent Communications, Inc., as amended June 27, 2000, December 11, 2000, January 26, 2001, and February 21, 2001 (incorporated by reference to Exhibit 10.2 to our Registration Statement on Form S-4, Commission File No. 333-71684, filed on October 16, 2001) *
- 10.4 David Schaeffer Employment Agreement with Cogent Communications Group, Inc., dated February 7, 2000 (incorporated by reference to Exhibit 10.6 to our Registration Statement on Form S-4, Commission File No. 333-71684, filed on October 16, 2001)
- 10.5 Form of Restricted Stock Agreement relating to Series H Participating Convertible Preferred Stock (incorporated by reference to Exhibit 10.2 to our Registration Statement on Form S-8, Commission File No. 333-108702, filed on September 11, 2003)
- 10.6 Lease for Headquarters Space by and between 6715 Kenilworth Avenue Partnership and Cogent Communications Group, Inc., dated September 1, 2000 (incorporated by reference to Exhibit 10.10 to our Registration Statement on Form S-4, Commission File No. 333-71684, filed on October 16, 2001)
- 10.7 Renewal of Lease for Headquarters Space, by and between 6715 Kenilworth Avenue Partnership and Cogent Communications Group, Inc., dated August 5, 2003 (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q, filed on November 14, 2003)
- 10.8 The Amended and Restated Cogent Communications Group, Inc. 2000 Equity Plan (incorporated by reference to Exhibit 10.12 to our Registration Statement on Form S-4, Commission File No. 333-71684, filed on October 16, 2001)
- 10.9 2003 Incentive Award Plan of Cogent Communications Group, Inc. (incorporated by reference to Exhibit 10.1 to our Registration Statement on Form S-8, Commission File No. 333-108702, filed on September 11, 2003)
- 10.10 2004 Incentive Award Plan of Cogent Communications Group, Inc. (incorporated by reference to Appendix A to our Definitive Information Statement on Schedule 14C, filed on September 22, 2004)
- 10.11 Dark Fiber Lease Agreement dated November 21, 2001, by and between Cogent Communications, Inc. and Qwest Communications Corporation (incorporated by reference to Exhibit 10.13 to our Registration Statement on Form S-4, as amended by a Form S-4/A (Amendment No. 2), Commission File No. 333-71684, filed on December 7, 2001)
- 10.12 Robert N. Beury, Jr. Employment Agreement with Cogent Communications Group, Inc., dated June 15, 2000 (incorporated by reference to Exhibit 10.20 to our Annual Report on Form 10-K, filed on March 31, 2003)
- 10.13 Mark Schleifer Employment Agreement with Cogent Communications Group, Inc., dated September 18, 2000 (incorporated by reference to Exhibit 10.21 to our Annual Report on Form 10-K, filed on March 31, 2003)
- 10.14 R. Reed Harrison Employment Agreement with Cogent Communications Group, Inc., dated July 1, 2004 (incorporated by reference to Exhibit 10.3 to our Quarterly Report on Form 10-Q, filed on August 16, 2004)
- 10.15 Conversion and Lock-up Letter Agreement, dated as of February 9, 2005, by and among Cogent Communications Group, Inc. and each of the several stockholders signatory thereto (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on February 15, 2005)

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

- 10.16 Conversion and Lock-up Letter Agreement, dated as of February 9, 2005, by and among Cogent Communications Group, Inc., Dave Schaeffer and the Schaeffer Descendents Trust (incorporated by reference to Exhibit 10.3 of our Current Report on Form 8-K filed on February 15, 2005)
- 10.17 Brad Kummer Employment Agreement with Cogent Communications Group, Inc., dated January 11, 2000, (incorporated by reference to Exhibit 10.23 to our Registration Statement on Form S-1, Commission File No. 333-122821, filed on February 14, 2005)
- 10.18 Note Purchase Agreement by and among Cogent Communications Group, Inc. and Columbia Ventures Corporation dated February 24, 2005 (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on February 28, 2005)
- 10.19 Extension of Lease for Headquarters Space, by and between 6715 Kenilworth Avenue Partnership and Cogent Communications Group, Inc., dated February 3, 2005 (previously filed as Exhibit 10.27 to our Annual Report on Form 10-K, filed on March 31, 2005, and incorporated herein by reference)
- 10.20 Amended and Restated Loan and Security Agreement by and between Cogent Communications, Inc., Cogent Communications Group, Inc. and other subsidiaries, and Silicon Valley Bank, dated as of December 16, 2005, (previously filed as Exhibit 10.1 to our Periodic Report on Form 8-K, filed on December 16, 2005, and incorporated herein by reference)
- 10.21 Notice of Grant, dated November 4, 2005, made to David Schaeffer (previously filed as Exhibit 10.1 to our Periodic Report on Form 8-K, filed on November 7, 2005, and incorporated herein by reference)
- 10.22 Extension of Lease for Headquarters Space to August 31, 2006, by and between 6715 Kenilworth Avenue Partnership and Cogent Communications Group, Inc., dated July 21, 2005 (previously filed as Exhibit 10.1 to our Quarterly Report on Form 10-K, filed on August 15, 2005, and incorporated herein by reference)
- 10.23 Option for extension of Lease for Headquarters Space to August 31, 2007, by and between 6715 Kenilworth Avenue Partnership and Cogent Communications Group, Inc., dated July 21, 2005 (previously filed as Exhibit 10.2 to our Quarterly Report on Form 10-K, filed on August 15, 2005, and incorporated herein by reference)
- 10.24 Extension of Lease for headquarters space to August 31, 2010, by and between 6715 Kenilworth Avenue Partnership and Cogent Communications Group, Inc., dated June 20, 2006 (previously filed as Exhibit 10.1 to our Quarterly Report on Form 10-Q, filed on August 8, 2006, and incorporated herein by reference)
- 10.25 Jeffery S. Karnes Employment Agreement with Cogent Communications Group, Inc., dated May 17, 2004 (filed herewith)
- 10.26 David Schaeffer Amendment No. 2 to Employment Agreement with Cogent Communications Group, Inc., dated as of March 12, 2007 (filed herewith)
- 10.27 Robert N. Beury, Jr. Employment Agreement with Cogent Communications Group, Inc., dated as of March 12, 2007 (filed herewith)
- 10.28 Thaddeus G. Weed Employment Agreements, dated September 25, 2003 through October 26, 2006 (filed herewith).
- 21.1 Subsidiaries (filed herewith)
- 23.1 Consent of Ernst & Young LLP (filed herewith)
- 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)

* **Confidential treatment requested and obtained as to certain portions. Portions have been omitted pursuant to this request where indicated by an asterisk.**

Schedule II

COGENT COMMUNICATIONS GROUP, INC. AND SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS
(in thousands)

Description	Balance at Beginning of Period	Charged to Costs and Expenses(a)	Acquisitions	Deductions	Balance at End of Period
<i>Allowance for doubtful accounts (deducted from accounts receivable)</i>					
Year ended December 31, 2004	\$ 2,868	\$ 4,406	\$ 2,247	\$ 6,292	\$ 3,229
Year ended December 31, 2005	\$ 3,229	\$ 4,831	\$	\$ 6,623	\$ 1,437
Year ended December 31, 2006	\$ 1,437	\$ 3,410	\$	\$ 3,614	\$ 1,233
<i>Allowance for Credits (deducted from accounts receivable)</i>					
Year ended December 31, 2004	\$ 150	\$	\$	\$	\$ 150
Year ended December 31, 2005	\$ 150	\$ 33	\$	\$	\$ 183
Year ended December 31, 2006	\$ 183	\$	\$	\$ 61	\$ 122
<i>Allowance for Unfulfilled Customer Purchase Obligations (deducted from accounts receivable)</i>					
Year ended December 31, 2004	\$ 317	\$ 537	\$ 1,254	\$ 1,944	\$ 164
Year ended December 31, 2005	\$ 164	\$ 2,008	\$	\$ 1,767	\$ 405
Year ended December 31, 2006	\$ 405	\$ 1,585	\$	\$ 1,406	\$ 584
<i>Restructuring accrual</i>					
Year ended December 31, 2004	\$	\$ 1,821	\$	\$ 210	\$ 1,611
Year ended December 31, 2005	\$ 1,611	\$ 1,319	\$	\$ 1,378	\$ 1,552
Year ended December 31, 2006	\$ 1,552	\$ 114	\$	\$ 1,273	\$ 393

(a) Bad debt expense, net of recoveries, was approximately \$4.0 million for the year ended December 31, 2004, \$4.6 million for the year ended December 31, 2005 and \$2.6 million for the year ended December 31, 2006.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Dated: March 13, 2007

COGENT COMMUNICATIONS GROUP, INC.
By: /s/ DAVID SCHAEFFER
Name: David Schaeffer
Title: *Chairman and Chief Executive Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ DAVID SCHAEFFER David Schaeffer	Chairman and Chief Executive Officer (Principal Executive Officer)	March 13, 2007
/s/ THADDEUS G. WEED Thaddeus G. Weed	Chief Financial Officer (Principal Financial and Accounting Officer)	March 13, 2007
/s/ EDWARD GLASSMEYER Edward Glassmeyer	Director	March 13, 2007
/s/ EREL MARGALIT Erel Margalit	Director	March 13, 2007
/s/ JEAN-JACQUES BERTRAND Jean-Jacques Bertrand	Director	March 13, 2007
/s/ TIMOTHY WEINGARTEN Timothy Weingarten	Director	March 13, 2007
/s/ STEVEN BROOKS Steven Brooks	Director	March 13, 2007
/s/ RICHARD T. LEIBHABER Richard T. Liebhaber	Director	March 13, 2007
/s/ DAVID BLAKE BATH David Blake Bath	Director	March 13, 2007
/s/ KENNETH D. PETERSON, JR. Kenneth D. Peterson, Jr.	Director	March 13, 2007