COGENT COMMUNICATIONS GROUP INC
Form 10-K
February 27, 2013

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2012

OR

o **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)	**52-2337274** (I.R.S. Employer Identification No.)
1015 31st Street N.W. **Washington, D.C.** (Address of Principal Executive Offices)	**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 o No ý

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 ý

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 ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý 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. o

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

Large accelerated filer ý	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company 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 ý

The number of shares outstanding of the issuer's common stock, par value $0.001 per share, as of February 22, 2013 was 47,129,700.

The aggregate market value of the Common Stock held by non-affiliates of the registrant, based on the closing price of $19.24 per share on June 29, 2012 as reported by the NASDAQ Global Select Market was approximately $845 million.

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COGENT COMMUNICATIONS GROUP, INC.
FORM 10-K ANNUAL REPORT
FOR THE YEAR ENDED DECEMBER 31, 2012

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for the registrant's 2013 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," "may," "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 forecasts 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.

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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 primarily to small and medium-sized businesses, communications service providers and other bandwidth-intensive organizations in North America and Europe. We recently began expansion into the Japanese market.

Our on-net service consists of high-speed Internet access and IP connectivity ranging from 100 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. Because of our integrated network architecture, we are not dependent on local telephone companies to serve these on-net customers. We provide on-net Internet access to net-centric and corporate customers. Our primary on-net service offered to our corporate customers is Internet access at a speed of 100 Megabits per second. Our corporate customers are located in multi-tenant office buildings and typically include law firms, financial services firms, advertising and marketing firms and other professional services businesses. Our on-net services offered to our net-centric customers include Internet access at speeds of up to 10 Gigabits per second. Our net-centric customers include certain bandwidth-intensive users such as universities, other Internet service providers, telephone companies, cable television companies, web hosting companies, content delivery networks and commercial content providers. These customers generally receive service in colocation facilities and in our data centers. For the years ended December 31, 2010, 2011 and 2012, our on-net customers generated 77.8%, 76.3% and 73.4%, respectively, of our total service revenue.

Our off-net services are sold to businesses that are connected to our network primarily by means of "last mile" access service lines obtained from other carriers, primarily in the form of point-to-point, TDM, POS, SDH and/or Carrier Ethernet circuits. For the years ended December 31, 2010, 2011 and 2012, our off-net customers generated 21.0%, 22.8%, and 25.8%, respectively, of our total service revenue.

Our non-core services, which consist primarily of legacy services of companies whose assets or businesses we have acquired and continue to support but do not actively sell, primarily include voice services (only provided in Toronto, Canada). For the years ended December 31, 2010, 2011 and 2012, non-core services generated 1.2%, 0.9% and 0.8%, respectively, of our total service revenue.

We also operate 43 data centers comprising over 420,000 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, high-speed Internet service at attractive prices.

Low Cost of Operation. We offer a streamlined set of products on an integrated network. Our network design allows us to avoid many of the costs that our competitors incur associated with circuit-switched and TDM networks related to provisioning, monitoring and maintaining multiple transport protocols. We believe that our low cost of operation also gives us greater pricing flexibility and a significant advantage in a competitive environment characterized by falling Internet access prices. We believe our value proposition is equal or superior to our competitors' in all of the on-net multi-tenant office buildings and carrier neutral data centers in which we operate.

Network. Our on-net service does not rely on circuits that must be provisioned by a third party carrier. In on-net multi-tenant office buildings we provide our customers the entire network, including the last mile and the in-building wiring to our customer's suite. In carrier neutral data centers we are colocated with our customers so only a connection within-the-data center is required to provide our services. This gives us more control over our service, quality and pricing. It also allows us to provision services more quickly and efficiently than provisioning services on a third-party carrier network. We are typically able to activate service to our customers in one of our on-net buildings in approximately ten business days.

High Quality, Reliable Service. We are able to offer high-quality Internet service due to our network (created solely to transmit IP data) and our 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 compared to traditional circuit-switched networks. We believe that we deliver a high level of technical performance because our network is optimized for IP traffic. We believe that our network is more reliable and delivers IP traffic at lower cost than networks built as overlays to traditional circuit-switched networks.

High Traffic Network Footprint. We have strategically chosen locations, such as over 1,300 large multi-tenant office buildings in major North American cities and colocation facilities in North America and Europe with high levels of Internet traffic, to maximize our revenue opportunities and expand our margins. Our network is connected to our on-net multi-tenant office buildings where we offer our services to a diverse set of high-quality, low churn corporate customers within close physical proximity of each other. Our network is also directly connected to over 610 carrier neutral colocation and data centers where our net-centric customers directly interconnect with our network.

Low Capital Cost to Grow Our Business. We have a history of efficient network expansion and integration execution. We believe that we have incurred relatively lower costs in growing our business than our competitors because we use Internet routers without additional legacy equipment, offer a streamlined set of products, and have acquired optical fiber from the excess inventory in existing networks.

Proven and 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 over 20 years of experience in the telecommunications industry and have been working together at Cogent for several years. Several members of the senior management team have been working together at Cogent since 2000. Our senior management team has designed and built our network and led the integration of our network assets and customers we acquired through 13 significant acquisitions and managed the expansion and growth of our business.

Our Strategy

We intend to become the leading provider of high-quality, high-speed 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, video, voice over IP (VOIP), remote data storage, distributed computing, cloud services 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 connecting more multi-tenant office buildings and carrier neutral data centers to our network. We emphasize our on-net service because our on-net service generates greater profit margins and we have more control over service levels, quality, pricing and faster provisioning of services than our off-net services. Our fiber network connects directly to our on-net customers' premises and we pay no local access ("last mile") charges to other carriers to provide our on-net service. We are responding to this on-net revenue opportunity by increasing our sales and marketing efforts including increasing our number of sales representatives, implementing strategies to optimize sales productivity and expanding our on-net addressable market by adding service locations 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 on our network and to add revenues with minimal incremental costs. Given our record of successful asset integration, we believe we can continue to successfully integrate new businesses as they are acquired. We may also make opportunistic acquisitions of network assets.

Our Network

Our network is comprised of in-building riser facilities, metropolitan optical networks, metropolitan traffic aggregation points and inter-city transport facilities. We believe that we deliver a high level of technical performance because our network is optimized for IP traffic. We believe that 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 over 180 metropolitan markets in North America, Europe and Japan and encompasses:

- over 1,300 multi-tenant office buildings strategically located in commercial business districts;
- over 610 carrier-neutral Internet aggregation facilities, data centers and single-tenant buildings;
- over 570 intra-city networks consisting of over 26,300 fiber miles;
- an inter-city network of more than 56,600 fiber route miles; and
- multiple high-capacity transatlantic and transpacific circuits that connect the North American, European and Japanese portions of our network.

We have created our network by acquiring optical fiber from carriers with large amounts of unused fiber and directly connecting Internet routers to our 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 our profitability with limited incremental capital expenditures.

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 typically two strands of optical fiber out of the multiple fibers owned by the carrier. We install the optical and electronic equipment necessary to amplify, regenerate, and route the optical signals along these networks. We have the right to use the optical fiber under long term agreements. We pay these

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providers our pro rata fees for the maintenance of the optical fiber and provide our own equipment maintenance.

Intra-city Networks

In each metropolitan area in which we provide our high-speed on-net Internet access services, our backbone network is connected to one or more routers that are 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 optical fiber networks in those cities. These metropolitan networks consist of optical fiber that runs from the central router in a market into routers located in our 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 the connection to each of our on-net customers.

Within the cities where we offer our off-net Internet access services, we lease circuits from telecommunications carriers, primarily local telephone companies, to provide the last mile connection to our 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 typically containing 12 to 288 optical fiber strands that run from our equipment in the basement of the building through the building riser to the customer location. Our service is initiated by connecting a fiber optic cable from our customer's local area network to the infrastructure in the building riser. Our customer then has dedicated and secure access to our network using an Ethernet connection. We believe that Ethernet is the lowest cost network connection technology and is almost universally used for the local area networks that businesses operate.

Data Centers

We operate 43 data centers across the United States and in Europe. These facilities comprise over 420,000 square feet of floor space and are directly connected to our network. Each location is equipped with secure access, uninterruptable power supplies (UPS), and backup generators. Our customers typically purchase bandwidth, rack space, and power within these facilities.

Internetworking

The Internet is an aggregation of interconnected networks. We have settlement-free interconnections between our network and most major Internet Service Providers, or ISPs. We interconnect our network to other networks predominantly through private peering arrangements. Larger ISPs 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, we have settlement-free peering arrangements with other providers. We purchase no transit services to reach any portion of the Internet. 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 do not treat our settlement-free peering arrangements as generating revenue or

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expense related to the traffic exchanged. However, we charge customers for transit services across our network. We directly connect with over 4,360 total networks of which over 4,300 are paying customers.

Network Management and Customer Care

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. Our customer care call centers are located in Washington, D.C., Herndon, Virginia, Madrid, Spain, Paris, France, and Frankfurt, Germany. 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 our high-speed Internet access and IP connectivity services primarily to small and medium-sized businesses, communications providers and other bandwidth-intensive organizations located in North America and Europe. We recently began offering our services at a single location in Japan.

The table below shows our primary service offerings:

On-Net Services	Bandwidth (Mbps)
Fast Ethernet	100
Gigabit Ethernet	1,000
10 Gigabit Ethernet	10,000
Point-to-Point	10 to 2,000
Colocation with Internet Access	10 to 10,000

Off-Net Services	Bandwidth (Mbps)
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 over 180 metropolitan markets. We serve over 1,860 on-net buildings. 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. We also offer Internet access services at higher speeds of up to 10 Gigabits per second. These services are generally used by customers that have businesses, such as web hosting and ISP's 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 43 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 access 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 offer lower prices for longer term and volume commitments. We emphasize the sale of our on-net services because we believe that we have a competitive advantage in providing these services and these services generate greater gross profit margins than our off-net services.

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We offer our off-net services to customers that are not located in our on-net buildings. These services are primarily provided in the metropolitan markets in North America and Europe in which we offer on-net services primarily dedicated Internet access and Layer 2 services. These services are generally provided to small and medium-sized businesses in approximately 4,050 off-net buildings.

We support certain non-core services that we assumed with certain of our acquisitions. These services primarily include voice services (only provided in Toronto, Canada). We expect that the revenue from our non-core services will continue to decline. We do not actively sell these services and expect the growth of our Internet access services to compensate for this loss.

No single customer accounted for more than 0.5% of our 2012 revenues.

Sales and Marketing

Sales. We employ a direct sales and marketing approach including telesales. As of February 1, 2013, our sales force included 324 full-time employees. Our quota bearing sales force includes 185 employees focused primarily on the corporate market and 64 employees focused primarily on the net-centric market. Our sales personnel work through direct face-to-face contact in addition to telesales with potential customers in, or intending to locate in, our 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. Sales personnel are compensated with a base salary plus quota-based commissions and incentives. We use a customer relationship management system to efficiently track sales activity levels and sales productivity.

Marketing. Because of our focus on a direct sales force and a telesales effort, 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, in building marketing events 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 larger 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.

Unlike some of our competitors, we generally 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 under indefeasible rights of use, or IRUs with providers some of which also compete with us. We rely on the third-party maintenance of such dark fiber to provide our on-net services to our customers. We are also dependent on third party providers, some of which compete with us, for the local loop facilities for the provision of connections 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

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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, ATM and frame relay. While the Internet access speeds offered by traditional ISPs serving multi-tenant office buildings typically do not match our on-net offerings in terms of throughput or quality, these slower services are usually priced lower than our offerings and thus provide competitive pressure on pricing, particularly for more price-sensitive customers. These and other downward pricing pressures particularly in carrier neutral data centers 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 the state public utilities commissions exercise jurisdiction over intrastate basic telecommunications services. Our Internet service offerings are not currently regulated by state public utility commissions. The FCC has promulgated rules intended to regulate some aspects of the way traffic is handled by Internet service providers. We may become subject to additional regulation in the U.S. at the federal and state levels and in other countries. 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. We are subject to similar requirements in other countries.

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 subsidiaries outside of the United States generally operate in more highly regulated environments for the types of services they provide. In many such 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 into new markets, in particularly in non EU member countries, 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 liabilities.

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Employees

As of February 1, 2013, we had 605 employees. Unions represent twenty-four of our employees in France. We believe that we have a satisfactory relationship with our employees.

Available Information

We were incorporated in Delaware in 1999. 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 "About Cogent" tab at 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.

We currently generate positive cash flow from our operations. We are not consistently cash flow positive overall and we have limited funds available to us. If we do not become consistently cash flow positive or if we acquire or invest in additional businesses, assets, services or technologies we may need to raise additional capital beyond that available from our operating cash flow. 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, our cash flow may be impaired and 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 we raise additional funds by issuing equity securities, substantial dilution to existing stockholders may result.

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

In order to become consistently profitable and 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 is dependent on a number of factors, including the turnover of existing customers, the pricing of our product offerings and the revenue mix among our customers. We may not succeed in adding customers if our sales and marketing plans are 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. It has been our experience that such target customers are often reluctant to switch providers due to costs and effort 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 0.5% of our 2012 revenues, a migration of a few very large Internet users to their own networks or the loss or reduced purchases from several significant customers could impair our growth, cash flow and profitability.

Our growth and financial health are subject to a number of economic risks.

A downturn in the world economy, especially the economies of North America and Europe would negatively impact our growth. We would be particularly impacted by a decline in the development of new applications and businesses that make use of the Internet. Our revenue growth is predicated on growing use of the Internet that makes up for the declining prices of Internet service. An economic downturn could impact the Internet business more significantly than other businesses that are less dependent on new applications and growth in the use of those applications because of the retrenchment by consumers and businesses that typically occurs in an economic downturn.

Our business and operations are growing rapidly and we may not be able to efficiently manage our growth.

We have rapidly grown our company through network expansion and obtaining new customers through our 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 financial and 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 expansion in Eastern Europe, Mexico and Japan and may incur related unexpected costs and regulatory issues.

We began to expand our network into Eastern Europe in 2007, into Mexico in 2009 and recently into Japan. We have experienced difficulty in acquiring dark fiber and other difficulties in making our network operational in Eastern European and Mexican markets. Our expansion may also cost more than we have planned and we may experience regulatory issues. Finally, we may be unsuccessful in selling our services in these markets. If we are not successful in developing our market presence in Eastern Europe, Mexico and Japan our operating results and revenue growth could be adversely impacted.

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

Currently, we plan on continuing to increase the number of carrier-neutral facilities and multi-tenant office buildings that are connected to our network. We may be unsuccessful at identifying appropriate buildings or negotiating favorable terms for acquiring access to such buildings, and consequently, we may experience difficulty in adding customers to our network and fully using our network's available capacity.

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 network providers who operate their own networks that interconnect 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 paid dedicated network capacity (transit or paid peering) and to maintain high network performance is dependent upon our ability to establish and maintain peering relationships and expand our customer base of other network operators. 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 exchange 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 or reliable services, which could cause us to lose existing and potential customers, damage our reputation and have a material adverse effect on our business. We have in the past had peering disputes with other network providers that resulted in a temporary disruption of the exchange of traffic between our network and the network of the other carrier. We have resolved the majority of such disputes through negotiations. We continue to experience resistance from certain incumbent telephone companies to upgrade the settlement-free peering connections necessary to accommodate the growth of the traffic that we exchange with 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 may be required to censor content on the Internet, which we may find difficult to do and which may impact our ability to provide service in some countries as well as impact the growth of Internet usage, upon which we depend.

Some governments attempt to limit access to certain content on the Internet. It is impossible for us (and other providers as far as we know) to filter all content that flows across the Internet connections we provide. For example, some content is encrypted when a secure web site is accessed. It is difficult to limit access to web sites that engage in practices that make it difficult to block them by blocking a fixed set of Internet addresses. Should any government require us to perform these types of blocking procedures we could experience difficulties ranging from incurring additional expenses to ceasing to provide service in that country. We could also be subject to penalties if we fail to implement the censorship.

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 significant acquisitions. We compete with other companies for acquisition opportunities and we cannot assure you that we will be able to execute 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 the long-term agreements that we have acquired. 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.

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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.

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 revenue declines with respect to customers we may acquire in the future.

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

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

Our business could suffer because telephone companies and cable companies may provide better delivery of Internet content originating on their own networks.

Broadband connections provided by cable TV and telephone companies have become the predominant means by which consumers connect to the Internet. The providers of these broadband connections may treat Internet content or other broadband content delivered from different sources differently. The possibility of this has been characterized as an issue of "net neutrality." As many of our customers operate websites and services that deliver content to consumers our ability to sell our services would be negatively impacted if Internet content delivered by us was less easily received by consumers than Internet content delivered by others. We cannot predict whether or not the FCC and other regulators around the world will mandate an "open" Internet. We also do not know the extent to which the providers of broadband connections to consumers may favor certain content of providers in ways that may disadvantage us.

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

The nature of our operations outside of the United States involve a number of risks, including:

- fluctuations in currency exchange rates;
- exposure to additional regulatory and legal 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 into other countries, 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 operations outside the U.S. may have a material adverse effect on our business and results of operations.

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

Our operations outside the U.S. expose us to currency fluctuations and exchange rate risk. For example, while we record revenues and the financial results of 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. We fund certain of our cash flow requirements of our operations outside of the United States in U.S. dollars. Accordingly, in the event that the foreign currency strengthens against the U.S. dollar to a greater extent than we anticipate, the cash flow requirements associated with these operations may be significantly greater 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.

Our network may be the target of potential cyber-attacks and other security breaches that could have significant negative consequences.

Our business depends on our ability to limit and mitigate interruptions or degradation to our network availability. Our network, including our routers, may be vulnerable to unauthorized access, computer viruses, cyber-attacks, and other security breaches. An attack on or security breach of our network could result in interruption or cessation of services, our inability to meet our service level commitments, and potentially compromise customer data transmitted over our network. We cannot guarantee that our security measures will not be circumvented, thereby resulting in network failures or interruptions that could impact our network availability and have a material adverse effect on our business, financial condition and operational results. We may be required to expend significant resources to protect against such threats, and may experience a reduction in revenues, litigation, and a diminution in goodwill, caused by a breach. Although our customer contracts limit our liability, affected customers and third parties may seek to recover damages from us under various legal theories.

Our network could suffer serious disruption if certain locations experience serious damage.

There are certain locations through which a large amount of our Internet traffic passes. Examples are facilities in which we exchange traffic with other carriers, the facilities through which our transatlantic traffic passes, and certain of our network hub sites. If any of these facilities were destroyed or seriously damaged a significant amount of our network traffic could be disrupted. Because of the large volume of traffic passing through these facilities our ability (and the ability of carriers with whom we exchange traffic) to quickly restore service would be challenged. There could be parts of our network or the networks of other carriers that could not be quickly restored or that would experience substantially reduced service for a significant time. If such a disruption occurs, our reputation could be negatively impacted which may cause us to lose customers and adversely affect our ability to attract new customers, resulting in an adverse effect on our business and operating results.

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If the information systems that we depend on to support our customers, network operations, sales, billing and financial reporting 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, bill our customers for those services and prepare our financial statements depends upon the effective integration of our various information systems. If our information systems, individually or collectively, fail or do not perform as expected, our ability to process and provision orders, to make timely payments to vendors, to ensure that we collect amounts owed to us and prepare our financial statements 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, and the inability to prepare accurate and timely financial statements all of which would adversely affect our business and results of operations.

We have historically incurred operating losses.

Since we initiated operations in 2000 and through 2009, we generated operating losses. Operating 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.

The utilization of certain of our net operating loss carryforwards are limited and depending upon the amount of our taxable income we may be subject to paying income taxes earlier than planned.

Due to the uncertainty surrounding the realization of our net deferred tax asset, we have recorded a valuation allowance for the substantial majority of our net deferred tax asset. Section 382 of the Internal Revenue Code in the United States limits the utilization of net operating losses when ownership changes, as defined by that section, occur. We have performed an analysis of our Section 382 ownership changes and have determined that the utilization of certain of our net operating loss carryforwards in the United States is limited.

We may have difficulty intercepting communications as required by the U.S. Communications Assistance for Law Enforcement Act and similar laws of other countries.

The U.S. Communications Assistance for Law Enforcement Act and the laws of other countries require that we be able to intercept communications when required to do so by law enforcement agencies. We may experience difficulties and incur significant costs in complying with these laws. If we are unable to comply with the laws we could be subject to fines in the United States of up to $1.0 million per event and equal or greater fines in other countries.

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 dark fiber. We are contractually obligated under the agreements with these carriers to pay maintenance fees, and if we are unable to continue to pay such fees we would be in default under these agreements. If these carriers fail to maintain the fiber or disrupt our fiber connections due to our default or 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 unless we have or can obtain alternative fiber routes. 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

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service to our customers in connection with future service interruptions, and as a result we may lose customers.

Our business depends on agreements with carrier neutral data center operators, which we could fail to obtain or maintain.

Our business depends upon access to customers in carrier neutral data 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 carrier neutral data centers allow any carrier to operate within the facility (for a standard fee). We expect to enter into additional agreements with carrier neutral data center operators as part of our growth plan. Current government regulations do not require carrier neutral data center 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 located in their facilities because we offer low-cost, high-capacity Internet service to their customers. Any deterioration in our existing relationships with these operators could harm our sales and marketing efforts and could substantially reduce our potential customer base. Increasing concentration in this industry, such as the mergers between Switch & Data Facilities Company, Inc. and Equinix, Inc., and Verizon Communications, Inc. and Terremark Worldwide, Inc. could negatively impact us if any such combined entities decide to discontinue operation of their facilities in a carrier neutral fashion.

Our ability to serve customers in multi-tenant office buildings depends on license agreements with building owners and managers, which we could fail to obtain or maintain.

Our on-net 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 these 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 sales and 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 they may elect not to renew or amend our access agreements. 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 in those locations.

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 negatively impact our growth opportunities.

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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.

Furthermore, we cannot assure you that the steps taken by us to protect our intellectual property rights will be adequate to deter misappropriation of proprietary information or that we will be able to detect unauthorized use and take appropriate steps to enforce our intellectual property rights. We also are subject to the risk of litigation alleging infringement of third party intellectual property rights. Any such claims could require us to spend significant sums in litigation, pay damages, develop non-infringing intellectual property or acquire licenses to the intellectual property that is the subject of the alleged infringement.

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 technologies or services that could make our services less attractive to potential customers.

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 when they are developed, 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 is part of the Internet which is a network of networks. 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 our network could result in the interruption of customer service until we affect the 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 facilities 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 liabilities for information disseminated through our network.

The law relating to the liabilities 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 liabilities upon us for information carried on and disseminated through our network could require us to implement measures to reduce our exposure to such liabilities, 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 liabilities could harm our business.

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

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

Changes in laws, rules, and enforcement could adversely affect us.

As an Internet service provider, we are not subject to substantial regulation by the FCC or the state public utilities commissions in the United States. However, the FCC has recently promulgated limited rules applicable to Internet service providers and proposed changes to the contribution mechanism for the U.S. universal service fund that might require contributions from Internet service providers. Internet service is also subject to minimal regulation in Western Europe and in Canada. In Eastern Europe and Mexico the regulation is greater, though not as extensive as the regulation for providers of voice services. 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 these 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 and could have a material adverse effect on our business, financial condition or results of operations.

Much of the law related to the liability of Internet service providers remains unsettled. Some jurisdictions have laws, regulations, or court decisions that impose obligations upon Internet access providers to restrict access to certain content. Other legal issues, such as the sharing of copyrighted information, trans border data flow, unsolicited commercial email ("spam"), universal service, and

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liability for software viruses could become subjects of additional legislation and legal development and changes in enforcement policies. We cannot predict the impact of these changes on us. They could have a material adverse effect on our business, financial condition or results of operations.

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

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, Madrid and London, cities that have historically been targets for terrorist attacks. We are also susceptible to other catastrophic events such as major natural disasters, extreme weather, fire or similar events that could affect our headquarters, other offices, our network, infrastructure or equipment, which could adversely affect our business.

If we do not comply with laws regarding corruption and bribery, we may become subject to monetary or criminal penalties.

The U.S. Foreign Corrupt Practices Act generally prohibits companies and their intermediaries from bribing foreign officials for the purpose of obtaining or keeping business. Other countries have similar laws to which we are subject. We currently take precautions to comply with these laws. However, these precautions may not protect us against liability, particularly as a result of actions that may be taken in the future by agents and other intermediaries through whom we have exposure under these laws even though we may have limited or no ability to control such persons. Our competitors include foreign entities that are not subject to the U.S. Foreign Corrupt Practices Act or laws of similar stringency, and hence we may be at a competitive disadvantage.

Risk Factors Related to Our Indebtedness

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

Our total indebtedness, net of discount, at December 31, 2012 was $395.4 million. As of December 31, 2012, we have $92.0 million of face value of senior convertible notes outstanding. The holders of the convertible notes have the right to compel us to repurchase for cash on June 15, 2014, June 15, 2017 and June 15, 2022, all or some of their convertible notes. They also have the right to be paid the principal upon default and upon certain designated events, such as certain changes of control. In January 2011 we issued $175.0 million in senior secured notes that are due in 2018 and require interest payments totaling $14.7 million per year. We may not have sufficient funds to pay the interest and principal related to these obligations at the time we are obligated to do so, which could result in bankruptcy, or we may only be able to raise the necessary funds on unfavorable terms.

Our total indebtedness at December 31, 2012 includes $137.9 million of capital lease obligations for dark fiber primarily under 15 - 20 year IRUs. The amount of our IRU capital lease obligations may be impacted due to our expansion activities, the timing of payments and fluctuations in foreign currency rates.

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Our substantial level of indebtedness could adversely affect our financial condition and prevent us from fulfilling our obligations under our notes and our other indebtedness.

We have substantial indebtedness. Our substantial debt may have important consequences. For instance, it could:

- make it more difficult for us to satisfy our financial obligations, including those relating to our debt;
- require us to dedicate a substantial portion of any cash flow from operations to the payment of interest and principal due under our debt, which will reduce funds available for other business purposes, including the growth of our operations, capital expenditures and acquisitions;
- place us at a competitive disadvantage compared with some of our competitors that may have less debt and better access to capital resources; and
- limit our ability to obtain additional financing required to fund working capital and capital expenditures, for strategic acquisitions and for other general corporate purposes.

Our ability to satisfy our obligations and to reduce our total debt depends on our future operating performance and on economic, financial, competitive and other factors, many of which are beyond our control. Our business may not generate sufficient cash flow, and future financings may not be available to provide sufficient net proceeds, to meet these obligations or to successfully execute our business strategy.

Despite our leverage we may still be able to incur more debt. This could further exacerbate the risks that we and our subsidiaries face.

We and our subsidiaries may incur additional indebtedness, including additional secured indebtedness, in the future. The terms of our debt indentures restrict, but do not completely prohibit, us from doing so. In addition, the indentures allow us to issue additional notes and other indebtedness secured by the collateral under certain circumstances. Moreover, we are not prevented from incurring other liabilities that do not constitute indebtedness, including additional capital lease obligations in the form of IRUs. These liabilities may represent claims that are effectively prior to the claims of our note holders. If new debt or other liabilities are added to our debt levels the related risks that we and our subsidiaries now face could intensify.

The agreements governing our various debt obligations impose restrictions on our business and could adversely affect our ability to undertake certain corporate actions.

The agreements governing our various debt obligations, include covenants imposing significant restrictions on our business. These restrictions may affect our ability to operate our business and may limit our ability to take advantage of potential business opportunities as they arise. These covenants place restrictions on our ability to, among other things:

- incur additional debt;
- create liens;
- make certain investments;
- enter into certain transactions with affiliates;
- declare or pay dividends, redeem stock or make other distributions to stockholders; and

consolidate, merge or transfer or sell all or substantially all of our assets.

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Our ability to comply with these agreements may be affected by events beyond our control, including prevailing economic, financial and industry conditions. These covenants could have an adverse effect on our business by limiting our ability to take advantage of financing, merger and acquisition or other corporate opportunities. The breach of any of these covenants or restrictions could result in a default under the agreements governing our debt obligations.

To service our indebtedness, we will require a significant amount of cash. However, our ability to generate cash depends on many factors beyond our control.

Our ability to make payments on and to refinance our indebtedness and to fund planned capital expenditures will depend on our ability to generate cash in the future, which, in turn, is subject to general economic, financial, competitive, regulatory and other factors, many of which are beyond our control.

Our business may not generate sufficient cash flow from operations and we may not have available to us future borrowings in an amount sufficient to enable us to pay our indebtedness or to fund our other liquidity needs. In these circumstances, we may need to refinance all or a portion of our indebtedness on or before maturity. We may not be able to refinance any of our indebtedness on commercially reasonable terms or at all. Without this financing, we could be forced to sell assets or secure additional financing to make up for any shortfall in our payment obligations under unfavorable circumstances. However, we may not be able to secure additional financing on terms favorable to us or at all and, in addition, the terms of the indentures governing our notes limit our ability to sell assets and also restrict the use of proceeds from such a sale. We may not be able to sell assets quickly enough or for sufficient amounts to enable us to meet our obligations, including our obligations under our notes.

ITEM 2. DESCRIPTION OF PROPERTIES

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

Our headquarters facility consists of approximately 15,350 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, 2015.

We also lease a total of approximately 540,000 square feet of space for our data centers, regional offices and operations centers. The remaining term of these leases ranges from 5 months to 11 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 effect on our business, financial condition or results of operations. For a discussion of the significant proceedings in which we are involved, see Note 6 to our consolidated financial statements.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our sole class of common equity is our common stock, par value $0.001, which is currently traded on the NASDAQ Global Select 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 February 1, 2013, there were approximately 181 holders of record of shares of our common stock holding 46,874,349 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
Calendar Year 2011		
First Quarter	$ 16.14	$ 13.10
Second Quarter	17.23	12.68
Third Quarter	17.99	12.23
Fourth Quarter	17.84	12.63
Calendar Year 2012		
First Quarter	$ 20.24	$ 14.50
Second Quarter	19.65	16.67
Third Quarter	23.01	17.54
Fourth Quarter	23.77	20.30

On August 7, 2012, our board of directors approved the payment of a dividend of $0.10 per common share to holders of record on August 22, 2012. The $4.5 million dividend payment was made on September 12, 2012. On November 5, 2012, our board of directors approved the payment of a dividend of $0.11 per common share to holders of record on November 21, 2012. The $5.0 million dividend payment was made on December 12, 2012. Dividend payments are recorded as a reduction to retained earnings. Dividends on unvested restricted shares of common stock are paid as the awards vest. On February 20, 2013, our board of directors approved the payment of a dividend of $0.12 per common share to holders of record on March 4, 2013 with payment estimated to be approximately $5.5 million and to be made on March 15, 2013.

The payment of any future quarterly dividends will be at the discretion of our board of directors and will be dependent upon our financial position, results of operations, available cash, cash flow, capital requirements and other factors deemed relevant by our board of directors.

On January 26, 2011, we issued our 8.375% Senior Secured Notes (the "Senior Notes") due February 15, 2018, for an aggregate principal amount of $175.0 million in a private offering for resale to qualified institutional buyers pursuant to SEC Rule 144A. The indenture governing the Senior Notes, among other things, limits our ability and a guarantors' ability to incur indebtedness; to pay dividends or make other distributions; to make certain investments and other restricted payments; to create liens; consolidate, merge, sell or otherwise dispose of all or substantially all of its assets; to incur restrictions on the ability of a subsidiary to pay dividends or make other payments; and to enter into certain transactions with our affiliates.

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Performance Graph

Our common stock currently trades on the NASDAQ Global Select Market. The chart below compares the relative changes in the cumulative total return of our common stock for the period December 31, 2007 December 31, 2012, against the cumulative total return for the same period of the (1) The Standard & Poor's 500 (S&P 500) Index and (2) the NASDAQ Telecommunications Index and (3) an industry peer group consisting of Internap Network Services Corporation (NASDAQ: INAP) and TW Telecom Inc. (NASDAQ: TWTC). Cogent's original industry peer group, selected in 2003, consisted of five companies. Only two of the original peer group companies remain publicly traded companies. The customized peer group is now too small to reflect a meaningful market comparison as intended by this graph. Accordingly, we have replaced the customized peer group with the NASDAQ Telecommunications Index. The customized industry peer group is included here for comparison purposes. The comparison below assumes $100 was invested on December 31, 2007 in our common stock, the S&P 500 Index and the industry peer group, with dividends, if any, reinvested.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Cogent Communications Group, the S&P 500 Index,
the NASDAQ Telecommunications Index, and a Peer Group

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*

$100 invested on 12/31/07 in stock or index, including reinvestment of dividends.
Fiscal year ending December 31.

Please note Time Warner Telecom Inc. changed its name to TW Telecom Inc

	12/07	12/08	12/09	12/10	12/11	12/12
Cogent Communications Group	$ 100.00	$ 27.54	$ 41.59	$ 59.64	$ 71.24	$ 96.47
S&P 500	100.00	63.00	79.67	91.67	93.61	108.59
NASDAQ Telecommunications	100.00	57.58	72.97	86.05	90.30	89.62
Peer Group	100.00	40.33	81.12	82.71	92.58	120.33

Issuer Purchases of Equity Securities

In February 2011, we announced that our Board of Directors had authorized a plan to permit the repurchase of up to $50.0 million of our common stock in negotiated and open market transactions. As of December 31, 2012, we had purchased 306,940 shares of our common stock pursuant to these authorizations for an aggregate of $4.2 million; approximately $45.8 million remained available for such negotiated and open market transactions concerning our common stock. We may purchase shares and our convertible notes from time to time depending on market, economic, and other factors.

There were no common stock repurchases during the fourth quarter of 2012 made pursuant to this authorization.

Equity Compensation Plan Information

The information required by this Item 5 regarding Securities Authorized for Issuance Under Equity Compensation Plans is incorporated in this report by reference to the information set forth under the caption "Equity Plan Information" in the 2013 Proxy Statement.

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, Item 7. "Management's Discussion and Analysis of Financial Condition and Results of

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Operations", the consolidated financial statements and notes included elsewhere in this report and in our SEC filings.

	Years Ended December 31,				
	2012	**2011**	**2010**	**2009**	**2008**
	(dollars in thousands)				
CONSOLIDATED STATEMENT OF OPERATIONS DATA:					
Service revenue	$ 316,973	$ 305,500	$ 263,416	$ 235,807	$ 215,489
Operating expenses:					
Network operations	143,113	131,650	118,653	102,603	92,727
Equity-based compensation expense network operations	529	510	370	172	328
Selling, general, and administrative	72,091	69,799	65,793	68,470	62,917
Equity-based compensation expense SG&A	7,794	7,185	6,267	8,435	17,548
Asset impairments			594		1,592
Depreciation and amortization	62,478	59,850	56,524	59,913	62,589
Total operating expenses	286,005	268,994	248,201	239,593	237,701
Operating income (loss)	30,968	36,506	15,215	(3,786)	(22,212)
Gains purchases of senior convertible notes					23,075
Gains lease obligation restructurings and releases		2,739			
Interest expense and other, net	(34,468)	(33,663)	(15,723)	(14,612)	(14,549)
(Loss) income before income taxes	(3,500)	5,582	(508)	(18,398)	(13,686)
Income tax (provision) benefit	(751)	1,960	1,177	1,247	(1,536)
Net (loss) income	$ (4,251)	$ 7,542	$ 669	$ (17,151)	$ (15,222)
Net (loss) income per common share basic and diluted	$ (0.09)	$ 0.17	$ 0.01	$ (0.39)	$ (0.34)
Dividends declared per common share	$ 0.21				
Weighted-average common shares basic	45,514,844	45,180,485	44,633,878	44,028,736	44,563,727
Weighted-average common shares diluted	45,514,844	45,704,052	44,790,753	44,028,736	44,563,727
CONSOLIDATED BALANCE SHEET DATA (AT PERIOD END):					
Total assets	606,531	597,651	376,103	354,995	347,793
Long-term debt (including capital leases and current portion) (net of unamortized discount of $9,494, $15,366, $20,758, $25,708 and $30,253, respectively)	395,432	386,308	182,925	175,934	165,918

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

You should read the following discussion and analysis together with "Item 7. Selected Consolidated Financial 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. Factors that could cause or contribute to these differences include those discussed in "Item 1A. Risk Factors," as well as those discussed elsewhere. You should read "Item 1A. Risk Factors" and "Special Note Regarding Forward-Looking Statements." Our actual results could differ materially from those discussed here. Factors that could cause or contribute to these differences include, but are not limited to:

Future economic instability in the global economy, which could affect spending on Internet services; the impact of changing foreign exchange rates (in particular the Euro to USD and Canadian dollars to USD exchange rates) on the translation of our non-USD denominated revenues, expenses, assets and liabilities; legal and operational difficulties in new markets; the imposition of a requirement that we contribute to the U. S. Universal Service Fund; changes in government policy and/or regulation, including rules regarding data protection and cyber security; increasing competition leading to lower prices for our services; our ability to attract new customers and to increase and maintain the volume of traffic on our network; the ability to maintain our Internet peering arrangements on favorable terms; our reliance on an equipment vendor, Cisco Systems Inc., and the potential for hardware or software problems associated with such equipment; the dependence of our network on the quality and dependability of third-party fiber providers; our ability to retain certain customers that comprise a significant portion of our revenue base; the management of network failures and/or disruptions; and outcomes in litigation as well as other risks discussed from time to time in our filings with the Securities and Exchange Commission, including, without limitation, this annual report on Form 10-K for the fiscal year ended December 31, 2012.

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. We deliver our services to small and medium-sized businesses, communications service providers and other bandwidth-intensive organizations in North America and Europe. We recently began expansion into Japan.

Our on-net service consists of high-speed Internet access and IP connectivity ranging from 100 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. We provide on-net Internet access to net-centric and corporate customers. Our net-centric customers include bandwidth-intensive users such as universities, other Internet service providers, telephone companies, cable television companies, web hosting companies, content delivery networks and commercial content and application providers. These customers generally receive our service in colocation facilities and in our data centers. Our corporate customers are located in multi-tenant office buildings and typically include law firms, financial services firms, advertising and marketing firms and other professional services businesses.

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

Our network is comprised of in-building riser facilities, metropolitan optical fiber networks, metropolitan traffic aggregation points and inter-city transport facilities. Our network is physically connected entirely through our facilities to over 1,860 buildings in which we provide our on-net services, including over 1,300 multi-tenant office buildings. We also provide on-net services in carrier-neutral colocation facilities, Cogent controlled data centers and single-tenant office buildings. Because of our integrated network architecture, we are not dependent on local telephone companies to serve our on-net customers. We emphasize the sale of our on-net services because we believe we have a competitive advantage in providing these services and these services generate gross profit margins that are greater than the gross profit margins on our off-net services.

We believe our key growth opportunity is provided by our high-capacity network, which provides us with the ability to add a significant number of customers to our network with minimal direct incremental costs. Our focus is to add customers to our network in a way that maximizes its use and at the same time provides us with a profitable customer mix. We are responding to this opportunity by increasing our sales and marketing efforts including increasing our number of sales representatives and expanding our network to locations that we believe can be economically integrated and represent significant concentrations of Internet traffic. One of our keys to developing a profitable business will be to carefully match the cost of extending our network to reach new customers with the revenue expected to be generated by those customers. In addition, we may add customers to our network through strategic acquisitions.

We believe some of the most important trends in our industry are the continued long-term growth in Internet traffic, a decline in Internet access prices on a per megabit basis within carrier neutral data centers and relatively flat pricing per corporate customer connection. The effective price per megabit for our corporate customers is declining as the bandwidth utilization and connection size of our corporate customer connections increases. As Internet traffic continues to grow and prices per unit of traffic continue to decline, we believe we can continue to load our network and gain market share from less efficient network operators. However, continued erosion in Internet access prices will likely have a negative impact on the rate at which we can increase our revenues and our profitability. Our revenue may also be negatively affected if we are unable to grow our Internet traffic or if the rate of growth of Internet traffic does not offset the expected decline in per unit pricing. We do not know if Internet traffic will increase or decrease, or the rate at which it will grow or decrease. Changes in Internet traffic will be a function of the number of users, the applications for which the Internet is used, the bandwidth intensity of these applications and the pricing of Internet services, and other factors.

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

We are a facilities-based provider of Internet access and communications services. Facilities-based providers require significant physical assets, or network facilities, to provide their services. Typically when a facilities-based network services provider begins providing its services in a new jurisdiction losses are incurred for several years until economies of scale have been achieved. Our foreign operations are primarily in Europe, Canada, Mexico and Japan. Europe accounts for roughly 75% of our foreign operations. Our European operations have incurred losses and will continue to do so until the European customer base and revenues have grown sufficiently to achieve economies of scale.

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Due to our strategic acquisitions of network assets and equipment, we believe we are well positioned to grow our revenue base. We continue to purchase and deploy network equipment to parts of our network to maximize the utilization of our assets and to expand and increase the capacity of our network. Our future capital expenditures will be based primarily on the expansion of our network, the addition of on-net buildings and the concentration and growth of our customer base. We plan to continue to expand our network and to increase the number of on-net buildings we serve including multi-tenant office buildings and carrier neutral data centers. Many factors can affect our ability to add buildings to our network. These factors include the willingness of building owners to grant us access rights, the availability of optical fiber networks to serve those buildings, and equipment availability.

Results of Operations

Year Ended December 31, 2011 Compared to the Year Ended December 31, 2012

Our management reviews and analyzes several key financial measures in order to manage our business and assess the quality of and potential variability of our service revenue and cash flows. The following summary table presents a comparison of our results of operations for the years ended December 31, 2011 and 2012 with respect to certain key financial measures. The comparisons illustrated in the table are discussed in greater detail below.

	Year Ended December 31,		Percent
	2011	**2012**	**Change**
	(in thousands)		
Service revenue	$ 305,500	$ 316,973	3.8%
On-net revenues	233,012	232,587	(0.2)%
Off-net revenues	69,640	81,928	17.6%
Non-core revenues	2,848	2,458	(13.7)%
Network operations expenses(1)	132,160	143,642	8.7%
Selling, general, and administrative expenses(2)	76,984	79,885	3.8%
Depreciation and amortization expenses	59,850	62,478	4.4%
Interest expense	34,511	36,319	5.2%
Release of lease obligation gain	2,739		(100.0)%
Income tax benefit (expense)	1,960	(751)	(138.3)%

(1) Includes non-cash equity-based compensation expense of $510 and $529 for 2011 and 2012, respectively, which, if excluded would have resulted in a period-to-period change of 8.7%.

(2) Includes non-cash equity-based compensation expense of $7,185 and $7,794 for 2011 and 2012, respectively, which, if excluded would have resulted in a period-to-period change of 3.3%.

Service Revenue. Our service revenue increased 3.8% from $305.5 million for 2011 to $317.0 million for 2012. Exchange rates negatively impacted the increase in service revenue by approximately $5.4 million. All foreign currency comparisons herein reflect results for 2012 translated at the average foreign currency exchange rates for 2011. For 2011 and 2012, on-net, off-net and non-core revenues represented 76.3%, 22.8% and 0.9% and 73.4%, 25.8% and 0.8% of our service revenue, respectively. In January 2012, our largest (net-centric) customer, who represented approximately 5.5% of our 2011 service revenue, was indicted by the U.S. government and as a result our on-net service to this customer and the associated revenue terminated in January 2012. The loss of this on-net net-centric customer negatively impacted our revenue growth rate in 2012.

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Revenue from our corporate and net-centric customers represented 48.9% and 51.1% of our service revenue, respectively, for 2011, and represented 51.5% and 48.5% of our service revenue, respectively, for 2012. Revenue from corporate customers increased 9.2% from $149.4 million for 2011 to $163.1 million for 2012. Revenue from our net-centric customers decreased 1.4% from $156.1 million for 2011 to $153.8 million for 2012. The decrease in net-centric revenue is attributed to the loss of our largest net-centric customer noted above.

Our on-net revenue decreased 0.2% from $233.0 million for 2011 to $232.6 million for 2012. We increased the number of our on-net customer connections by 17.1% to approximately 29,900 at December 31, 2012 from approximately 25,500 at December 31, 2011. The loss of our largest on-net customer in January 2012 and the negative impact of foreign exchange negatively impacted our on-net revenue growth rate from 2011 to 2012. Additionally, our on-net customer connections increased at a greater rate than our on-net revenue due to a decline in our average revenue per on-net customer connection, resulting primarily from our net-centric customers. This decline is partly attributed to volume and term based pricing discounts. Further, our on-net customers who cancel their service from our installed base of customers, in general, have greater average revenue per connection than our new on-net customers. These trends and events resulted in a reduction to our average revenue per on-net connection.

Our off-net revenue increased 17.6% from $69.6 million for 2011 to $81.9 million for 2012. Our off-net customer connections increased 14.0% from approximately 3,900 at December 31, 2011 to approximately 4,500 at December 31, 2012. Our off-net revenue increased at a greater rate than our off-net customer connections due to an increase in our average revenue per off-net customer connection. Our off-net customers who cancel their service with us, in general, have a lower average revenue per connection than our new off-net customers who generally purchase higher-bandwidth connections which carry a higher revenue per connection.

Our non-core revenue decreased 13.7% from $2.8 million for 2011 to $2.5 million for 2012. The number of our non-core customer connections decreased 16.6% from approximately 560 at December 31, 2011 to approximately 470 at December 31, 2012. We do not actively market these acquired non-core services and expect that the service revenue associated with them will continue to decline.

Network Operations Expenses. Network operations expenses include the costs of personnel associated with service delivery, network management, and customer support, network facilities costs, fiber and equipment maintenance fees, leased circuit costs, and access and facilities fees paid to building owners. Non-cash equity-based compensation expense is included in network operations expenses consistent with the classification of the employee's salary and other compensation. Our network operations expenses increased 8.7% from $132.2 million for 2011 to $143.6 million for 2012. The increase is primarily attributable to an increase in costs related to our network and facilities expansion activities and the increase in our off-net revenue. When we provide our off-net services we also assume the cost of the associated tail-circuits. The impact of exchange rates resulted in a decrease of network operations expenses for 2012 of approximately $2.4 million.

Selling, General, and Administrative Expenses ("SG&A"). Our SG&A expenses increased 3.8% from $77.0 million for 2011 to $79.9 million for 2012. Non cash equity-based compensation expense is included in SG&A expenses consistent with the classification of the employee's salary and other compensation and was $7.2 million for 2011 and $7.8 million for 2012. There were no significant variations in the components of our SG&A expenses from the year ended December 31, 2011 to the year ended December 31, 2012. The impact of exchange rates resulted in a decrease of approximately $1.3 million in SG&A expenses.

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Depreciation and Amortization Expenses. Our depreciation and amortization expenses increased 4.4% from $59.9 million for 2011 to $62.5 million for 2012. The increase is primarily due to the depreciation expense associated with the increase related to newly deployed fixed assets more than offsetting the decline in depreciation expense from fully depreciated fixed assets. The impact of exchange rates resulted in a decrease of approximately $0.8 million in depreciation and amortization expenses.

Interest Expense. Interest expense results from interest incurred on our $175.0 million of senior notes issued in January 2011, our $92.0 million of 1.00% convertible senior notes issued in June 2007, and interest on our capital lease obligations. Our interest expense increased 5.2% from $34.5 million for 2011 to $36.3 million for 2012. The increase is attributed to approximately $1.1 million of interest expense related to the issuance of our senior notes since they were outstanding for only a portion of 2011 and to an increase in our capital lease obligations. The impact of exchange rates resulted in a decrease in our interest expense for 2012 of approximately $0.5 million.

Release of Lease Obligation-Gain. In 2011, the requirements for extinguishment were met and we were released from an obligation under an IRU capital lease obligation totaling $2.7 million resulting in a gain. The IRU asset related to this obligation had been fully impaired in 2008 when it was determined that the IRU asset was no longer in use.

Income Tax Benefit (Expense). Our income tax benefit was $2.0 million for 2011 and our income tax expense was $0.8 million for 2012. The net income tax benefit for 2011 includes income tax expense for the United States of approximately $3.4 million related to state income taxes (including approximately $3.0 million related to uncertain tax benefits) an income tax benefit of $6.3 million resulting from the reduction of the valuation allowance on net deferred tax assets related to our operations in certain jurisdictions in the United States, and $0.9 million of income tax expense related to our European and Canadian operations. The net income tax expense for 2012 includes United States state income taxes of $1.4 million and a state income tax benefit of $2.4 million resulting from the reversal of uncertain tax benefits due to the expiration of specific state statutes of limitation and the closing of a state income tax audit, $1.7 million of income tax expense related to our Canadian operations and $0.1 million of income tax expense related to our European operations.

Buildings On-net. As of December 31, 2011 and 2012 we had a total of 1,744 and 1,867 on-net buildings connected to our network, respectively.

Year Ended December 31, 2010 Compared to the Year Ended December 31, 2011

Our management reviews and analyzes several key financial measures in order to manage our business and assess the quality of and potential variability of our service revenues and cash flows. The following summary table presents a comparison of our results of operations for the years ended

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December 31, 2010 and 2011 with respect to certain key financial measures. The comparisons illustrated in the table are discussed in greater detail below.

	Year Ended December 31, 2010	Year Ended December 31, 2011	Percent Change
	(in thousands)		
Service revenue	$ 263,416	$ 305,500	16.0%
On-net revenues	205,004	233,012	13.7%
Off-net revenues	55,294	69,640	25.9%
Non-core revenues	3,118	2,848	(8.7)%
Network operations expenses(1)	119,023	132,160	11.0%
Selling, general, and administrative expenses(2)	72,060	76,984	6.8%
Asset impairment	594		(100.0)%
Depreciation and amortization expenses	56,524	59,850	5.9%
Interest expense	16,682	34,511	106.9%
Release of lease obligation gain		2,739	100.0%
Income tax benefit	1,177	1,960	66.5%

(1) Includes non-cash equity-based compensation expense of $370 and $510 for 2010 and 2011, respectively, which, if excluded would have resulted in a period-to-period change of 11.0%.

(2) Includes non-cash equity-based compensation expense of $6,267 and $7,185 for 2010 and 2011, respectively, which, if excluded would have resulted in a period-to-period change of 6.1%.

Service Revenue. Our service revenue increased 16.0% from $263.4 million for 2010 to $305.5 million for 2011. Exchange rates positively impacted the increase in service revenues by approximately $3.9 million. All foreign currency comparisons herein reflect results for 2011 translated at the average foreign currency exchange rates for 2010. For 2010 and 2011, on-net, off-net and non-core revenues represented 77.8%, 21.0% and 1.2% and 76.3%, 22.8% and 0.9% of our service revenue, respectively. Our largest customer accounted for 5.5% of our 2011 revenue. In January 2012, our largest (net-centric) customer was indicted by the U.S. government and as a result our on-net service to this customer and the associated revenue terminated in January 2012. The loss of this on-net net-centric customer negatively impacted our revenue growth rate in 2012.

Revenue from our corporate and net-centric customers represented 49.4% and 50.6% of our service revenue, respectively, for 2010, and represented 48.9% and 51.1% of our service revenue, respectively, for 2011. Revenue from corporate customers increased 14.9% from $130.1 million for 2010 to $149.4 million for 2011. Revenue from our net-centric customers increased 17.0% from $133.3 million for 2010 to $156.1 million for 2011.

Our on-net revenue increased 13.7% from $205.0 million for 2010 to $233.0 million for 2011. Our on-net revenue increased as we increased the number of our on-net customer connections by 22.3% from approximately 20,900 at December 31, 2010 to approximately 25,500 at December 31, 2011. On-net customer connections increased at a greater rate than on-net revenue due to a decline in the average revenue per on-net customer connection primarily resulting from the pricing per connection related to our net-centric customers. This decline in the average revenue per on-net customer connection is partly attributed to volume and term based pricing discounts. Additionally, on-net customers who cancel or renew their service from our installed base of customers, in general, have greater average revenue per connections than new or renewed customers. These trends resulted in a reduction to our average revenue per on-net connection.

Our off-net revenue increased 25.9% from $55.3 million for 2010 to $69.6 million for 2011. Our off-net customer connections increased 11.0% from approximately 3,500 at December 31, 2010 to approximately 3,900 at December 31, 2011. Off-net revenue increased at a greater rate than off-net customer connections due to an increase in the average revenue per off-net customer connection. Off-net customers who cancel their service, in general, have an average revenue per connection and per connection bandwidth speed that is less than the average revenue per connection for new off-net customers who generally purchase higher-bandwidth connections.

Our non-core revenue decreased 8.7% from $3.1 million for 2010 to $2.8 million for 2011. The number of our non-core customer connections decreased 12.8% from approximately 650 at December 31, 2010 to approximately 560 at December 31, 2011. We do not actively market these acquired non-core services and expect that the service revenue associated with them will continue to decline.

Network Operations Expenses. Network operations expenses 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 and facilities fees paid to building owners. Non cash equity-based compensation expense is included in network operations expenses consistent with the classification of the employee's salary and other compensation. Our network operations expenses increased 11.0% from $119.0 million for 2010 to $132.2 million for 2011. The increase in network operations expenses is primarily attributable to an increase in costs related to our network and facilities expansion activities including personnel and related operating expenses and an increase in our off-net revenues. When we provide off-net revenues we also assume the cost of the associated tail-circuits. The impact of exchange rates resulted in an increase of network operations expenses for 2011 of approximately $1.5 million.

Selling, General, and Administrative Expenses ("SG&A"). Our SG&A expenses increased 6.8% from $72.1 million for 2010 to $77.0 million for 2011. Non cash equity-based compensation expense is included in SG&A expenses consistent with the classification of the employee's salary and other compensation and was $6.3 million for 2010 and $7.2 million for 2011. SG&A expenses increased primarily from the increase in salaries and related costs required to support our expansion efforts including an increase in our sales and marketing efforts. The impact of exchange rates resulted in an increase of approximately $0.9 million in SG&A expenses.

Asset Impairment. In 2010, we recorded an impairment charge of $0.6 million related to certain property and equipment that were no longer in use. There were no such charges in 2011.

Depreciation and Amortization Expenses. Our depreciation and amortization expense increased 5.9% from $56.5 million for 2010 to $59.9 million for 2011. The increase is primarily due to the depreciation expense associated with the increase related to newly deployed fixed assets more than offsetting the decline in depreciation expense from fully depreciated fixed assets and an adjustment to our asset retirement obligations, discussed below. The impact of exchange rates resulted in an increase of approximately $0.6 million in depreciation and amortization expenses.

In the first quarter of 2010, we revised our estimates of the cash flows that we believed will be required to settle our leased facility asset retirement obligations at the end of the respective lease terms, which resulted in a reduction to our asset retirement obligation liability. These revisions reduced our asset retirement obligation liability by $0.9 million with an offsetting reduction to depreciation and amortization of $0.7 million and selling, general and administrative expenses of $0.2 million.

Interest Expense. Interest expense results from interest incurred on our $175.0 million of Senior Notes issued in January 2011, our $92.0 million of 1.00% convertible senior notes (the "Convertible Notes") issued in June 2007, and interest on our capital lease obligations. Our interest expense

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increased 106.9% from $16.7 million for 2010 to $34.5 million for 2011. The increase is attributed to approximately $14.0 million of interest expense related to the issuance of our Senior Notes and to an increase in our capital lease obligations. The impact of exchange rates resulted in an increase in our interest expense for 2011 of approximately $0.3 million.

Release of Lease Obligation-Gain. In 2011, the requirements for extinguishment were met and we were released from an obligation under an IRU capital lease obligation totaling $2.7 million resulting in a gain. The IRU asset related to this obligation had been fully impaired in 2008 when it was determined that the IRU asset was no longer in use.

Income Tax Benefit. Our income tax benefit was $1.2 million for 2010 and $2.0 million for 2011. The net income tax benefit for 2010 includes income taxes for the United States of approximately $0.7 million for state income taxes (including approximately $0.3 million related to uncertain tax benefits), $0.1 million of income tax provision related to our European operations offset by a tax benefit of $1.5 million from the reduction of the remaining valuation allowance on net deferred tax assets related to our Canadian operations and $0.6 million related to a refund of federal alternative minimum taxes. The net income tax benefit for 2011 includes income taxes for the United States of approximately $3.4 million for state income taxes (including approximately $3.0 million related to uncertain tax benefits) a tax benefit of $6.3 million from the reduction of the valuation allowance on net deferred tax assets related to our operations in certain state and municipal jurisdictions in the United States, and, $0.3 million and $0.6 million of income tax provision related to our European and Canadian operations, respectively.

Buildings On-net. As of December 31, 2010 and 2011 we had a total of 1,579 and 1,744 on-net buildings connected to our network, respectively.

Liquidity and Capital Resources

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

The following table sets forth our consolidated cash flows for the years ended December 31, 2010, 2011, and 2012.

	Year Ended December 31,		
	2010	2011	2012
	(in thousands)		
Net cash provided by operating activities	$ 71,477	$ 75,814	$ 79,943
Net cash used in investing activities	(52,227)	(45,812)	(44,196)
Net cash (used in) provided by financing activities	(18,874)	152,636	(27,204)
Effect of exchange rates on cash	(22)	(714)	535
Net increase in cash and cash equivalents during the year	$ 354	$ 181,924	$ 9,078

Net Cash Provided By Operating Activities. Our primary source of operating cash is 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, employees and interest payments made to our capital lease vendors and our note holders. Net cash provided by operating activities was $71.5 million for 2010, $75.8 million for 2011 and $79.9 million for 2012. The increases in cash provided by operating activities are primarily due to increases in our operating profit and working capital management. Cash provided by operating activities for 2011 and 2012 includes interest payments of $8.1 million and $14.7 million, respectively, under our senior secured notes, further described below. Our future operating cash flow will be impacted by annual interest payments of $14.7 million related to our senior secured notes.

Net Cash Used In Investing Activities. Net cash used in investing activities was $52.2 million for 2010, $45.8 million for 2011 and $44.2 million for 2012. Our primary use of investing cash is for purchases of property and equipment. These amounts were $52.8 million, $45.9 million and $44.3 million for 2010, 2011 and 2012, respectively. The annual changes in purchases of property and equipment are primarily due to the timing and scope of our network expansion activities including geographic expansion and adding buildings to our network.

Net Cash (Used In) Provided By Financing Activities. Financing activities used cash of $18.9 million for 2010 and $27.2 million for 2012. Financing activities provided cash of $152.6 million for 2011. Our primary use of financing cash is for principal payments under our capital lease obligations. These amounts were $19.1 million, $15.5 million and $16.8 million for 2010, 2011 and 2012, respectively. Additionally, financing activities include amounts paid under our stock buyback program. These amounts were $3.0 million for 2011 and $1.3 million for 2012. There were no stock purchases in 2010. In January 2011, we issued our 8.375% Senior Secured Notes (the "Senior Notes") due February 15, 2018, for an aggregate principal amount of $175.0 million. We received net proceeds of approximately $170.5 million after deducting $4.5 million of issuance costs. We began paying a quarterly dividend on our common stock in the third quarter of 2012. During 2012 we paid $9.5 million for our third and fourth quarter dividend payments.

Indebtedness

Our total indebtedness, net of discount, at December 31, 2012 was $395.4 million. Our total indebtedness at December 31, 2012 includes $137.9 million of capital lease obligations for dark fiber primarily under 15-20 year IRUs. Our total cash and cash equivalents were $247.3 million at December 31, 2012.

Senior Secured Notes

In January 2011, we issued our Senior Notes for an aggregate principal amount of $175.0 million in a private offering for resale to qualified institutional buyers pursuant to SEC Rule 144A. The Senior Notes are secured and bear interest at 8.375% per annum. Interest is payable in cash semiannually in arrears on February 15 and August 15, of each year, beginning on August 15, 2011. We received net proceeds of approximately $170.5 million after deducting $4.5 million of issuance costs. We intend to use the net proceeds from the Senior Notes for general corporate purposes and/or repurchases of our common stock or our Convertible Notes or a special dividend or recurring dividends.

The Senior Notes are fully guaranteed on a senior secured basis, jointly and severally, by each of our existing domestic and future material domestic subsidiaries, subject to certain exceptions and permitted liens. Under certain circumstances, subsidiaries may be released from these guarantees without the consent of the holders of the Senior Notes. The Senior Notes and the guarantees are secured by (i) first priority liens on substantially all of our and our guarantors' assets, (ii) all of the equity interests in any of our domestic subsidiaries and (iii) 65% of the equity interests of our first-tier foreign subsidiaries held by us and our guarantors. The Senior Notes and the guarantees represent our and the guarantors' senior secured obligations and effectively rank equally and ratably with all of our and the guarantors' existing and future first lien obligations, to the extent of the value of the collateral securing such indebtedness, subject to permitted liens; are structurally subordinated to any existing and future indebtedness and liabilities of non-guarantor subsidiaries and rank equally in right of payment with all of our and the guarantors' existing and future senior indebtedness.

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The Senior Notes may be redeemed, in whole or in part, at any time prior to February 15, 2015 at a price equal to 100% of the principal amount plus a "make-whole" premium, plus accrued and unpaid interest, if any, to the date of redemption. The Senior Notes are redeemable, in whole or in part, at any time on or after February 15, 2015 at the applicable redemption prices specified under the indenture governing the Senior Notes plus accrued and unpaid interest, if any, to the date of redemption. In addition, we may redeem up to 35% of the Senior Notes before February 15, 2014 with the net cash proceeds from certain equity offerings. If we experience specific kinds of changes of control, we must offer to repurchase all of the Senior Notes at a purchase price of 101% of their principal amount, plus accrued and unpaid interest, if any, to the repurchase date.

The indenture governing the Senior Notes, among other things, limits our ability and our guarantors' ability to incur indebtedness; to pay dividends or make other distributions; to make certain investments and other restricted payments; to create liens; consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; to incur restrictions on the ability of a subsidiary to pay dividends or make other payments; and to enter into certain transactions with our affiliates.

Convertible Senior Notes

In June 2007, we issued our Convertible Notes due June 15, 2027, for an aggregate principal amount of $200.0 million in a private offering for resale to qualified institutional buyers pursuant to SEC Rule 144A. The Convertible Notes are unsecured and bear interest at 1.00% per annum. The Convertible Notes will rank equally with any future senior debt and senior to any future subordinated debt and will be effectively subordinated to all of our subsidiary's existing and future liabilities and to any secured debt that we may issue to the extent of the value of the collateral. Interest is payable in cash semiannually in arrears on June 15 and December 15, of each year, beginning on December 15, 2007. We received proceeds of approximately $195.1 million after deducting the original issue discount of 2.25% and issuance costs.

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

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

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

Common Stock Buyback Program

In June 2007, we used approximately $50.1 million of the net proceeds from our issuance of our Convertible Notes to repurchase approximately 1.8 million shares of our common stock. In August 2007, our board of directors approved a $50.0 million common stock buyback program. In June 2008, our board of directors approved an additional $50.0 million for purchases of our common stock to occur prior to December 31, 2009. In February 2011, our board of directors approved an additional $50.0 million of purchases of our common stock. In the years ended December 31, 2011 and 2012, we purchased approximately 0.2 million, and 0.1 million shares of our common stock, respectively, for approximately $3.0 million and $1.3 million, respectively and there was $45.8 million available for additional purchases at December 31, 2012. There were no purchases in the year ended December 31, 2010. All purchased common shares were subsequently retired. In February 2013, our board of directors extended the February 2011 program through February 2014.

Dividends on Common Stock

On August 7, 2012, our board of directors approved payment of a dividend of $0.10 per common share. The dividend payment totaling $4.5 million was paid on September 12, 2012 to holders of record as of August 22, 2012. On November 5, 2012, our board of directors approved the payment of a dividend of $0.11 per common share. On December 12, 2012, a dividend payment totaling $5.0 million was paid to holders of record as of November 21, 2012. On February 20, 2013, our board of directors approved the payment of a dividend of $0.12 per common share to holders of record on March 4, 2013 and the dividend payment totaling $5.5 million will be paid on March 15, 2013.

The payment of any future quarterly dividends will be at the discretion of our board of directors and will be dependent upon our financial position, results of operations, available cash, cash flow, capital requirements and other factors deemed relevant by our board of directors.

Contractual Obligations and Commitments

The following table summarizes our contractual cash obligations and other commercial commitments as of December 31, 2012.

	Payments due by period				
	Total	Less than 1 year	1 - 3 years	3 - 5 years	After 5 years
			(in thousands)		
Convertible Notes(1)	$ 93,358	$ 920	$ 92,438	$	$
Senior Notes(2)	255,609	14,656	29,312	29,312	182,329
Capital lease obligations(3)	299,995	29,968	40,537	38,938	190,552
Operating leases and other(4)	313,257	48,631	78,091	55,846	130,689
Unconditional purchase obligations(5)	75,960	24,853	25,397	2,292	23,418
Total contractual cash obligations	$ 1,038,179	$ 119,028	$ 265,775	$ 126,388	$ 526,988

(1) The Convertible Notes are assumed to be outstanding until June 15, 2014 which is the earliest put date and these amounts include interest and principal payment obligations on the Convertible Notes to the put date.

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(2) The $175.0 million Senior Notes were issued in January 2011 and these amounts include interest and principal payment obligations through the maturity date of February 15, 2018.

(3) 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 $137.9 million at December 31, 2012. These leases generally have initial terms of 15 to 20 years

(4) These amounts include operating lease, building access and tenant license agreement obligations.

(5) As of December 31, 2012, we had committed to additional dark fiber IRU operating and capital lease agreements totaling approximately $35.7 million in future principal and interest payments. In January 2013, we entered into an amended equipment purchase agreement with a vendor which require us to order $37 million of equipment through 2016.

Due to uncertainty regarding the completion of tax audits and possible outcomes, an estimate of the timing of payments related to uncertain tax positions and interest cannot be made and these amounts are excluded from the contractual cash obligations above. See Note 5 Income Taxes.

Future Capital Requirements

We believe that our cash on hand and cash generated from our operating activities will be adequate to meet our working capital, capital expenditure, debt service, dividend payments and other cash requirements if we execute our business plan.

Any future acquisitions or other significant unplanned costs or cash requirements in excess of amounts we currently hold 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 and markets that we add to our network, reduce our planned increase in our sales and marketing efforts, or require us to otherwise alter our business plan or take other actions that could have a material adverse effect on our business, results of operations and financial condition. If issuing equity securities raises additional funds, substantial dilution to existing stockholders may result.

Off-Balance Sheet Arrangements

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

Income taxes

Due to the uncertainty surrounding the realization of our net deferred tax asset, we have recorded a valuation allowance for a substantial majority of our net deferred tax asset. Section 382 of the Internal Revenue Code in the United States limits the utilization of net operating losses when ownership changes, as defined by that section, occur. We have performed an analysis of our Section 382 ownership changes and have determined that the utilization of certain of our net operating loss carryforwards in the United States is limited.

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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. 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.

The accounting policies we believe to be most critical to understanding our financial results and condition or 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 longer of estimated customer life or contract term. We determine the estimated customer life using a historical analysis of customer retention and contract terms. If our estimated customer life and contract terms increase, we will recognize installation revenue over a longer period. We expense the 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

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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. If circumstances relating to specific customers change or economic conditions change such that our past collections experience and assessment of the economic environment are no longer appropriate, our estimate of the recoverability of our trade receivables could be impacted.

Our valuation allowance for our net deferred tax asset reflects the uncertainty surrounding the realization of our net operating loss carry-forwards and our other deferred tax assets. Valuation allowances are established when management determines it is "more likely than not" that some portion or the entire deferred tax asset will not be realized. To reflect for the uncertainty of future taxable income we have recorded a valuation allowance for the significant majority of our net deferred tax asset. We have not recorded valuation allowance associated with our deferred tax assets in our Canadian operations or in certain states. At each balance sheet date, we assess the likelihood that we will be able to realize our deferred tax assets. We consider all available positive and negative evidence, on a jurisdictional basis, in assessing the need for a valuation allowance including our operating results, ongoing tax planning, and our forecast of future taxable income. Significant judgment is required with respect to the determination of whether a valuation allowance is required for certain of our deferred tax assets. Based on our ongoing review of this evidence, we believe a possibility exists that all or a portion of the valuation allowance against our domestic deferred tax assets may be reduced within the next twelve months.

Uncertain Tax Positions

In the normal course of business we take positions on our tax returns that may be challenged by taxing authorities. We evaluate all uncertain tax positions to assess whether the position will more likely than not be sustained upon examination. If we determine that the tax position is more likely than not to be sustained, we record the amount of the benefit that is more likely than not to be realized when the tax position is settled. We adjust our estimated liabilities for uncertain tax positions periodically because of ongoing examinations by, and settlements with, the various taxing authorities, as well as changes in tax laws, regulations and interpretations. Our consolidated tax provision in any given year includes adjustments to prior year income tax accruals that are considered appropriate and any related estimated interest.

Equity-based Compensation

We grant options for shares of our common stock to certain of our employees with a strike price equal to the market value at the grant date. We grant shares of restricted stock to our senior management team and to certain other employees and to our board members. We determine the fair value of grants of restricted stock by the closing trading price of our common stock on the grant date. We determine the fair value of grants of options for shares of common stock by the closing trading price of our common stock on the grant date using the Black-Scholes method. Grants of shares of restricted stock and options for common stock generally vest over periods ranging from three to four-years. We record equity-based compensation expense related to grants of restricted stock with vesting subject to performance conditions when it is considered probable that the performance conditions will be met. Compensation expense for all awards is recognized ratably over the service period.

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The accounting for equity-based compensation expense requires us to make estimates and judgments that affect our financial statements. These estimates include the following.

Expected Dividend Yield Prior to our initial declaration of a quarterly cash dividend in the third quarter of 2012, we used an expected dividend yield of 0% as we did not historically pay cash dividends on our common stock. We now use an expected dividend yield of 2.0%

Expected Volatility We use the historical volatility for a period commensurate with the expected term of the option.

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.

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

Capital Lease Obligations

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 establish the number of renewal option periods used in determining the lease term, if any, based upon our assessment at the inception of the lease of the number of option periods for which failure to renew the lease imposes a penalty on us in such amount that renewal appears to be reasonably assured. 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. We estimate the fair value of leased assets primarily using estimated replacement cost data for similar assets.

Other Accounting Policies

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 compensation costs 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. In the normal course of business we are 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. In accordance with the accounting guidance for contingencies, we accrue our estimate of a contingent liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Where it is probable that a liability has been incurred and there is a range of expected loss for which no amount in the range is more likely than any other amount, we accrue at the low end of the range. We review our accruals at least quarterly and adjust them to reflect the impact of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular matter. Judgment is required in estimating the ultimate outcome of any dispute resolution process, as well as any other amounts that may be incurred to conclude the negotiations or settle any litigation. Actual results may differ from these estimates under different assumptions or conditions and such differences could be material.

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

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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, if any, for amortizing leasehold improvements based upon our assessment at the inception of the lease of the number of option periods that are reasonably assured.

We recognize a liability for the estimated fair value of legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or the normal operation of a long-lived asset in the period incurred. The fair value of the obligation is also capitalized as property, plant and equipment and then amortized over the estimated remaining useful life of the associated asset. Increases to the asset retirement obligation liability due to the passage of time are recognized as accretion expense and included within selling, general and administrative expenses. Changes in the liability due to revisions to future cash flows are recognized by increasing or decreasing the liability with the offset adjusting the carrying amount of the related long-lived asset. To the extent that the downward revisions exceed the carrying amount of the related long-lived asset initially recorded when the asset retirement obligation liability was established, we record the remaining adjustment as a reduction to depreciation expense, to the extent of historical depreciation of the related long-lived asset, and then to selling, general and administrative expense.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to certain market risks. These risks, which include interest rate risk and foreign currency exchange risk, arise in the normal course of business rather than from trading activities.

Interest Rate Risk

Our cash flow exposure due to changes in interest rates related to our debt is limited as our Convertible Notes and Senior Notes have fixed interest rates. The fair value of our Convertible Notes and Senior Notes may increase or decrease for various reasons, including fluctuations in the market price of our common stock, fluctuations in market interest rates and fluctuations in general economic conditions.

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

Foreign Currency Exchange Risk

Our operations outside of the U.S. expose us to potentially unfavorable adverse movements in foreign currency rate changes. We have not entered into forward exchange contracts related to our foreign currency exposure. While we record financial results and assets and liabilities from our international operations in the functional currency, which is generally the local currency, 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 local currencies, in particular the Euro, the Canadian dollar and Mexican Peso. In addition, we fund certain cash flow requirements of our international operations in U.S. dollars. Accordingly, in the event that the local currencies strengthen versus the U.S. dollar to a greater extent than planned, the revenues, expenses and cash flow requirements associated with our international operations may be significantly higher in U.S.-dollar terms than planned. Changes in foreign currency rates could adversely affect our operating results.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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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, 2012 and 2011, and the related consolidated statements of comprehensive income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the financial statement schedule listed in the index at 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, 2012 and 2011, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, 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.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Cogent Communications Group, Inc.'s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

McLean, VA
February 27, 2013

COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 2012 AND 2011

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	$ 247,285	$ 238,207
Accounts receivable, net of allowance for doubtful accounts of $3,083 and $3,345, respectively	23,990	25,029
Prepaid expenses and other current assets	9,978	10,051
Total current assets	281,253	273,287
Property and equipment:		
Property and equipment	889,229	836,047
Accumulated depreciation and amortization	(578,054)	(528,069)
Total property and equipment, net	311,175	307,978
Deposits and other assets ($442 and $457 restricted, respectively)	14,103	16,386
Total assets	$ 606,531	$ 597,651
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 14,734	$ 14,199
Accrued and other current liabilities	26,519	21,944
Current maturities, capital lease obligations	10,487	11,700
Total current liabilities	51,740	47,843
Senior secured notes	175,000	175,000
Capital lease obligations, net of current maturities	127,461	122,996
Convertible senior notes, net of discount of $9,494 and $15,366, respectively	82,484	76,612
Other long term liabilities	10,067	11,199
Total liabilities	446,752	433,650
Commitments and contingencies		
Stockholders' equity:		
Common stock, $0.001 par value; 75,000,000 shares authorized; 47,116,644 and 45,893,347 shares issued and outstanding, respectively	47	46
Additional paid-in capital	497,349	489,021
Accumulated other comprehensive income	667	(582)
Accumulated deficit	(338,284)	(324,484)
Total stockholders' equity	159,779	164,001
Total liabilities and stockholders' equity	$ 606,531	$ 597,651

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

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COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR EACH OF THE THREE YEARS ENDED DECEMBER 31, 2012

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	2012	2011	2010
Service revenue	$ 316,973	$ 305,500	$ 263,416
Operating expenses:			
Network operations (including $529, $510 and $370 of equity-based compensation expense, respectively, exclusive of amounts shown separately)	143,642	132,160	119,023
Selling, general, and administrative (including $7,794, $7,185 and $6,267 of equity-based compensation expense, respectively)	79,885	76,984	72,060
Asset impairment			594
Depreciation and amortization	62,478	59,850	56,524
Total operating expenses	286,005	268,994	248,201
Operating income	30,968	36,506	15,215
Release of lease obligation (Note 6)		2,739	
Interest income and other	1,851	848	959
Interest expense	(36,319)	(34,511)	(16,682)
(Loss) income before income taxes	(3,500)	5,582	(508)
Income tax (expense) benefit	(751)	1,960	1,177
Net (loss) income	$ (4,251)	$ 7,542	$ 669
Comprehensive (loss) income:			
Net (loss) income	$ (4,251)	$ 7,542	$ 669
Foreign currency translation adjustment	1,249	(1,626)	(932)
Comprehensive (loss) income	$ (3,002)	$ 5,916	$ (263)
Basic and diluted net (loss) income per common share	$ (0.09)	$ 0.17	$ 0.01
Dividends declared per common share	$ 0.21		
Weighted-average common shares basic	45,514,844	45,180,485	44,633,878
Weighted-average common shares diluted	45,514,844	45,704,052	44,790,753

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 EACH OF THE THREE YEARS ENDED DECEMBER 31, 2012

(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholder's Equity
	Shares	Amount				
Balance at December 31, 2009	**44,853,974**	**$ 45**	**$ 475,158**	**$ 1,976**	**$ (332,695)**	**$ 144,484**
Forfeitures of shares granted to employees	(61,800)					
Equity-based compensation			7,305			7,305
Foreign currency translation				(932)		(932)
Issuances of common stock	999,500	1				1
Exercises of options	46,836		274			274
Net income					669	669
Balance at December 31, 2010	**45,838,510**	**$ 46**	**$ 482,737**	**$ 1,044**	**$ (332,026)**	**$ 151,801**
Forfeitures of shares granted to employees	(33,038)					
Equity-based compensation			8,620			8,620
Foreign currency translation				(1,626)		(1,626)
Issuances of common stock	224,920					
Exercises of options	95,311		633			633
Common stock purchases and retirement	(232,356)		(2,969)			(2,969)
Net income					7,542	7,542
Balance at December 31, 2011	**45,893,347**	**$ 46**	**$ 489,021**	**$ (582)**	**$ (324,484)**	**$ 164,001**
Forfeitures of shares granted to employees	(82,580)					
Equity-based compensation			9,164			9,164
Foreign currency translation				1,249		1,249
Issuances of common stock	1,338,120	1				1
Exercises of options	42,341		404			404
Common stock purchases and retirement	(74,584)		(1,265)			(1,265)
Excess income tax benefit			25			25
Dividends paid					(9,549)	(9,549)
Net (loss)					(4,251)	(4,251)
Balance at December 31, 2012	**47,116,644**	**$ 47**	**$ 497,349**	**$ 667**	**$ (338,284)**	**$ 159,779**

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

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COGENT COMMUNICATIONS GROUP, INC., AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR EACH OF THE THREE YEARS ENDED DECEMBER 31, 2012

(IN THOUSANDS)

	2012	2011	2010
Cash flows from operating activities:			
Net (loss) income	$ (4,251)	$ 7,542	$ 669
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	62,478	59,850	56,524
Asset impairment			594
Amortization of debt discount convertible notes	6,031	5,609	4,950
Equity-based compensation expense (net of amounts capitalized)	8,323	7,695	6,637
Gain release of lease obligation		(2,739)	
Gains dispositions of assets and other, net	(971)	(96)	(208)
Changes in assets and liabilities:			
Accounts receivable	1,247	(1,554)	(1,603)
Prepaid expenses and other current assets	459	(1,238)	(1,257)
Deferred income taxes	2,692	(5,735)	(1,436)
Deposits and other assets	(436)	343	(888)
Accounts payable, accrued liabilities and other long-term liabilities	4,371	6,137	7,495
Net cash provided by operating activities	79,943	75,814	71,477
Cash flows from investing activities:			
Purchases of property and equipment	(44,337)	(45,856)	(52,757)
Proceeds from asset sales	141	44	530
Net cash used in investing activities	(44,196)	(45,812)	(52,227)
Cash flows from financing activities:			
Net proceeds from issuance of senior secured notes		170,512	
Dividends paid	(9,549)		
Principal payments of capital lease obligations	(16,794)	(15,540)	(19,148)
Purchases of common stock	(1,265)	(2,969)	
Proceeds from exercises of common stock options	404	633	274
Net cash (used in) provided by financing activities	(27,204)	152,636	(18,874)
Effect of exchange rate changes on cash	535	(714)	(22)
Net increase in cash and cash equivalents	9,078	181,924	354
Cash and cash equivalents, beginning of year	238,207	56,283	55,929
Cash and cash equivalents, end of year	$ 247,285	$ 238,207	$ 56,283

Supplemental disclosures of cash flow information: