COGENT COMMUNICATIONS HOLDINGS, INC.
Form 10-Q
November 01, 2018
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2018

OR

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

Commission File No. 000-51829

COGENT COMMUNICATIONS HOLDINGS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**46-5706863**

(State of Incorporation) (I.R.S. Employer Identification Number)

2450 N Street N.W.

Washington, D.C. 20037

(Address of Principal Executive Offices and Zip Code)

(202) 295-4200

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

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

Common Stock, $.001 par value 46,471,871 Shares Outstanding as of October 31, 2018

Table of Contents

INDEX

PART I
FINANCIAL INFORMATION

PART II
OTHER INFORMATION

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. **FINANCIAL STATEMENTS**

COGENT COMMUNICATIONS HOLDINGS, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

AS OF SEPTEMBER 30, 2018 AND DECEMBER 31, 2017

(IN THOUSANDS, EXCEPT SHARE DATA)

	September 30, 2018 (Unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 284,558	$ 247,011
Accounts receivable, net of allowance for doubtful accounts of $1,614 and $1,499, respectively	40,993	39,096
Prepaid expenses and other current assets	32,956	20,011
Total current assets	358,507	306,118
Property and equipment, net	381,004	381,282
Deferred tax assets	6,326	17,616
Deposits and other assets	11,482	5,572
Total assets	$ 757,319	$ 710,588
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 8,262	$ 11,592
Accrued and other current liabilities	46,728	47,947
Installment payment agreement, current portion, net of discount of $450 and $337, respectively	8,617	7,816
Current maturities, capital lease obligations	8,665	7,171
Total current liabilities	72,272	74,526
Senior secured 2022 notes, net of unamortized debt costs of $2,887 and $1,870, respectively and including premium of $1,507 and $382, respectively	443,620	373,512
Senior unsecured 2021 notes, net of unamortized debt costs of $1,625 and $2,060, respectively	187,600	187,165
Capital lease obligations, net of current maturities	152,954	150,333
Other long term liabilities	26,717	27,596
Total liabilities	883,163	813,132
Commitments and contingencies:		
Stockholders equity:		
Common stock, $0.001 par value; 75,000,000 shares authorized; 46,461,371 and 45,960,799 shares issued and outstanding, respectively	46	46
Additional paid-in capital	472,817	456,696
Accumulated other comprehensive income foreign currency translation	(8,672)	(4,600)
Accumulated deficit	(590,035)	(554,686)
Total stockholders deficit	(125,844)	(102,544)

Total liabilities and stockholders deficit	$	757,319	$	710,588

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

Table of Contents

COGENT COMMUNICATIONS HOLDINGS, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2018 AND SEPTEMBER 30, 2017

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	Three Months Ended September 30, 2018 (Unaudited)	Three Months Ended September 30, 2017 (Unaudited)
Service revenue	$ 130,139	$ 122,969
Operating expenses:		
Network operations (including $250 and $179 of equity-based compensation expense, respectively, exclusive of depreciation and amortization shown separately below)	54,615	53,584
Selling, general, and administrative (including $4,571 and $3,555 of equity-based compensation expense, respectively)	33,409	32,915
Depreciation and amortization	20,276	19,147
Total operating expenses	108,300	105,646
Gains on equipment transactions	416	397
Operating income	22,255	17,720
Interest income and other, net	1,937	1,632
Interest expense	(12,767)	(12,266)
Income before income taxes	11,425	7,086
Income tax provision	(3,194)	(3,436)
Net income	$ 8,231	$ 3,650
Comprehensive income:		
Net income	$ 8,231	$ 3,650
Foreign currency translation adjustment	(485)	3,790
Comprehensive income	$ 7,746	$ 7,440
Net income per common share:		
Basic and diluted net income per common share	$ 0.18	$ 0.08
Dividends declared per common share	$ 0.54	$ 0.46
Weighted-average common shares - basic	45,105,830	44,767,163
Weighted-average common shares - diluted	45,699,635	45,118,607

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

Table of Contents

COGENT COMMUNICATIONS HOLDINGS, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018 AND SEPTEMBER 30, 2017

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	Nine Months Ended September 30, 2018 (Unaudited)	Nine Months Ended September 30, 2017 (Unaudited)
Service revenue	$ 388,144	$ 359,949
Operating expenses:		
Network operations (including $671 and $431 of equity-based compensation expense, respectively, exclusive of depreciation and amortization shown separately below)	163,868	155,362
Selling, general, and administrative (including $12,629 and $9,175 of equity-based compensation expense, respectively)	100,637	96,165
Depreciation and amortization	60,280	56,583
Total operating expenses	324,785	308,110
Gains on equipment transactions	891	3,543
Operating income	64,250	55,382
Interest income and other, net	3,817	3,502
Interest expense	(37,547)	(36,245)
Income before income taxes	30,520	22,639
Income tax provision	(8,953)	(10,536)
Net income	$ 21,567	$ 12,103
Comprehensive income:		
Net income	$ 21,567	$ 12,103
Foreign currency translation adjustment	(4,072)	11,281
Comprehensive income	$ 17,495	$ 23,384
Net income per common share:		
Basic net income per common share	$ 0.48	$ 0.27
Diluted net income per common share	$ 0.47	$ 0.27
Dividends declared per common share	$ 1.56	$ 1.32
Weighted-average common shares - basic	45,096,472	44,787,067
Weighted-average common shares - diluted	45,591,217	45,083,765

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

Table of Contents

COGENT COMMUNICATIONS HOLDINGS, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018 AND SEPTEMBER 30, 2017

(IN THOUSANDS)

	Nine months Ended September 30, 2018 (Unaudited)	Nine months Ended September 30, 2017 (Unaudited)
Cash flows from operating activities:		
Net income	$ 21,567	$ 12,103
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	60,280	56,583
Amortization of debt discount and premium	1,126	899
Equity-based compensation expense (net of amounts capitalized)	13,300	9,606
Gains equipment transactions and other, net	(727)	(4,394)
Deferred income taxes	7,527	9,835
Changes in operating assets and liabilities:		
Accounts receivable	(2,280)	(4,317)
Prepaid expenses and other current assets	(663)	645
Accounts payable, accrued liabilities and other long-term liabilities	(5,473)	(1,411)
Deposits and other assets	(1,462)	793
Net cash provided by operating activities	93,195	80,342
Cash flows from investing activities:		
Purchases of property and equipment	(39,000)	(35,183)
Net cash used in investing activities	(39,000)	(35,183)
Cash flows from financing activities:		
Dividends paid	(71,371)	(59,824)
Net proceeds from issuance of 2022 secured notes net of debt costs of $1,363	69,862	
Purchases of common stock		(1,829)
Proceeds from exercises of stock options	1,520	919
Principal payments on installment payment agreement	(6,888)	(2,183)
Principal payments of capital lease obligations	(8,158)	(9,368)
Net cash used in financing activities	(15,035)	(72,285)
Effect of exchange rates changes on cash	(1,613)	3,572
Net increase (decrease) in cash and cash equivalents	37,547	(23,554)
Cash and cash equivalents, beginning of period	247,011	274,319
Cash and cash equivalents, end of period	$ 284,558	$ 250,765
Supplemental disclosure of non-cash investing and financing activities:		
Non-cash component of network equipment obtained in exchange transactions	$ 876	$ 3,509
PP&E obtained for installment payment agreement	$ 8,609	$ 6,577
Capital lease obligations incurred	$ 15,074	$ 18,105

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

Table of Contents

COGENT COMMUNICATIONS HOLDINGS, INC., AND SUBSIDIARIES

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of the business and recent developments:

Reorganization and merger

On May 15, 2014, pursuant to the Agreement and Plan of Reorganization (the Merger Agreement) by and among Cogent Communications Group, Inc. (Group), a Delaware corporation, Cogent Communications Holdings, Inc., a Delaware corporation (Holdings) and Cogent Communications Merger Sub, Inc., a Delaware corporation, Group adopted a new holding company organizational structure whereby Group is now a wholly owned subsidiary of Holdings. Holdings is a successor issuer to Group pursuant to Rule 12g-3(a) under the Securities Exchange Act of 1934, as amended (the Exchange Act).

References to the Company for events that occurred prior to May 15, 2014 refer to Cogent Communications Group, Inc. and its subsidiaries and on and after May 15, 2014 the Company refers to Cogent Communications Holdings, Inc. and its subsidiaries.

Description of business

The Company is a Delaware corporation and is headquartered in Washington, DC. The Company is a facilities-based provider of low-cost, high-speed Internet access services, private network services and data center colocation space. The Company s network is specifically designed and optimized to transmit packet routed data. The Company delivers its services primarily to small and medium-sized businesses, communications service providers and other bandwidth-intensive organizations in North America, Europe and Asia.

The Company offers on-net Internet access and private network services exclusively through its own facilities, which run from its network to its customers premises. The Company is not dependent on local telephone companies or cable TV companies to serve its customers for its on-net Internet access services because of its integrated network architecture. The Company offers its on-net services to customers located in buildings that are physically connected to its network. The Company s on-net service consists of high-speed Internet access and private network services offered at speeds ranging from 100 Megabits per second to 100 Gigabits per second of bandwidth. The Company provides its on-net Internet access services and private network services to its corporate and net-centric customers. The Company s 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. The Company s net-centric customers include bandwidth-intensive users such as other Internet service providers, telephone companies, cable television companies, web hosting companies, content delivery network companies and commercial content and application service providers. These net-centric customers obtain the Company s services in colocation facilities and in the Company s data centers. The Company operates data centers throughout North America and Europe that allow its customers to collocate their equipment and access the Company s network.

In addition to providing its on-net services, the Company provides Internet connectivity and private network services to customers that are not located in buildings directly connected to its network. The Company provides this off-net service primarily to corporate customers using other carriers facilities to provide the last mile portion of the link from the customers premises to the Company s network. The Company also provides certain non-core services that resulted from acquisitions. The Company continues to support but does not actively sell these non-core services. Beginning in the second quarter of 2018 the Company began to offer and sell its software-defined wide area network (SDWAN) service.

Basis of presentation

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the unaudited condensed consolidated financial statements reflect all normal recurring adjustments that the Company considers necessary for the fair presentation of its results of operations and cash flows for the interim periods covered, and of the financial position of the Company at the date of the interim condensed consolidated balance sheet. Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The operating results for interim periods are not necessarily indicative of the operating results for the entire year. While the Company believes that the disclosures are adequate to not make the information misleading, these interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in its annual report on Form 10-K for the year ended December 31, 2017.

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

Use of estimates

The preparation of consolidated financial statements in conformity with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets

Table of Contents

and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates.

Financial instruments

At September 30, 2018, the carrying amount of cash and cash equivalents, accounts receivable, prepaid and other current assets, accounts payable and accrued expenses approximated fair value because of the short-term nature of these instruments. The Company measures its cash equivalents at amortized cost, which approximates fair value based upon quoted market prices (Level 1). Based upon recent trading prices (Level 2 market approach) at September 30, 2018 the fair value of the Company s $189.2 million senior unsecured notes was $190.6 million and the fair value of the Company s $445.0 million senior secured notes was $449.5 million.

Gross receipts taxes, universal service fund and other surcharges

Revenue recognition standards include guidance relating to taxes or surcharges assessed by a governmental authority that are directly imposed on a revenue-producing transaction between a seller and a customer and may include, but are not limited to, gross receipts taxes, excise taxes, Universal Service Fund fees and certain state regulatory fees. Such charges may be presented gross or net based upon the Company s accounting policy election. The Company records certain excise taxes and surcharges on a gross basis and includes them in its revenues and costs of network operations. Excise taxes and surcharges billed to customers and recorded on a gross basis (as service revenue and network operations expense) were $3.0 million and $2.7 million for the three months ended September 30, 2018 and September 30, 2017, respectively, and $9.3 million and $8.0 million for the nine months ended September 30, 2018 and September 30, 2017, respectively.

Basic and diluted net income per common share

Basic earnings per share (EPS) excludes dilution for common stock equivalents and is computed by dividing net income or (loss) available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is based on the weighted-average number of shares of common stock outstanding during each period, adjusted for the effect of dilutive common stock equivalents. Shares of restricted stock are included in the computation of basic EPS as they vest and are included in diluted EPS, to the extent they are dilutive, determined using the treasury stock method. The Company s employees exercised options for 14,057 and 12,743 common shares for the three months ended September 30, 2018 and 2017, and exercised options for 44,753 and 30,656 common shares for the nine months ended September 30, 2018 and 2017, respectively.

The following details the determination of diluted weighted average shares:

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Weighted average common shares - basic	45,105,830	44,767,163	45,096,472	44,787,067
Dilutive effect of stock options	39,488	32,399	34,644	29,061
Dilutive effect of restricted stock	554,317	319,045	460,101	267,637

Weighted average common shares - diluted	45,699,635	45,118,607	45,591,217	45,083,765

The following details unvested shares of restricted common stock as well as the anti-dilutive effects of stock options and restricted stock awards outstanding:

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Unvested shares of restricted common stock	1,350,320	1,175,235	1,350,320	1,175,235
Anti-dilutive options for common stock	30,836	54,908	47,422	52,064
Anti-dilutive shares of restricted common stock		195	1,348	99,737

Recent Accounting Pronouncements Adopted

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* (ASC 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers, and also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenues and cash flows from contracts with customers. ASC 606 replaced most existing revenue recognition guidance in U.S. GAAP. The new standard was effective for the Company on January 1, 2018. The standard permits the use of either the full retrospective or modified retrospective transition method. The Company adopted ASC 606 using the modified retrospective transition method on January 1, 2018 and applied the standard to all of its customer contracts that are not considered completed as of the adoption date. Under the modified retrospective method, the cumulative effect of applying the standard was recognized at the date of initial application and resulted in a reduction to the Company s accumulated deficit of $14.5 million, recording customer contract costs (a new asset) of $17.3 million, a decrease to deferred revenue of $0.9 million and a decrease to deferred income tax assets of $3.8 million. The Company refers to contract liabilities as deferred revenue on the condensed consolidated balance sheets and related disclosures. Results for reporting periods beginning January 1, 2018 are presented under ASC 606, while prior period amounts were not adjusted and continue to be reported in accordance with the Company s historic accounting under Topic 605, *Revenue Recognition*.

Table of Contents

The effect of adopting ASC 606, changed the period for which the Company recognizes revenue for fees billed in connection with customer installations. Installation fees for contracts with terms longer than month-to-month are now recognized over the contract term which may be a shorter period than the average customer life which was previously used to recognize revenue. The Company believes the installation fee does not give rise to a material right as defined by ASC 606 for contracts with terms longer than month-to-month. Consistent with previous GAAP, the Company is recognizing revenues over the estimated average customer life for installation fees associated with month-to-month contracts, because the fee represents a material right as defined by ASC 606.

Additionally, the Company is required to capitalize certain contract acquisition costs that relate directly to a customer contract, including commissions paid to its sales team and sales agents, and to amortize these costs on straight-line basis over the period the services are transferred to the customer for commissions paid to its sales team (estimated customer life) and over the contract term for agent commissions. The Company previously expensed these contract acquisition costs as incurred in selling, general and administrative expenses. Management assesses these costs for impairment at least quarterly and as triggering events occur that indicate it is more likely than not that an impairment exists.

The impact on the Company s financial statement line items from adopting ASC 606 was as follows (in thousands, except earnings per share). There was no net impact on net cash provided by operating activities.

Financial Statement Line Items	As Reported September 30, 2018	Balances Without the Adoption of ASC 606
Balance Sheet		
Prepaid expenses and other current assets	$ 32,956	$ 19,873
Deposits and other assets	$ 11,482	$ 6,072
Deferred tax assets	$ 6,326	$ 10,128
Accrued and other current liabilities	$ 46,728	$ 46,504
Other long term liabilities	$ 26,717	$ 27,865
Accumulated deficit	$ (590,035)	$ (604,588)
Statement of Comprehensive Income		
Three months ended September 30, 2018		
Service revenue	$ 130,139	$ 129,964
Selling, general and administrative expenses	$ 33,409	$ 33,331
Operating income	$ 22,255	$ 22,158
Net income	$ 8,231	$ 8,134
Basic earnings per share	$ 0.18	$ 0.18
Diluted earnings per share	$ 0.18	$ 0.18
Comprehensive income	$ 7,746	$ 7,649
Statement of Comprehensive Income		
Nine months ended September 30, 2018		
Service revenue	$ 388,144	$ 388,112
Selling, general and administrative expenses	$ 100,637	$ 101,962
Operating income	$ 64,250	$ 62,893
Net income	$ 21,567	$ 20,210
Basic earnings per share	$ 0.48	$ 0.45
Diluted earnings per share	$ 0.47	$ 0.44
Comprehensive income	$ 17,495	$ 16,209

	September 30, 2018	At Adoption January 1, 2018
Customer contract costs current portion (included in prepaid and other current assets)	$ 13,083	$ 11,893

Customer contract costs	non-current portion (included in deposits and other assets)	5,410	5,400
Deferred revenue	current portion (included in accrued and other current liabilities)	4,280	3,846
Deferred revenue	non-current portion (included in other long-term liabilities)	1,762	2,865

Service revenue recognized from amounts in deferred revenue at the beginning of the period during the three months ended September 30, 2018 was $1.9 million and during the nine months ended September 30, 2018 was $5.8 million. Amortization expense for contract costs was $4.2 million for the three months ended September 30, 2018 and $12.5 million for the nine months ended September 30, 2018.

Revenue recognition

The Company s service offerings consist of on-net and off-net telecommunications services. Fixed fees are billed monthly in advance and usage fees are billed monthly in arrears. Amounts billed are due upon receipt and contract lengths range from month to month to 60 months. The Company satisfies its performance obligations to provide services to customers over time as the services are rendered. In accordance with ASC 606, revenue is recognized when a customer obtains the promised service. The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for these services. The Company has adopted the practical expedient related

Table of Contents

to certain performance obligation disclosures since it has a right to consideration from its customer in an amount that corresponds directly with the value to the customer of the Company s performance completed to date.

To achieve this core principle, the Company followed the following five steps:

1) Identification of the contract, or contracts with a customer

2) Identification of the performance obligations in the contract

3) Determination of the transaction price

4) Allocation of the transaction price to the performance obligations in the contract

5) Recognition of revenue when, or as, we satisfy a performance obligation

Fees billed in connection with customer installations are deferred (as deferred revenue) and recognized as noted above. To the extent a customer contract is terminated prior to its contractual end the customer is subject to termination fees. The Company vigorously seeks payment of these amounts. The Company recognizes revenue for these amounts as they are collected.

Recent Accounting Pronouncements to be Adopted

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (ASU 2016-02). ASU 2016-02 will replace most existing lease accounting guidance when it becomes effective. ASU 2016-02 is effective for the Company beginning on January 1, 2019. Early application is permitted. In July 2018 the FASB approved an Accounting Standards Update which, among other changes, allows a company to elect to adopt ASU 2016-02 using a cumulative effect adjustment to the opening balance of its retained earnings on the adoption date. ASU 2016-02 will require the Company to record a right to use asset and a lease liability for most of its leases, including its leases currently treated as operating leases. The Company is continuing to evaluate the effect that ASU 2016-02 will have on its consolidated financial statements and related disclosures and the Company will elect to apply certain practical expedients. The Company estimates that the effect of ASU 2016-02 would be to record a right to use asset and lease liability totaling approximately $95 million. The estimated lease liability is not considered a liability under the consolidated leverage ratio calculations in the indentures governing the Company s senior unsecured and senior secured note obligations. The Company will not early adopt ASU 2016-02 and will adopt the standard using the modified retrospective approach with a cumulative-effect adjustment on January 1, 2019.

In September 2016, the FASB issued ASU No. 2016-13, *Financial Instruments Credit Losses: Measurement of Credit Losses on Financial Instruments.* This guidance is intended to introduce a revised approach to the recognition and measurement of credit losses, emphasizing an updated model based on expected losses rather than incurred losses. This new standard is effective for annual and interim reporting periods beginning after December 15, 2019 and early adoption is permitted. The Company is currently evaluating the impact that this guidance may have on its financial statements and related disclosures.

2. Property and equipment:

Depreciation and amortization expense related to property and equipment and capital leases was $20.3 million and $19.1 million for the three months ended September 30, 2018, and 2017 respectively, and $60.3 million and $56.6 million for the nine months ended September 30, 2018 and 2017, respectively. The Company capitalized salaries and related benefits of employees working directly on the construction and build-out of its network of $2.6 million and $2.5 million for the three months ended September 30, 2018 and 2017, respectively, and $7.9 million and $7.2 million for the nine months ended September 30, 2018 and 2017, respectively.

Exchange agreement

In the three and nine months ended September 30, 2018 and 2017, the Company exchanged certain used network equipment and cash consideration for new network equipment. The fair value of the equipment received was estimated to be $1.5 million and $1.0 million for the three months ended September 30, 2018 and 2017, respectively, and $3.0 million and $7.9 million for the nine months ended September 30, 2018 and 2017, respectively and after considering the cash component the transactions resulted in gains of $0.4 million and $0.4 million for the three months ended September 30, 2018 and 2017, respectively, and $0.9 million and $3.5 million for the nine months ended September 30, 2018 and 2017, respectively. The estimated fair value of the equipment received was based upon the cash consideration price the Company pays for the new network equipment on a standalone basis (Level 3).

Installment payment agreement

In March 2015, the Company entered into an installment payment agreement (IPA) with a vendor. Under the IPA the Company may purchase network equipment in exchange for interest free note obligations each with a twenty-four month term. There are no payments under each note obligation for the first nine months followed by eighteen equal installment payments for the remaining eighteen month term. As of September 30, 2018, and December 31, 2017 there was $12.5 million and $10.7 million, respectively, of note obligations outstanding under the IPA, secured by the related equipment. The Company recorded the assets purchased and the net present value of the note obligation utilizing an imputed interest rate. The resulting discount was $0.5 million and $0.4 million as of September 30, 2018 and December 31, 2017, respectively, and is being amortized over the note term using the effective interest rate method.

Table of Contents

3. Long-term debt:

Limitations under the indentures

The Company has $189.2 million of senior notes and $445.0 million of senior secured notes outstanding. The $189.2 million of senior notes are due on April 15, 2021 (the 2021 Notes) and bear interest at a rate of 5.625% per year. Interest is paid semi-annually on April 15 and October 15. The $445.0 million of senior secured notes are due on March 1, 2022 (the 2022 Notes) and bear interest at a rate of 5.375% per year. Interest is paid semi-annually on March 1 and September 1. In August 2018, the Company issued an additional $70.0 million par value of its 2022 Notes at a premium of 101.75% of par value increasing the par value outstanding from $375.0 million to $445.0 million. The Company received net proceeds of $69.9 million after deducting $1.4 million of offering costs. The $1.2 million premium and offering costs are being amortized to interest expense to the maturity date using the effective interest rate method. The net proceeds from this offering are intended to be used for general corporate purposes.

The indentures governing the 2022 Notes and 2021 Notes, among other things, limit the ability of Group (the company owned by Holdings which owns the operating companies) 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 its affiliates. Limitations on the ability to incur additional indebtedness (excluding IRU agreements incurred in the normal course of business) include a restriction on incurring additional indebtedness if Group s consolidated leverage ratio, as defined in the indentures, is greater than 5.0. The indentures prohibit certain payments, such as dividends and stock purchases, when Group s consolidated leverage ratio, as defined by the indentures, is greater than 4.25. A certain amount of such unrestricted payments is permitted notwithstanding this prohibition. The unrestricted payment amount may be increased by Group s consolidated cash flow, as defined in the indentures, as long as the Group s consolidated leverage ratio is less than 4.25. Group s consolidated leverage ratio was above 4.25 as of September 30, 2018. As of September 30, 2018, a total of $163.5 million ($162.2 million held by Holdings in cash) was permitted for investment payments including dividends to Holdings.

4. Commitments and contingencies:

Current and potential litigation

In accordance with the accounting guidance for contingencies, the Company accrues its 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, the Company accrues at the low end of the range. The Company reviews its accruals at least quarterly and adjusts them to reflect the impact of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular matter. The Company has taken certain positions related to its obligations for leased circuits for which it is reasonably possible could result in a loss of up to $2.8 million in excess of the amount accrued at September 30, 2018.

The Company is engaged in an arbitration proceeding in Spain in which a former provider of optical fiber to the Company is seeking approximately $9 million for the Company s early termination of the optical fiber leases, which amount the Company accrued in 2015. The Company has counterclaimed for damages and is contesting its obligation to pay the termination liability in an arbitration proceeding in Spain.

The arbitration is being conducted by the Civil and Commercial Arbitration Court (CIMA) in Madrid, Spain.

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

5. Income taxes:

The components of income before income taxes consist of the following (in thousands):

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Domestic	$ 16,652	$ 12,210	$ 46,234	$ 37,266
Foreign	(5,227)	(5,124)	(15,714)	(14,627)
Total	$ 11,425	$ 7,086	$ 30,520	$ 22,639

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act (the Act). The Act amended the Internal Revenue Code and reduced the corporate tax rate from a maximum of 35% to a flat 21% rate. The rate reduction was effective on January 1, 2018. The Company s net deferred tax assets represent a decrease in corporate taxes expected to be paid in the future. Under generally accepted accounting principles deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets

Table of Contents

and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Although the tax rate reduction is known, the Company has not collected all of the necessary data to complete its analysis of the effect of the Tax Act on all of its underlying deferred taxes and as such, the amounts recorded are provisional. The actual impact on the Company s net deferred tax asset may vary from this amount from certain changes in interpretations of the Act, additional guidance issued by the U.S. Treasury Department, the IRS, and other standard-setting bodies, additional data collected and revisions to assumptions that the Company has made. Those adjustments may materially impact the Company s provision for income taxes and effective tax rate in the period in which the adjustments are made. The accounting for the tax effects of the Tax Act will be completed in 2018.

6. Common stock buyback program:

The Company s Board of Directors has approved purchases of the Company s common stock under a buyback program (the Buyback Program) through December 31, 2019. At September 30, 2018, there was approximately $41.5 million remaining for purchases under the Buyback Program. During the nine months ended September 30, 2017 the Company purchased 46,750 shares of its common stock for $1.8 million. There were no purchases of common stock during the three and nine months ended September 30, 2018.

7. Dividends on common stock:

Dividends are recorded as a reduction to retained earnings. Dividends on unvested restricted shares of common stock are paid as the awards vest. The Company s initial quarterly dividend payment was made in the third quarter of 2012. On October 31, 2018, the Company s Board of Directors approved the payment of a quarterly dividend of $0.56 per common share. This dividend for the fourth quarter of 2018 will be paid to holders of record on November 16, 2018. This estimated $25.3 million dividend payment is expected to be made on November 30, 2018.

The payment of any future dividends and any other returns of capital, including stock buybacks will be at the discretion of the Company s Board of Directors and may be reduced, eliminated or increased and will be dependent upon the Company s financial position, results of operations, available cash, cash flow, capital requirements, limitations under the Company s debt indentures and other factors deemed relevant by the Company s Board of Directors. The Company is a Delaware Corporation and under the General Corporate Law of the State of Delaware distributions may be restricted including a restriction that distributions, including stock purchases and dividends, do not result in an impairment of a corporation s capital, as defined under Delaware Law. The indentures governing the Company s notes limit the Company s ability to return cash to its stockholders.

8. Related party transactions:

Office leases

The Company s headquarters is located in an office building owned by Sodium LLC whose owner is the Company s Chief Executive Officer. The fixed annual rent for the headquarters building is $1.0 million per year plus an allocation of taxes and utilities. The lease began in May 2015 and the lease term is for five years which is cancellable by the Company upon 60 days notice. The Company s audit committee reviews and approves all transactions with related parties. The Company paid $0.5 million and $0.4 million in the three months ended September 30, 2018

and 2017, respectively, and $1.3 million and $1.3 million in the nine months ended September 30, 2018 and 2017, respectively, for rent and related costs (including taxes and utilities) to Sodium LLC for this lease.

9. Segment information:

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

Three months Ended September 30, 2018

Revenues	On net	Off-net	Non-core	Total
North America	$ 75,245	$ 32,111	$ 131	$ 107,487
Europe	17,869	3,945	16	21,830
Asia Pacific	676	146		822
Total	$ 93,790	$ 36,202	$ 147	$ 130,139

Three months Ended September 30, 2017

Revenues	On net	Off-net	Non-core	Total
North America	$ 70,313	$ 30,941	$ 196	$ 101,450
Europe	17,279	3,833	10	21,122
Asia Pacific	306	91		397
Total	$ 87,898	$ 34,865	$ 206	$ 122,969

Nine months Ended September 30, 2018

Revenues	On net	Off-net	Non-core	Total
North America	$ 222,391	$ 96,131	$ 444	$ 318,966
Europe	55,128	11,913	42	67,083
Asia Pacific	1,686	409		2,095
Total	$ 279,205	$ 108,453	$ 486	$ 388,144

Nine months Ended September 30, 2017

Revenues	On net	Off-net	Non-core	Total
North America	$ 207,263	$ 91,064	$ 615	$ 298,942
Europe	49,003	10,923	33	59,959
Asia Pacific	805	243		1,048
Total	$ 257,071	$ 102,230	$ 648	$ 359,949

	September 30, 2018	December 31, 2017
Long lived assets, net		
North America	$ 279,382	$ 282,112
Europe	101,283	99,194
Total	$ 380,665	$ 381,306

The majority of North American revenue consists of services delivered within the United States.

Table of Contents

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

You should read the following discussion and analysis together with our condensed consolidated financial statements and related notes included in this report. The discussion in this report contains forward-looking statements that involve risks and uncertainties, such as statements of our plans, objectives, expectations and intentions. The cautionary statements made in this report should be read as applying to all related forward-looking statements wherever they appear in this report. Our actual results could differ materially from those discussed here. Factors that could cause or contribute to these differences include, 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 US dollar and Canadian dollar to US dollar exchange rates) on the translation of our non-US dollar denominated revenues, expenses, assets and liabilities; legal and operational difficulties in new markets; the imposition of a requirement that we contribute to the US Universal Service Fund on the basis of our Internet revenue; changes in government policy and/or regulation, including rules regarding data protection, cyber security and net neutrality; 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, our annual report on Form 10-K for the year ended December 31, 2017.

General Overview

We are a leading facilities-based provider of low-cost, high-speed Internet access, private network services and data center colocation space. Our network is specifically designed and optimized to transmit packet routed data. We deliver our services primarily to small and medium-sized businesses, communications service providers and other bandwidth-intensive organizations in North America, Europe and in Asia.

Our on-net service consists of high-speed Internet access and private network services provided at speeds ranging from 100 Megabits per second to 100 Gigabits per second. We offer our on-net services to customers located in buildings that are physically connected to our network. We provide on-net Internet access and private network services to corporate customers and net-centric customers. Our corporate customers are located in multi-tenant office buildings and in our data centers and typically include law firms, financial services firms, advertising and marketing firms and other professional services businesses. Our net-centric customers include bandwidth-intensive users such as other Internet access providers, telephone companies, cable television companies, web hosting companies, content delivery networks and commercial content and application service providers. These net-centric customers generally receive our services in carrier neutral colocation facilities and in our data centers.

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 metropolitan Ethernet 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, are actively discontinuing providing certain of these services and we 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 2,635 buildings in which we provide our on-net services, including 1,720 multi-tenant office buildings. We also provide on-net services in carrier-neutral data centers, Cogent controlled

Table of Contents

data centers and single-tenant office buildings. We operate 52 Cogent controlled data centers totaling 588,000 square feet. Because of our integrated network architecture, we are not dependent on local telephone companies or cable 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 of 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 and a decline in Internet access prices on a per megabit basis. 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 an expected decline in our per unit pricing. We do not know if Internet traffic will increase or decrease, or the rate at which it will increase or decrease. Changes in Internet traffic will be a function of the number of Internet users, the amount of time users spend on the Internet, 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 vast 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. Over the past several years, our revenue from corporate customers has grown faster than our revenue from our net-centric customers.

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 in Europe, Canada, Mexico and Asia. Europe accounts for roughly 75% of our foreign operations. Our European operations have incurred losses and will continue to do so until our European customer base and revenues have grown enough to achieve sufficient economies of scale.

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 and the addition of on-net buildings. We plan to continue to expand our network and to increase the number of on-net buildings we serve including multi-tenant office buildings, carrier neutral data centers and Cogent controlled 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, the cost to connect buildings to our network and equipment availability.

Three Months Ended September 30, 2018 Compared to the Three Months Ended September 30, 2017

The following summary table presents a comparison of our results of operations with respect to certain key financial measures. The comparisons illustrated in the table are discussed in greater detail below.

	Three months ended September 30,		
	2018	2017	Percent Change
	(in thousands)		
Service revenue	$ 130,139	$ 122,969	5.8%
On-net revenue	93,790	87,898	6.7%
Off-net revenue	36,202	34,865	3.8%
Network operations expenses (1)	54,615	53,584	1.9%
Selling, general, and administrative expenses (2)	33,409	32,915	1.5%
Gains on equipment transactions	416	397	4.8%
Depreciation and amortization expenses	20,276	19,147	5.9%
Interest expense	12,767	12,266	4.1%
Income tax provision	3,194	3,436	(7.0)%

(1) Includes equity-based compensation expenses of $250 and $179 in the three months ended September 30, 2018 and 2017, respectively.

(2) Includes equity-based compensation expenses of $4,571 and $3,555 in the three months ended September 30, 2018 and 2017, respectively.

Table of Contents

	Three Months Ended September 30, 2018		2017		Percent Change
Other Operating Data					
Average Revenue Per Unit (ARPU)					
ARPU on net	$	471	$	502	(6.2)%
ARPU off-net	$	1,140	$	1,220	(6.6)%
Average Price per Megabit installed base	$	0.78	$	1.08	(27.6)%
Customer Connections end of period					
On-net		67,370		59,357	13.5%
Off-net		10,698		9,724	10.0%

Service Revenue. Our service revenue increased 5.8% for the three months ended September 30, 2018 from the three months ended September 30, 2017. The impact of exchange rates resulted in a decrease in revenues for the three months ended September 30, 2018 of approximately $0.4 million. Any foreign currency comparisons herein reflect our third quarter 2018 results translated at the average foreign currency exchange rates for the third quarter of 2017. We increased our total service revenue by increasing the number of sales representatives selling our services, by expanding our network, by adding additional buildings to our network, by increasing our penetration into the buildings connected to our network and by gaining market share by offering our services at lower prices than our competitors.

Revenue recognition standards include guidance relating to any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, gross receipts taxes, Universal Service Fund fees and certain state regulatory fees. We record these taxes billed to our customers on a gross basis (as service revenue and network operations expense) in our consolidated statements of operations. The impact of these taxes including the Universal Service Fund resulted in an increase in our revenues for the three months ended September 30, 2018 from the three months ended September 30, 2017 of approximately $0.3 million.

Our 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. Revenues from our corporate and net-centric customers represented 65.7% and 34.3% of total service revenue, respectively, for the three months ended September 30, 2018 and represented 62.2% and 37.8% of total service revenue, respectively, for the three months ended September 30, 2017. Revenues from corporate customers increased 11.8% to $85.5 million for the three months ended September 30, 2018 from the three months ended September 30, 2017 primarily due to an increase in our number of our corporate customers. Revenues from our net-centric customers decreased by 4.0% to $44.6 million for the three months ended September 30, 2018 from the three months ended September 30, 2017 primarily due to an increase in our number of net-centric customers being offset by a decline in our average price per megabit. Our revenue from our net-centric customers has declined as a percentage of our total revenue and grew at a slower rate than our corporate customer revenue because net-centric customers purchase our services based upon a price per megabit basis and our average price per megabit declined by 27.6% from the three months ended September 30, 2017 to the three months ended September 30, 2018. Additionally, the net-centric market experiences a greater level of pricing pressure than the corporate market and net-centric customers who renew their service with us expect their renewed service to be at a lower price than their current price. We expect that our average price per megabit will continue to decline at similar rates which would result in our corporate revenues continuing to represent a greater portion of our total revenues and our net-centric revenues continuing to grow at a lower rate than our corporate revenues. Additionally, the impact of foreign exchange rates has a more significant impact on our net-centric revenues.

Our on-net revenues increased 6.7% for the three months ended September 30, 2018 from the three months ended September 30, 2017. We increased the number of our on-net customer connections by 13.5% at September 30, 2018 from September 30, 2017. On-net customer connections increased at a greater rate than on-net revenues primarily due to the 6.2% decline in our on-net ARPU, primarily from a decline in ARPU for our net-centric customers. ARPU is determined by dividing revenue for the period by the average customer connections for that

period. Our average price per megabit for our installed base of customers is determined by dividing the aggregate monthly recurring fixed charges for those customers by the aggregate committed data rate for the same customers. The decline in on-net ARPU is partly attributed to volume and term based pricing discounts. Additionally, on-net customers who cancel their service from our installed base of customers, in general, have an ARPU that is greater than the ARPU for our new customers due to declining prices primarily for our on-net services sold to our net-centric customers. These trends resulted in the reduction to our on-net ARPU and a 27.6% decline in our average price per megabit for our installed base of customers.

Our off-net revenues increased 3.8% for the three months ended September 30, 2018 from the three months ended September 30, 2017. Our off-net revenues increased as we increased the number of our off-net customer connections by 10.0% at September 30, 2018 from September 30, 2017. Our off-net customer connections increased at a greater rate than our off-net revenue primarily due to the 6.6% decrease in our off-net ARPU.

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, access and facilities fees paid to building owners and excise taxes billed to our customers and recorded on a gross basis. Non-cash equity-based compensation

Table of Contents

expense is included in network operations expenses consistent with the classification of the employee s salary and other compensation. Our network operations expenses, including non-cash equity-based compensation expense, increased 1.9% for the three months ended September 30, 2018 from the three months ended September 30, 2017 as we are connected to 12.9% more customer connections and we were connected to 163 more on-net buildings as of September 30, 2018 compared to September 30, 2017. The increase in network operations expense is primarily attributable to an increase in costs related to our network and facilities expansion activities and the increase in our off-net revenues. When we provide off-net services we also assume the cost of the associated tail circuits.

Selling, General, and Administrative (SG&A) Expenses. Our SG&A expenses, including non-cash equity-based compensation expense, increased by 1.5% for the three months ended September 30, 2018 from the three months ended September 30, 2017. 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 $4.6 million for the three months ended September 30, 2018 and $3.6 million for the three months ended September 30, 2017. SG&A expenses increased primarily from an increase in salaries and related costs required to support our expansion and the increase in our sales efforts, partly offset by the impact of the new revenue accounting standard which requires us to capitalize certain commissions paid to our sales agents and sales employees. Our sales force headcount increased from 565 at September 30, 2017 to 583 at September 30, 2018 and our total headcount increased from 919 at September 30, 2017 to 938 at September 30, 2018.

Gains on Equipment Transactions. In the three months ended September 30, 2018 and September 30, 2017, we exchanged certain used network equipment and cash consideration for new network equipment resulting in gains of $0.4 million and $0.4 million, respectively, based upon the estimated fair value of the new network equipment less the carrying amount of the returned used network equipment and the cash paid.

Depreciation and Amortization Expenses. Our depreciation and amortization expense increased by 5.9% for the three months ended September 30, 2018 from the three months ended September 30, 2017. The increase is primarily due to the depreciation expense associated with the increase in deployed fixed assets.

Interest Expense. Interest expense results from interest incurred on our $445.0 million of senior secured notes, interest incurred on our $189.2 million of senior unsecured notes, interest on our installment payment agreement and interest on our capital lease obligations. Our interest expense increased by 4.1% for the three months ended September 30, 2018 from the three months ended September 30, 2017 primarily due to the issuance of $70.0 million of senior secured notes in August 2018 and an increase in our capital lease obligations.

Income Tax Provision. Our income tax provision was $3.2 million for the three months ended September 30, 2018 and $3.4 million for the three months ended September 30, 2017. The reduction is primarily due to the impact of the reduction in the corporate income tax rate from a maximum of 35% to a flat 21% rate that was effective on January 1, 2018.

Buildings On-net. As of September 30, 2018 and 2017, we had a total of 2,635 and 2,472 on-net buildings connected to our network, respectively. The increase in on-net buildings was a result of our disciplined network expansion program. We anticipate adding a similar number of buildings to our network for the next several years.

Nine Months Ended September 30, 2018 Compared to the Nine Months Ended September 30, 2017

The following summary table presents a comparison of our results of operations with respect to certain key financial measures. The comparisons illustrated in the table are discussed in greater detail below.

	Nine months ended September 30,		
	2018	2017	Percent Change
	(in thousands)		
Service revenue	$ 388,144	$ 359,949	7.8%
On-net revenue	279,205	257,071	8.6%
Off-net revenue	108,453	102,230	6.1%
Network operations expenses (1)	163,868	155,362	5.5%
Selling, general, and administrative expenses (2)	100,637	96,165	4.7%
Gains on equipment transactions	891	3,543	(74.9)%
Depreciation and amortization expenses	60,280	56,583	6.5%
Interest expense	37,547	36,245	3.6%
Income tax provision	8,953	10,536	(15.0)%

(1) Includes equity-based compensation expenses of $671 and $431 in the nine months ended September 30, 2018 and 2017, respectively.

(2) Includes equity-based compensation expenses of $12,629 and $9,175 in the nine months ended September 30, 2018 and 2017, respectively.

Table of Contents

	Nine Months Ended September 30, 2018	2017	Percent Change
Other Operating Data			
Average Revenue Per Unit (ARPU)			
ARPU on net	$ 482	$ 509	(5.3)%
ARPU off-net	$ 1,167	$ 1,240	(5.9)%
Average Price per Megabit installed base	$ 0.85	$ 1.15	(25.8)%
Customer Connections end of period			
On-net	67,370	59,357	13.5%
Off-net	10,698	9,724	10.0%

Service Revenue. Our service revenue increased 7.8% for the nine months ended September 30, 2018 from the nine months ended September 30, 2017. The impact of exchange rates resulted in an increase in revenues for the nine months ended September 30, 2018 of approximately $4.9 million. Any foreign currency comparisons herein reflect our results for the nine months ended September 30, 2018 translated at the average foreign currency exchange rates for the nine months ended September 30, 2017. We increased our total service revenue by increasing the number of sales representatives selling our services, by expanding our network, by adding additional buildings to our network, by increasing our penetration into the buildings connected to our network and by gaining market share by offering our services at lower prices than our competitors.

Revenue recognition standards include guidance relating to any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, gross receipts taxes, Universal Service Fund fees and certain state regulatory fees. We record these taxes billed to our customers on a gross basis (as service revenue and network operations expense) in our consolidated statements of operations. The impact of these taxes including the Universal Service Fund resulted in an increase in our revenues for the nine months ended September 30, 2018 from the nine months ended September 30, 2017 of approximately $1.3 million.

Our 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. Revenues from our corporate and net-centric customers represented 64.4% and 35.6% of total service revenue, respectively, for the nine months ended September 30, 2018 and represented 62.0% and 38.0% of total service revenue, respectively, for the nine months ended September 30, 2017. Revenues from corporate customers increased 11.9% to $249.9 million for the nine months ended September 30, 2018 from the nine months ended September 30, 2017 primarily due to an increase in our number of our corporate customers. Revenues from our net-centric customers increased by 1.2% to $138.2 million for the nine months ended September 30, 2018 from the nine months ended September 30, 2017 primarily due to an increase in our number of net-centric customers, partially offset by a decline in our average price per megabit. Our revenue from our net-centric customers has declined as a percentage of our total revenue and grew at a slower rate than our corporate customer revenue because net-centric customers purchase our services based upon a price per megabit basis and our average price per megabit declined by 25.8% from the nine months ended September 30, 2017 to the nine months ended September 30, 2018. Additionally, the net-centric market experiences a greater level of pricing pressure than the corporate market and net-centric customers who renew their service with us expect their renewed service to be at a lower price than their current price. We expect that our average price per megabit will continue to decline at similar rates which would result in our corporate revenues continuing to represent a greater portion of our total revenues and our net-centric revenues continuing to grow at a lower rate than our corporate revenues. Additionally, impact of foreign exchange rates has a more significant impact on our net-centric revenues.

Our on-net revenues increased 8.6% for the nine months ended September 30, 2018 from the nine months ended September 30, 2017. We increased the number of our on-net customer connections by 13.5% at September 30, 2018 from September 30, 2017. On-net customer connections increased at a greater rate than on-net revenues primarily due to the 5.3% decline in our on-net ARPU, primarily from a decline in ARPU for our net-centric customers. ARPU is determined by dividing revenue for the period by the average customer connections for that

period. Our average price per megabit for our installed base of customers is determined by dividing the aggregate monthly recurring fixed charges for those customers by the aggregate committed data rate for the same customers. The decline in on-net ARPU is partly attributed to volume and term based pricing discounts. Additionally, on-net customers who cancel their service from our installed base of customers, in general, have an ARPU that is greater than the ARPU for our new customers due to declining prices primarily for our on-net services sold to our net-centric customers. These trends resulted in the reduction to our on-net ARPU and a 25.8% decline in our average price per megabit for our installed base of customers.

Our off-net revenues increased 6.1% for the nine months ended September 30, 2018 from the nine months ended September 30, 2017. Our off-net revenues increased as we increased the number of our off-net customer connections by 10.0% at September 30, 2018 from September 30, 2017. Our off-net customer connections increased at a greater rate than our off-net revenue primarily due to the 5.9% decrease in our off-net ARPU.

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, access and facilities fees paid to building owners and excise taxes billed to our customers and recorded on a gross basis. 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, including non-cash equity-based compensation expense, increased 5.5% for the nine months ended September 30, 2018 from the nine months ended September 30, 2017 as we are connected to 12.9% more customer connections and we were

Table of Contents

connected to 163 more on-net buildings as of September 30, 2018 compared to September 30, 2017. The increase in network operations expense is primarily attributable to an increase in costs related to our network and facilities expansion activities and the increase in our off-net revenues. When we provide off-net services we also assume the cost of the associated tail circuits.

Selling, General, and Administrative (SG&A) Expenses. Our SG&A expenses, including non-cash equity-based compensation expense, increased by 4.7% for the nine months ended September 30, 2018 from the nine months ended September 30, 2017. 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 $12.6 million for the nine months ended September 30, 2018 and $9.2 million for the nine months ended September 30, 2017. SG&A expenses increased primarily from an increase in salaries and related costs required to support our expansion and the increase in our sales efforts, partly offset by the impact of the new revenue accounting standard which requires us to capitalize certain commissions paid to our sales agents and sales employees. Our sales force headcount increased from 565 at September 30, 2017 to 583 at September 30, 2018 and our total headcount increased from 919 at September 30, 2017 to 938 at September 30, 2018.

Gains on Equipment Transactions. In the nine months ended September 30, 2018 and September 30, 2017, we exchanged certain used network equipment and cash consideration for new network equipment resulting in gains of $0.9 million and $3.5 million, respectively, based upon the estimated fair value of the new network equipment less the carrying amount of the returned used network equipment and the cash paid. The reduction in gains from the nine months ended September 30, 2017 to the nine months ended September 30, 2018 was due to purchasing more equipment under the exchange program in the nine months ended September 30, 2017 than the nine months ended September 30, 2018.

Depreciation and Amortization Expenses. Our depreciation and amortization expense increased by 6.5% for the nine months ended September 30, 2018 from the nine months ended September 30, 2017. The increase is primarily due to the depreciation expense associated with the increase in deployed fixed assets.

Interest Expense. Interest expense results from interest incurred on our $445.0 million of senior secured notes, interest incurred on our $189.2 million of senior unsecured notes, interest on our installment payment agreement and interest on our capital lease obligations. Our interest expense increased by 3.6% for the nine months ended September 30, 2018 from the nine months ended September 30, 2017 primarily due to the issuance of $70.0 million of senior secured notes in August 2018 and an increase in our capital lease obligations.

Income Tax Provision. Our income tax provision was $9.0 million for the nine months ended September 30, 2018 and $10.5 million for the nine months ended September 30, 2017. The reduction is primarily due to the impact of the reduction in the corporate income tax rate from a maximum of 35% to a flat 21% rate that was effective on January 1, 2018.

Buildings On-net. As of September 30, 2018 and 2017, we had a total of 2,635 and 2,472 on-net buildings connected to our network, respectively. The increase in on-net buildings was a result of our disciplined network expansion program. We anticipate adding a similar number of buildings to our network for the next several years.

Liquidity and Capital Resources

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

Cash Flows

The following table sets forth our consolidated cash flows.

	Nine months ended September 30,	
(in thousands)	**2018**	**2017**
Net cash provided by operating activities	$ 93,195	$ 80,342
Net cash used in investing activities	(39,000)	(35,183)
Net cash used in financing activities	(15,035)	(72,285)
Effect of exchange rates changes on cash	(1,613)	3,572
Net increase (decrease) in cash and cash equivalents	$ 37,547	$ (23,554)

Net Cash Provided by Operating Activities. Our primary sources of operating cash are receipts from our customers who are billed on a monthly basis for our services. Our primary uses of operating cash are payments made to our vendors, employees and interest payments made to our capital lease vendors and our note holders. Our changes in cash provided by operating activities are primarily due to changes in our operating profit. Cash provided by operating activities for the nine months ended September 30, 2018 and 2017 includes interest payments on our note obligations of $27.4 million and $25.5 million, respectively.

Net Cash Used In Investing Activities. Our primary use of cash for investing activities is for purchases of property and equipment. Purchases of property and equipment were $39.0 million and $35.2 million for the nine months ended September 30, 2018 and 2017, respectively. The 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.

Table of Contents

Net Cash Used In Financing Activities. Our primary uses of cash for financing activities are for principal payments under our capital lease obligations and our installment payment agreement, purchases of our common stock and dividend payments. Principal payments under our capital lease obligations were $8.2 million and $9.4 million for the nine months ended September 30, 2018 and 2017, respectively. Principal payments under our installment payment agreement were $6.9 million and $2.2 million for the nine months ended September 30, 2018 and 2017, respectively. During the nine months ended September 30, 2018 and 2017 we paid $71.4 million and $59.8 million, respectively, for our quarterly dividend payments. During the nine months ended September 30, 2017 we paid $1.8 million for purchases of our common stock. There were no purchases of our common stock in the nine months ended September 30, 2018. During the nine months ended September 30, 2018 we raised net proceeds of $69.9 million from the issuance of $70.0 million of face value of our senior secured notes.

Cash Position and Indebtedness

Our total indebtedness at September 30, 2018 was $808.3 million and our total cash and cash equivalents were $284.6 million. Our total indebtedness at September 30, 2018 includes $161.6 million of capital lease obligations for dark fiber under long term IRU agreements.

Summarized Financial Information of Holdings

Holdings is not a restricted subsidiary as defined under the indentures governing our 2021 Notes and our 2022 Notes. Holdings is a guarantor under these notes. Under the indentures we are required to disclose financial information of Holdings including its assets, liabilities and its operating results (Holdings Financial Information). The Holdings Financial Information as of and for the nine months ended September 30, 2018 is detailed below (in thousands).

		September 30, 2018 (Unaudited)
Cash and cash equivalents	$	162,194
Accrued interest receivable		164
Total assets	$	162,358
Investment from subsidiaries	$	311,810
Common stock		46
Accumulated deficit		(149,498)
Total equity	$	162,358

		Nine Months Ended September 30, 2018 (Unaudited)
Equity-based compensation expense	$	14,601
Interest income		762
Net loss	$	(13,839)

Common Stock Buyback Program

Our Board of Directors has approved purchases of our common stock under a buyback program (the Buyback Program). During the three and nine months ended September 30, 2017 we purchased 46,750 shares of our common stock for $1.8 million. There were no purchases of our common stock in the nine months ended September 30, 2018. As of September 30, 2018, there was a total of $41.5 million available under the Buyback Program which is authorized to continue through December 31, 2019.

Dividends on Common Stock and Return of Capital Program

Dividends are recorded as a reduction to retained earnings. Dividends on unvested restricted shares of common stock are paid as the awards vest. Our initial quarterly dividend payment was made in the third quarter of 2012. On October 31, 2018, our Board of Directors approved the payment of our quarterly dividend of $0.56 per common share. This dividend for the fourth quarter of 2018 will be paid to holders of record on November 16, 2018. This estimated $25.3 million dividend payment is expected to be made on November 30, 2018.

The payment of any future dividends and any other returns of capital, including stock buybacks, will be at the discretion of our Board of Directors and may be reduced, eliminated or increased and will be dependent upon our financial position, results of operations, available cash, cash flow, capital requirements, limitations under our debt indentures and other factors deemed relevant by the our Board of Directors. We are a Delaware Corporation and under the General Corporate Law of the State of Delaware distributions may be restricted including a restriction that distributions, including stock purchases and dividends, do not result in an impairment of a corporation s capital, as defined under Delaware Law. The indentures governing our notes limit our ability to return cash to our stockholders. See Note 3 of our interim condensed consolidated financial statements for additional discussion of limitations on distributions.

Table of Contents

Contractual Obligations and Commitments

There have been no material changes to our contractual obligations and commitments included in Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations of our annual report on Form 10-K for the year ended December 31, 2017 except for the $70.0 million of par value of senior secured notes we issued in August 2018.

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 for the next twelve months 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.

We may need to or elect to refinance all or a portion of our indebtedness at or before maturity and we cannot provide assurances that we will be able to refinance any such indebtedness on commercially reasonable terms or at all. In addition, we may elect to secure additional capital in the future, at acceptable terms, to improve our liquidity or fund acquisitions or for general corporate purposes. In addition, in an effort to reduce future cash interest payments as well as future amounts due at maturity or to extend debt maturities, we may, from time to time, issue new debt, enter into debt for debt, or cash transactions to purchase our outstanding debt securities in the open market or through privately negotiated transactions. We will evaluate any such transactions in light of the existing market conditions. The amounts involved in any such transaction, individually or in the aggregate, may be material.

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 risks that could arise if we had engaged in these relationships.

Critical Accounting Policies and Significant Estimates

Management believes that as of September 30, 2018, there have been no material changes to our critical accounting policies and significant estimates from those listed in Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations of our annual report on Form 10-K for the year ended December 31, 2017.

Recent Accounting Pronouncements

Recent Accounting Pronouncements to be Adopted

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (ASU 2016-02). ASU 2016-02 will replace most existing lease accounting guidance when it becomes effective. ASU 2016-02 is effective for us beginning on January 1, 2019. Early application is permitted. In July 2018 the FASB approved an Accounting Standards Update which, among other changes, allows a company to elect to adopt ASU 2016-02 using a cumulative effect adjustment to the opening balance of its retained earnings on the adoption date. ASU 2016-02 will require us to record a right to use asset and a lease liability for most of our leases, including our leases currently treated as operating leases. We are continuing to evaluate the effect that ASU 2016-02 will have on our consolidated financial statements and related disclosures and we will elect to apply certain practical expedients. We estimate that the effect of ASU 2016-02 would be to record a right to use asset and lease liability totaling approximately $95 million. The estimated lease liability is not considered a liability under the consolidated leverage ratio calculations in our indentures governing our senior unsecured and senior secured note obligations. We will not early adopt ASU 2016-02 and we will adopt the standard using the modified retrospective approach with a cumulative-effect adjustment on January 1, 2019.

In September 2016, the FASB issued No. ASU 2016-13, *Financial Instruments Credit Losses: Measurement of Credit Losses on Financial Instruments.* This guidance is intended to introduce a revised approach to the recognition and measurement of credit losses, emphasizing an updated model based on expected losses rather than incurred losses. This new standard is effective for annual and interim reporting periods beginning after December 15, 2019 and early adoption is permitted. We are currently evaluating the impact that this guidance may have on our financial statements and related disclosures.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Management believes that as of September 30, 2018, there have been no material changes to our exposures to market risk from those disclosed in Item 7A Quantitative and Qualitative Disclosures About Market Risk, of our annual report on Form 10-K for the year ended December 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES.

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

Table of Contents

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

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

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are involved in legal proceedings in the ordinary course of our business that we do not expect to have a material impact on our operations or results of operations. Note 4 of our interim condensed consolidated financial statements includes information on these proceedings.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Our Board of Directors has authorized a plan to permit the repurchase of our common stock in negotiated and open market transactions through December 31, 2019. We may purchase shares from time to time depending on market, economic, and other factors. There were no purchases of our common stock during the third quarter of 2018.

ITEM 6. EXHIBITS.

(a) Exhibits

Exhibit Number	Description
3.2	Amended and Restated Bylaws of Cogent Communications Holdings, Inc. dated September 10, 2018 (filed as Exhibit 3.2 to the Company s Current Report on Form 8-K dated September 10, 2018 and incorporated herein by reference).
4.1	Second Supplemental Indenture related to the 5.375% Senior Secured Notes due 2022, dated as of August 20, 2018, among Cogent Communications Group, Inc., the guarantors named therein and Wilmington Trust, National Association, as trustree and collateral agent (filed as Exhibit 4.1 to the Company s Current Report on Form 8-K dated August 20, 2018 and incorporated herein by reference).
31.1	Certification of Chief Executive Officer (filed herewith)
31.2	Certification of Chief Financial Officer (filed herewith)

32.1	Certification of Chief Executive Officer (furnished herewith)
32.2	Certification of Chief Financial Officer (furnished herewith)
101.1	The following materials from the Registrant s Quarterly Report on Form 10-Q for the quarter ended September 30, 2018, formatted in Extensible Business Reporting Language (XBRL), include: (i) the Condensed Consolidated Statements of Comprehensive Income, (ii) the Condensed Consolidated Balance Sheets, (iii) the Condensed Consolidated Statements of Cash Flows, and (iv) related notes (filed herewith).

SIGNATURES

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

Date: November 1, 2018	**COGENT COMMUNICATIONS HOLDINGS, INC.**		
	By:	/s/ David Schaeffer	
		Name:	David Schaeffer
		Title:	Chief Executive Officer
Date: November 1, 2018	By:	/s/ Thaddeus G. Weed	
		Name:	Thaddeus G. Weed
		Title:	Chief Financial Officer (Principal Accounting Officer)