COGENT COMMUNICATIONS HOLDINGS, INC.
Form 10-Q
November 03, 2016
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# 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, 2016**

**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 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 x No 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 x | Accelerated filer o |
| Non-accelerated filer o<br>(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 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 45,486,222 Shares Outstanding as of October 31, 2016

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## PART I FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

### COGENT COMMUNICATIONS HOLDINGS, INC., AND SUBSIDIARIES

### CONDENSED CONSOLIDATED BALANCE SHEETS

### AS OF SEPTEMBER 30, 2016 AND DECEMBER 31, 2015

### (IN THOUSANDS, EXCEPT SHARE DATA)

| | September 30, 2016 (Unaudited) | December 31, 2015 |
|---|---|---|
| **Assets** | | |
| **Current assets:** | | |
| Cash and cash equivalents | $ 148,151 | $ 203,591 |
| Accounts receivable, net of allowance for doubtful accounts of $1,804 and $1,757, respectively | 33,487 | 30,718 |
| Prepaid expenses and other current assets | 20,642 | 17,030 |
| Total current assets | 202,280 | 251,339 |
| **Property and equipment, net** | 370,749 | 360,136 |
| **Deferred tax assets - noncurrent** | 36,716 | 45,142 |
| **Deposits and other assets - $132 and $355 restricted, respectively** | 7,877 | 6,199 |
| Total assets | $ 617,622 | $ 662,816 |
| | | |
| **Liabilities and stockholders equity** | | |
| **Current liabilities:** | | |
| Accounts payable | $ 13,019 | $ 12,401 |
| Accrued and other current liabilities | 41,790 | 38,355 |
| Installment payment agreement, current portion, net of discount of $106 and $678, respectively | 1,028 | 11,901 |
| Current maturities, capital lease obligations | 6,122 | 6,247 |
| Total current liabilities | 61,959 | 68,904 |
| **Senior secured 2022 notes, net of unamortized debt costs of $1,121 and $1,252, respectively** | 248,879 | 248,748 |
| **Senior unsecured 2021 notes, net of unamortized debt costs of $2,703 and $3,305, respectively** | 186,522 | 196,695 |
| **Capital lease obligations, net of current maturities** | 134,229 | 129,763 |
| **Other long term liabilities** | 26,519 | 30,977 |
| Total liabilities | 658,108 | 675,087 |
| **Commitments and contingencies:** | | |
| **Stockholders equity:** | | |
| Common stock, $0.001 par value; 75,000,000 shares authorized; 45,537,353 and 45,198,718 shares issued and outstanding, respectively | 45 | 45 |
| Additional paid-in capital | 442,125 | 434,161 |
| Accumulated other comprehensive income foreign currency translation | (11,898) | (14,693) |

| | | | | |
|---|---|---|---|---|
| Accumulated deficit | | (470,758) | | (431,784) |
| Total stockholders deficit | | (40,486) | | (12,271) |
| **Total liabilities and stockholders deficit** | $ | 617,622 | $ | 662,816 |

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

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**COGENT COMMUNICATIONS HOLDINGS, INC., AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2016 AND SEPTEMBER 30, 2015**

**(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)**

| | Three Months Ended September 30, 2016 (Unaudited) | Three Months Ended September 30, 2015 (Unaudited) |
|---|---|---|
| **Service revenue** | $ 113,057 | $ 103,017 |
| **Operating expenses:** | | |
| Network operations (including $161 and $126 of equity-based compensation expense, respectively, exclusive of depreciation and amortization shown separately below) | 48,827 | 45,182 |
| Selling, general, and administrative (including $2,830 and $2,578 of equity-based compensation expense, respectively) | 30,050 | 27,318 |
| Depreciation and amortization | 18,804 | 17,634 |
| Total operating expenses | 97,681 | 90,134 |
| **Gain on capital lease termination** | | 1,484 |
| **Gains on equipment transactions** | 687 | 1,152 |
| **Operating income** | 16,063 | 15,519 |
| **Interest income and other, net** | 207 | 50 |
| **Interest expense** | (9,891) | (10,002) |
| **Income before income taxes** | 6,379 | 5,567 |
| **Income tax provision** | (2,920) | (2,406) |
| **Net income** | $ 3,459 | $ 3,161 |
| | | |
| **Comprehensive income:** | | |
| Net income | $ 3,459 | $ 3,161 |
| Foreign currency translation adjustment | 688 | 228 |
| **Comprehensive income** | $ 4,147 | $ 3,389 |
| | | |
| **Net income per common share:** | | |
| **Basic and diluted net income per common share** | $ 0.08 | $ 0.07 |
| | | |
| **Dividends declared per common share** | $ 0.38 | $ 0.34 |
| | | |
| **Weighted-average common shares - basic** | 44,574,583 | 44,474,724 |
| | | |
| **Weighted-average common shares - diluted** | 44,776,918 | 44,702,127 |

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

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**COGENT COMMUNICATIONS HOLDINGS, INC., AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2016 AND SEPTEMBER 30, 2015**

**(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)**

| | Nine Months Ended September 30, 2016 (Unaudited) | Nine Months Ended September 30, 2015 (Unaudited) |
|---|---|---|
| **Service revenue** | $ 331,304 | $ 299,057 |
| **Operating expenses:** | | |
| Network operations (including $427 and $458 of equity-based compensation expense, respectively, exclusive of depreciation and amortization shown separately below) | 143,976 | 128,673 |
| Selling, general, and administrative (including $7,432 and $8,486 of equity-based compensation expense, respectively) | 89,403 | 85,922 |
| Depreciation and amortization | 55,161 | 52,517 |
| Total operating expenses | 288,540 | 267,112 |
| **Losses on debt purchases and installment loan repayment** | (587) | |
| **Gain on capital lease terminations** | | 11,593 |
| **Gains on equipment transactions** | 7,071 | 3,420 |
| **Loss on debt extinguishment and redemption** | | (10,144) |
| **Operating income** | 49,248 | 36,814 |
| **Interest income and other, net** | 677 | 566 |
| **Interest expense** | (30,200) | (31,000) |
| **Income before income taxes** | 19,725 | 6,380 |
| **Income tax provision** | (8,688) | (3,964) |
| **Net income** | $ 11,037 | $ 2,416 |
| | | |
| **Comprehensive income (loss):** | | |
| Net income | $ 11,037 | $ 2,416 |
| Foreign currency translation adjustment | 2,795 | (5,485) |
| **Comprehensive income (loss)** | $ 13,832 | $ (3,069) |
| | | |
| **Net income per common share:** | | |
| **Basic and diluted net income per common share** | $ 0.25 | $ 0.05 |
| | | |
| **Dividends declared per common share** | $ 1.11 | $ 1.11 |
| | | |
| **Weighted-average common shares - basic** | 44,563,279 | 44,907,505 |
| | | |
| **Weighted-average common shares - diluted** | 44,758,202 | 45,190,206 |

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

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**COGENT COMMUNICATIONS HOLDINGS, INC., AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2016 AND SEPTEMBER 30, 2015**

**(IN THOUSANDS)**

| | Nine months Ended September 30, 2016 (Unaudited) | Nine months Ended September 30, 2015 (Unaudited) |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 11,037 | $ 2,416 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 55,161 | 52,517 |
| Amortization of debt discount and premium | 879 | (10) |
| Equity-based compensation expense (net of amounts capitalized) | 7,859 | 8,944 |
| Losses on debt extinguishment and redemption | | 10,144 |
| Gain on capital lease termination | | (11,593) |
| Loss on debt purchases and installment loan repayment | 587 | |
| Gains equipment transactions and other, net | (7,124) | (3,018) |
| Deferred income taxes | 8,453 | 3,830 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (2,478) | 1,118 |
| Prepaid expenses and other current assets | (3,256) | (3,254) |
| Accounts payable, accrued liabilities and other long-term liabilities | 4,499 | 766 |
| Deposits and other assets | (1,529) | (50) |
| Net cash provided by operating activities | 74,088 | 61,810 |
| **Cash flows from investing activities:** | | |
| Purchases of property and equipment | (38,039) | (30,620) |
| Proceeds from disposition of assets | | 111 |
| Net cash used in investing activities | (38,039) | (30,509) |
| **Cash flows from financing activities:** | | |
| Dividends paid | (50,011) | (50,269) |
| Purchases of common stock | (1,666) | (39,394) |
| Purchases of senior unsecured 2021 notes | (10,775) | |
| Net proceeds from issuance of senior secured 2022 notes | | 248,603 |
| Redemption of senior secured 2018 notes | | (251,280) |
| Proceeds from exercises of stock options | 894 | 288 |
| Principal payments on installment payment agreement | (21,203) | (95) |
| Principal payments of capital lease obligations | (9,658) | (16,942) |
| Net cash used in financing activities | (92,419) | (109,089) |
| **Effect of exchange rates changes on cash** | 930 | (2,712) |
| **Net decrease in cash and cash equivalents** | (55,440) | (80,500) |
| **Cash and cash equivalents, beginning of period** | 203,591 | 287,790 |
| **Cash and cash equivalents, end of period** | $ 148,151 | $ 207,290 |
| **Supplemental disclosure of non-cash financing and investing activities:** | | |
| Non-cash component of network equipment obtained in exchange transactions | $ 7,071 | $ 5,717 |
| PP&E obtained for installment payment agreement | 19,875 | 15,602 |
| Fair value of equipment acquired in leases | 1,744 | 595 |
| Capital lease obligations incurred | $ 13,120 | $ 17,820 |

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

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**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 ( Merger Sub ), 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 and Internet Protocol ( IP ) communications services. The Company s network is specifically designed and optimized to transmit data using IP. The Company delivers its services 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 services exclusively through its own facilities, which run from its network to its customers premises. The Company is not dependent on local telephone 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 IP connectivity ranging from 100 Megabits per second to 100 Gigabits per second of bandwidth. The Company provides its on-net Internet access 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 universities, 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 carrier neutral data centers 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 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.

**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, 2015.

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

*Use of estimates*

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

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*Financial instruments*

At September 30, 2016, 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, 2016 the fair value of the Company s $189.2 million senior unsecured notes was $193.0 million and the fair value of the Company s $250.0 million senior secured notes was $256.6 million.

The Company was party to letters of credit totaling $0.1 million as of September 30, 2016 and $0.3 million as of December 31, 2015. These letters of credit are secured by investments that are restricted and included in other assets.

*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 $2.4 million, $6.5 million, $1.8 million and $1.9 million for the three and nine months ended September 30, 2016 and September 30, 2015, respectively.

*Basic and diluted net income (loss) 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. For the three and nine months ended September 30, 2016 and 2015, the Company s employees exercised options for 10,995, 39,473, 6,883 and 19,507 common shares, respectively.

The following details the determination of diluted weighted average shares:

| | **Three Months Ended September 30, 2016** | **Three Months Ended September 30, 2015** | **Nine Months Ended September 30, 2016** | **Nine Months Ended September 30, 2015** |
|---|---|---|---|---|
| Weighted average common shares - basic | 44,574,583 | 44,474,724 | 44,563,279 | 44,907,505 |
| Dilutive effect of stock options | 29,400 | 33,370 | 33,792 | 42,182 |
| Dilutive effect of restricted stock | 172,935 | 194,033 | 161,131 | 240,519 |

| | | | | |
|---|---|---|---|---|
| Weighted average common shares - diluted | 44,776,918 | 44,702,127 | 44,758,202 | 45,190,206 |

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, 2016** | **Three Months Ended September 30, 2015** | **Nine Months Ended September 30, 2016** | **Nine Months Ended September 30, 2015** |
|---|---|---|---|---|
| Unvested shares of restricted common stock | 999,464 | 1,028,197 | 999,464 | 1,028,197 |
| Anti-dilutive options for common stock | 75,687 | 136,220 | 87,611 | 118,517 |
| Anti-dilutive shares of restricted common stock | | 617,243 | 126,993 | 360,101 |

*Recent accounting pronouncements to be adopted*

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. The ASU will replace most existing accounting for lease guidance when it becomes effective. The new standard is effective for the Company beginning on January 1, 2019. Early application is permitted. The standard must be adopted using the modified retrospective approach. The standard will require the Company to record a right to use asset and a lease liability for most of the Company s leases including the Company s leases currently treated as operating leases. The Company is evaluating the effect that ASU 2016-02 will have on its consolidated financial statements and related disclosures and has not yet determined the effect of the standard on its ongoing financial reporting.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, 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. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company beginning on January 1, 2018. Early application is permitted for annual periods beginning after December 31, 2016. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

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**2. Property and equipment:**

Depreciation and amortization expense related to property and equipment and capital leases was $18.8 million, $55.2 million, $17.6 million and $52.5 million for the three and nine months ended September 30, 2016 and 2015, respectively. The Company capitalized salaries and related benefits of employees working directly on the construction and build-out of its network of $2.2 million, $6.6 million, $2.1 million and $6.3 million for the three and nine months ended September 30, 2016 and 2015, respectively.

*Exchange agreement*

In the three and nine months ended September 30, 2016 and 2015, 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 $1.6 million, $14.1 million, $2.7 million and $11.0 million, respectively. After considering the fair value of the new network equipment less the carrying amount of the returned used network equipment and the cash paid, the transactions resulted in gains of $0.7 million, $7.1 million, $1.1 million and $3.3 million 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 is able to purchase up to $25.0 million of 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 six months followed by eighteen equal installment payments for the remaining eighteen month term. In June 2016, the Company elected to repay the outstanding $17.1 million principal balance of the IPA prior to its maturity resulting in a loss of $0.4 million from the remaining unamortized discount. During the three months ended September 30, 2016 the Company entered into additional note obligations totaling $2.7 million. As of September 30, 2016 and December 31, 2015 there was $2.7 million and $21.2 million, respectively, of note obligations outstanding under the IPA, secured by the related equipment. The Company records the net present value of each note obligation utilizing an imputed interest rate. The resulting discount of $0.1 million and $0.8 million as of September 30, 2016 and December 31, 2015, respectively, is amortized over the note term using the effective interest rate method.

*Gains on capital lease terminations*

In March 2015 the Company elected to terminate certain IRU capital lease obligations in Spain with a vendor. The Company has obtained alternative fiber to serve its customers in Spain. Under its estimate of the termination provisions of the related contracts the Company has recorded an estimated termination liability of $8.1 million included in accrued and other current liabilities. The difference between the remaining carrying amount of the related IRU capital lease liabilities ($29.9 million), the remaining net book value of the IRU assets ($10.0 million) and the termination liability and amounts due through the termination date was recorded as a gain on capital lease termination of $10.1 million.

In July 2015, the Company settled a dispute for the payment of the remaining balances for certain IRU capital lease obligations in Europe with a vendor. The IRU assets were fully depreciated in 2012 when the related fiber was replaced and was no longer used by the Company. The difference between the remaining net present value of the related IRU capital lease obligations ($1.8 million) and the settlement liability ($0.4 million) was recorded as a $1.5 million gain on termination of capital lease obligations.

**3. Long-term debt:**

*Senior unsecured notes- $189.2 million*

Group is obligor on $189.2 million (originally $200.0 million) of 5.625% Senior Notes due 2021 (the 2021 Notes ). The 2021 Notes were sold in private offerings for resale to qualified institutional buyers pursuant to SEC Rule 144A. Holdings provided a guarantee of the 2021 Notes but Holdings is not subject to the covenants under the indenture.

In the second quarter of 2016, the Company paid $10.9 million for the purchase of $10.8 million of par value and accrued interest on its 2021 Notes reducing the principal amount to $189.2 million and resulting in a loss of $0.2 million. The loss resulted from the write off of the remaining unamortized debt issuance costs related to the purchased notes.

*Debt extinguishment, redemption and new debt issuance- $250.0 million senior secured notes*

In March 2015, Group redeemed its $240.0 million 8.375% senior notes due in 2018 (the 2018 Notes ) with the proceeds from its February 2015 issuance of $250.0 million of 5.375% senior secured notes (the 2022 Notes ) and existing cash on hand. In February 2015 the Company deposited $251.6 million with the trustee for the benefit of the holders of the 2018 Notes in order to redeem on March 12, 2015 the entire outstanding amount of 2018 Notes at a redemption price of 104.188% of the $240.0 million principal amount thereof plus accrued and unpaid interest. As a result of this transaction the Company incurred a loss on debt extinguishment and redemption of $10.1 million.

The 2022 Notes were sold in private offerings for resale to qualified institutional buyers pursuant to SEC Rule 144A and mature on March 1, 2022. Interest accrues at 5.375% beginning on February 20, 2015 and is paid semi-annually in arrears on March 1 and September 1 of each year, commencing on September 1, 2015. The net proceeds from the offering were $248.7 million after deducting discounts and commissions and offering expenses.

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*Senior secured notes- $240.0 million*

On January 26, 2011 and on August 19, 2013, the Company issued its 8.375% 2018 Notes for aggregate principal amounts of $175.0 million and $65.0 million, respectively, in private offerings for resale to qualified institutional buyers pursuant to SEC Rule 144A. The 2018 Notes were secured and bore interest at 8.375% per annum. Interest was payable in cash semiannually in arrears on February 15 and August 15, of each year. On January 26, 2011, the Company received net proceeds of $170.5 million after deducting $4.5 million of issuance costs from issuing $175.0 million of its 2018 Notes. On August 19, 2013, the Company received net proceeds of approximately $69.9 million after deducting $1.0 million of issuance costs from issuing $65.0 million of 2018 Notes. The 2018 Notes sold in August 2013 were sold at 109.00% of par value. The resulting $5.9 million premium was being amortized as a reduction to interest expense to the maturity date using the effective interest rate method. In March 2015, the 2018 Notes were extinguished and redeemed with the proceeds of the Company s issuance of its $250.0 million of 2022 Notes and cash on hand.

*Limitations under the indentures*

The indentures governing the 2022 and 2021 Notes, among other things, limit the Company s 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 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 the Company 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 the Company 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 the Company s consolidated cash flow, as defined in the indentures, as long as the Company s consolidated leverage ratio is less than 4.25. The Company s consolidated leverage ratio is currently below 4.25 as of September 30, 2016, and as a result a total of $169.4 million is permitted for investment payments including dividends and stock purchases.

**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 $2.3 million in excess of the amount accrued at September 30, 2016.

In December 2011, certain former sales employees of the Company filed a collective action against the Company in the United States District Court, Southern District of Texas, Houston Division alleging misclassification of the Company s sales employees throughout the United States in violation of the Fair Labor Standards Act. The lawsuit sought to recover pay for allegedly unpaid overtime and other damages, including attorney s fees. In March 2014, the judge de-certified the collective action. Each of the former employees that opted-in to the collective action retained the right to file an individual action. Approximately 70 former employees did so. The Company has settled a number of the cases that were filed and made the required settlement payments. Currently, only one case in California remains (Ambrosia v. Cogent Communications, Inc. in the U. S. District Court for the Northern District of California). On January 4, 2016, the judge provisionally certified a class and collective action related to the employees in California. The Company denies the claims and believes that the claims for unpaid overtime are without merit. The Company believes its classification of sales employees is in compliance with applicable law.

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

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| | Three Months Ended September 30, 2016 | Three Months Ended September 30, 2015 | Nine Months Ended September 30, 2016 | Nine Months Ended September 30, 2015 |
|---|---|---|---|---|
| Domestic | $ 11,971 | $ 9,343 | $ 36,589 | $ 10,245 |
| Foreign | (5,592) | (3,776) | (16,864) | (3,865) |
| Total | $ 6,379 | $ 5,567 | $ 19,725 | $ 6,380 |

**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, 2016. At September 30, 2016, there was approximately $46.1 million remaining for purchases under the Buyback Program. During the three and nine months ended September 30, 2016 and 2015 the Company purchased 46,983, 46,983, 0.4 million and 1.2 million shares of its common stock for $1.7 million, $1.7 million, $12.2 million and $39.4 million, respectively.

**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, 2016, the Company s Board of Directors approved the payment of our quarterly dividend of $0.40 per common share. The dividend for the fourth quarter of 2016 will be paid to holders of record on November 22, 2016. This estimated $16.9 million dividend payment is expected to be made on December 9, 2016.

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. Incentive award plan:**

The Company has an award plan, the 2004 Incentive Award Plan, as amended (the Award Plan ), under which grants of stock and options are made. In May 2016 the Company granted 73,450 restricted shares under the Award Plan with a grant date fair value of $2.9 million that are subject to certain performance conditions based upon the Company s operating metrics and will be recognized as equity-based compensation expense on a straight line basis over the service period. In the second quarter of 2016, the Company also granted 247,180 restricted shares to certain of its employees that will vest on a quarterly basis in 2019 and over a four year period. These restricted shares had a grant date fair value of $9.6 million and will be recognized as equity-based compensation expense on a straight line basis over the service period.

**9. Related party transactions:**

*Office leases*

The Company s headquarters was located in an office building owned by Niobium LLC (a successor to 6715 Kenilworth Avenue Partnership). The two owners of Niobium LLC are the Company s Chief Executive Officer, David Schaeffer, who has a 51% interest in Niobium LLC and his wife who has a 49% interest. The lease was scheduled to end on August 31, 2016 and was cancellable by the Company upon 60 days notice. The Company terminated the lease effective as of May 10, 2015. In April 2015, the Company entered into a new lease agreement for its headquarters building with Sodium LLC whose two owners are the Company s Chief Executive Officer, who has a 51% interest in Sodium LLC and his wife who has a 49% interest. The Company moved into the new headquarters building in May 2015. The fixed annual rent for the new headquarters building is $1.0 million per year plus an allocation of taxes and utilities. The lease term is for five years and 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, $1.3 million, $0.3 million and $0.7 million in the three and nine months ended September 30, 2016 and 2015, respectively, for rent and related costs (including taxes and utilities) to these lessors for these leases.

**10. Segment information:**

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

| | Three Months Ended September 30, 2016 | Three Months Ended September 30, 2015 | Nine Months Ended September 30, 2016 | Nine Months Ended September 30, 2015 |
|---|---|---|---|---|
| **Revenues** | | | | |
| North America | $ 94,597 | $ 85,084 | $ 276,080 | $ 245,914 |
| Europe | 18,460 | 17,933 | 55,224 | 53,143 |
| Total | $ 113,057 | $ 103,017 | $ 331,304 | $ 299,057 |

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| | September 30, 2016 | December 31, 2015 |
|---|---|---|
| **Long lived assets, net** | | |
| North America | $ 289,275 | $ 285,187 |
| Europe | 81,500 | 74,976 |
| Total | $ 370,775 | $ 360,163 |

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

## 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; 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, 2015.*

### 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 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 IP connectivity ranging from 100 Megabits per second to 100 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 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 universities, other Internet service 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 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 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 2,334 buildings in which we provide our on-net services, including 1,577 multi-tenant office buildings. We also provide on-net services in carrier-neutral data centers, Cogent controlled data centers and single-tenant office buildings. We operate 51 Cogent controlled data centers totaling 565,000 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.

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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.

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 80% 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 design 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, augmenting the capacity on existing network segments and the maintenance of our network. 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, 2016 Compared to the Three Months Ended September 30, 2015*

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, 2016 | Three months ended September 30, 2015 | Percent Change |
|---|---|---|---|
| | (in thousands) | | |
| Service revenue | $ 113,057 | $ 103,017 | 9.7% |
| On-net revenue | 81,846 | 75,088 | 9.0% |
| Off-net revenue | 30,972 | 27,688 | 11.9% |
| Network operations expenses (1) | 48,827 | 45,182 | 8.1% |
| Selling, general, and administrative expenses (2) | 30,050 | 27,318 | 10.0% |
| Gains on equipment transactions | 687 | 1,152 | -40.4% |
| Gain on capital lease termination | | 1,484 | NM |
| Depreciation and amortization expenses | 18,804 | 17,634 | 6.6% |
| Interest expense | 9,891 | 10,002 | -1.1% |
| Income tax provision | 2,920 | 2,406 | 21.4% |

(1) Includes equity-based compensation expenses of $161 and $126 in the three months ended September 30, 2016 and 2015, respectively.

(2) Includes equity-based compensation expenses of $2,830 and $2,578 in the three months ended September 30, 2016 and 2015, respectively.

NM Not meaningful

| | Three Months Ended September 30, 2016 | | 2015 | Percent Change |
|---|---|---|---|---|
| **Other Operating Data** | | | | |
| *Average Revenue Per Unit (ARPU)* | | | | |
| ARPU on net | $ | 544 | $ 586 | (7.2)% |
| ARPU off-net | $ | 1,272 | $ 1,369 | (7.1)% |
| Average Price per Megabit installed base | $ | 1.28 | $ 1.57 | (18.4)% |
| *Customer Connections end of period* | | | | |
| On-net | | 51,079 | 43,364 | 17.8% |
| Off-net | | 8,259 | 6,897 | 19.7% |

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*Service Revenue.* Our service revenue increased 9.7% for the three months ended September 30, 2016 from the three months ended September 30, 2015. The impact of exchange rates resulted in an increase of revenues for the three months ended September 30, 2016 of approximately $0.1 million. All foreign currency comparisons herein reflect our third quarter 2016 results translated at the average foreign currency exchange rates for the third quarter of 2015. 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 of our revenues for the three months ended September 30, 2016 of approximately $0.6 million.

Revenues from our corporate and net centric customers represented 60.6% and 39.4% of total service revenue, respectively, for the three months ended September 30, 2016 and represented 58.8% and 41.2% of total service revenue, respectively, for the three months ended September 30, 2015. Revenues from corporate customers increased 13.0% to $68.5 million for the three months ended September 30, 2016 from $60.6 million for the three months ended September 30, 2015. Revenues from our net-centric customers increased by 5.1% to $44.5 million for the three months ended September 30, 2016 from $42.4 million for the three months ended September 30, 2015.

Our on-net revenues increased 9.0% for the three months ended September 30, 2016 from the three months ended September 30, 2015. We increased the number of our on-net customer connections by 17.8% at September 30, 2016 from September 30, 2015. On-net customer connections increased at a greater rate than on-net revenues primarily due to the 7.2% 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 18.4% decline in our average price per megabit for our installed base of customers.

Our off-net revenues increased 11.9% for the three months ended September 30, 2016 from the three months ended September 30, 2015. Our off-net revenues increased as we increased the number of our off-net customer connections by 19.7% at September 30, 2016 from September 30, 2015. Our off-net customer connections, which are primarily corporate customer connections, increased at a greater rate than our off-net revenue primarily due to the 7.1% 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 8.1% for the three months ended September 30, 2016 from the three months ended September 30, 2015. The increase is primarily attributable to an increase in costs related to our network and facilities expansion activities including the expansion of Cogent controlled data centers, a $0.6 million increase in taxes billed to our customers recorded on a gross basis (in service revenue and cost of network operations expense) 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 10.0% for the three months ended September 30, 2016 from the three months ended September 30, 2015. 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 $2.8 million for the three months ended September 30, 2016 and $2.6 million for the three months ended September 30, 2015. 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 and a $0.5 million increase in our legal and economic analysis fees primarily associated with U.S. net neutrality and interconnection regulatory matters. Our sales force headcount increased by 8.9% from 474 at September 30, 2015 to 516 at September 30, 2016 and our total headcount increased by 6.2% from 808 at September 30, 2015 to 858 at September 30, 2016.

*Gains on Equipment Transactions.* In the three months ended September 30, 2016 and September 30, 2015, we exchanged certain used network equipment and cash consideration for new network equipment resulting in gains of $0.7 million and $1.2 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.

*Gain on capital lease termination.* In July 2015, we settled a dispute for the payment of the remaining balances for certain IRU capital lease obligations with a vendor. The IRU assets were fully depreciated in 2012 when the related fiber was replaced and was no longer used by us. The difference between the remaining net present value of the related IRU capital lease obligations and the settlement liability was recorded as a gain of $1.5 million.

*Depreciation and Amortization Expenses.* Our depreciation and amortization expense increased 6.6% for the three months ended September 30, 2016 from the three months ended September 30, 2015. 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 $250.0 million of senior secured notes that we issued on February 20, 2015, $200.0 million of senior unsecured notes that we issued on April 9, 2014, interest on our installment payment agreement that we entered into in March 2015 and interest on our capital lease obligations. Our interest expense decreased by 1.1% for the three months ended September 30, 2016 from the three months ended September 30, 2015. In the second quarter of 2016, we paid $10.9 million for the purchase of $10.8 million of par value and accrued interest of our $200.0 million senior unsecured notes reducing the principal to $189.2 million and resulting in a loss of $0.2 million. The loss resulted from the write off of the remaining unamortized debt issuance costs related to the purchased notes. In June 2016, we elected to repay the outstanding $17.1 million principal balance of the installment payment agreement prior to its maturity resulting in a loss of $0.4 million from the remaining unamortized discount.

*Income Tax Provision.* Our income tax provision was $2.9 million for the three months ended September 30, 2016 and $2.4 million for the three months ended September 30, 2015. The increase in our income tax provision was related to an increase in deferred income tax expense from an increase in income before taxes in the United States.

*Buildings On-net.* As of September 30, 2016 and 2015, we had a total of 2,334 and 2,221 on-net buildings connected to our network, respectively.

*Nine Months Ended September 30, 2016 Compared to the Nine Months Ended September 30, 2015*

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, 2016 | Nine months ended September 30, 2015 | Percent Change |
|---|---|---|---|
| | (in thousands) | | |
| Service revenue | $ 331,304 | $ 299,057 | 10.8% |
| On-net revenue | 240,091 | 218,331 | 10.0% |
| Off-net revenue | 90,476 | 79,940 | 13.2% |
| Network operations expenses (1) | 143,976 | 128,673 | 11.9% |
| Selling, general, and administrative expenses (2) | 89,403 | 85,922 | 4.1% |
| Gains on equipment transactions | 7,071 | 3,420 | 106.8% |
| Gains on lease terminations | | 11,593 | NM |
| Depreciation and amortization expenses | 55,161 | 52,517 | 5.0% |
| Interest expense | 30,200 | 31,000 | (2.6)% |
| Loss on debt extinguishment and redemption | | 10,144 | NM |
| Income tax provision | 8,688 | 3,964 | 119.2% |

(1) Includes equity-based compensation expenses of $427 and $458 in the nine months ended September 30, 2016 and 2015, respectively.

(2) Includes equity-based compensation expenses of $7,432 and $8,486 in the nine months ended September 30, 2016 and 2015, respectively.

NM not meaningful

| | Nine Months Ended September 30, 2016 | | 2015 | | Percent Change |
|---|---|---|---|---|---|
| **Other Operating Data** | | | | | |
| *Average Revenue Per Unit (ARPU)* | | | | | |
| ARPU on net | $ | 553 | $ | 583 | (5.3)% |
| ARPU off-net | $ | 1,294 | $ | 1,370 | (5.5)% |
| Average Price per Megabit installed base | $ | 1.37 | $ | 1.64 | (16.6)% |
| *Customer Connections end of period* | | | | | |
| On-net | | 51,079 | | 43,364 | 17.8% |
| Off-net | | 8,259 | | 6,897 | 19.7% |

*Service Revenue.* Our service revenue increased 10.8% for the nine months ended September 30, 2016 from the nine months ended September 30, 2015. The impact of exchange rates resulted in a decrease of revenues for the nine months ended September 30, 2016 of approximately $0.6 million. All foreign currency comparisons herein reflect our results for the nine months ended September 30, 2016 translated at the average foreign currency exchange rates for the nine months ended September 30, 2015. 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 of our revenues for the nine months ended September 30, 2016 of approximately $4.7 million.

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Revenues from our corporate and net centric customers represented 60.3% and 39.7% of total service revenue, respectively, for the nine months ended September 30, 2016 and represented 57.8% and 42.2% of total service revenue, respectively, for the nine months ended September 30, 2015. Revenues from corporate customers increased 15.5% to $199.7 million for the nine months ended September 30, 2016 from $172.9 million for the nine months ended September 30, 2015. Revenues from our net-centric customers increased by 4.3% to $131.6 million for the nine months ended September 30, 2016 from $126.2 million for the nine months ended September 30, 2015. The negative impact of foreign exchange had a more significant impact on our net-centric revenues.

Our on-net revenues increased 10.0% for the nine months ended September 30, 2016 from the nine months ended September 30, 2015. We increased the number of our on-net customer connections by 17.8% at September 30, 2016 from September 30, 2015. 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 and from the negative impact of foreign exchange. 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 16.6% decline in our average price per megabit for our installed base of customers.

Our off-net revenues increased 13.2% for the nine months ended September 30, 2016 from the nine months ended September 30, 2015. Our off-net revenues increased as we increased the number of our off-net customer connections by 19.7% at September 30, 2016 from September 30, 2015. Our off-net customer connections, which are primarily corporate customer connections, increased at a greater rate than our off-net revenue primarily due to the 5.5% 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 11.9% for the nine months ended September 30, 2016 from the nine months ended September 30, 2015. The increase is primarily attributable to an increase in costs related to our network and facilities expansion activities including the expansion of Cogent controlled data centers, a $4.7 million increase in taxes billed to our customers recorded on a gross basis (in service revenue and cost of network operations expense) 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 4.1% for the nine months ended September 30, 2016 from the nine months ended September 30, 2015. 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 $7.4 million for the nine months ended September 30, 2016 and $8.5 million for the nine months ended September 30, 2015. 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 and were partly offset by a $1.1 million reduction in non-cash equity based compensation expense and a $0.4 million decrease in our bad debt expense. Our sales force headcount increased by 8.9% from 474 at September 30, 2015 to 516 at September 30, 2016 and our total headcount increased by 6.2% from 808 at September 30, 2015 to 858 at September 30, 2016.

*Gains on Equipment Transactions.* In the nine months ended September 30, 2016 and September 30, 2015, we exchanged certain used network equipment and cash consideration for new network equipment resulting in gains of $7.1 million and $3.4 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.

*Gains on capital lease terminations.* In March 2015 we elected to terminate certain IRU capital lease obligations with a vendor. Under our estimate of the termination provisions of the related contract we recorded an estimated termination liability of $8.1 million. The difference between the remaining net present value of the related IRU capital leases, the remaining net book value of the IRU assets and the termination liability and amounts due through the termination date was recorded as a gain on capital lease termination of $10.1 million in the nine months ended September 30, 2015.

In July 2015, we settled a dispute for the payment of the remaining balances for certain IRU capital lease obligations with a vendor. The IRU assets were fully depreciated in 2012 when the related fiber was replaced and was no longer used by us. The difference between the remaining net present value of the related IRU capital lease obligation and the settlement liability was recorded as a gain on lease obligations of $1.5 million.

*Depreciation and Amortization Expenses.* Our depreciation and amortization expense increased 5.0% for the nine months ended September 30, 2016 from the nine months ended September 30, 2015. 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 $250.0 million of senior secured notes that we issued on February 20, 2015, $200.0 million of senior unsecured notes that we issued on April 9, 2014, $240.0 million of senior secured notes that we issued in August 2013 and January 2011 and redeemed in March 2015, interest on our installment payment agreement that we entered into in March 2015 and interest on our capital lease obligations. Our interest expense decreased by 2.6% primarily due to the March 2015 redemption of our $240 million of 8.375% senior secured notes that carried a higher interest rate than our $250.0 million of 5.375% senior secured notes that we issued in February 2015. Additionally, in March 2015 we elected to terminate $29.9 million of capital lease obligations in Spain with a vendor reducing our interest expense on our capital leases.

In the second quarter of 2016, we paid $10.9 million for the purchase of $10.8 million of par value and accrued interest of our $200.0 million senior unsecured notes reducing the principal to $189.2 million and resulting in a loss of $0.2 million. The loss resulted from the write off of the remaining unamortized debt issuance costs related to the purchased notes. In June 2016, we elected to repay the outstanding $17.1 million principal balance of the installment payment agreement before its maturity date resulting in a loss of $0.4 million from the remaining unamortized discount.

*Debt extinguishment, redemption and new debt issuance- $250.0 million*. In March 2015, we redeemed our $240.0 million 8.375% senior notes due in 2018 at a redemption price of 104.188% of the $240.0 million principal amount thereof plus accrued and unpaid interest with the proceeds from our February 2015 issuance of $250.0 million of 5.375% senior secured notes and existing cash on hand. As a result of this transaction we incurred a loss on debt extinguishment and redemption of $10.1 million in the nine months ended September 30, 2015.

*Income Tax Provision.* Our income tax provision was $8.7 million for the nine months ended September 30, 2016 and $4.0 million for the nine months ended September 30, 2015. The increase in our income tax provision was related to an increase in deferred income tax expense from an increase in income before taxes in the United States.

*Buildings On-net.* As of September 30, 2016 and 2015, we had a total of 2,334 and 2,221 on-net buildings connected to our network, respectively.

***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)** | **2016** | **2015** |
| Net cash provided by operating activities | $ 74,088 | $ 61,810 |
| Net cash used in investing activities | (38,039) | (30,509) |