COGENT COMMUNICATIONS GROUP INC
Form S-1
May 18, 2004

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As filed with the Securities and Exchange Commission on May 18, 2004

Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM S-1

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

COGENT COMMUNICATIONS GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	4813	52-2337274
(State or Other Jurisdiction of Incorporation or Organization)	(Primary Standard Industrial Classification Number)	(IRS Employer Identification No.)

1015 31st Street N.W.
Washington, D.C. 20007
Tel: (202) 295-4200
(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

Dave Schaeffer
Chief Executive Officer
Cogent Communications Group, Inc.
1015 31st Street N.W.
Washington, D.C. 20007
Tel: (202) 295-4200
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

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Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this registration statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If the delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

CALCULATION OF REGISTRATION FEE

Title of each Class of Securities to be Registered	Proposed Maximum Aggregate Offering Price(a)(b)	Amount of Registration Fee
Common stock, $0.001 par value	$75,000,000	$9,503

(a) Estimated solely for the purpose of calculating the registration fee in accordance with Rule 457(o) promulgated under the Securities Act of 1933.

(b) Including shares of common stock which may be purchased by the underwriters to cover over-allotments, if any.

The Registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and we are not soliciting offers to buy these securities in any state where the offer or sale is not permitted.

PROSPECTUS
(Subject to Completion, dated May 18, 2004)

Shares of Common Stock

Cogent Communications Group, Inc.

We are offering shares of our common stock.

Immediately prior to this offering, we will implement a 1-for-20 reverse stock split and all of our outstanding shares of preferred stock will be converted into shares of our common stock. Our common stock is traded on the American Stock Exchange under the symbol "COI." The last reported sale price of our common stock on the American Stock Exchange on May 17, 2004 was $1.55 per share, which would have been $31.00 per share after giving effect to the reverse stock split.

We and certain selling stockholders have granted the underwriters the right to purchase up to an additional shares to cover over-allotments.

Investing in our common stock involves risks. See "Risk Factors" beginning on page 7.

	Per Share	Total
Price to Public	$	$
Underwriting Discounts		
Proceeds to us (before expenses)		

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities, or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares to purchasers on , 2004.

Jefferies & Company, Inc.

CIBC World Markets

Friedman Billings Ramsey

The date of this prospectus is , 2004

[INSIDE FRONT COVER]

Description of Artwork

Graphics depicting map of portions of North America and Western Europe portraying company fiber optic network, access points and colocation centers.

Cogent Communications Logo with phrase "Optical Internet."

You should rely only on the information contained in this prospectus. We and the underwriters have not authorized anyone to provide you with different or additional information. This prospectus is not an offer to sell or a solicitation of an offer to buy our common stock in any jurisdiction where it is unlawful to do so. The information contained in this prospectus is accurate only as of its date, regardless of the date of delivery of this prospectus or of any sale of our common stock.

TABLE OF CONTENTS

	Page
Prospectus Summary	1
Risk Factors	7
Special Note Regarding Forward-Looking Statements	19
Special Note Regarding Arthur Andersen LLP	19
Use of Proceeds	20
Common Stock Price Range	20
Dividend Policy	20
Capitalization	21
Dilution	22
Unaudited Condensed Pro Forma Financial Statements	23
Selected Consolidated Financial and Other Data	27
Management's Discussion and Analysis of Financial Condition and Results of Operations	29
Business	47
Management	54
Principal Stockholders	61
Certain Relationships and Related Transactions	64
Description of Capital Stock	65
United States Federal Income Tax Consequences to Non-United States Holders	67
Shares Eligible for Future Sale	70
Underwriting	72
Legal Matters	76
Experts	76
Where You Can Find More Information	76
Index to Consolidated Financial Statements	F-1

PROSPECTUS SUMMARY

The following summary is qualified in its entirety by, and should be read in conjunction with, the more detailed information and financial statements and notes thereto appearing elsewhere in this prospectus. Before you decide to invest in our common stock, you should read the entire prospectus carefully, including the risk factors and financial statements and related notes included in this prospectus. All references to "we," "us," "our" or "Cogent" refer to Cogent Communications Group, Inc. and its consolidated subsidiaries.

Overview

We are a leading facilities-based provider of low-cost, high-speed Internet access and Internet Protocol connectivity. Our network has been designed and optimized to transmit data using Internet Protocol, which provides us with significant cost and performance advantages over legacy networks. We deliver our services to more than 4,300 small and medium-sized businesses, communications service providers and other bandwidth-intensive organizations in North America and Europe. Our primary service is providing Internet access at a speed of 100 Megabits per second, much faster than typical Internet access currently offered to businesses, and is delivered through our own facilities running all the way to our customers' premises.

Our network is comprised of in-building riser facilities, metropolitan optical fiber networks, metropolitan traffic aggregation points and intercity transport facilities. The network is physically connected entirely through our facilities to over 900 buildings in which we provide our on-net services, including over 760 multi-tenant office buildings. We also provide on-net services in carrier-neutral colocation facilities, data centers and single-tenant office buildings. Because of our network architecture, we are not dependent on local telephone companies to serve our on-net customers. In addition to providing our on-net services, we also provide Internet connectivity to customers that are not located in buildings directly connected to our network. We serve these off-net customers using other carriers' facilities to provide the "last mile" portion of the link from our customers' premises to our network. We emphasize the sale of on-net services because sales of these services generate higher gross profit margins. For the three months ended March 31, 2004, 64.4% of our net service revenue was generated from on-net customers compared to 51.5% in the same period in 2003.

We have created our network by purchasing dark fiber from carriers with large unused capacity, by constructing facilities and by acquiring financially distressed companies or their assets at a significant discount to their original cost. Our intercity network consists of more than 21,000 fiber route miles and operates at between 40 and 80 Gigabits per second. Our metropolitan area networks in 25 markets in North America and Europe consist of over 8,000 fiber miles and over 150 operational rings with each ring configured to operate at between 12 and 80 Gigabits per second. Our in-building networks consist of one or more racks of equipment installed in each building with in-building riser connectivity ranging from 12 to 288 strands of fiber. Our network was constructed with dark fiber facilities that we control and have activated. Our fiber facilities are primarily obtained through long-term indefeasible rights of use, or IRUs.

Our network allows us to respond to the growing demand for low-cost, high-speed Internet connectivity. On average, we currently serve approximately 4% of the tenants in each of our multi-tenant on-net buildings. We believe these buildings have an average of 45 tenants. In addition, we currently serve less than 1% of the approximately 172,000 small and medium-sized businesses in the geographic regions in which we offer our off-net services. We also operate 27 data centers comprising 305,780 square feet throughout North America and Europe that allow customers to colocate their equipment and access our network. We intend to continue to expand our addressable market by selectively adding buildings to our network.

Competitive Advantages

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

Low Cost of Operation. We have built our network on a facilities-based platform to optimally deliver IP services. We believe our network architecture gives us a cost advantage over our competitors who have constructed their networks to overlay legacy voice networks. We have minimized the cost of constructing and maintaining our network by acquiring strands of fiber from carriers with large unused capacity. We also have minimized our capital expenditures by acquiring financially distressed companies or their assets at a significant discount to their original cost. Our high-capacity network's existing connections to over 900 buildings enable us to increase the total number of customers we serve with minimal incremental investment in our network and operational infrastructure. Finally, our focus on a simple set of Internet connectivity services reduces our costs of provisioning and customer support.

Independent Network. Our high-speed on-net Internet access service does not rely on infrastructure controlled by local incumbent telephone companies. We provide the entire network, including the last mile and the in-building wiring to the customer's suite. This gives us more control over our service, quality and pricing and allows us to provision services more quickly and efficiently. We are typically able to activate customer services in one of our on-net buildings in fewer than nine days. Our off-net services are generally installed within 30 days and utilize more traditional circuits, such as T1 and T3 lines, purchased from local telecommunications providers.

Reliable Service. Over the last 30 months, our network has averaged 99.99% customer connection availability. The majority of our network is configured in a ring structure that enables us to route customer traffic in either direction around the network rings both at the metropolitan and intercity levels. The availability of two data transmission paths around each ring serves as a backup that minimizes loss of service in the event of equipment failure or damage.

High Quality. We are able to offer high quality Internet service due to our network, which was designed solely to transmit IP data, and dedicated intracity bandwidth for each customer. Our intracity network is designed to allow customers to transmit and receive data simultaneously at the maximum stated rate for their connections without performance degradation. This design increases the speed and throughput of our network and reduces the number of data packets dropped during transmission.

Experienced Management Team. Our management team is composed of seasoned executives with extensive expertise in the communications industry, as well as knowledge of the markets in which we operate. Our management team has designed and built our network and has guided us through the recent telecommunications industry downturn. The team has also integrated the network assets, customers and service offerings we acquired through six major and three minor acquisitions.

Our Strategy

We intend to become the leading provider of high-capacity IP data services to customers in the markets we serve and to increase our profitability and cash flow. The principal elements of our strategy include:

Focus on Providing Low-Cost, High-Speed Internet Access and IP Connectivity. We intend to further leverage our high-capacity network to respond to the growing demand among businesses for high-speed Internet service. We currently offer services with speeds ranging between 500 Kilobits per second, or Kbps, and 1,000 Megabits per second, or Mbps. Our primary service is offered at a speed of 100 Mbps, much faster than typical Internet access currently offered to businesses.

Pursuing On-Net Customer Growth. We intend to expand and intensify the efforts of our direct field sales organization. Our direct field sales organization markets to tenants in our on-net buildings. Our marginal cost to serve new on-net customers is low because of our network design and focused service offerings. We estimate that we now serve only 4% of the tenants in our on-net buildings, providing us with a significant opportunity for customer and revenue growth. We intend to increase usage of our network and operational infrastructure by adding customers in our existing on-net buildings as well as adding buildings to our network, particularly in Europe.

Selectively Expanding Our Service Offerings. We have recently expanded the geographic reach of our Internet protocol-based services to include Europe. We will continue to evaluate opportunities to offer complementary application services on our network, such as voice-over-Internet Protocol, or VoIP, remote storage, Internet Protocol virtual private networks, or IP VPNs, and secure networks.

Selectively Pursuing Acquisition Opportunities. In the first quarter of 2004, we consummated the acquisition of the European portion of our network. We will continue to evaluate opportunities to acquire network assets and customers through selective acquisitions. We may also use acquisitions to expand into new geographic markets.

The Reverse Stock Split and Equity Conversion

Immediately prior to this offering, we will implement a 1-for-20 reverse stock split under which the outstanding 14,147,464 shares of our common stock will be combined into 707,373 shares of our common stock, which we refer to as the Reverse Stock Split, and an equity conversion under which the outstanding shares of our preferred stock will be converted into 25,008,658 shares of our common stock on a post-Reverse Stock Split basis, which we refer to as the Equity Conversion. As a result of the Reverse Stock Split and Equity Conversion and without regard to the shares to be issued in this offering, we will have 25,716,031 shares of common stock outstanding and no shares of preferred stock outstanding immediately prior to the offering.

Company Information

We were incorporated in Delaware in August 1999. In February 2002, in connection with our merger with Allied Riser Communications Corporation, shares of our common stock started public trading on the American Stock Exchange and we became subject to, and commenced reporting under, the Securities and Exchange Act of 1934. Our principal executive offices are located at 1015 31st Street N.W., Washington, D.C. 20007. Our telephone number is (202) 295-4200 and our web site address is www.cogentco.com. The information contained, referenced or incorporated in our web site is not a part of this prospectus.

The Offering

Common stock offered by us	shares
Common stock to be outstanding after this offering	shares
Use of proceeds	We intend to use the proceeds that we receive from this offering to repay the entire $17.0 million of our indebtedness to Cisco, to fund the expansion of our sales and marketing efforts, to fund the increase in the number of on-net buildings we serve, and for general corporate purposes, which may include potential acquisitions of complementary businesses. See "Use of Proceeds."
American Stock Exchange symbol	"COI"

The number of shares of our common stock that will be outstanding after this offering reflects our Reverse Stock Split, is based on shares outstanding as of May 5, 2004 and includes:

- 707,373 shares of our common stock outstanding;
- 25,008,658 shares of our common stock issuable as a result of the Equity Conversion; and
- shares of our common stock to be issued in this offering.

The number of shares of our common stock that will be outstanding after this offering excludes:

- 5,189 shares of our common stock issuable upon exercise of outstanding common stock warrants;
- 1,066 shares of our common stock issuable upon conversion of our $7^{1}/_{2}$% Convertible Subordinated Notes Due 2007;
- 6,080 shares of our common stock issuable upon the exercise of outstanding stock options issued by us under our stock-based employee compensation plans; and
- 1,254,574 additional shares of our common stock reserved for future grants under our stock-based employee compensation plans, 698,077 of which have been designated for grants to employees in the second quarter of this year.

Unless we specifically state otherwise, all information in this prospectus assumes:

- the underwriters do not exercise their over-allotment option of up to shares;
- the Reverse Stock Split and Equity Conversion; and
- a public offering price of $ per share (such price assumes the completion of the Reverse Stock Split and the Equity Conversion).

Risk Factors

You should carefully read and consider the information set forth in "Risk Factors" and all other information set forth in this prospectus before investing in our common stock.

Summary Consolidated Financial and Other Data

The following summary historical and pro forma financial information should be read in conjunction with "Selected Consolidated Financial and Other Data," "Unaudited Condensed Pro Forma Financial Statements," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our historical financial statements and other related notes included elsewhere in this prospectus.

The pro forma statement of operations data and other financial data presented below give effect to the acquisition of Firstmark Communications Participations S.à r.l. as if it had occurred as of January 1, 2003. The Firstmark acquisition was consummated on January 5, 2004. Since the Firstmark results of operations for the period from January 1, 2004 through January 4, 2004 are not material, a pro forma statement of operations for the three months ended March 31, 2004 is not required to be presented.

	Year Ended December 31,			Pro Forma	Three Months Ended March 31,	
	2001	2002	2003	Year Ended December 31, 2003	2003	2004
				(unaudited)	(unaudited)	
	(in thousands, except operating data)					
Statement of Operations Data:						
Net service revenue	$ 3,018	$ 51,913	$ 59,422	$ 85,953	$ 14,233	$ 20,945
Operating expenses:						
Cost of network operations	19,990	49,091	47,017	59,910	10,682	15,735
Amortization of deferred compensation cost of network operations	307	233	1,307	1,307	57	212
Selling, general, and administrative	27,322	33,495	26,570	48,719	6,402	9,581
Amortization of deferred compensation selling, general, and administrative	2,958	3,098	17,368	17,368	761	2,820
Asset impairment and loss				3,279		
Gain on settlement of vendor litigation		(5,721)				
Depreciation and amortization	13,535	33,990	48,387	55,835	11,211	14,536
Total operating expenses	64,112	114,186	140,649	186,418	29,113	42,884
Operating loss	(61,094)	(62,273)	(81,227)	(100,465)	(14,880)	(21,939)
Gains on debt extinguishment			240,234	345,517	24,802	
Settlement of noteholder litigation		(3,468)				
Interest income (expense) and other, net	(5,819)	(34,545)	(18,264)	(26,493)	(8,008)	(2,231)
(Loss) income before extraordinary item	(66,913)	(100,286)	140,743	218,559	1,914	(24,170)
Extraordinary gain Allied Riser merger		8,443				
Net (loss) income before cumulative effect of accounting change	(66,913)	(91,843)	140,743	218,559	1,914	(24,170)
Cumulative effect on prior years SFAS 143				(289)		
Net (loss) income	(66,913)	(91,843)	140,743	218,270	1,914	(24,170)
Beneficial conversion of preferred stock	(24,168)		(52,000)	(54,575)		(22,028)
Net (loss) income applicable to common stock	$ (91,081)	$ (91,843)	$ 88,743	$ 163,695	$ 1,914	$ (46,198)

				Pro Forma	Three Months Ended March 31,	
Other Financial Data:						
Capital expenditures	$ 118,020	$ 75,214	$ 24,016		$ 13,082	$ 1,833
Net cash used in operating activities	(46,786)	(41,567)	(27,357)		(14,971)	(11,582)
Net cash (used in) provided by investing activities	(131,652)	(19,786)	(25,316)		(13,965)	29,495
Net cash provided by (used in) financing activities	161,862	51,694	20,562		2,141	(2,217)

	As of and for the Year Ended December 31,			As of and for the Three Months Ended March 31,	
	2001	2002	2003	2003	2004
				(unaudited)	
Operating Data:					
Percent of revenue on-net	59.7%	31.9%	55.6%	51.5%	64.4%
Percent of revenue off-net	40.3%	40.7%	26.4%	28.1%	23.4%
Percent of revenue non-core		27.4%	18.0%	20.4%	12.2%
On-net customer connections	189	881	1,649	1,032	2,092
On-net buildings	127	511	813	629	877

	March 31, 2004	
	Actual	As Adjusted
	(unaudited) (in thousands)	
Balance Sheet Data:		
Cash and cash equivalents and short-term investments ($664, restricted)	$ 24,098	$ 77,473
Working capital	3,910	57,285
Property and equipment, net	357,058	357,058
Total assets	407,489	460,864
Capital lease obligations	109,566	109,566
Long term notes payable (net of discount of $5,853)	22,180	4,338
Convertible preferred stock	119,774	
Stockholders' equity	245,459	316,676

The as adjusted balance sheet data presented above gives effect to the completion of this offering and the application of proceeds as set forth in "Use of Proceeds" as if this offering had occurred as of March 31, 2004.

RISK FACTORS

Investing in our common stock involves risk. You should carefully consider the following risks as well as the other information contained in this prospectus, including our financial statements and the related notes, before investing in our common stock. The occurrence of any of the risks identified below could have a material adverse effect on our business, results of operations and financial condition and could cause sharp declines in the price of our common stock.

Risks Related to Our Business

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

Until we can generate sufficient levels of cash from our operations, we will continue to rely on our cash reserves and, potentially, additional equity and debt financings to meet our cash needs. Our future capital requirements likely will increase if we acquire or invest in additional businesses, assets, services or technologies. We may also face unforeseen capital requirements for new technology required to remain competitive and for unforeseen maintenance of our network and facilities. Given the recent condition of the financial markets, it has been very difficult to raise capital, especially for telecommunications companies. We cannot assure you that access to additional capital will become any easier in the future, nor can we assure you that any such financing will be available on terms that are acceptable to us or our stockholders. If additional funds are raised by issuing equity securities, substantial dilution to existing stockholders may result.

We need to increase the number of our on-net customers in order to become profitable and cash-flow positive.

In order to become profitable and cash flow positive, we need to keep the customers we have and significantly increase the number of our customers. We may fail to do so. This could happen if our marketing plan is unsuccessful, we hire the wrong sales force to implement the marketing plan, or we are unable to retain a high-quality sales force.

We have historically incurred operating losses and we expect our losses to continue for the foreseeable future.

Since we initiated operations in 2000, we have generated increasing operating losses and we anticipate that these operating losses will continue to increase for the foreseeable future. In 2001, we had an operating loss of $61.1 million, in 2002 we had an operating loss of $62.3 million, in 2003 we had an operating loss of $81.2 million, and during the first quarter of 2004, we had an operating loss of $21.9 million. As of March 31, 2004, we had an accumulated deficit of $78.2 million. Continued losses may prevent us from pursuing our strategies for growth or require us to seek unplanned additional capital, and could cause us to be unable to meet our debt service obligations, capital expenditure requirements or working capital needs.

We are a relatively small company in an industry that is capital intensive, rapidly evolving and subject to significant economies of scale. If we fail to grow, we may not be able to successfully compete with larger, better-established companies.

Because the communications industry is capital intensive, rapidly evolving and subject to significant economies of scale, as a relatively small organization, we are at a competitive disadvantage. The growth we must achieve to reduce that disadvantage will put a significant strain on all of our resources. Our ability to sustain our current operations and to achieve the growth that we believe will be necessary for us to achieve profitability will depend on a number of factors, including our success in increasing the number of customers we serve, the expenses associated with the maintenance of our network and adding new on-net buildings to our network, regulatory changes, the levels of competition that we face,

technological developments, merger and acquisition activity and condition of the North American and European economies and their ability to recover from the recent downturn.

We may not be able to efficiently manage our growth.

Our future largely depends on our ability to implement our business strategy and continue to increase the size of our business in order to create new business and revenue opportunities. This planned expansion will place significant strains on our personnel, financial and other resources. The failure to efficiently manage our growth could adversely affect the quality of our services, our business and our financial condition. Our ability to manage our growth will be particularly dependent on our ability to develop and retain an effective sales force and qualified technical and managerial personnel. We may not be able to hire and retain sufficient numbers of qualified personnel, maintain the quality of our operations, control our costs, maintain compliance with all applicable regulations or expand our internal management, technical, information and accounting systems in order to support our desired growth. In addition, we must achieve the steps necessary to manage our growth in a timely manner, at reasonable costs and on satisfactory terms and conditions. Failure to effectively manage our planned expansion could have a material adverse effect on our business, growth, financial condition, results of operations, and ability to meet our obligations.

We may incur significant costs, and may not realize the benefits we anticipate, from our recent acquisitions in Europe.

We very recently completed our acquisitions of LambdaNet Communications France SAS, LambdaNet Communications Espana SA and the rights to dark fiber and other network assets that were once part of Carrier 1 International S.A. in Germany. Prior to these transactions, we had only minimal European operations. If we are not successful in developing our market presence in Europe, our operating results could be adversely affected. The assets that were part of Carrier 1 have not yet been fully integrated into our network. We may incur significant additional and unexpected costs and operating difficulties in fully integrating these European operations and assets with our strategies, technologies, information systems and services.

In addition, LambdaNet France and LambdaNet Spain operated a combined telecommunications network and shared operations systems with a formerly affiliated entity, LambdaNet Germany. Because we did not acquire LambdaNet Germany, we are now in the process of separating the operations of LambdaNet Germany from the LambdaNet companies we acquired. Our failure to efficiently accomplish this task would subject us to additional expenses.

We may experience delays and additional costs in completing the activation of our network in Germany.

We acquired the rights to our network in Germany on March 30, 2004, pursuant to a binding term sheet that is to be replaced by a more detailed contract. We have not yet completed negotiation of that contract and may experience delays in doing so. If we are unable to complete the contract we may have to operate the network under the less complete terms of the binding term sheet. This could lead to disputes over matters such as obligations to repair damage to the fiber and to provide access to various facilities.

We have activated the transmission equipment on the German network and expect to achieve full interconnection with our network in France by the end of June 2004. We could experience delays or additional costs in obtaining and activating the fiber connections necessary for this. We may also experience delays and unanticipated costs as we begin to add customers to the German network for reasons we do not foresee because of our inexperience in operating and installing equipment and providing services in the German market.

We may not successfully make or integrate acquisitions or enter into strategic alliances.

As part of our growth strategy, we intend to pursue selected acquisitions and strategic alliances. We have already completed nine acquisitions, including seven in the last two years. We compete with other companies for these opportunities and we cannot assure you that we will be able to effect future acquisitions or strategic alliances on commercially reasonable terms or at all. Even if we enter into these transactions, we may experience:

- delays in realizing the benefits we anticipate or we may not realize the benefits we anticipate;
- difficulties or higher-than-anticipated costs associated with integrating any acquired companies, products or services into our existing business;
- attrition of key personnel from acquired businesses;
- unexpected costs or charges; or
- unforeseen operating difficulties that require significant financial and managerial resources that would otherwise be available for the ongoing development or expansion of our existing operations.

Consummating these transactions could also result in the incurrence of additional debt and related interest expense, as well as unforeseen contingent liabilities, all of which could have a material adverse effect on our business, financial condition and results of operations. Because we have purchased financially distressed companies or their assets, and may continue to do so in the future, we have not had, and may not have, the opportunity to perform extensive due diligence or obtain contractual protections and indemnifications that are customarily provided in corporate acquisitions. As a result, we may face unexpected contingent liabilities arising from these acquisitions. We may also issue additional equity in connection with these transactions, which would dilute our existing shareholders.

In connection with each of our acquisitions in which we have acquired customer contracts, some portion of these customers have elected not to continue purchasing services from us. Accordingly, historical operating results from the acquired businesses or assets have not been indicative of our combined results.

Our substantial debt may adversely affect our financial condition and operating activity.

We have, and after the completion of this offering will continue to have, substantial debt and substantial debt service obligations. At March 31, 2004, as adjusted to give effect to this offering and the application of a portion of the proceeds of this offering to repay all of our indebtedness to Cisco Systems Capital Corporation, we would have had outstanding indebtedness of approximately $10.2 million in face value under our 7$^{1}/_{2}$% Convertible Subordinated Notes Due 2007, and approximately $109.6 million of obligations under capital leases.

Our level of indebtedness has important consequences to you, including:

- requiring us to use a substantial portion of our cash flow from operations to pay interest and principal on our 7$^{1}/_{2}$% Convertible Subordinated Notes Due 2007 and to meet our obligations under the capital leases, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, acquisitions and other general corporate purposes;
- limiting our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions and other general corporate purposes;
- subjecting us to the possibility of an event of default under the covenants contained in our 7$^{1}/_{2}$% Convertible Subordinated Notes Due 2007 and our other debt obligations; and

limiting our ability to adjust to rapidly changing market conditions, reducing our ability to withstand competitive pressures and making us more vulnerable to a downturn in general economic conditions than our competitors with less debt.

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

Our future performance depends to a significant degree upon the continued contribution of our executive management team and other key employees, in particular, our President and Chief Executive Officer, Dave Schaeffer. Accordingly, our future success depends on our ability to attract, hire, train and retain highly skilled management, technical, sales, marketing and customer support personnel. Competition for qualified employees is intense, and we compete for qualified employees with companies that may have greater financial resources than we have. We may not be successful in attracting, hiring, training and retaining the people we need, which would significantly impede our ability to implement our business strategy.

Our European operations expose us to economic, regulatory and other risks.

The nature of our European business involves a number of other risks, including:

exposure to additional regulatory requirements;

import restrictions and controls, tariffs and other trade barriers;

difficulties in staffing and managing our foreign operations;

fluctuations in currency exchange rates;

changes in political and economic conditions;

exchange controls; and

exposure to additional and potentially adverse tax regimes.

As we continue to expand our European business, our success will depend, in part, on our ability to anticipate and effectively manage these and other risks. Our failure to manage these risks and grow our European operations may have a material adverse effect on our business and results of operations.

Our business could suffer delays and problems due to the actions of network providers on whom we are partially dependent.

Our off-net customers are connected to our network by means of communications lines that are provided as services by local telephone companies and others. We may experience problems with the installation, maintenance and pricing of these lines and other communications links, which could adversely affect our results of operations and our plans to add additional customers to our network using such services.

If the information systems that we depend on to support our customers, network operations, sales and billing do not perform as expected, our operations and our financial results may be adversely affected.

Our ability to track sales leads, close sales opportunities, provision services and bill our customers for those services, depends upon the close and effective integration of our various information systems. If our systems, individually or collectively, fail or do not perform as expected, our ability to process and provision orders, to make timely payments to vendors and to ensure that we collect revenue owed to us would be adversely affected. The integration of our new European operations could increase the likelihood that these systems do not perform as desired. Such failures or delays could result in increased capital expenditures, customer and vendor dissatisfaction, loss of business or the inability to

add new customers or additional services, all of which would adversely affect our business and results of operations.

Our business could suffer from an interruption of service from our fiber providers.

Our intercity and intracity dark fiber is maintained by the carriers from whom it has been obtained. If these carriers fail to maintain the fiber or disrupt our fiber connections for other reasons, such as business disputes with us or governmental takings, our ability to provide service in the affected markets or parts of markets would be impaired. We may incur significant delays and costs in restoring service to our customers, and we may lose customers if delays are substantial.

Our rights to the use of the dark fiber that makes up our network may be affected by the financial health of our fiber providers.

We do not have title to most of the dark fiber that makes up the foundation of our network. Our interests in that dark fiber are in the form of long-term leases or IRUs. We have made substantial advance payments pursuant to these IRUs for the long-term use of the dark fiber. There has been increasing financial pressure on some of our fiber providers as part of the overall weakening of the telecommunications market over the past several years. Our largest supplier of our metropolitan fiber networks, AboveNet, and our primary supplier of our national backbone fiber, WilTel Communications, each recently emerged from bankruptcy. The future bankruptcy or other insolvency of AboveNet, WilTel or one or more of the other entities with which we have entered into IRUs could significantly and adversely impact our results of operations. For example, bankruptcies or insolvencies could result in a loss of our rights to use the fiber pursuant to our IRUs. If this occurred we would need to obtain alternative fiber capacity in order to continue to transmit data over the affected portion of our network. We cannot assure you that we would be able to obtain such alternative capacity in a timely manner, on reasonable terms or at all, as there may be locations where alternate providers do not exist. Even if we were able to continue to use the fiber subject to such IRUs upon the bankruptcy or insolvency of one or more of our fiber suppliers, these suppliers may cease providing certain other services under the IRUs that we currently rely upon. This may, among other things, require us to expend additional funds for maintenance of the fiber or directly fund right of way obligations.

Our business depends on license agreements with building owners and managers, which we could fail to obtain or maintain.

Our business depends upon our in-building networks. Our in-building networks depend on access agreements with building owners or managers allowing us to install our in-building networks and provide our services in the buildings. These agreements typically have terms of five to ten years. Any deterioration in our existing relationships with building owners or managers could harm our marketing efforts and could substantially reduce our potential customer base. We expect to enter into additional access agreements as part of our growth plan. Current federal and state regulations do not require building owners to make space available to us, or to do so on terms that are reasonable or nondiscriminatory. While the FCC has adopted regulations that prohibit common carriers under its jurisdiction from entering into exclusive arrangements with owners of multi-tenant commercial office buildings, these regulations do not require building owners to offer us access to their buildings. Building owners or managers may decide not to permit us to install our networks in their buildings or may elect not to renew or amend our access agreements. The failure to obtain or maintain these agreements would reduce our revenue, and we might not recover our costs of procuring building access and installing our in-building networks.

We may not be able to obtain or construct additional building laterals to connect new buildings to our network.

In order to connect a new building to our network we need to obtain or construct a lateral from our metropolitan network to the building. We may not be able to obtain fiber in an existing lateral at an attractive price from a provider and may not be able to construct our own lateral due to the cost of construction or municipal regulatory restrictions. Failure to obtain fiber in an existing lateral or to construct a new lateral could keep us from adding new buildings to our network and from increasing our revenues.

Impairment of our intellectual property rights and our alleged infringement on other companies' intellectual property rights could harm our business.

We regard certain aspects of our business as proprietary and attempt to protect them through trade secret laws, restrictions on disclosure and other methods. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use this information.

We are aware of several other companies in our and other industries that use the word "Cogent" in their corporate names. One company has informed us that it believes our use of the name "Cogent" infringes on their intellectual property rights in that name. If such a challenge is successful, we could be required to change our name and lose the goodwill associated with the Cogent name in our markets.

The sector in which we operate is highly competitive, and we may not be able to compete effectively.

We face significant competition from traditional and new communications companies, including companies that provide local and long distance telephone services, cable modem services, Internet connectivity, digital subscriber line services, fixed and mobile wireless services and satellite data services. Relative to us, traditional providers have significantly greater financial resources, more well-established brand names, larger customer bases, more diverse strategic plans and technologies.

Intense competition from these traditional and new communications companies has led to declining prices and margins for many communications services, and we expect this trend to continue as competition intensifies in the future. Decreasing prices for high-speed Internet services have diminished the competitive advantage that we have enjoyed as a result of our service pricing. If our competitors successfully focus on our target markets, this key advantage may be further eroded and our business may suffer.

Some of our competitors are in bankruptcy or may soon emerge from bankruptcy, and some already have done so. Because the bankruptcy process allows for the discharge of debts and rejection of certain obligations, these competitors may have more pricing flexibility and a lower cost structure than us.

Our quarterly operating results are subject to substantial fluctuations and you should not rely on them as an indication of our future results.

Our quarterly operating results may vary significantly due to a combination of factors, including:

- demand for our services;
- our ability to meet the demand for our services;
- changes in pricing policies by us and our competitors;
- increased competition;
- the impact of acquisitions;

network outages or failures;

delays, reductions or interruptions from suppliers; and

changes in the North American or European economy.

Many of these factors are beyond our control. Accordingly, our quarterly operating results may vary significantly in the future and period-to-period comparisons of our results of operations may not be meaningful and should not be relied upon as indicators of our full year performance or future performance. Our share price may be subject to greater volatility due to these fluctuations in our operating results.

Our connections to the Internet require us to establish and maintain relationships with other providers, which we may not be able to maintain.

The Internet is composed of various public and private network providers who operate their own networks and interconnect them at public and private interconnection points. Our network is one such network. In order to obtain Internet connectivity for our network, we must establish and maintain relationships with other such providers and incur the necessary capital costs to locate our equipment and connect our network at these various interconnection points.

By entering into what are known as settlement-free peering arrangements, providers agree to exchange traffic between their respective networks without charging each other. Our ability to avoid the higher costs of acquiring dedicated network capacity and to maintain high network performance is dependent upon our ability to establish and maintain peering relationships. We cannot assure you that we will be able to continue to establish and maintain those relationships. The terms and conditions of our peering relationships may also be subject to adverse changes, which we may not be able to control. If we are not able to maintain and increase our peering relationships in all of our markets on favorable terms, we may not be able to provide our customers with high performance or affordable services which would have a material adverse effect on our business.

We make some of these connections pursuant to agreements that make data transmission capacity available to us at negotiated rates. In some instances these agreements have minimum and maximum volume commitments. If we fail to meet the minimum, or exceed the maximum, volume commitments, our rates and costs may rise.

Network failure or delays and errors in transmissions expose us to potential liability.

Our network uses a collection of communications equipment, software, operating protocols, and proprietary applications for the high-speed transportation of large quantities of data among multiple locations. Given the complexity of our network, it may be possible that data will be lost or distorted. Delays in data delivery may cause significant losses to a customer using our network. Our network may also contain undetected design faults and software bugs that, despite our testing, may not be discovered in time to prevent harm to our network. The failure of any equipment or facility on the network could result in the interruption of customer service until we effect necessary repairs or install replacement equipment. Network failures, delays and errors could also result from natural disasters, power losses, s