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Aug 14, 2020

## Cogent Communications (CCOI)

**$68.91** (As of 08/13/20)

Price Target (6-12 Months): **$72.00**

| | | |
|---|---|---|
| Long Term: 6-12 Months | **Zacks Recommendation:** (Since: 05/11/20) Prior Recommendation: Outperform | **Neutral** |
| Short Term: 1-3 Months | **Zacks Rank:** (1-5) | **4-Sell** |
| | Zacks Style Scores: | VGM:C |
| | Value: D \| Growth: A \| Momentum: D | |

## Summary

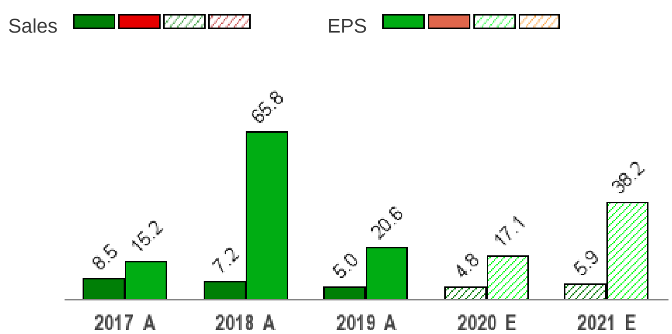

Cogent is well poised to benefit from its On-Network segment as it generates significant revenues and serves a range of net-centric customers in various regions. The company primarily benefits from its cost-effective operations, backed by efficient network expansion and pricing flexibility. Low-churn corporate customers help generate positive cash flow with accretive customer connections. However, it reported unimpressive second-quarter 2020 results, with the top and the bottom line missing the respective Zacks Consensus Estimate. Radical technological changes and patent infringement cause multiple disruptions. Forex woes and severe competition from Internet Service Providers are primary headwinds for Cogent's business operations. Dependency on a single network vendor increases operating risks and makes it susceptible to service outages.


## Price, Consensus & Surprise


## Data Overview

| | |
|---|---|
| 52 Week High-Low | $92.43 - $53.24 |
| 20 Day Average Volume (sh) | 421,731 |
| Market Cap | $3.3 B |
| YTD Price Change | 4.7% |
| Beta | 0.29 |
| Dividend / Div Yld | $2.82 / 3.9% |
| Industry | Wireless National |
| Zacks Industry Rank | Bottom 23% (195 out of 252) |
| | |
| Last EPS Surprise | -21.7% |
| Last Sales Surprise | -1.7% |
| EPS F1 Est- 4 week change | -10.7% |
| Expected Report Date | 11/05/2020 |
| Earnings ESP | -4.4% |
| | |
| P/E TTM | 74.1 |
| P/E F1 | 77.4 |
| PEG F1 | 7.3 |
| P/S TTM | 5.8 |

## Sales and EPS Growth Rates (Y/Y %)




## Sales Estimates (millions of $)

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|---|---|---|---|---|---|
| 2021 | 149 E | 151 E | 153 E | 155 E | 606 E |
| 2020 | 141 A | 141 A | 143 E | 147 E | 572 E |
| 2019 | 134 A | 135 A | 137 A | 140 A | 546 A |

## EPS Estimates

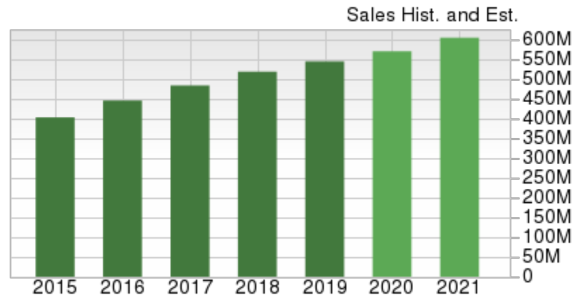
| | Q1 | Q2 | Q3 | Q4 | Annual* |
|---|---|---|---|---|---|
| 2021 | $0.29 E | $0.32 E | $0.35 E | $0.39 E | $1.23 E |
| 2020 | $0.20 A | $0.18 A | $0.24 E | $0.28 E | $0.89 E |
| 2019 | $0.20 A | $0.16 A | $0.30 A | $0.25 A | $0.76 A |

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/13/2020. The reports text is as of 08/14/2020.

## Overview

Founded in 1999 and based in Washington, DC, Cogent Communications Holdings Inc. is a Tier 1 Internet Service Provider (ISP) that offers low-cost high-speed Internet access, private network services and colocation center services with ultra-low latency data transmission. The company provides its services to more than 204 major markets and interconnect with more than 6,840 other networks, spanning across North America, Europe Asia, Latin America and Australia. It addresses the dynamic needs of various small and medium-sized businesses, ISPs and other bandwidth-intensive organizations with the help of efficient network expansion and integration execution.


Cogent's network comprises metropolitan optical networks, in-building riser facilities, inter-city transport facilities and metropolitan traffic aggregation points. It transmits low cost packet switched traffic over a reliable and secure network compared with traditional circuit-switched telephone networks. Its network infrastructure encompasses 1,735 multi-tenant office buildings, 889 carrier-neutral Internet aggregation facilities and single-tenant buildings, 804 intra-city networks consisting of 32,946 fiber miles and an inter-city network of 57,426 fiber route miles.

By type of network service, Cogent generates significant revenues from two types of Internet access services — On-Net services and Off-Net services.

**On-Net services** (73.7% of total service revenues in second-quarter 2020): On-Net services are provided to corporate and net-centric customers located in buildings that are physically connected to its network by Cogent facilities. Corporate customers include financial services, law firms, advertising and marketing and other professional services businesses. Net-centric customers include telephone firms, cable television, ISPs and commercial content and application service providers.

**Off-Net services** (26.3%): Off-Net services are provided to customers located in buildings that are connected to Cogent's network using other carriers' facilities and services by means of "last mile" or local access service lines from the customers' premises. These services are delivered to small and medium-sized corporate customers in more than 6,650 off-net buildings with major presence in the metropolitan markets of North America and Europe.

## Reasons To Buy:

Cogent's cost-effective operations, enhanced data centers and augmented network infrastructure make it poised to generate higher revenues for long-term growth.

- Being the leading provider of high-speed Internet access, Cogent benefits from cost-effective operations. The company offers a streamlined set of products, which help in eliminating redundant costs and give greater pricing flexibility. It incurs relatively lower costs compared with competitors owing to the usage of Internet routers without additional legacy equipment. Backed by efficient network expansion and integration execution, it also offers high-quality Internet service due to the highly economical metro and intercity network infrastructure. Its seamless network delivers high throughput, which reduces the frequency of data packets dropped during transmission compared with traditional circuit-switched networks, thereby creating a more reliable and robust network infrastructure.

- Operating as one of the most interconnected Tier 1 networks in the world, Cogent provides efficient on-network and off-network connectivity solutions to various Enterprise segments, including financial companies, educational institutions and law firms at affordable costs. The company offers state-of-the art colocation data center services that provide incessant power supply and backup generators, making it ideal for disaster recovery and data backup. Its data centers are popularly known for providing a conducive environment for coherent connectivity, security, availability and performance to its end customers. High-speed bandwidth and dedicated Internet access remain the highest priority backed by a team of committed customer support and local provisioning teams to clinch maximum reliability.

- Cogent has a high traffic network footprint across major multi-tenant office buildings in North American cities and carrier neutral colocation centers in North America and Europe, delivering high levels of Internet traffic. Its pervasive and interconnected network gives a competitive edge over its rivals, which helps in augmenting its revenue opportunities and margins. Its end-to-end optical transport network and advanced routing technology provide reliable and scalable network services and connect Cogent's significant markets throughout North America, Europe and Asia. Moreover, its augmented geographical footprint also accelerates acquisition opportunities, thereby increasing its customer base. This, in turn, offers high-quality, low-churn corporate customers, which ultimately aids in generating positive cash flow with proliferating customer connections.

- As of Jun 30, 2020, the company had $417 million in cash and cash equivalents with finance lease liabilities of $189 million. This means that Cogent is likely to pay off its short-term financial obligations in the near term. Despite a debt-to-capital ratio of 1.3 compared with 0.5 of the sub-industry, Cogent's times interest earned has improved steadily in the past few quarters to 1.9. This indicates that the company is more likely to clear its debt obligations in the near term. Its dividend payout rate has increased to 279.6% compared with 276.9% in the prior quarter. This suggests that the company is paying more to its shareholders than earnings which might hamper Cogent's dividend sustainability in the future.

## Reasons To Sell:

Complex peering relationships, intense competition and foreign exchange vulnerabilities have significantly weakened its competitive position in the global market.

- Cogent offers its services in a highly competitive environment, wherein it requires to establish and maintain profitable relationships with other companies. These include customers who connect their network by buying Internet access from the company or major ISPs with whom it works on a settlement-free peering basis. This, in turn, stresses its margins as the company has to incur high operating costs in order to maintain its network infrastructure. Moreover, the need to maintain accretive customer base is also dependent on a number of factors like pricing of product offerings, sales and marketing and turnover generated from customer connections. Hence, in order to generate maximum revenues, Cogent is not only incumbent to augment its customer base but also increase its networking capacity, which could otherwise impair its growth, cash flow and profitability in the days to come.

- Cogent's network infrastructure equipment is significantly manufactured and provided by a single network infrastructure vendor — Cisco. This increases operating risks and makes it susceptible to service outages. Also, migrating from Cisco to any other vendor would be perilous as it involves a lot of time and effort to install and operate new vendor's equipment. This, in turn, amplifies the costs and reduces the operational efficacy, thereby hampering its overall financial condition. Further, due to the prevailing cases of technological changes and patent infringement in the communications industry, Cogent experiences multiple disruptions, thereby often failing to operate as a multi-vendor network.

- Due to its augmented network footprint in various regions, Cogent is susceptible to encounter numerous economic risks. As it primarily operates in North America and Europe, any economic downturn in these regions negatively hampers its growth. The company's business gets majorly affected due to decline in the development of new applications and businesses that make significant usage of its Internet services. Moreover, due to its international exposure, fluctuations in foreign exchange rates also hinder its financial position and operational activities. It is exposed to regulatory and legal requirements like import restrictions, tariffs, trade barriers, exchange controls, privacy and data protection and adverse tax regimes. Hence, Cogent remains under constant threat of currency fluctuations and exchange rate risk.

## Last Earnings Report

**Cogent Misses Earnings & Revenue Estimates in Q2**

| Quarter Ending | 06/2020 |
|---|---|
| Report Date | Aug 06, 2020 |
| Sales Surprise | -1.66% |
| EPS Surprise | -21.74% |
| Quarterly EPS | 0.18 |
| Annual EPS (TTM) | 0.93 |

Cogent reported unimpressive second-quarter 2020 results, with the top and the bottom line missing the respective Zacks Consensus Estimate.

### Net Income

Net income in the June-end quarter was $8.6 million or 18 cents per share compared with $7.1 million or 16 cents per share in the year-ago quarter. The bottom line missed the Zacks Consensus Estimate by 5 cents.

### Revenues

Quarterly service revenues increased 4.6% year over year to $141 million. On a constant-currency basis, revenues increased 5.1% year over year. However, the top line lagged the consensus estimate of $143 million.

On-net revenues increased to $103.8 million from $97.5 million in the year-ago quarter. On-net service is provided to customers located in buildings that are physically connected to Cogent's  network by its facilities. The number of on-net buildings increased by 117 year over year to 2,854 as of Jun 30.

Off-net revenues slipped to $37 million from $37.2 million in the year-ago quarter. Off-net customers are located in buildings directly connected to the company's network using other carriers' facilities.

### Other Details

Total operating expenses were $113.6 million compared with $113 million in the prior-year quarter. Operating income was $27.6 million compared with $22 million in the year-ago quarter. Adjusted EBITDA totaled $53.6 million compared with $47.3 million in the year-ago quarter for a margin of 38% and 35.1%, respectively.

Despite the COVID-19 pandemic, Cogent increased its dividend for the 32nd consecutive quarter. It hiked dividend by 2.5 cents per share to 70.5 cents for third-quarter 2020. The amount is payable on Sep 4 to shareholders on record as of Aug 21.

### Cash Flow & Liquidity

In the first half of 2020, Cogent generated $69.8 million of net cash from operating activities compared with $69.3 million in the year-ago period. As of Jun 30, the company had $417 million in cash and cash equivalents with $189 million of finance lease obligations.

## Valuation

Cogent shares are up 24% over the trailing 12-month period. Stocks in the Zacks sub-industry are up 9% over the past year, and stocks in the Zacks Computer and Technology sector are up 38.8% in the same period.

The S&P 500 Index is up 18.7% in the past year.

The stock is currently trading at 19.67X trailing 12-month EV/EBITDA, which compares to 6.3X for the Zacks sub-industry, 13.36X for the Zacks sector and 12.75X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 25.67X and as low as 12.21X, with a 5-year median of 15.79X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $72 price target reflects 13.33X forward 12-month sales.

The table below shows summary valuation data for CCOI

| Valuation Multiples - CCOI | | | | | |
|---|---|---|---|---|---|
| | | Stock | Sub-Industry | Sector | S&P 500 |
| EV/EBITDA TTM | Current | 19.67 | 6.3 | 13.36 | 12.75 |
| | 5-Year High | 25.67 | 11.55 | 13.51 | 12.84 |
| | 5-Year Low | 12.21 | 5.41 | 7.59 | 8.24 |
| | 5-Year Median | 15.79 | 6.7 | 10.91 | 10.9 |
| P/E F12M | Current | 56.9 | 13.44 | 26.26 | 22.91 |
| | 5-Year High | 117.92 | 15 | 26.31 | 22.91 |
| | 5-Year Low | 44.91 | 10.1 | 16.72 | 15.25 |
| | 5-Year Median | 62.9 | 12.25 | 19.61 | 17.58 |
| P/S F12M | Current | 5.4 | 1.65 | 4.07 | 3.7 |
| | 5-Year High | 7.21 | 1.67 | 4.07 | 3.7 |
| | 5-Year Low | 2.78 | 1.17 | 2.32 | 2.53 |
| | 5-Year Median | 4.01 | 1.47 | 3.14 | 3.05 |

As of 08/13/2020

## Industry Analysis **Zacks Industry Rank:** Bottom 23% (195 out of 252)


## Top Peers

| Company (Ticker) | Rec | Rank |
|---|---|---|
| ATN International, Inc. **(ATNI)** | Outperform | 3 |
| Cambium Networks Corporation **(CMBM)** | Outperform | 2 |
| CenturyLink, Inc. **(CTL)** | Neutral | 3 |
| GCI Liberty, Inc. **(GLIBA)** | Neutral | 2 |
| Gogo Inc. **(GOGO)** | Neutral | 4 |
| TMobile US, Inc. **(TMUS)** | Neutral | 3 |
| Telenav, Inc. **(TNAV)** | Neutral | 4 |
| United States Cellular Corporation **(USM)** | Neutral | 3 |

## Industry Comparison Industry: Wireless National

Industry Peers

| | CCOI | X Industry | S&P 500 | ATNI | CMBM | GOGO |
|---|---|---|---|---|---|---|
| **Zacks Recommendation (Long Term)** | Neutral | - | - | Outperform | Outperform | Neutral |
| **Zacks Rank (Short Term)** | 4 | - | - | 3 | 2 | 4 |
| **VGM Score** | C | - | - | A | B | A |
| Market Cap | 3.26 B | 310.92 M | 23.58 B | 944.21 M | 330.08 M | 291.77 M |
| # of Analysts | 5 | 5 | 14 | 2 | 4 | 3 |
| Dividend Yield | 3.95% | 0.00% | 1.68% | 1.15% | 0.00% | 0.00% |
| **Value Score** | D | - | - | B | D | B |
| Cash/Price | 0.12 | 0.13 | 0.07 | 0.13 | 0.08 | 0.79 |
| EV/EBITDA | 20.62 | 8.12 | 13.34 | 9.15 | 43.47 | 10.27 |
| PEG Ratio | 7.22 | 4.43 | 2.99 | NA | 1.58 | NA |
| Price/Book (P/B) | NA | 1.38 | 3.20 | 1.19 | 7.54 | NA |
| Price/Cash Flow (P/CF) | 27.85 | 7.23 | 12.83 | 10.37 | 77.20 | 7.84 |
| P/E (F1) | 76.71 | 21.00 | 21.99 | 181.94 | 31.53 | NA |
| Price/Sales (P/S) | 5.83 | 1.17 | 2.53 | 2.11 | 1.31 | 0.41 |
| Earnings Yield | 1.29% | 1.25% | 4.35% | 0.54% | 3.19% | -104.37% |
| Debt/Equity | -4.76 | 0.43 | 0.77 | 0.17 | 1.22 | -2.11 |
| Cash Flow ($/share) | 2.47 | 2.47 | 6.94 | 5.70 | 0.17 | 0.44 |
| **Growth Score** | A | - | - | A | B | A |
| Hist. EPS Growth (3-5 yrs) | 58.01% | 6.43% | 10.41% | -32.91% | NA | NA |
| Proj. EPS Growth (F1/F0) | 16.84% | -5.50% | -6.32% | 395.45% | -13.30% | -97.61% |
| Curr. Cash Flow Growth | 3.99% | 3.99% | 5.20% | -14.75% | -47.20% | 299.85% |
| Hist. Cash Flow Growth (3-5 yrs) | 9.91% | 2.65% | 8.55% | -2.08% | NA | 33.75% |
| Current Ratio | 4.97 | 1.34 | 1.33 | 2.06 | 1.92 | 1.34 |
| Debt/Capital | NA% | 44.22% | 44.59% | 14.32% | 55.04% | NA |
| Net Margin | 6.97% | 4.48% | 10.13% | -1.04% | 1.34% | -30.70% |
| Return on Equity | -20.17% | 8.21% | 14.51% | 0.52% | 16.65% | NA |
| Sales/Assets | 0.59 | 0.48 | 0.51 | 0.40 | 1.47 | 0.59 |
| Proj. Sales Growth (F1/F0) | 4.71% | 0.00% | -1.43% | 2.28% | -3.98% | -34.96% |
| **Momentum Score** | D | - | - | C | A | D |
| Daily Price Chg | -1.40% | 0.00% | -0.44% | -0.54% | 0.08% | 0.59% |
| 1 Week Price Chg | -17.20% | 1.49% | 2.30% | 2.17% | -2.56% | 11.51% |
| 4 Week Price Chg | -15.22% | 1.25% | 4.38% | -0.37% | 16.92% | 4.89% |
| 12 Week Price Chg | -8.43% | 6.38% | 13.59% | 2.85% | 221.25% | 42.92% |
| 52 Week Price Chg | 24.05% | -2.39% | 5.75% | 11.34% | 42.78% | -18.33% |
| 20 Day Average Volume | 421,731 | 213,139 | 1,984,154 | 30,658 | 93,281 | 1,645,623 |
| (F1) EPS Est 1 week change | -4.00% | 0.00% | 0.00% | 0.00% | 62.16% | -17.72% |
| (F1) EPS Est 4 week change | -10.69% | 1.29% | 2.08% | 370.83% | 252.94% | -17.72% |
| (F1) EPS Est 12 week change | -10.17% | 0.39% | 2.66% | 152.85% | 4,100.00% | -24.09% |
| (Q1) EPS Est Mthly Chg | -12.71% | 0.00% | 0.94% | -6.25% | 145.46% | -9.76% |

## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

## Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

## Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

## Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

| | |
|---|---|
| Value Score | D |
| Growth Score | A |
| Momentum Score | D |
| VGM Score | C |

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

## Disclosures

**This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock.The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page.** Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

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