Cogent Communications Holdings, Inc. (Q1 2021 Earnings)

May 20, 2021

Corporate Speakers:

- David Schaeffer; Cogent Communications Holdings, Inc.; Founder, Chairman, CEO & President
- Sean Wallace; Cogent Communications Holdings, Inc.; VP, CFO & Treasurer

Participants:

- Michael Elias; Cowen and Company, LLC; Research Associate
- Walter Piecyk; LightShed Partners; Partner & TMT Analyst
- Timothy Horan; Oppenheimer & Co. Inc.; MD & Senior Analyst
- Nicholas Del Deo; MoffettNathanson LLC; Analyst
- James Breen; William Blair & Company L.L.C.; Communication Services Analyst
- Evan Young; KeyBanc Capital Markets Inc.; Research Analyst
- Frank Louthan; Raymond James & Associates, Inc.; MD of Equity Research
- Angela Zhao; BofA Securities; Associate
- Bora Lee-Marks; RBC Capital Markets; Assistant VP

PRESENTATION

Operator: Good morning, and welcome to the Cogent Communications Holdings First Quarter 2021 Earnings Conference Call.

As a reminder, this conference call is being recorded, and it will be available for replay at www.cogentco.com. (Operator Instructions) Cogent's summary of financial and operational results attached to its press release can be downloaded from the Cogent website.

I would now like to turn the call over to Mr. Dave Schaeffer, Chairman and Chief Executive Officer of Cogent Communications Holdings.

David Schaeffer: Thank you, and good morning, everyone. Welcome to our first quarter 2021 earnings conference call. I'm Dave Schaeffer, Cogent's Chief Executive Officer. With me on this morning's call is Sean Wallace, our Chief Financial Officer.

Now for a few comments on our results. As a number of COVID-19 cases in the United States have begun to decline, businesses have initiated plans to begin the reopening offices. We have begun to see improving business climate for our Corporate segment. We have seen declining unit churn in our Corporate segment sequentially for the last 5 months, and our churn levels for the first quarter were lower than the elevated levels that we saw in 2020.

Our NetCentric business continues to benefit from the greater-than-expected growth in streaming subscriptions, and the segment saw its third sequential quarter of accelerated growth. For the first quarter, our traffic was up 8% on a sequential basis and 36% on a year-over-year basis. Despite these improvements, we remain cautious in our outlook about the uncertainty of the current economic environment and the challenges that the pandemic has caused.

Our first quarter results show a higher level of growth in revenues as our revenues grew sequentially by 2% to $146.8 million, an increase of 4.2% on a year-over-year basis. On a constant currency basis, we experienced a revenue growth rate sequentially of 1.7%, a year-over-year growth rate of 2.3%.

We continue to operate in an extremely efficient network. Our network serves a growing number of markets, including carrier-neutral data centers and multi-tenant office buildings in the central business districts of North American cities, and is able to handle the increase in traffic volume at a relatively fixed cost base.

We experienced year-over-year and sequential growth in our non-GAAP gross profit, our non-GAAP gross profit margin and substantial year-over-year growth in our EBITDA and EBITDA margin. Our non-GAAP gross profit grew by 2.7% sequentially and grew by 7.6% on a year-over-year basis. Our non-GAAP gross margin percentages for the quarter improved by 40 basis points sequentially to our record-high of 62.5% and grew by 200 basis points on a full year-over-year basis. Our quarterly EBITDA grew by 10.2% on a year-over-year basis. Our quarterly EBITDA margin increased by 200 basis points from the first quarter of 2020 and to 37.8%.

The performance of our existing customer base continues to be strong despite the impact of COVID-19. Customer churn, day sales outstanding, and maybe most importantly, cash collections all improved in the quarter, as I noted earlier, and our corporate churn rate fell for the second quarter in a row. Our days sales outstanding at 21 days is the best ever in Cogent's history. Bad debt expense as a percentage of our revenues was stable sequentially and improved on a year-over-year basis. We believe that these statistics indicate the strong credit quality of our customer base, and maybe most importantly, the importance of Cogent to those organizations.

During the quarter, we returned $36.1 million to our shareholders through our regular quarterly dividend program. We did not repurchase any stock during the first quarter and have a total of $30.4 million available for stock buybacks under our program, which our Board has authorized to continue through December 31, 2021. Over the past 12 months, we have repurchased $4.5 million worth of stock, representing approximately 79,000 shares of stock.

Our cash held at Cogent Holdings was approximately $59.2 million at quarter's end. This cash is unrestricted and available to use for dividends and stock buybacks. Cash held at our operating companies was $178.8 million at quarter's end, and our consolidated cash position was approximately $238 million at quarter's end.

Our gross leverage ratio fell from 5.14x EBITDA to 4.39 in the last quarter, and our net leverage ratio also declined from 3.4 to 3.31. Our consolidated leverage ratios, as calculated under our note indenture, is 4.41 at quarter's end. Our leverage ratio fell as a result of the recently disclosed purchase of $115.9 million of principal amounts of our secured senior notes that are scheduled to mature in March of 2022, the decline in the value of our euro notes versus U.S. dollar, and is, on a translated basis, for our $350 million euro notes of -- or excuse me, $18.8 million increase in our operating cash flow.

Now for dividends. Our Board of Directors, which reflected on our strong cash-generating capabilities and investment opportunities, have decided to increase our quarterly dividend again by another $0.025 per share per quarter, raising our quarterly dividend from $0.755 to $0.78 per share. This increase represents the 35th consecutive sequential increase in our regular quarterly dividend, and our annualized growth rate in our dividend is 14.7%.

Now I'd like to have Sean read our safe harbor language, give you an update on some additional COVID-19 details and give you some additional color on some of our operating performance in the quarter.

Sean Wallace: Thank you, Dave. Good morning, everyone.

This earnings conference call includes forward-looking statements. These forward-looking statements are based upon our current intent, belief and expectations. These forward-looking statements and all other statements that may be made on this call that are not historical facts are subject to a number of risks and uncertainties, and actual results may differ materially. Please refer to our SEC filings for more information on the factors that could cause actual results to differ. Cogent undertakes no obligation to update or revise our forward-looking statements.

If we use non-GAAP financial measures during this call, you will find these reconciled to the GAAP measurement in our earnings release, which is posted on our website at www.cogentco.com.

We'll update on COVID-19. Like many other companies, Cogent continues to be impacted by the COVID-19 pandemic and the accompanying responses by governments around the world. Virtually, our entire workforce continues to work remotely. I want to thank the entire Cogent workforce and in particular, our IT department for their continued hard work during these very challenging times. I also want to thank our field engineers, contractors, billing and collection staff and many other Cogent employees who continue to work on the front lines installing our new customers, maintaining and upgrading our network and providing outstanding service to our customers.

These and other risks are described in more detail in our annual report on Form 10-K for 2020 and in our quarterly reports on Form 10-Q for the quarters ended March 31, 2021, September 30, 2020, and June 30, 2020.

Throughout this discussion, we will highlight several operational statistics. I will review in greater detail certain operational highlights and trends. Following our remarks, we'll open up the call for Q&A.

Now I'd like to turn the call back to Dave.

David Schaeffer: Hey, thanks, Sean.

Hopefully, you've had a chance to review our earnings press release. Our press release includes a number of historical metrics that we report on a consistent basis. Now for a few comments against our results against long-term multiyear targets that we have been reaffirming.

Our targeted long-term EBITDA annual margin expansion guidance is for an approximately 200 basis points per year of marginal -- of margin expansion. Our targeted multiyear constant currency long-term growth rate is approximately 10%. Our revenue and EBITDA guidance targets are intended to be multiyear goals and are not intended to be used as quarterly guidance.

Our Corporate business represents 62.7% of our revenues. Our Corporate business declined year-over-year by 5.1% from the first quarter of 2020 and declined by 1.8% from the fourth quarter of 2020.

Our NetCentric business, which represents 37.3% of our revenues, had yet another strong quarter and showed accelerating growth of sequentially growing 9.2% quarter-over-quarter and grew by 24.6% as compared to the first quarter of 2020. The volatility in foreign exchange rates primarily impact our NetCentric business as approximately half of that business is outside of the U.S. On a constant currency basis, our NetCentric business increased by 18.7% from the first quarter of 2020 and by 8.3% on a sequential basis from the fourth quarter of 2020.

Now Sean will provide some additional details on our quarterly results.

Sean Wallace: Thanks, Dave, and again, good morning to everyone.

Talking about Corporate and NetCentric revenue and customer connections. We analyze our revenues based upon network type. That includes on-net, off-net and non-core, and we also analyze our revenues based on customer type. We classify all of our customers into 2 types: NetCentric customers and Corporate customers.

Our Corporate customers buy bandwidth from us in large multi-tenant office buildings or in carrier-neutral data centers. These customers are typically professional services firms, financial services firms and educational institutions located in multi-tenant office buildings or connecting to our network through our CNDC footprint.

Our NetCentric customers buy significant amounts of bandwidth from us in carrier-neutral data centers and includes streaming companies and content distribution service providers as well as access networks who serve the consumers of content.

Revenue from our Corporate customers for the quarter fell sequentially by 1.8% to $92 million and fell year-over-year by 5.1%. An increase in the USF tax rate had a $0.4 million sequential positive impact on our quarterly Corporate revenues and had a $0.8 million positive impact year-over-year. The USF tax rate changes quarterly, and we cannot predict the impact of future U.S. freight changes on our revenues.

As we have discussed in previous earnings calls, we believe that the growth of our Corporate revenues was directly impacted by reduced building occupancy in central business districts of major cities as a result of the COVID-19 pandemic. We also found that as a result of the work-from-home environment and general challenges from the pandemic that many of our Corporate customers delayed decisions about system upgrades and new network investments. The slowdown in sales, combined with normal historical levels of churn, has contributed to a modest reduction in Corporate revenues for the past several quarters.

On a positive note, we are seeing some signs that indicate Corporate buying patterns are beginning to return to a more normal level. Sales of our largest product by revenue and connections, our 1 gigabit per second direct Internet access product had its third quarter in a row of rising sales. We are also seeing some of our larger Corporate clients begin to expand and reconfigure their networks. And in terms of churn in our Corporate base, we are encouraged that churn has fallen in each of the last 5 months, and most of the churn is derived from our older 100 megabits per second VPN and direct Internet access products, and we continue to see very low levels of churn from our 1 gigabit connections.

The higher USF rate, which only applies to Corporate VPN connections, increased Corporate revenues by $0.4 million for the quarter, while the continuing trend of lower loop pricing contributed to the reduction in our year-over-year off-net Corporate revenues as we continue to pass on these savings to new off-net customers. We had 46,719 Corporate customer connections on our network at quarter-end which was a decline of 1% versus the fourth quarter and a decrease of 3.7% from the first quarter of 2020.

Continued growth in international traffic and streaming services helped our NetCentric business continue to accelerate growth in the first quarter and for the past 9 months. Quarterly revenue from our NetCentric customers increased sequentially by 9.2% to $54.8 million and increased year-over-year by an impressive 24.6%.

We had 44,206 NetCentric customer -- connections on our network at quarter end, an increase of 4.2% sequentially and an increase of 14.2% over the first quarter of 2020. Our NetCentric business benefited from continued strong demand for our larger 10 gigabits and 100 gigabits per second ports.

The demand from outside the United States was particularly strong, and our sales activity from Europe in the first quarter was significantly higher than the quarterly average of last year. Our NetCentric revenue growth experiences significantly more volatility than our Corporate revenues due to the impact of foreign exchange, larger customer size and certain seasonal factors primarily related to usage.

Traffic grew on our network by 8% sequentially and by 36% year-on-year primarily as a result of increased NetCentric traffic.

Our on-net revenue was $109.9 million for the quarter, a sequential quarterly increase of 2.6% and a year-over-year increase of 6.3%. Our on-net customer connections increased by 1.4% sequentially and increased by 4.3% year-over-year. We ended the quarter with 78,389 on-net customer connections on our network in our 2,939 total on-net multi-tenant office and CNDC buildings. Our off-net revenue was 36.7 million for the quarter, a sequential quarterly increase of 0.1% and a year-over-year decrease of 1.6%.

When we sell new off-net circuits, we incorporate the cost savings from the lower local loop prices into our pricing and the introduction of these customers into our base lowers our overall off-net ARPU.

Our off-net customer connections increased sequentially by 2.1% and increased by 4.2% year-over-year. We ended the quarter serving 12,216 off-net customer connections in over 7,285 off-net buildings. These off-net buildings are primarily in North America.

Consistent with our historical trends, our average price per megabit of both installed customer base decreased for the quarter. However, the average price per megabit of our new customer contracts sequentially increased. The average price per megabit for our installed base declined by 6.8% to $0.38 and declined by 28.1% from the first quarter of 2020. The average price per megabit of our new customer contracts for the first quarter increased to $0.20 from $0.19 from the fourth quarter. Our average price per megabit for our new customer contracts was unchanged from $0.20 from the first quarter of 2020.

As we continue to succeed in selling larger 10 gigabit and 100 gigabit connections to customers, this change in our connection mix change will have the effect of lowering our price per megabit at a greater rate than changes in our pricing per connection, or ARPU. Our on-net ARPU increased sequentially and year-over-year. Our off-net ARPU decreased sequentially and year-over-year. The increases in our on-net ARPU reflects the growing importance and change in the mix of our larger bandwidth products for the Corporate and NetCentric markets. Growth in our 1 gigabit connections to Corporate customers continues to contribute to a higher on-net ARPU.

Another product that is contributing to our higher net ARPU is our 100 gigabit product which is sold primarily to our NetCentric customers. The growth in units and the size of respective ARPUs is having a positive impact on our on-net ARPU. Our on-net ARPU, which includes both Corporate and NetCentric customers was $471 for the quarter, an increase of 1.3% from last quarter and an increase of 2.2% from the first quarter of 2020.

Our off-net ARPU, which is predominantly comprised of Corporate customers, was $1,012 for the quarter, a decrease of 1.4% from last quarter and a decrease of 4.9% from the first quarter of 2020.

We expect that off-net ARPU will continue to decline as we take advantage of volume and time-based discounts in order to lower the cost of our local loops. These reductions in costs are passed on to our Corporate customers and are making us more competitive in this market.

Our sequential quarterly on-net connection churn rate was stable, and our off-net connection churn rate improved. Our on-net unit churn rate was 1% for this quarter, the same as last quarter. Our off-net unit churn was 1.1% for this quarter, an improvement from 1.4% last quarter.

In order to reduce our customer turnover, we employ a dedicated sales group, which works primarily to retain customers who have indicated that they are considering terminating their services with us. They offer pricing discounts to these customers in order to induce them to purchase additional service and/or to extend the term of their contracts with us.

Due to the commodity nature of NetCentric services, the vast majority of our move, add or change contracts are related to our NetCentric customers. During the quarter, certain of our NetCentric customers took advantage of our volume and contract term discounts and entered into long-term contracts with us for over 2,600 customer connections, increasing their total revenue commitment to Cogent by over $21.3 million.

Our EBITDA is reconciled to our cash flow from operations in each of our quarterly earnings press releases. Seasonal factors that typically impact our SG&A expenses include the resetting of payroll taxes in the United States at the beginning of each year, annual cost of living or CPI increases, seasonal vacation periods, the timing and level of our audit and tax services, our annual sales meeting costs and our benefit plan annual cost increases.

Our EBITDA was flat sequentially, primarily due to seasonal increases in our SG&A costs and our EBITDA increased by $5.2 million year-over-year, primarily a result of $6.5 million increase in our on-net revenue. Our quarterly EBITDA margin decreased by 90 basis points sequentially to 37.8% and increased by year-over-year by 200 basis points, which is in line with our long-term expectations.

Our basic and diluted income or loss per share was $0.41 for the quarter, that's adjusted income, compared to a loss per share of $0.14 last quarter. And income per share was $0.20 for the quarter -- first quarter of 2020. Unrealized gains and losses on the translation of our 2024 Euro notes into U.S. dollars are the primary contributor to the variability in our net income and consequently, our income and loss per share, in particular, last quarter and this quarter.

Our revenue earned outside of the United States is reported in U.S. dollars and increased to approximately 25% of total quarterly revenues from 24% of our total quarterly revenues in the fourth quarter of 2020. Approximately 18% of our revenues this quarter were based in Europe, and about 7% of our revenues were related to our Canadian, Mexican, Asia Pacific, South American and African operations. We have not hedged our foreign currency obligations, including our payments on our euro notes.

Continued volatility in foreign currency exchange rates can materially impact our quarterly reported revenue results and our overall financial results. The foreign exchange impact of our quarterly sequential revenue was a positive $0.5 million, and the year-over-year foreign exchange impact was a positive $2.6 million. Our quarterly revenue growth rate on a constant currency basis was 1.7% sequentially and 2.3% year-over-year. Variability in foreign exchange rates primarily impacts our NetCentric business.

The average euro to U.S. dollar rates so far this quarter is 1.19, and the average Canadian dollar exchange rate is 0.8. Should these average foreign exchange rates remain at the current average levels for the remainder of our second quarter of 2021, we estimate that the FX conversion impact on our sequential quarterly revenues for our second quarter would be a negative $0.2 million, and the year-over-year FX conversion impact on our quarterly revenues would be a positive $2.5 million.

We believe that our revenue and customer base is not highly concentrated. Our top 25 customers represented less than 6.2% of our revenues for this quarter. Our quarterly capital expenditures decreased by $0.4 million sequentially and increased by $2.6 million year-over-year. Our capital expenditures were $15.4 million this quarter compared to $15.9 million for the fourth quarter of 2020 and $12.9 million for the first quarter of 2020. A good deal of the increase in our capital expenditures was a result of the need to increase capacity on certain parts of the network as a result of the growing demand in our NetCentric segment.

We continue to anticipate a reduction in our capital expenditures for fiscal 2021. Our finance lease IRU obligations are for long-term dark fiber leases and typically have initial terms of 15 to 20 years or longer, and often include multiple renewal options after the initial term.

Our finance lease IRU fiber lease obligations totaled $218.5 million at March 31, 2021. At quarter end, we had IRU contracts with a total of 280 different dark fiber suppliers. Our finance lease principal payments were $5.7 million for the quarter, primarily due to purchases of dark fiber in international markets compared to $6.2 million for quarter 1 2020 and $4.6 million for the fourth quarter of 2020. Our finance lease principal payments combined with our capital expenditures were $21.2 million this quarter compared to $20.5 million last quarter and were $19 million for the first quarter of 2020.

As of March 31, 2021, our cash and cash equivalents totaled $238 million. For the quarter, our cash decreased by $133.3 million, primarily from the principal payment of

$119.7 million on the partial redemption of our 2022 notes and an increase in our quarterly dividend payment.

Our quarterly cash flow from operations increased sequentially by 25.4% to $47.1 million, primarily due to an $8.7 million increase in our working capital. Our quarterly cash flow from operations increased by $18.6 million year-over-year. Our cash flow from operations this quarter represented the largest amount in Cogent's history.

Our total gross debt at par, including our finance lease IRU obligations, was $963.4 million at March 31, 2021, and our net debt was $725.4 million. Our total gross debt to trailing 12 months EBITDA as adjusted was 4.39% at March 31, 2020, and our net debt ratio was 3.31. Our consolidated leverage ratio, as calculated under our note indenture agreements, was 4.41 at March 31, 2021.

Our $350 million euro notes are reported in U.S. dollars and converted to U.S. dollars at each month end using the month end euro to U.S. dollar exchange rate. The unrealized foreign exchange gain on our euro notes was $18.9 million this quarter or $0.41 per share compared to an unrealized loss of $19.2 million last quarter and an unrealized gain of $2.9 million for the first quarter of 2020.

Our bad debt expense as a percentage of our revenues improved year-over-year and was stable sequentially. Our bad debt expense was 0.6% of our revenues for the quarter compared to 0.5% of our revenues last quarter and 0.8% in the first quarter of 2020. Our bad debt expense was 0.5% of our revenues last quarter. Our days sales outstanding, or DSO, for worldwide accounts receivable was 21 days for the quarter, representing a corporate record for GSO and a significant improvement from our 24 days last quarter.

I want to thank and recognize our worldwide billing and collections team members for continuing to do a fantastic job in serving our customers and collecting from customers during very challenging times.

And with that, I'll turn it back to Dave.

David Schaeffer: Hey. Thanks, Sean.

I'd like to highlight a couple of the strengths of our network, our customer base and our sales force. As I stated earlier, we saw an acceleration in revenue growth in our NetCentric business during the last 3 quarters and an impressive NetCentric growth rate of 24.6% year-over-year. Streaming subscriptions, primarily in international markets, continue to outpace analysts' expectations and we are a direct beneficiary of this trend. But a highlight, some of the key statistics that we believe reflects some of the strength in our NetCentric business.

At quarter end, we connected to 1,274 carrier-neutral data centers and 54 Cogent data centers. This is more than any other carrier globally, as measured by independent third-party research. The breadth of this coverage allows our NetCentric customers to better optimize their networks and reduce their latency. We expect that will widen our lead in this market as we project to connect to over an additional 100 carrier-neutral data centers per year for the next several years based on the planned construction pipeline of these facilities.

At quarter end, we directly connected to 7,470 networks. This represents a 6.1% increase from a year earlier. This collection of ISPs, telco companies, cable networks, mobile network operators and other carriers allows us rapid access to the majority of the world's broadband subscribers and mobile phone users.

At quarter-end, we had a sales force of 239 professionals solely focused on the NetCentric market. We believe that this group of professionals gives us one of the largest and most sophisticated sales teams in this industry segment.

Now for some comments on our Corporate business. We are seeing some positive trends in our Corporate business, but they have yet to fully materialize in positive revenue growth. As work-from-home environment becomes established as part of the way people will work going forward, our Corporate customers continue to look to upgrade their internet access infrastructure to larger connections and symmetric connections.

Our Corporate customers are aggressively integrating some of the new applications that have become part of the work-from-home world, such as video conferencing. This usage will require high-capacity connections, both inside and outside of the premise. As Sean mentioned earlier, this has been an aggressive push for us to increase our Corporate customers' connection size to either 1 gigabit, and in some cases, 10 gigabit symmetric connections.

Our sales force continued to experience improvement from the continued training efforts and the accelerated management out of underperforming reps. As a result, on a sequential basis, our total sales force headcount did decline to 547 reps and our full-time equivalent reps shrank to 522 full-time equivalents at quarter's end. Year-over-year, our sales force increased by 5 reps or 1%, and our full-time equivalent rep count was flat.

Our sales force turnover was 6.6% per month in the quarter, which is a slight drop from the 6.9% per month that we experienced in the fourth quarter of 2020, primarily as a result of our disciplined approach in monitoring our remote sales force and managing out those underperformers and improving the efficacy of our sales force. These factors resulted in a continued rebound in sales productivity to 4.3 orders per full-time equivalent per month of 2.4% sequential increase from the 4.2 orders installed per full-time equivalent per month in the previous quarter.

Overall, we believe our sales force has accomplished a great deal in the past year. The first quarter was our sales team's best quarter in the company's history. Much of that business is installing and will be fully reflected in the second quarter. I wanted to thank our entire sales force and the entire Cogent support team for all they've done and the hard work that they've had throughout COVID-19 and the continued improvements that we're implementing in 2021.

So in summary, Cogent is a low-cost provider of Internet access transit services. The value proposition remains unmatched in the industry. Demonstrating our low-cost position is the fact that since 2016, we have lowered our cost of goods sold per byte mile transmitted by an annual compounded rate of 22.5%. And we remain optimistic about our unique position in serving small and medium-sized businesses located in the central business districts of major cities in North America, with approximately 1,800 multi-tenant office buildings on-net and over 975 million square feet.

Despite the recent drop in new tenancy in many of these cities, we are beginning to see landlords aggressively entice new tenants into their space with lower rents, shorter lease terms and improved tenant amenities, which will keep these Class A buildings at high occupancy levels. As COVID vaccinations increase throughout the United States and in Canada, our tenants will begin to return to the multi-tenant footprint.

We believe that our Corporate business can return to its long-term historic growth trends. Our customers churn bad debt days sales outstanding are all better than our historic numbers. We believe this represents the unique, high credit quality of our customer base and the value of our service to these customers.

Our targeted multiyear constant currency revenue growth rate of 10% and EBITDA margin expansion of 200 basis points per year remains our current best outlook. Our Board of Directors has increased our dividend for the 35th consecutive quarter at $0.025 per share per quarter to $0.78, representing a 14.7% annual growth rate in dividend.

Our consistent dividend increases demonstrate our optimism in the business, the operating leverage of our business model and most importantly, the accelerating cash flow generating capabilities of our business. While we did not repurchase stock in the quarter, we did have over $30 million available for a repurchase program to remain in place through year-end.

Now I'd like to take a moment and just close on some of our capital markets activity. We are looking to optimize our balance sheet and take advantage of the current interest rate environment. We anticipate being able to lower our cash interest expense by over $10 million a year.

In the first quarter, we repurchased $115.9 million of principal senior secured notes that are due March of 2022 with cash on hand. We also issued a conditional call for another $45 million of these notes. Assuming that we do perform on this call, our pro forma leverage will fall below 4.25x as defined in our indentures, both in our 2022 and 2024 notes. As a result of that, we will be able to transfer an accumulated builder basket from the operating company to the holding company, freeing up more capital to be returned to shareholders.

As part of this capital management program, we are planning to offer $500 million of new senior secured notes due in 2026 under 144A. Yesterday afternoon, we released our 10-Q/A quarter -- for quarter ending March 31, 2021, and our quarterly press release to facilitate this transaction.

My apologies to our research analysts who expect this information early the next morning, but we felt it was critical to get this information into the market, so our potential debt investors could analyze our improved business outlook. If we are successful in pricing this offering, we will complete our conditional call, retire $45 million of our 2022 senior secured notes, we will reclassify $121.5 million into our permitted restricted payments, we can then move this cash from holdings to fund future dividends and share buybacks.

Post this reclassification, we will repay the full balance of the senior secured 2022 notes through and issue our new 2026 notes. Pro forma this transaction, we will have $390 million of cash on hand in total and $145 million available at the holding company for dividends and share repurchases.

Again, I'd like to thank all of our investors for their continued support and the entire Cogent team for an excellent quarter.

Now I'd like to open the floor for questions.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions)

Your first question is from the line of Colby Synesael with Cowen & Company.

Michael Elias: This is Michael on for Colby. Two questions, if I may. Were there any onetime items we should be aware of in the quarter, particularly within the NetCentric business? And as part of that, how should we think about the sustainability of the momentum and growth that we're seeing in the NetCentric business currently?

And then also, I would ask you, you mentioned improving sales backdrop. Is there any quantification you could give us on what you're seeing or the improvement you're seeing in your corporate sales funnel either quarter-over-quarter or year-over-year? That would be great.

David Schaeffer: Yes. Sure, Michael. Thanks for the 3 questions. So first of all, there were no extraordinary items in our NetCentric business. This was actually a very broad number of customers, both content delivery and access networks increasing the utilization of our network. We benefited from the fact that our new sale price actually increased rather than declined. This is a result both of foreign currency translation, since nearly half of that business is outside of the U.S., and the continued broadening of our customer base.

Almost 69% of our traffic results in a 2-sided payment, where both the customer sending and the customer receiving are paying Cogent. Only about 31% of our traffic exits or enters our network through one of our settlement free peers. And to remind investors, Cogent does not sell peering or purchase peering or transit as a service.

To your second part of the NetCentric question, we think that this reflects an accelerated shift in viewership throughout the world, moving from linear video to streaming video, improving resolution, improving content, improving choices and subscription models. All of these things first occurred in the U.S. and are now becoming more internationalized. That should bode very well for the NetCentric business, and in particular, Cogent should capture a disproportionate share of that due to the global nature of our network. The carrier-neutral footprint that we described and the sheer number of access networks that connect to us versus any other carrier, give us a sustainable advantage.

Now this is a usage-based business. It typically generally does not grow as rapidly on a sequential basis and more months as in cool because people spend more time outside, less time consuming video. This year may be a bit different, particularly because some of the lockdowns throughout Europe, where people are not able to go out and enjoy the good weather the same way they would normally be able to. In the U.S., we are seeing, I think, a more normalized seasonal pattern.

As I think about the Corporate business, the 24-plus percent year-over-year growth that we delivered was either the best or the second best in the company's history over 21 years. That business ebbs and flows, but has averaged a 9% growth rate. We were underperforming ever since the loss of Megaupload and some of the peering issues with violations of net neutrality. We are encouraged by the current regulatory backdrop and the current administration's commitment to an open Internet.

All of this bodes well for this business performing about at historic trends for the foreseeable future. Now we may have several really good quarters. But over the next 5 to 10 years, we think the NetCentric business can exhibit that high single digit, 9% or 10% year-over-year growth rate.

Now to the final part of your question around corporate visibility One, we have seen the decline in churn rates. We have seen most of that churn come from smaller, older customers who have felt economic pressure because of the pandemic. Offsetting that has been the increase in larger connection sizes and the increased activity level of the sales force, as measured by number of spoke to's per day, number of spoke to's converted in the opportunities, a number of opportunities sold, and that is demonstrated by the increase in sales force productivity with over 65% of the sales force focused on the corporate market here in North America.

Many companies are expecting to return to the office, either on a full-time or a hybrid basis. These companies realize that they need to plan for that return to work and still accommodate work from home. That has been a positive trend for us as companies now are looking for symmetric, larger connections and more locations. There will be some network grooming of some offices, but for the most part, we anticipate sequential continued improvement in our Corporate business and a return to its long-term average growth rate as corporate workforces return to the office in a post-pandemic world.

Operator: The next question is from the line of Walter Piecyk with LightShed.

Walter Piecyk: So let's go back to the Corporate. Obviously, it's been down, as you explain USF of 2% or more in the last 3 quarters sequentially. Aside from the long term, returning to growth as people come back, how do the trends look for the current June quarter? Can you maintain flat revenue in the June quarter?

David Schaeffer: So I actually think we will see continued improvement, the rate of decline has troughed, as I commented, the churn numbers have sequentially declined now for 5 consecutive months and preliminary data for this month indicates it will decline even further. In addition to that, based on sales activities, we actually believe that the Corporate business will improve on a sequential basis in the second quarter. Whether that is enough to return to an aggregate positive number is yet to be seen. But in many parts of the country, probably everywhere, except the Northeast and Toronto, we're seeing an increase in office reopenings and an immediate need to accommodate this new hybrid work model.

Walter Piecyk: So it's improving. So when you say improving, you're just seeing like some KPIs within the business, but it's unclear if that can deliver flat revenue sequentially. Do I understand that right?

David Schaeffer: That's correct. I do not have visibility. What I do have visibility to is the fact that the rate of revenue decline will improve. Will it improve to a 0 rate of decline? It's too early in the quarter to tell.

Sean Wallace: Walter, I just add it to Dave's insights. I think we look -- if we look at what happened in 2020, what's interesting is when we look at the 2 products, the Gigi product, which is an 1,000 megabits per second versus 100, virtually, all that churn was in our 100 megabit product. We grew every month on our gigabit product.

And as we've discussed earlier, that mix of products between 100 meg to gig. 100 meg was our biggest product, indeed in the first quarter of last year. It's gone from over 50% of that Corporate revenue down to 3.3. So the impact of that decline is going down. And so the impact of older clients who are disconnecting is going down. And we mentioned that as we've seen churn go down 5 months in a row. And we also look at growth in our direct Internet access product. January, our units declined, but in February and March, we saw the first increases in net units since the beginning of last year.

So we see a bunch of green shoots all over the place, lower churn. Companies beginning to look at how they're going to operate their business in the new environment. Great growth in our 10-gig VPN product, which is a small product, but tripled in sort of units.

So we see all sorts of improvements of -- the churn that we had suffered over 2020 is going down, and corporates are beginning to reconfigure their network and are beginning to make decisions about what they're going to do, and that typically means they're going to increase their capacity, and we're the right company to do that.

Walter Piecyk: Got it. And can I just ask one quick question also on the balance sheet. When you cite your net debt numbers, you exclude the operating lease liabilities, which obviously increased over the course of the year.

Can you just refresh our memory in terms of across '22, why that went from -- I guess it was $88 million Q1 last year to $109 million this year. And then is there -- if that goes up, is there like an offset in terms of expenses that are not booked as expenses and are just depreciated? And if so, does that factor into kind of the debt covenants that you're citing when you're talking about this 3.2x debt leverage?

David Schaeffer: It's 3.31, is our current net...

Walter Piecyk: Right. Well, I include operating lease liabilities, could I assume that the includes any benefits from that accounting of having operating lease liabilities than if you include the $200 million of -- excuse me, $109 million -- actually, $120 million of operating lease, then it takes the leverage up to 3.8.

So I'm just trying to understand kind of the puts and takes on operating lease. I know that was kind of from an accounting change from a year ago or so, but is there a benefit to EBITDA?

David Schaeffer: So if you remember, last year, FASB changed the rules for lease accounting. You used also have to classify your future contingent obligations, but they were not those types of characterizations as an operating lease liability. As a result, we saw some of our expenses reclassified as capital leases, particularly some long-term O&M contracts on fiber IRUs. Secondly, we...

Walter Piecyk: Which helps EBITDA, right?

David Schaeffer: Which does help EBITDA, and that was clearly disclosed last year in the first quarter. And then also, we have seen the operating lease balance now increase because some of those future obligations now need to be classified as operating leases.

And Sean, I don't know if you want to add any more accounting...

Walter Piecyk: I think that was clear. I'm just trying to look at the right net debt leverage, whether we include it. Like if you're using the 3.3, I guess we have to put those expenses back in if we're excluding operating leases. In any event, it's obviously your leverage is up year-over-year.

Do you think this is kind of the max on leverage, if you just -- forget about the last 4 quarters, even the current quarter annualized. Do you think we've kind of reached the peak in terms of your leverage, however you're calculating the numerator and denominator?

David Schaeffer: Yes. So there is no P&L impact of this accounting change. This is purely a balance sheet gross up. So there is no impact on our ratios.

Walter Piecyk: Yes. And we expect over the next couple of quarters, given the growth in cash flow and given a modest reduction in CapEx that our EBITDA level -- debt-to-EBITDA levels are going to come down marginally quarter-on-quarter.

David Schaeffer: And finally, as I mentioned earlier in the call, we anticipate with this proposed refinancing and the effective constant level of debt when going back to prior to our repurchase of the 116 -- $115.9 million of debt that we will end up saving about $10 million a year in cash interest expense.

Operator: Our next question is from the line of Tim Horan with Oppenheimer.

Timothy Horan: I might have missed. Could you give the corporate customer connection total this quarter and last? If you have it?

David Schaeffer: Yes. Let me get you the exact number. It is, I think...

Sean Wallace: Corporate connections, is that what you're asking?

Timothy Horan: Yes.

Sean Wallace: So we had 46,719 at the end of this quarter. We had 47,175 million at the end of last quarter.

David Schaeffer: So a decrease of 1%?

Sean Wallace: 1%.

Timothy Horan: Okay, got it. But it's a little weird -- and that churn. Well, I guess that was due to the off-net churn over the last couple of quarters, why it kind of declined?

David Schaeffer: That is correct. And the decline in smaller connections. So while we can have unit churn, it is actually possible because of the ARPU uplift from larger connections to actually see the revenue growth improve. We also get the benefit of the mix shift with more connections and bits being on-net than off-net. Off-net are those primarily secondary offices, so we also get that benefit to our cash flow.

Timothy Horan: Got it. So the Corporate ARPU, that would be -- it would have been down slightly year-over-year, just so we're on the same page, right?

David Schaeffer: That is correct.

Timothy Horan: So I guess how is that climbing, if the mix is shifting to gigabit from 100 megs? I would expect that number to have increased?

Sean Wallace: So you have 2 things going on. On the on-net side, you are seeing an increase in ARPU. On the off-net side, it is declining very rapidly.

David Schaeffer: Because of lower loop pricing.

Sean Wallace: And indeed, that's part of the strategy. Our lower -- our ARPU on off-net has declined sort of 8% to 10% per year, much faster than our changes in our on-net connections.

Timothy Horan: Got it. Got it. And that 9% decline per year, I mean, I guess what's the average like connection price now? And will that stabilize at some point, do you think?

Sean Wallace: Through off-net?

Timothy Horan: Yes.

Sean Wallace: Off-net is about $1,725 for a 1 gigabit connection. And again, that's declining in high single digits per year as part of the strategy so that we can become more and more competitive.

Timothy Horan: I mean, the $1,700 just seems a little high. I mean, the cable guys are out there, gigabit connections. I mean, I know it's not the same quality, but for a couple of hundred dollars. I know you have fiber and symmetrical, yes.

Sean Wallace: So it's typically 100 megabits...

David Schaeffer: (inaudible) and that's really the difference. And remember, 100% of our off-net services, just like our on-net services, are only delivered over a fiber connection. There is no coax. And companies can have surge capacity, but when they have work-from-home; employees, they quickly realize that a cable 1 gigabit product is not what they believe it is, and it does not support that type of VPN connection.

Timothy Horan: Got it. So I guess the $1,700, who are you competing with? And what's the market price point out there?

David Schaeffer: So let's go back. First of all, most of our off-net business is sold in conjunction with on-net. So we developed the relationship with the on-net connection, which is most likely a 1 gig connection in the kind of $500 to $700 price range, depending on contract term.

The customer then says, "I want a similar service in an off-net location." We look at our database of nearly 4 million fiber-served buildings from 90 different vendors. We get the very best loop price in an automated tool, and then go and double that to get a 50% gross margin product to offer that customer.

Our win rates are much lower in off-net. We're probably competing with inferior products, delivered over TDM or over coax. And we are selling an -- just a naked pipe. We're not selling bundled services. And again, the off-net business is not a dedicated, viable business, but rather, it is an adjunct to our on-net relationship, and that's why many customers buy from us in many locations.

Sean Wallace: Yes. And it's just simplicity. So if you're if you're a company reconfiguring, you got 8 locations and, let's say, 4 are on-net and 4 are off-net, it's much more difficult to go to another vendor to buy that. So when you blend all the costs of our on-net circuit versus our off-net circuit, most corporates will prefer to use one vendor, i.e., Cogent, versus having to use multiple vendors for different circuits.

Timothy Horan: Very helpful. Last, do you expect the traffic growth overall to slow? I know it's been kind of relatively stable the last 5 months, just the year-over-year comps could get pretty difficult in the second half of this year.

David Schaeffer: It's a little hard to answer that question because it is usage based. While we are returning to work in the U.S. much of the rest of the world is behind the U.K., Singapore, Korea, Israel. There are some markets where we're seeing pretty good reopenings, but there is still a lot of shutdowns and people required to stay in place.

So I actually think we're going to continue to see elevated traffic growth rates for the foreseeable future. And then we also have this long-term phenomenon, which is the reduction in linear packages and the adoption of multiple streaming packages. And I think we're still at the early stages of people figuring out how many concurrent packages they're going to have.

But the broadening of the streaming supply chain actually helps 2 ways. It helps us in charging more for streaming, it's going out. And it means the receivers who are also paying us are probably receiving more bytes, more hours of the day.

Operator: Your next question is from the line of Nick Del Deo with MoffettNathanson.

Nicholas Del Deo: First, on the NetCentric front. Obviously, the improvement there has been pretty stunning. The drivers you call out all make sense, but I feel like they've been chunking along for a while. So it's kind of hard to tie to the changes in growth.

Like OTT adoption has been growing for some time. You've been pushing overseas for some time. The customer base has been broadening out for some time. I think the pace of traffic growth this quarter even ticked down a little bit. Is there anything else that's different now that's having such a dramatic impact on the growth and drove such an inflection?

David Schaeffer: Okay. So first of all, we'll start by thanking you for participating in Cogent. I have not had a chance to do that, Nick, so I want to thank you for that. But I think these are really continuations of long-term trends.

The NetCentric business tends to be a bit lumpy. These trends tend to take several quarters to fully manifest themselves. And you are right that the sequential traffic growth did tick down slightly as it normally would this time of year. But effectively, we have been able to get a higher revenue per byte. You see that two ways. One, the average price of new benefits sold actually slightly went up. That's a reflection of a broader buyer universe. We also were helped by the fact that more of the access network growth is coming outside of the United States where we are stronger.

In the U.S., the 3 largest access networks are not Cogent transit customers in the U.S. but are rather peers. Now all of those 3 companies do buy transit from us in international markets, but that is not true of the converse for some of our European and Asian peers. They buy from us -- or customers, they buy from us globally. They are not peers anywhere. So this internationalization phenomena, I think, has a long way to go.

And it also is back to the question about impacting COVID. It really has been worse in Continental Europe than it has been in most of the U.S. Probably with the exception of the Northeast, most of the U.S. appears to be reopening.

Sean Wallace: Nick, I would just add, I'd say, they may disagree with. I think there is clearly more growth overseas. You talk about HBO Max, which has had a slow start but is now beginning to really pick up steam. They are indicating that they're going from 1 market to 61 markets. And as Dave mentioned, they're not a customer in the United States, but outside.

Theoretically, they would find Cogent a much more -- a much better vendor, given that we're in 47 countries where in all these DCS. And as Dave points out, we have all these access networks. So as streaming goes international, and that happened over the last several months, I think we've benefited from an outsized portion versus competitors.

Nicholas Del Deo: Okay. Okay. And then just maybe one last one on the Corporate segment. Kind of thinking about the mechanics of how a business goes from a potential tenant in a building to a Cogent customer. How should we think about the time it would typically take from a time -- from when a business starts looking for space and signs a lease and takes the space and moves in and signs up for a DIA. What does that cycle typically look like?

David Schaeffer: So for the new tenant, that's the best news. They have to make a decision. There's a forcing event. Typically, a company will look anywhere from 1 month. If they're moving into a spec suite that's pre-built out to as much as a year in advance until they intend to take occupancy if there's an extensive build-out. I think because many of the new leases tend to be for shorter duration and the landlords, in order to improve occupancy, have been more willing to build spec suites, I think that window from decision to actual move-in on average is shortening.

I think the much more important trend, though, for Cogent is what is impacting the decision cycle of an existing tenant as they think about bringing their employees back to the office, and they are not a Cogent customer today. And there -- I think, there are 3 key factors.

One, the belief that some portion of the workforce will continue to work from home. So therefore, I need to make sure I've got enough bandwidth both in and out of my network. Two, the applications that I'm deploying are more and more going to be off-prem and the data computing and storage will be more and more off-prem. All of these drivers have companies reevaluate their Internet access requirement. Later on top of that, the VPN transition. So as we've talked about many times, have been dominated by MPLS. That degradation was happening long before the pandemic.

Actually, in a way, the pandemic provided a lifeline to those MPLS providers because customers were necessarily in kind of a wait-and-see mode as opposed to making a new network architecture decision. Now that they're coming back to the office, and this was to the first question Michael asked.

One of the questions is, what's my new office-to-office connectivity going to look like. And that is a very strong positive. So while we'll win new customers coming in, the bigger opportunity for us is those existing customers or existing tenants who are not Cogent customers when in return to the office, needing a new network architecture.

Operator: Our next question is from the line of James Breen with William Blair.

James Breen: Dave, have you guys had any discussions on the landlord side just around as companies start to downsized our real estate footprint? Is an opportunity here where your average 50 tenant starts to go up as it tends to take less space? And you've talked in the past about the best opportunity for selling when changes happen. Just to do your thoughts on that.

David Schaeffer: Yes. So we have reached out to our roughly 350 institutional owners of MTOB, so 1,800 buildings owned by about 350 different organizations from the largest brookfield to maybe a small single building owner. And what we have heard as our real estate team has engaged with them is 3 things.

One, the increased need for high-quality bandwidth as a tenant amenity to attract people to their space. So we've even seen some of our landlords come to us and say, we have another building that may not have met Cogent's criteria. We'll actually give you a free license agreement as opposed to the license agreement you paid for to serve that building up. We may even put part of the bill for you to construct into the building.

I can think of a handful of buildings in New York right now that are being repositioned that we're doing exactly that a lot.

The second thing we're seeing is landlords increasing the amount of spec, and those are designed for smaller tenants. What I would love to get the big Martindale-Hubbell kind of top 10 law firm for a 15- or 20-year lease. Those leases are hard to come by. Some are moving down market to smaller tenants to attract them. The landlords are spending $150 a foot building out spec suites, hoping the tenants come in. And the good news there is they come quickly, and having high-speed Internet access that's immediately available, very attractive.

The third thing that's happened is there's actually a decrease in proportion of the building that has been used for shared amenities. So there was a bit of a war going on by landlords of how fancy of a gym they could put in, how much of a conference center they can put in, how free beer was available in a party room for tenants.

And now, we're seeing people go back to a more traditional leasing model where they say, "All I care about is my space. I don't really care about that shared space." And that means there's more square footage available for rent paying and Internet purchasing tenants. So I think all of these things bode well to increase our total addressable market.

Operator: Your next question is from the line of Brandon Nispel with KeyBanc.

Evan Young: It's Evan Young on for Brandon. You're showing a growing trend in international NetCentric demand. Where do you see the kind of the mix between domestic and international revenue settling in the next few years? Does more international demand affects the average price per byte?

David Schaeffer: So there are two very different trends. The first one is content production tends to be pretty much an American phenomenon. Yes, there's Bollywood. There are some other markets, but virtually all of the major streaming services are U.S.-based. Now in order to reduce latency, they may purchase both domestically and internationally from us, and the revenue will be reflected accordingly, but they're priced on a global purchase agreement.

The second thing is for the receiving access network. The adoption of streaming in the less-developed world and even in Europe lags behind the U.S., and that is a positive. Eventually, as we look at Internet traffic, the U.S. has declined in 20 years from 85% of global Internet traffic to 33%. That will eventually decline to somewhere between 4% and 5% because that's what percentage of the world's population we are. That's a multi-decade trend because teledensity and infrastructure in most of the world lags behind the U.S.

I know we get a lot of for poor infrastructure. Everybody looks at Korea, for example, as this model for broadband. But for the most part, there is still more ubiquity and higher speed -- much higher prices in the U.S. than the rest of the world. And we are seeing significant fiber-to-the prem builds being promulgated by government incentives, such as U.K. Openreach, the Iliad build in France, our two very strong examples of a national getting fiber in every premise.

There is a major effort in Germany to overbill, major effort in the Netherlands. So I think over time, international will represent a larger and larger percentage of our NetCentric business. I think it's impossible to predict the exact mix 3 or 4 years out.

Operator: Our next question is from the line of Frank Louthan with Raymond James.

Frank Louthan: Great. All right, you probably can get your answer to this one. But are you in any way concerned about some of the fixed wireless claims, some of the larger carriers, particularly for the off-net business for backup-type services. It seems like where they're targeting some of that will be more in some suburban-type areas where maybe some of your off-net business generally lives. Just give us your thoughts on that.

David Schaeffer: So as we've stated many times, Frank, anything that brings more traffic to the Internet is ultimately a positive for Cogent. More access technologies, whether they be fiber-to-the-prem or fixed wireless, domestically or internationally, bodes well for our business.

Now our off-net corporate business is an adjunct to our on-net business. There is no fixed wireless service that is on a per-unit basis anywhere nearly as reliable or cost-effective as our on-net services. We fully admit that our off-net services are more expensive and less reliable, even though they're delivered over fiber from someone else. We have refused to resell fixed wireless access because of the very high cost per byte. There is a segment of the market that will use that product.

Now whether or not that's going to be material to broadband traffic growth, I'm very skeptical just because the cost per bit is so high. Just as we've had questions around new satellite ventures such as Starlink. Very ambitious, generate lots of subscribers, but at the end of the day, the constraint is it's a fixed wireless path that is very, very expensive per byte, and it will never compete if there is a terrestrial fiber alternative.

It will work in those white unserviceable areas that are the white space that fiber cannot be cost-justified in. But what we're seeing is a concerted effort in the U.S. and governments around the world to realize that finally, the digital divide needs to be closed, and fiber is a necessary infrastructure of society.

Frank Louthan: All right. Great. And just quickly, what is your outlook for sales headcount growth for the year? Or do you expect to end up relative to where you did at the beginning of the year?

David Schaeffer: So our stated goal remains to grow the total sales force at 7% to 10% per year, rolling up 1% right now on a year-over-year basis. So we are lagging. Part of that is the challenges in managing a remote sales force in the pandemic and/or lag at managing out underperforming RINs.

I think we have put those systems in place to be able to monitor rep productivity, and that's why our sales force productivity is increasing. We are all hoping for a return to our offices, at least in North America and the U.K., by the end of summer. And that should allow us to reaccelerate our hiring and get back to a more traditional onboarding and training program that should get us back on track for that 7% to 10% total sales force growth.

Operator: Our next question is from the line of Angela Zhao with Bank of America.

Angela Zhao: This is Angela on for Mike Funk. So earlier in the call, you talked about the new sales force being focused on NetCentric margins. Could you expand on that? And could you talk about the overall margin progression for the remainder of 2021? And two, if I may, can you talk about the projected growth in enterprise connections going forward from here?

David Schaeffer: Yes. So let me start with margin. When we add $1 of on-net, it carries 100% gross margin contribution and $0.95 of EBITDA. In our Corporate business, roughly 60% of sales are on-net, 40% are off. In NetCentric, it's over 90% on and only 10% off. So the increase in NetCentric growth bodes well for gross margin expansion and EBITDA margin expansion.

We have guided to a 200 basis point per year multiyear expansion and EBITDA margins with roughly half coming from gross margin expansion and half coming from EBITDA. We actually achieved that, but most of the benefit was on the gross margin side and the increased cost of operating in the pandemic offset some of the SG&A improvement. As we return to the office, we think those factors should normalize, and we should be able to continue to say about 200 basis points a year until EBITDA margins plateau at around 50% based on the size of our addressable market.

Now to the enterprise connection question, we expect to continue to increase the penetration in the on-net buildings that we have. We also expect that we'll return to an average of 1.5 connections sold per customer, with half of the customers taking a second connection either for backup or for VPN. We also believe that not all of the secondary offices will be shuttered, only those in the same metropolitan market. So as a result, we think our off-net unit volume growth should mirror that of our on-net business, call it, kind of a 11%, 12% grow long term, which has been the long-term averages.

But as Sean mentioned earlier, the input cost for loops off-net have been coming down. To Tim Horan's question about our ARPU for those 1 gigabit connections, we've seen a 9% or 10% annual cost reduction in those loops, and we expect that to continue as cable and telco continue to overbuild fiber and put pressure on those suburban infrastructure facilities. Vertical systems now indicate that 64% of all business premises that have 20 or more employees have one or more fiber suppliers to them. This has greatly expanded our off-net addressable market.

Operator: Our next question is from the line of Bora Lee with RBC Capital Markets.

Bora Lee-Marks: You touched on aspects of this during the call. I'm just trying to understand the path that the traffic takes perhaps by in the U.S. as a model. Can you talk about the network patterns you saw in the U.S. as it relates to COVID shutdowns and reopening and where Europe is on that curve? And to the extent that there's any quantification you can provide.

David Schaeffer: Yes, sure, Bora. So a couple of points. First of all, 90% of our traffic is from our NetCentric business. On the Corporate side, what we saw, I talked about that 10% first, as people work from home, the bandwidth going in and out of a business actually needed to be symmetric as opposed to in a normal time when the employees are sitting in the office, they're sending a few request bids out and just pulling information in and the connection can be much more asymmetric, more down than up.

I think in a hybrid corporate model, which appears to be what is evolving for businesses, that symmetry is going to become increasingly important. Now to where 90% of the traffic comes from, and that is content going to consumer, residential consumer. That content is distributed in data centers. We have over 1,300 of them, which gives us a competitive advantage. That content wants to be closer to the customer to have greater -- lower latency, but also needs to have high utilization to justify the space and power expense. We then need direct connectivity to as many access networks as possible. We have that.

Now in North America, more of our exiting traffic goes to our peers rather than our customers. We do have several very large cable operators as customers. Many independent telcos, thousands of small regional players, whether they be in very rural areas or rural telcos. But as a percentage of the U.S. customer base, they're relatively small.

If we pivot over to the international market, we have most of the PTTs in the world buying from us, most of the cable operators and most of the competitive carriers. So internationally, we have a much higher percentage of traffic where we're getting paid on both sides versus the U.S. And this increased internationalization has improved our effective price per megabit.

Bora Lee-Marks: Great. And in terms of sales reps tenure, I think you've said in the past is an indicator of how efficient the sales force is, can you just provide an updated number given all the moving pieces in the headcount?

David Schaeffer: Yes. Actually, our sales force tenure has actually increased slightly throughout the pandemic. We've gone from an average rep life of about 28 months to just around 30 months, which is the optimal point where productivity peaks. Most of our sales force turnover occurs in the first 6 months of the rep's tenure at Cogent.

The first month is for onboarding and training. And then in the next 5 months are expected to hit a number of KPIs that may not include significant quota, but do require a large number of customer spoke to's and funnel-building activity.

And that's really where we have seen the greatest struggle in the pandemic environment to train reps to build adequate funnels. And what then happens is in that first 5 or 6 months of being on the phone, if your funnel is inadequate, there's no way you can succeed and those reps are then managed out of the business.

Bora Lee-Marks: Okay. So it sounds like you're well -- the sales force is reasonably well positioned to actually take advantage when, if things reopen?

David Schaeffer: I believe so. I mean, we can always do better, and we are looking to grow the sales force, to Frank's question, but we feel we are absolutely in a position to capture market share as people come back to the office.

Bora Lee-Marks: Okay. Great. And just one last question. It looks like you launched your global peer connect service in the third quarter. Can you just provide a little color on the service, what you're hoping to achieve? And customer interest that you've seen since the launch?

David Schaeffer: Sure. So we are a firm believer that transit is the best way for smaller networks to connect to the public Internet. However, there is about 10% of the market that have chosen to use single-location exchanges, such as they may be replicated in multiple markets. We took advantage of our unique assets and built a global exchange, where there is no distant sensitivity and there is no fixed port commitment. That has been very well received. We have sold hundreds of ports to hundreds of networks.

Now it does require the networks entering the exchange to affirmatively agree to exchange traffic with one another, where when you purchase transit, that becomes the obligation of your upstream provider. The vast majority of our traffic still goes through transit. It's easier to use. It's cheaper, and it provides more scalability. But there is this 10% of the market that wants that direct control feature of an exchange. And I think our exchange has been very successful.

I do think there is a network effect. And our transit business has a 20-year head start, but we're very encouraged by the early adoption of the exchange and the hundreds of customers who have chosen to connect to them.

Operator: At this time, there are no further questions. I will turn the call back to the host for any closing remarks.

David Schaeffer: I'd just like to thank everyone. I know these calls go long. We did really work on trying to shorten our script, but we did have the Capital Markets activity that we needed to touch on.

So again, I want to thank everyone. Please stay in touch, and thank you for your support, and stay safe and well. Bye-bye.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for your participation, and have a wonderful day. You may all disconnect.