Cogent Communications Holdings, Inc. (Q2 2021 Earnings)
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Corporate Speakers

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

Participants

- George Engroff; Credit Suisse AG; Analyst
- Philip Cusick; JPMorgan Chase & Co; Analyst
- Frank Louthan; Raymond James & Associates, Inc.; Analyst
- Colby Synesael; Cowen and Company, LLC; Analyst
- Walter Piecyk; LightShed Partners; Analyst
- Nick Del Deo; MoffettNathanson LLC; Analyst

PRESENTATION

Operator: Good morning, and welcome to the Cogent Communications Holdings Second 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. A transcript of this conference call will be posted on the same website when it becomes available.

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 to everyone. Welcome to our second quarter 2021 earnings conference call. I'm Dave Schaeffer, Cogent's Chief Executive Officer; and with me on this morning's call is Sean Wallace, our Chief Financial Officer.

As a result of the pandemic-related efforts that have shifted towards a broad reopening of the U.S. economy and as many large businesses have developed plans and deadlines to reopen their offices, we've seen some signs of improvement in the business climate for our Corporate segment. Our NetCentric business continues to benefit from the greater-than-expected growth in streaming subscribers and the continued internationalization of the Internet and the streaming phenomenon, where our global footprint positions Cogent as the best network to deliver traffic on an end-to-end basis globally.

For the second quarter, our traffic growth moderated somewhat from the fast pace of growth in previous periods but was up 1% sequentially in what is traditionally a seasonally slow period and increased 25% on a year-over-year basis. Despite these improvements, we remain cautious in our outlook, given the uncertain economic climate,

and the challenges that have resulted as the continuation of the pandemic and the emergence of the Delta variant.

Our second quarter revenues grew sequentially by 0.8% to $147.9 million, an increase of 4.9% on a year-over-year basis. On a constant currency basis, we experienced sequentially revenue growth of 0.6% and a year-over-year constant currency growth rate of 2.8%. We've made progress with our sales force as our sales rep productivity improved to 4.5 installed orders per month per full-time equivalent, up from 4.3 in the previous quarter. And the turnover rate in our sales force, our sales rep churn rate, declined from 6.6% a month to 5.6% per month on a sequential basis.

We continue to operate an extremely efficient network. Our network services are able to be perceived in a growing number of markets, additional carrier-neutral data centers and multi-tenant office buildings and is able to handle a continuing growth in traffic volume at a fixed cost basis. This operating leverage allows us to achieve year-over-year and sequential growth in our EBITDA and EBITDA margin.

Our quarterly EBITDA grew by 2.9% and grew by 7.2% on a year-over-year basis. Our quarterly EBITDA margin was 38.7%, which is an increase of 90 basis points, both on a sequential and on a year-over-year basis.

The performance of our existing customer base continues to be strong throughout the pandemic. Customer churn, day sales outstanding and cash collections, all are within historical norms. Bad debt as a percentage of our revenue improved sequentially and also improved on a year-over-year basis. We believe that these are strong indicators of the credit quality of our customer base and the seminal importance of our services to these organizations.

During the quarter, we returned $37 million to our shareholders through our regular quarterly dividend. We did not repurchase any stock during the first quarter, and have a total of $30.4 million available for buybacks under our stock repurchase program, which has been authorized through December 31, 2021. Our cash held at Cogent Holdings was $148.2 million at quarter end. This cash is unrestricted and available to use for dividends and/or stock buybacks. Cash held at our operating company was $225.7 million, and our total cash in both operating and holding companies were $374 million at quarter end. Our gross leverage ratio was 5.13 and our net leverage ratio was 3.45 at the end of second quarter 2021.

Our consolidated leverage ratio as calculated under our indentures was slightly lower at 5.10. In the second quarter, we successfully issued $500 million of 3.5% senior secured notes due in 2026. The proceeds from this offering were primarily used to retire our $445 million of 5 3/8 senior secured notes that were due in 2022 and provide us additional liquidity.

A couple of things to note regarding this financing. We're gratified to receive a ratings upgrade by Standard & Poor's and now have a senior secured rating of Ba3/BB, which

we believe reflects the strength of the company's operational excellence and financial conditions. This $500 million fundraising was the largest in the company's history. And the 3.5% interest rate that we achieved was the lowest interest rate the company has paid on debt. We expect to save approximately $6.5 million in interest expense as a result of this transaction in addition to receiving $55 million of incremental liquidity.

Now with regard to dividends, our Board of Directors, which reflected on the strength in the cash flow generating capabilities of our business, the investment opportunities that we remain disciplined in executing and the ability to deploy capital internally to grow our sales force decided to increase our quarterly dividend yet again by another $0.025 per share, therefore, raising our quarterly dividend from $0.78 per share to $0.805 per share in the second quarter to be paid in the third quarter. This increase represents the 36th consecutive sequential increase in our regular quarterly dividend, and our dividend grew at a rate of 14.2% year-over-year.

Now I'd like to turn things over to Sean to read our safe harbor language, give a little more color on our COVID-19 policies and challenges, and review some of our operating performance for the quarter.

Sean Wallace: Thank you, Dave, and 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 measurements in our earnings release, which is posted on our website at www.cogentco.com.

An 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 services 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 June 30, 2021, March 31, 2021 and September 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 it back over to Dave.

David Schaeffer: Okay. Thanks, Sean. Hopefully, you've had a chance to review our earnings press release. Our press release includes a number of historical quarterly metrics which we reported on a consistent basis. Our targeted long-term EBITDA annual margin expansion guidance is for an improvement of 200 basis points per year. Our targeted multiyear constant currency revenue growth target is still approximately 10%. Our revenue and EBITDA guidance targets are intended to be multiyear goals and are not intended to be used as quarterly or annual guidance for any specific year.

Our Corporate business at the end of the quarter represented 61.2% of our revenues in the second quarter. Our Corporate business declined by 1.6% from the first quarter of 2021 and declined by 6.7% from the second quarter of 2020 due to the impact of the pandemic.

Our NetCentric business, which represents 38.8% of our revenues, had another strong quarter and showed continued growth of 4.8% on a sequential basis quarter-over-quarter and grew at a historically high rate of 30.5% on a year-over-year basis from the second quarter of 2020. Volatility in foreign exchange rates primarily impacts our NetCentric business as approximately 50% of this business is outside of the U.S. On a constant currency basis, our NetCentric business increased by 23.8% on a year-over-year basis from the second quarter of 2020, and grew by 4.5% on a sequential basis from the first quarter of 2021.

Now Sean will provide some additional details on our performance for the second quarter.

Sean Wallace: Thanks, Dave, and again, good morning to everyone. I'll talk about Corporate and NetCentric revenue and customer connections. We analyze our revenues based upon network types: on-net, off-net and noncore. And we also analyze our revenues based on customer type. We classify all of our customers into two types, either NetCentric customers or 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 include streaming companies and content distribution service providers as well as access networks who serve the customers of content -- the consumers of content.

Revenue from our Corporate customers for the quarter fell sequentially by 1.6% to $90.5 million and fell year-over-year by 6.7%. Corporate revenues in the quarter, when you exclude USF taxes, fell by $1.8 million, which is an improvement from the decline in the

first quarter of $2.1 million and a decline of $2.4 million in the fourth quarter. An increase in the USF tax rate, which only applies to our Corporate VPN connections, had a $0.3 million sequential positive impact on our quarterly Corporate revenues and had a $1.5 million positive impact year-over-year. The USF tax rate changes quarterly, and we cannot predict the impact of future USF rate changes on our revenues.

As the focus of the pandemic has evolved towards the reopening of offices, we have begun to see some indications that our Corporate business is beginning to return to a more normal level of activity. Gross sales in the Corporate side, however, have not rebounded to pre-pandemic levels.

In terms of aggregate churn in our Corporate base, we continue to see the majority of churn coming from our older 100 megabits or Fast Ethernet product, and we continue to see net unit growth in our 1-gigabit per second product. The continuing trend of lower local loop pricing contributed to the reduction in our year-over-year off-net Corporate revenue as we continue to pass a portion of those savings to new off-net customers. We had 45,803 Corporate customer connections on our network at quarter end, which was a decline of 2% versus the quarter, and a decrease of 5.2% from the second quarter of 2020.

Our NetCentric business continues to benefit from the strong growth in streaming subscriptions and continued faster growth in traffic overseas. Quarterly revenue from our NetCentric customers increased sequentially by 4.8% to $57.4 million and increased year-over-year by 30.5%. We had 46,065 NetCentric customer connections on our network at quarter end, an increase of 4.2% sequentially and an increase of 15.7% over the second quarter of 2020.

Our NetCentric business benefited from continued strong demand for our larger 10-gigabits per second and 100-gigabits per second ports. The demand from outside of the United States was particularly strong. 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 sequentially by 1% for the quarter and by 25% on a year-on-year basis. We typically experience a seasonal slowdown in traffic growth in our second quarter versus our first quarter.

Our on-net revenue was $111.0 million for the quarter, a sequential quarterly increase of 1% and a year-over-year increase of 7%. Our on-net customer connections increased by 1% sequentially and increased by 4.2% year-over-year. Year-over-year, our on-net revenue grew at a faster rate than our on-net customer connections primarily due to a 2.6% increase in our on-net ARPU. We ended the quarter with 79,146 on-net customer connections on our network in our 2,975 total on-net multi-tenant office and carrier-neutral data center and Cogent data center buildings.

Our off-net revenue was $36.7 million for the quarter, a sequential quarterly decrease of 0.1% and a year-over-year decrease of 0.9%. 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 new and existing customers into our base lowers our off-net ARPU. Our off-net customer connections increased sequentially by 1.4% and increased by 4.6% year-over-year.

On a year-over-year basis, our off-net revenue results were moderately -- moderated primarily due to a 5.1% decrease in our off-net ARPU. This ARPU decrease is driven primarily by the continued falling cost of local loops necessary to sell this service. We ended the quarter serving 12,386 off-net customer connections in over 7,379 off-net buildings. These off-net buildings are primarily located in North America.

Pricing per megabit. Consistent with our historical trends, our average price per megabit of both our installed customer base and new customer contracts decreased for the quarter. The average price per megabit for our installed base declined sequentially by 6.1% to $0.36 and declined by 24.8% from the second quarter of 2020. The average price per megabit for our new customer contracts for the quarter decreased by $0.18 from $0.20 from the first quarter and decreased 21.9% from the second quarter of 2020.

ARPU. Our on-net ARPU slightly decreased sequentially but increased year-over-year. Our off-net ARPU decreased sequentially and year-over-year. The increase in our year-over-year 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 1-gigabits per second connections to Corporate customers continues to contribute to a higher on-net ARPU.

Another product that is contributing to our higher on-net ARPU is our 100-gigabits per second product, which is sold primarily to our NetCentric customers. The growth in units and the size of their respective ARPU is having a positive effect on our on-net ARPU. Our on-net ARPU, which includes both Corporate and NetCentric customers, was $470 for the quarter, a slight decrease of 0.2% from last quarter, but an increase of 2.6% from the second quarter of 2020. Our off-net ARPU, which is predominantly comprised of Corporate customers, was $994 for the quarter, a decrease of 1.8% from last quarter, and an increase of 5.1% from the second quarter of 2020. We expect that our off-net ARPU will continue to decline as we take advantage of the lower cost of local loops. A portion of these reductions in costs are passed on to our Corporate customers.

Churn rates. Our sequential quarterly on-net connection churn rate was stable and our off-net connection churn rate slightly increased. Our on-net unit churn rate was 1.0% for this quarter, the same churn rate as last quarter. Our off-net unit churn rate was 1.2% for this quarter as compared to 1.1% last quarter.

NetCentric MAC orders. In order to reduce 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. We may offer pricing discounts to these customers in order to induce them to purchase additional services 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 2,700 customer connections, increasing their total revenue commitment to Cogent by over $24.8 million.

EBITDA and EBITDA margin. 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 audit and tax services, our annual sales meeting costs and our benefit plan annual cost increases. Our EBITDA increased sequentially primarily due to our increase in revenue and the seasonal increases in the first quarter in our SG&A costs that do not continue in our second quarter.

Our EBITDA increased year-over-year primarily due to the $7.2 million increase in our on-net revenue. Our EBITDA increased by $1.6 million sequentially and increased by $3.8 million on a year-over-year basis. Our quarterly EBITDA margin was 38.7%, which was an increase of 90 basis points on a sequential and year-on-year basis.

Earnings per share. Our basic and diluted loss per share was $0.05 loss for the quarter compared to an income per share of $0.41 last quarter, an income per share of $0.19 for the second 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.

Foreign currency impact. Our revenue outside the United States is reported in U.S. dollars and increased to approximately 25.6% of our total quarterly revenues from 25.3% of our total quarterly revenues in the first quarter of 2021. Approximately 18% of our revenues this quarter were based in Europe; and about 7% of our revenues related to our Canadian, Mexican, Asia Pacific, South American and African operations. We have not hedged our foreign currency revenues or 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 on our quarterly sequential revenue was a positive $0.2 million, and the year-over-year foreign exchange impact was a positive $3 million. Our quarterly revenue growth rate on a constant currency basis was 0.6% sequentially and 2.8% year-over-year. Variability in foreign exchange rates primarily impacts our NetCentric revenues.

The average euro to U.S. dollar rate so far for this quarter is 1.18, and the average Canadian dollar rate is 0.80. Should these average foreign exchange rates remain at these current average levels for the remainder of our third quarter of 2021, we estimate that the

FX conversion impact on our sequential quarterly revenues for our second quarter would be a negative $0.6 million, and the year-over-year FX conversion impact on our quarterly revenues would be a positive $0.7 million.

Customer concentration. We do not believe that our revenue and customer base is highly concentrated. Our top 25 customers represent less than 6% of our revenues for this quarter. On CapEx, our quarterly capital expenditures increased by $1.8 million sequentially and increased by $3.3 million year-over-year. Our capital expenditures were $17.2 million this quarter compared to $15.4 million for the first quarter of 2021 and $13.9 million for the second quarter of 2020.

Finance leases and finance lease payments. 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 $224.6 million as of June 30, 2021. At quarter end, we had IRU contracts with a total of 282 different dark fiber suppliers.

Our finance lease principal payments were $6.2 million for the quarter, primarily due to purchases of dark fiber in international markets compared to $3.7 million for the quarter to the second quarter of 2020 and $5.7 million for the first quarter of 2021. Our finance lease principal payments combined with our capital expenditures were $23.4 million this quarter compared to $21.2 million last quarter and $35.5 million for the second quarter of 2020, a 34% reduction.

As of June 30, 2021, our cash and cash equivalents totaled $374.0 million. For the quarter, our cash increased by $136.0 million primarily from the issuance of our $500 million notes which offset -- which was offset by the redemption of our remaining $329.1 million of our 2022 notes, an increase in our quarterly dividend payment. Our quarterly cash flow from operations decreased sequentially by 15.6% to $39.7 million, primarily due to a $11.5 million prepayment of interest on our 2022 notes through December 1, 2021, the first date that our 2022 notes may be redeemed at par. Our quarterly cash flow from operations decreased by $1.6 million year-over-year.

Debt and debt ratios. Our total gross debt at par, including our finance lease IRU obligations, was $1.1 billion at June 30, 2021, and our net debt was $769.7 million. Our total gross debt to trailing last 12 months EBITDA, as adjusted, ratio was 5.13x at June 30, 2021, and our net debt ratio was 3.45x. Our consolidated leverage ratio, as calculated under our note indenture agreements, was 5.10 at June 30, 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 unrealized loss on our euro notes was $5.3 million this quarter or a loss of $0.11 per share compared to an unrealized gain of $18.9 million last quarter or $0.41 per share and an unrealized loss of $0.9 million for the second quarter of 2020. As a result of the change in the value of the euro since June 30, 2020, our consolidated leverage ratio increased by 10 basis points. On a constant currency basis, our

consolidated leverage ratio under our indentures would have been 5.00 versus 5.10 at quarter end.

Bad debt and days sales outstanding. Our bad debt expense as a percentage of revenues improved year-over-year and sequentially. Our bad debt expense improved to 0.5% of revenues for the quarter compared to 0.6% of our revenues last quarter and 0.9% in the second quarter of 2020. Our days sales outstanding, or DSO, for worldwide accounts receivables was 22 days for the quarter, a slight increase from 21 days last quarter, but better than our historical rates. 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 our customers during very challenging times.

And now I'll turn it back over to Dave.

David Schaeffer: Thanks, Sean. I'd like to highlight a couple of strengths about our network, our customer base and our sales force. As I stated earlier, we continue to see strength in our NetCentric business, with our revenues in that segment of our business increasing 30.5% year-over-year. Streaming service providers are aggressively targeting overseas markets, and we are a beneficiary of this growth.

We have positioned our network and our capabilities to support streaming on a global basis, and I'd like to highlight some of these important characteristics.

At quarter end, we connected to 1,309 carrier-neutral data centers in 48 countries around the world. In addition, we connected to 54 Cogent-owned data centers, more data centers connected to our network than any other carrier as measured by third-party research. The breadth of this coverage enables our NetCentric customers to better optimize their networks and reduce latency in the delivery of their content. We expect that we will continue to widen this lead in the market, as we continue to add approximately 100 carrier-neutral data centers to our network each year for the next several years.

At quarter end, we directly connected to over 7,530 access networks, which represent a 5.6% increase from a year earlier. This collection of Internet service providers, telephone companies, cable network operators and mobile phone companies provides us access to the vast majority of the world's broadband subscribers and mobile phone users. This critical mass of end users makes us attractive to streaming service providers who are looking to directly connect with our customers, improving quality of service and speeds of download. At quarter's end, we have the sales force of 231 professionals who focus exclusively on the NetCentric market. We believe that this group of professionals focusing on this market segment is the largest and most sophisticated sales team of its type in the industry.

Our Corporate customers have been seeing an increase in activity due to their planning for the eventual return to office of their workforces. We believe that North American cities will continue to get back to a more normal pre-pandemic level of activity as Corporate businesses will have their employees return to offices. And our Corporate

business will return to historical average levels of sales. We're also optimistic that there will be a pickup and a number of upgrades from Corporate customers as they've deferred many of the investments to reconfigure their internal networks.

We're experiencing an improvement in our sales force productivity due to our continuing training efforts and the continued aggressive managing out of underperforming reps. This has been challenging in a remote environment, and we are looking forward to having a portion of our sales force begin to return to the office.

On a sequential basis, our total sales rep headcount increased to 565 and the number of full-time equivalents within that sales force [declined] slightly to 511 at quarter's end. Year-over-year, our total sales rep head count decreased by 7 or 1.2% and the number of full-time equivalents decreased by 22 or 4.1%. Our sales force turnover at 5.6% per month in the quarter was a significant drop from the average of 6.6% per month we experienced in the first quarter and is consistent with our long-term averages. These factors have resulted in a continued rebound in our sales force productivity with 4.5 orders installed per rep per month, a 4.7% increase from the 4.3 orders installed per rep per month in this first quarter of 2021. Overall, we believe that our sales force continues to deliver industry-leading results.

I want to thank the entire sales force, the Cogent support team, for all the work they've done and the difficult conditions they've operated on through the pandemic, and I look forward to a strong second half of the year for Cogent, and the return of many of our employees back to our Cogent offices on a going forward basis.

Cogent, in summary, is a low-cost provider of Internet access and transit service. Our value proposition remains unmatched in the industry. Demonstrating this low-cost position is the fact that our cost of goods sold per byte mile transmitted has fell at a compounded rate since 2016 of 22.5%. We remain optimistic about our unique position in serving small and medium-sized businesses located in the central business districts of major North American cities. We have over 1,800 large multi-tenant office buildings on-net, comprising 980 million square feet.

In response to rising vacancies in major cities, we have seen landlords aggressively lower rents, shorten lease terms and provide significant tenant improvement allowances all designed to attract new tenants into Class A office space, the footprint that we serve. We are optimistic that our Corporate business can resume its historical average growth rates as Corporate employees continue to return to offices in these buildings.

our customer churn, our bad debt and days sales outstanding are all either improved or within historical norms. We believe that these statistics represent the strong credit quality of our customer base, and the seminal importance of Cogent's services to those businesses. Our targeted multiyear constant currency growth rate of approximately 10%, and our long-term targeted EBITDA margin expansion of about 200 basis points remains intact as we begin to emerge from the pandemic.

Our Board of Directors has approved our 36th consecutive increase on our regular quarterly dividend, growing net dividend sequentially by $0.025 to $0.805 per share for the quarter. This represents a 14.2% growth rate in our quarterly dividend. Our consistent dividend increases demonstrate the optimism regarding the increased cash flow capabilities of our business. Upon the payment of this dividend, Cogent will have returned, through a combination of dividends and share repurchases, over $1 billion to our equity stakeholders. This is a significant accomplishment, which includes the purchase of over 10.4 million shares of our common stock over the past 15 years. We have not repurchased any stock in the second quarter, and we have over $30.4 million remaining in our current buyback authorization, which is in place through the end of this year.

Our operating cash flow for the first 6 months of 2021 grew at 24.5% versus the first 6 months of 2020, and our dividend growth rate for this period was 17.3%.

Thank you, and I'd now like to open the floor for questions.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions) Your first question is from Sami Badri with Credit Suisse.

George Engroff: This is George Engroff on for Sami, actually. So Dave, in the past, you've talked about the composition of your NetCentric customer base and how it's changing and driven by a variety of new providers. I guess if you could walk us through how that's progressing and impacting the business, that would be great.

David Schaeffer: Yes, sure. So our NetCentric customers fall into two primary categories, those 7,530 access networks distributed around the world. In fact, while we have network in 48 countries, we have customer bases that actually purchase transport to reach the Cogent network, and our reach spans over 170 countries around the world. Their customer base is downloading content from the Internet. There's a significant asymmetry in the way in which different user groups use the Internet. End users primarily download much more than they upload, and we provide access to more content directly than any other provider.

On the other side, we have about 5,000 content-generating NetCentric customers. They are pushing applications and content out to those customers. What they are looking to do is get to as close to those customers, to be as efficient and possible in using the network and achieve the lowest price points for the transmission of their content. They tend to be a more concentrated base with very large service providers dominating that segment.

Today, over 71% of traffic stays on the Cogent network. Meaning it goes from a paying Cogent content generator to a paying Cogent access network operator. That number has consistently increased over the past several years, and it is part of what's driving our decision to continue to internationalize our footprint. 96% of our traffic comes from these 2 NetCentric segments.

In the remaining 29% of the cases, in either direction, either receiver or sender, that traffic is exchanged with one of our peers. We have less than 24 peers globally. And in those instances, we are only getting paid on one side of the transaction, meaning we get paid by our customer, but exchange that traffic at no revenue with that peer. We continue to see the two-sided traffic patterns increase for Cogent helping drive the profitability of our NetCentric segment.

George Engroff: Got it. And then I guess maybe a two-parter on refinancing. Could you help us understand what is driving the difference between the $10 million in interest rate savings that you -- or in interest savings that you previously noted and the $6.5 million you noted today? And then secondarily, given the credit rating increase, is there any opportunity to refinance your 2024 euro notes?

David Schaeffer: So two different comments. First of all, the differential that I had noted included two things. One, we raised an incremental $55 million of capital. So the savings was partially offset by the interest on that incremental capital. The second is that we are planning to enter into a fixed versus variable swap that will allow us to further reduce our interest rate, taking advantage of the low variable interest rate market and result in that incremental savings. So it's kind of a two-step process. We've completed the first portion of that.

Now with regard to the euro notes, interest rates have continued to decline. We are continuing to monitor that. We do have a significant make-whole on those euro notes that would be about a EUR10 million cost to us. I think we are monitoring that. And as that breakage cost declines over the next one to two years, we will probably look to refinance those notes.

George Engroff: Got it. And then one last one, if I could. Dave, you mentioned the continued return to office on this call, I guess, despite some of the coronavirus headlines that we've been seeing lately. I would be interested to understand how the commentary from your Corporate customers differs from last quarter.

David Schaeffer: So I think many Corporate customers remain cautious due to the emergence of the Delta variant. There has been revised CDC guidance, there have been indoor mask requirements placed in a number of markets. And there are a number of employees who have expanded their view of work and are looking for work-life balance that includes a hybrid work model. While that is not a direct result of the pandemic, it was clearly accelerated by that.

Offsetting that is the comments by many Corporate executives that employees are more productive in offices. In a recent survey, 45% of Fortune 500 companies responded saying that employees are more productive in an office environment than in a home environment. These forces are being kind of weighed by different companies. I think we've seen most businesses targeting after Labor Day as an inflection point. I think there will be variability based on geography and vaccinization rates. But we are seeing a slow

increase in employee return to office and an increase in traffic on those Corporate networks.

Operator: Your next question is from Phil Cusick with JPMorgan.

Philip Cusick: Let's maybe expand on the corporate environment improvement. Can you talk about just what the conversations with customers look like? It sounds like there's some early sort of sales indications. Let's sort of start there.

David Schaeffer: Yes. Sure, Phil. So our sales force is trying to reach out to about 100 prospects per salesperson per day. Now they don't have that many conversations but that's what their target is. From that, we have seen an increase in customers' willingness to engage, to begin planning for that return to office. We've seen an actual pickup with some of the early adopters in rep productivity, considering the majority of our sales force, over 70% of it, is Corporate. We're seeing heightened activity levels. We're also seeing companies realize that in a hybrid model, having a bigger connection gives them more flexibility. Sean commented around the 1-gigabit overtaking the 100-megabit product several quarters ago and continuing to outpace the growth. And most of the churn has been from the smaller customers who had the older 100-meg product.

I think if you had asked me this question five or six weeks ago, there was a much clearer path to return to office. I think the lack of ubiquity of vaccinization and the emergence of the Delta variant has caused many companies to either temporarily pause or reevaluate the reopening plans. I think there is a general consensus that after Labor Day, there'll be kind of a watershed event. And we've even seen some companies be more aggressive in moving to mandatory vaccinizations, which then, I think, gives them greater confidence around those employees being back in the office and, therefore, reaccelerating Corporate growth.

It's a bumpy road. I wish I had perfect visibility. But it does appear that the three sequential quarters where we've seen the dollar value of decline in Corporate revenues is improving, and we hope that, that rate of improvement is going to accelerate over the next quarter or two, and we should return back to that historic Corporate growth rate.

Philip Cusick: Can I follow up with one thing there? The slowdown or sort of backing off on return to office, is that mostly East Coast, West Coast? Or is that -- are you finding that in the center of the country as well?

David Schaeffer: I would say it's coastal for sure, East Coast and West Coast. L.A. was the first major jurisdiction to go to an indoor mask mandate. We've seen San Francisco adopt similar type policies. And then the East Coast was more cautious. Ironically, Texas, Florida, which are significant markets for us, had been much more aggressive about reopening. Yet now, they have the highest case volumes and highest hospitalization rates. There does seem to be a hope that they'll get that under control as vaccination rates in those two states are starting to rise. As President Biden indicated,

those two states indicate -- are responsible for over 1/3 of all cases in the United States. So it is very geographically disparate.

Sean Wallace: Yes. And Phil, just to add to what Dave said. We've also seen a bifurcation between tech companies and financial services. It's very clear that the financial services firms are -- want 100% to go back. Tech companies are much more flexible, including some that are doing that. So obviously, the San Francisco is a little bit more hybrid. New York City, D.C., Boston, we're seeing a lot more 100%.

The other thing I might add on sort of what we're seeing there, it's very clear that the -- that these firms are focusing on getting people back to office and getting things, they're not -- getting things back to normal. They're not focusing on upgrading their networks. I'd also indicate we had a conversation with a broker, and they have 12 KPIs that are looking at people and companies coming back to work. And the worst indicator, the one that had the lowest amount of take-up, is the re-leasing and subletting of the space. And so that really hasn't come back. And that, obviously, is a big opportunity for us as new entities come into some of that space that's been giving up, we think our sales force will be very successful there, but we haven't seen that as yet.

Operator: Your next question is from Frank Louthan with Raymond James.

Frank Louthan: Can you comment a little bit on -- you've mentioned the streaming services you're getting. What are the terms you're getting in those contracts? And how is the pricing relative to your base?

David Schaeffer: Yes. Sure, Frank. So our most common contract remains three years. The majority of our NetCentric customers do renegotiate those contracts in term. That was the 2,700 connections that Sean referred to in his remarks, and the approximately $28 million of incremental revenue commitment to Cogent going forward. Most of that actually does come from streamers.

We have a pretty transparent pricing model, which is the longer you commit for and the greater the volume, the lower your pricing. I had a call just last week with an international streaming company that was looking to get the exact same price as one of the major U.S. streaming companies. And I offered the identical price if they could commit to the volume, and they said, "Well, we're too far behind the curve in terms of volume to make that kind of commitment today." So I said, "Look, you're going to pay a higher price." Our average price continues to fall at about 23%. You saw that in this most recent quarter, where we commented both on the installed base falling at about 24%, the average new sale at about 21%. That differential bounces around a few points quarter-to-quarter. But overall, the long-term trend of 23% price decline per bit is continuing, and streamers do drive that.

The final point I'd make is our ability to expand gross margins and maintain low capital intensity is really a good indication of the architecture that we have chosen versus our competitors, and how we are so much more effective at capturing those advances in

technology than our competitors, which allows us to both price lower in the market, but also concurrently expand margins. Many of the companies we compete with have declining revenues and compressing margins. We're on the exact opposite side of that because of the architecture that we've deployed.

Operator: Your next question is from Colby Synesael with Cowen.

Colby Synesael: I'll just ask them all at once. First off, on Corporate revenue on-net, it was down about 3% sequentially. A little bit better than what we saw in the first quarter. I'm just curious if you have visibility as to when you think that, that could actually start to turn positive, or if it's just too difficult, particularly with the Delta variant still emerging.

Secondly, as it relates to leverage targets, just what are your thoughts there in terms of maybe bumping them up and how that might impact your ability to continue to trade the dividend going forward.

And then third, you spent, I think you said $6.2 million purchasing fiber in the quarter. Where do you think that, that metric trends over the next several quarters? Because it has been, I think, inching up a little bit versus maybe what we saw in previous quarters.

David Schaeffer: Yes. Sure, Colby. Three very good questions. First of all, with regard to Corporate on-net growth, you are correct. It is improving sequentially. We think that trend of improvement is going to continue. We also know that if we return to kind of a full occupancy environment, kind of like an environment that existed pre pandemic, we will be back to being kind of a 2% grower sequentially in our Corporate on-net business. When that will exactly happen, I am not sure. I think we are on a path to return to office. But that path is not perfectly linear and not perfectly visible to corporations.

As Sean mentioned, tech companies are taking a slightly different approach than, say, law firms. But I think businesses are anxious to get employees back into the office. And the Delta variant has injected yet another layer of uncertainty. I would suspect we'll continue to see improvement over the next couple of quarters. But I just don't have the visibility to predict whether it's two quarters, three quarters until we turn positive in the growth rate in that business.

Now let me touch on the leverage target portion of your questions. There, a big portion of the increase in our reported leverage has come from currency distortion. The fact that we do not hedge our obligations or our revenues outside of the U.S., 25% of revenues are outside the U.S., 17% of those revenues are in Europe. When we decided to utilize European debt, we understood that we were injecting a level of volatility into our earnings per share due to the real unrealized gains and losses as well as volatility into our leverage numbers.

We feel comfortable with the leverage ratios that the Board has authorized. We have 36 sequential quarters of growing the dividend. And at this point, we think the underlying

strength of the business, even with the pandemic, should allow us to continue to grow into the foreseeable future, the dividend, at a similar pace.

Sean Wallace: Yes. Colby, can I just add one more thing. I mean, we were really happy with the execution. We issued a $500 million note, as Dave mentioned, the 3.5%. We will evaluate, and it's just a math calculation eventually on the euros. But we are going to probably be around that 5x gross leverage. If we get really phenomenal execution, maybe we might consider that in the future. But for now, we're going to target 5x.

David Schaeffer: And then for your last question, Colby, on fiber purchases. We do not control where data centers are being built. We have seen a proliferation of data center construction and in some newer markets and even more extensively in international markets. Now when we look to light a data center, we have a series of criteria. Is it carrier neutral? Is it multi-tenanted? And is it close to fiber that we already have?

So we have about 975 rings in about 212 markets around the world. We map out those new data centers against those rings. But occasionally, there are data centers that are large enough or significant enough or are run by a credible-enough operator that we look to expand. And that's what's been driving these incremental fiber purchases.

We often use newer vendors. So our vendor supply chain has increased to 282 different fiber suppliers, up from 178 last -- or 278 last quarter, and that drove the incremental spending. I think as we look at what's on the drawing board, we're pretty comfortable that, that fiber expenditure should start to come down and be back in the more historical range of a couple of million dollars a quarter.

Operator: Your next question is from Walter Piecyk with LightShed.

Walter Piecyk: Dave, I want to go back to Phil's question. I think you mentioned like if you had gotten asked kind of that question five or six weeks ago, your answer would have been different in terms of the sequential growth. I think Phil did ask you that at this conference. And at the time, you talked about, I think, to be specific, you said within a few quarters, you expected to get to 2% to 2.5% sequential growth in the Corporate business. So now it sounds like you're saying within a couple of quarters, you hope to get just positive. Am I understanding that properly?

David Schaeffer: So first of all, you are accurate in my two comments. And what I said is, over the past six weeks, the interjection of the Delta variant has caused many Corporate customers and prospects to delay their process of returning to office. I don't have perfect visibility to each of those companies' decision-making process. Based on the rate of change in people's decisions, I am more cautious in saying that rather than getting back to normal, i.e. 2% to 2.5% sequential growth, positive growth. Now that's kind of based on the Delta variant continuing to get worse. I've seen some government officials predict that the case volume will go from 100,000 to 200,000 per day. And the death rate in the U.S. is already about triple where it had troughed at.

So again, I'm not an epidemiologist. I can't make exact predictions, but I know that the injection of this additional concern has slowed people returning to office. And that's why I am as confident as ever in the business that we had operated for 15 years prior to the pandemic, with Corporate growth being consistent and sequentially strong. And now we have this jolt to the system, and I can't tell you if it's going to be a linear recovery from that or a bumpy recovery. The Delta variant's kind of told me it's bumpy. So for that reason, I'm trying to be a little more cautious.

Walter Piecyk: Understood. So why reference Labor Day as a -- I think your quote was inflection point from earlier in this call. That's a month away. And the daily numbers on Delta, at least the ones that I see, seem to be getting worse.

David Schaeffer: So many companies, when surveyed, have indicated that, that is a significant date for them, and they are planning (inaudible).

Walter Piecyk: Sorry to interrupt you, Dave. But we just talked about how the fact that things are changing very quickly. So I'm not sure a survey done at some period in time, maybe a week or two ago, is how someone might look at it today.

David Schaeffer: Right. I am just repeating the most current data that's available. And companies may end up still having some employees come back to the office. And again, a pickup on Phil's question, there's a great deal of geographic variability here. So I think for those portions of the country that have very high vaccinization rates and, therefore, lower infection and death rates, the plans that were put in place will be more closely followed. Those parts of the country that have maybe been more aggressive in reopening, may be pulling back because of their higher infection rates.

So again, I'm responding to three things: what the sales force sees in their funnel, that's very specific Cogent data; two, third party survey data that we look at and look at, what Sean mentioned, broker studies from nationally recognized public brokers to surveys done by a number of trade organizations; and then finally, we look at the governmental data. We put all of that together and make our best prediction. I'm not going to get pinned down into quarterly revenue guidance or subsector guidance. But I can comment on the strength of the underlying business. And I feel good that the corporate market opportunity is still large enough in our footprint for us to resume the growth rate when those businesses come back to the office.

Now if you think you're never going to come back to the office, Cogent's probably not a good investment. And you should be [shorting] every office REIT because they're all going to go bankrupt. I just don't believe that's the reversal of a multi-hundred-year trend of urbanization that has occurred around the developed world.

Walter Piecyk: Got it, Dave. So some of the unit growth of -- that you had in those offices was already slowing, and some of the revenue growth was supported by upgrading customers to higher revenues. That obviously also helped your historic 2% revenue growth. And I think you're probably running -- there's only so much upgrading

you can do. But I want to move on to what Tom Rutledge said on his call in terms of SDN and fiber. Could you say that you've seen no impact from Charter at all up to this point in terms of any competitive impact on your business? I know historically, they've kind of been SMB, but they seem to be talking up they're moving to enterprise. Have you seen them at all?

David Schaeffer: So we purchased off-net loops from spectrum and from other cable companies and telcos. So as they expand their fiber footprint, they are a supplier. In our on-net Corporate footprint, they are not a significant competitor. They generally do not pay building license fees. They generally do not expend the money to prewire the rise or -- with fiber and therefore, are not competitive based on install times and on cost of install.

To your question -- to your comment, not your question, around upgrades. There's kind of two different points that you conflated, Walt. One is we do have customers upgrading from 100 meg to gig, and as Sean mentioned, even now some 10 gig, among some small segment of the Corporate marketplace.

But secondly, what has really been negatively impacted for Cogent is that VPN business. You mentioned SD-WAN. That is one of the two technologies. The other is VPLS. We support both of those technologies. Both are replacing MPLS. That replacement cycle was well underway pre pandemic. The pandemic paused that replacement cycle. It is now beginning to reaccelerate. That allows Cogent to sell a second connection at the same location.

And based on our network architecture versus Charter's, I feel very confident that our ability to offer a VPN alternative, based on our footprint, based on our non-oversubscription or our symmetry, would absolutely make our product vastly superior to what any cable provider can offer.

Walter Piecyk: Got it. And then just last question on the net debt leverage at 3.4, whatever, times, which is up from, I think in Q1 of last year, you were under 3. I've asked this before, I guess, is there a limit to how high you're going to take leverage and continue to expand the balance sheet in order to pay the dividend growth?

David Schaeffer: So again, we've been very clear that we have a range, and that range will be reevaluated by the Board if appropriate. We are basing it on our growth in free cash flow. Finally, a big portion of that leverage increase came from the unrealized reported loss due to the appreciation of the euro. We don't control currency fluctuations. But we know that we have sufficient cash flow, sufficient asset base to avail ourselves of lower-cost capital in Europe. And we think our job, as stewards of capital, is always to get the lowest cost of rented capital for the benefit of our equity holders. Will we raise the target? I don't know the answer to that, and we would look at the cause.

Walter Piecyk: Can you just refresh my memory on what the target is? Is it like 5x? Or where's the upper end of where you'll go at this point?

David Schaeffer: So we have a net leverage target of 2.5 to 3.5x.

Walter Piecyk: So you're at the high end.

David Schaeffer: We're above the median. We were below. And I remember you commenting when will we get to the higher end because we were not being efficient in the utilization of our balance sheet. We take a measured long-term approach. And we also look at the cause of that increase in leverage. And if it's coming from currency distortion, it's different than if it's coming from underperformance in the business.

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

Nick Del Deo: I guess regarding -- on the Corporate side, is there anything you have your salespeople doing different than normal to stay especially close to customers and prospects such that they'll be ready to catch them when those businesses are ready to buy rather than letting those opportunities slip? Or is it just the sheer volume of calls you talked about that does the trick on that front?

David Schaeffer: Yes. So Nick, I have to admit, running the sales force in a remote environment was a necessary thing to protect the health of that sales force, but it has been challenging to keep people doing the activity levels. And it was really challenging because the parties on the other side were remote as well. So as we see the IT departments of companies starting to either partially or completely return to office in preparation to support the work staff in those offices, there's a lot more engagement.

So one of the questions that salespeople are trying to gauge from a customer is, has the IT department actually come back to the office yet? Because that's a good leading indicator of the general workforce returning. There's kind of no substitute for outreaches. Our goal is to talk to every potential prospect in an on-net building once a month to just touch base and see if anything is changing with their IT requirements, and therefore, do they need more bandwidth. That's a very laudable goal.

We don't achieve it for a couple of reasons. One, we don't have enough salespeople. Two, some of the customers, or potential customers have not been willing to take the calls. We have seen, over the last couple of quarters, an increase in that call activity per capita, which is now translating into higher installs per capital. It's not a step function, it's a gradual ramp.

And to the question Walt asked, who was trying to get me to nail down the exact pacing of return to office, I just don't have that visibility.

Nick Del Deo: Okay. Got it. That's helpful. And maybe one on NetCentric. When I look at overseas markets where you don't yet have an on-net presence, India kind of stands out and it's a big country, it's early in streaming adoption. It Presumably wouldn't be hostile to a foreign carrier like Cogent. Is that something on your radar screen? Or

are there other hurdles such that serving your Indian customers by Europe will remain preferable to actually having a presence there.

David Schaeffer: So India is definitely on our radar screen. Today, we are the primary upstream provider to Jio which is the largest operator in India. Remember, the vast majority of the Indian population is purely mobile, not fixed line. The Indian license process is very bureaucratic and very lengthy. We have actually applied for that license a little over a year ago. We're still in one of the review phases. I believe we will get a license. But I think it's probably still at least a year away based on talking to our lawyers in India.

We tried the same thing in Russia a few years ago, and eventually gave up because it was clear that without violating the Foreign Practices Act, we could not get a license to serve Russia. So we serve most of the Russian carriers, but we do it in Helsinki or Stockholm or Frankfurt.

Today, for most of our Indian customers, we're serving them in Marseille. We've identified cable capacity, but we're just waiting on that license approval. And we do expect it but I don't think it's imminent.

Operator: And that concludes the Q&A session for today. I will turn the conference call back to Mr. Dave Schaeffer for closing.

David Schaeffer: Thank you very much. I'd like to thank everyone. Hopefully, we answered all your questions. We appreciate your support. And I want to thank the entire Cogent team for delivering in these difficult times. And hope everyone stays safe, and we can actually see each other soon. Take care. Bye-bye.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect. Stay safe and goodbye.