Cogent Communications Holdings, Inc. (Q3 2021 Earnings)
November 4, 2021

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
- Colby Synesael; Cowen and Company, LLC; Analyst
- Nicholas Del Deo; MoffettNathanson LLC; Analyst
- Walter Piecyk; LightShed Partners, LLC; Analyst
- Michael Rollins; Citigroup Inc.; Analyst
- Unidentified Participant; Raymond James; Analyst
- Evan Young; KeyBanc Capital Markets Inc.; Analyst

PRESENTATION

Operator: Good morning, and welcome to the Cogent Communications Holdings Third 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: Hey, thank you, and good morning, everyone. Welcome to our third quarter 2021 earnings conference call. I'm Dave Schaeffer, Cogent's CEO. And with me on this morning's call is Sean Wallace, our Chief Financial Officer.

Now for a few comments on our results. As the focus of the pandemic-related efforts of companies have shifted to a broad reopening of the U.S. and global economy and as most large businesses have developed plans and deadlines to reopen their offices, we've seen signs of improvement in our corporate business climate. However, despite this improvement, the delta variant has delayed a large portion of these back-to-work plans to early next year and many key indicators of office activity remains significantly below normal levels. And many U.S. northern cities and in Canada, we see that rates of employees working in offices and the leasing of commercial office space and central business districts remain significantly below historical levels.

Our NetCentric business continues to benefit from the greater-than-expected growth in streaming subscribers and the continued internationalization of the Internet, where our global footprint positions Cogent as the best network to deliver end-to-end on a global basis for our customers.

For the third quarter, our traffic growth moderated somewhat from the fast pace in the previous periods, but was up 1% sequentially and 25% on a year-over-year basis. Despite these improvements, we remain cautious in our near-term outlook on the uncertain economic environment and the challenges that are continuing because of the pandemic.

On a U.S. GAAP basis, our revenue was up slightly to $147.9 million in the quarter, an increase by 4% on a year-over-year basis. On a constant currency basis, we experienced sequential quarterly revenue growth of 0.5% and an improvement in our year-over-year growth rate to 3.6% from the 2.8% constant currency growth rate in Q2.

We continue to make progress with our sales force. Our sales force rep productivity was 4.3 orders installed per full-time equivalent rep in the quarter. We continue to operate an extremely efficient network. Our network services continue to be expanded into new markets, additional carrier-neutral data centers and multi-tenant office buildings and is able to handle the continued increase in traffic volume and in a relatively fixed cost basis.

The operating leverage because of our network has achieved -- allowed us to achieve both year-on-year and sequential growth in EBITDA and EBITDA margins. Our quarterly EBITDA grew 1% sequentially and grew by 5.8% year-over-year. Our quarterly EBITDA margin was 39%, the best in the company's history, which is an increase of 30 basis points on a sequential basis and 60 basis points on a year-over-year basis. The performance of our existing customer base continues to be strong throughout the entire pandemic. Bad debt expense and our customer cash collections remain within historical levels.

Our days of sales outstanding improved to 21 days, equaling the best DSOs in the company's history. Churn rates continue to decline, in particular in our corporate segment. We believe these statistics demonstrate the strong credit quality of our customer base and maybe most importantly, the importance of the Internet and Cogent's services to these organizations.

As our business continues to expand, we let our 3,000th building in the quarter and now have 3008 buildings directly connected to the Cogent network that now serves 50 countries around the world. During the quarter, we returned $37.7 million to our shareholders through our regular dividend. We did not purchase any stock during the quarter and have a total of $30.4 million available for stock buybacks in volatile situations as our Board has authorized us to continue through December 2022.

Our cash held at Cogent Holdings is $111 million at quarter end. Cash held in our operating companies is $244 million at quarter's end. And therefore, our total consolidated cash was $355 million at the end of the third quarter. Including cash at holdings, we have a total of $226 million that is permitted under our indentures dentures to be available to be returned to shareholders either for dividends or stock buybacks.

Our gross leverage ratio was 5.07 in the quarter, and our net leverage was 3.50. Our consolidated leverage, as calculated under our indentures, however, was slightly lower with a gross leverage of 5.02 and a net leverage of 3.47. Our Board of Directors reflected on the strong cash flow generating capabilities of our business and the investment opportunities that we have and decided an increase on our quarterly dividend of $0.025 was appropriate, raising our dividend sequentially by 3.1% from $0.805 a share in the second quarter to $0.83 per share in this quarter. The dividend increase represents our 37th consecutive sequential increase in our regular dividend, and our annual dividend growth rate is 13.7%.

Now I'd like to turn it over to Sean to read our safe harbor language and provide some updated information on our responses to the COVID-19 pandemic and review some of the 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.

A quick update on COVID-19. Like many companies, Cogent continues to be impacted by the lingering effects of the COVID-19 pandemic and the accompanying responses by governments around the world. In October of this year, our entire U.S. workforce returned to our offices after 18 months of working remotely. A majority of our offices in the rest of the world continue to work remotely, although our employees outside of the United States are scheduled to return to their Cogent offices by the end of the year.

I want to thank the entire Cogent workforce and in particular, our IT and finance departments 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 customer service.

The COVID-19 risks 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 September 30, 2021, June 30, 2021 and March 31, 2021. 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 questions and answers.

Now I'd like to turn it back over to Dave.

David Schaeffer: Thanks, Sean. Hopefully, you had a chance to review our earnings press release. Our press release includes a number of historical quarterly metrics that we report on a consistent basis. Our targeted long-term EBITDA margin expansion guidance is for an annual improvement of 200 basis points. Our targeted multiyear constant currency growth rate targets remain approximately 10%. Our revenue and EBITDA guidance are intended to be multiyear goals and are not meant to be used as either quarterly or specific annual guidance targets.

Our corporate business, which represents 60.2% of our revenues, our corporate business declined by 1.5% from the second quarter of 2021 and a decline of 6.9% from the third quarter of 2020, primarily due to the impact in the pandemic and some reductions in ARPU due to lower loop costs for our off-net customers.

Our NetCentric business, which represents 39.8% of revenues, had another strong quarter, and we achieved a continued growth rate of 2.5% quarter-over-quarter and grew on a year-over-year basis by 26.3% from the third quarter of 2020. Volatility in foreign exchange rates primarily impacts our NetCentric business and slightly over 50% of that NetCentric business is outside of the United States. On a constant currency basis, our NetCentric business increased by 25.1% in the third quarter from the third quarter of 2020 and 3.8% from Q2 of 2021.

Now Sean will give some additional detail on our financial performance for the quarter.

Sean Wallace: Thanks, Dave, and again, good morning to everyone. Let's talk about corporate and NetCentric revenue and customer connections. We analyze our revenues based upon network type, on-net, off-net and non-core, and we also analyze our revenues based upon customer type. We classify all of our customers into two types, NetCentric customers and corporate customers. These customers are typically professional service firms, financial service 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 consumers of content via fixed line and mobile networks.

Revenue and customer concentrations by customer type. Revenue from our corporate customers for the quarter declined sequentially by 1.5% to $89.1 million and declined year-over-year by 6.9%. Corporate revenues in the quarter, excluding the impact of USF taxes declined by $1.4 million. This is the fourth quarter of consecutive smaller declines in our corporate business, which peaked at a decline of $2.2 million in the fourth quarter of 2020.

An increase in the USF tax rate which only applies to our corporate VPN connections had no material impact on a sequential basis and had a $0.9 million positive impact on our year-over-year quarterly corporate revenues. The USF tax rate changes quarterly and we cannot predict the impact of future USF rate changes on our revenues.

While the delta variant slowed down the level of corporate customer activity, we continue to see indications that our corporate business is trending towards pre-pandemic levels but at a slower pace than expected. We are encouraged by the continued decline in the churn of our 100 megabits per second and 1 gigabit per second products, which is now lower than the pre-pandemic levels, but we have not seen our additions to these product categories return to pre-pandemic levels. Overall, the majority of our churn is in our older 100 megabits per second product, and we are encouraged that our net unit growth in our 1 gigabit per second product was positive for every month during the pandemic.

The continuing trend of lower local loop prices -- pricing contributed to the reduction in our year-over-year off-net corporate revenue as we continue to pass a portion of these savings to our off-net customers. Our off-net ARPU declined by 1.2% sequentially and declined by 5.9% year-over-year. We had 45,559 corporate customer connections on our network at quarter end, which was a decline of 0.5% versus the second quarter and a decline of 4.5% from the third quarter of 2020.

Our NetCentric business continues to benefit from the strong growth in streaming subscriptions and continued growth in our international network traffic. Quarterly revenue from our NetCentric customers increased sequentially by 2.5% to $58.8 million and increased year-over-year by 26.3%. On a constant currency basis, our NetCentric revenues increased by 25.1% from the third quarter of 2020 and grew by 3.8% from last quarter. We had 47,432 NetCentric customer connections on our network at quarter end, an increase of 3% sequentially and an increase of 16.3% over the third quarter of 2020. Our NetCentric business benefited from continued strong demand for our larger 10 gigabits per second and 100 gigabits per second products. The demand from outside of the United States for these products was particularly strong.

Our NetCentric revenue growth historically has experienced 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 on our network grew sequentially by 1% for the quarter and grew by 25% on a year-on-year basis, consistent with our prior quarter growth rates. Revenue and customer connections by network type. Our on-net revenue was $111.1 million for the quarter, a sequential quarterly increase of 0.1% and a year-over-year increase of 5.7%. Our on-net customer connections increased by 1.3% sequentially and increased by 5.0% 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 1% year-over-year increase in our on-net ARPU. This increase in our on-net ARPU is primarily due to customers increasing the interface speeds that they purchase from Cogent. We ended the quarter with 80,162 on-net customer connections on our network in our 3,008 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 1.2%. When we sell off-net circuits, we incorporate the cost savings from our lower local loop prices into our pricing and the effect of the introduction of these customers into our off-net customer base lowers our off-net ARPU. Our off-net customer connections increased sequentially by 0.9%, an increase by 5.5% year-over-year.

Our off-net revenue results were impacted primarily due to a decrease in our off-net ARPU. This off-net ARPU decrease is driven primarily by the continued falling cost of local loops that are an input and an incentive to selling the service. We ended the quarter serving 12,495 off-net customer connections in 7,492 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 for installed customer base decreased for the quarter. However, our average price per megabit for our new contracts increased and average price per megabit for our installed base rate of decline diminished from last quarter. Our average price per megabit for our installed base declined sequentially by 3.9% to $0.34 and declined by 23.3% from the third quarter of 2020. Our year-over-year price per megabit decline was 6.1% sequentially and 24.8% last quarter. Our average price per megabit for our new customer contracts for the third quarter increased by 11.4% to $0.20 from the second quarter and increased by 8.2% from the third quarter of 2020.

ARPU. Our on-net ARPU decreased sequentially but increased year-over-year. Our off-net ARPU decreased sequentially and decreased year-over-year. The increase in our year-over-year on-net ARPU reflects the growing importance and change in mix of our larger bandwidth products from our corporate and NetCentric markets. Growth in our 1 gigabit per section connections sold to our corporate customers continues to contribute to an increase in our 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 sales and the ARPU for this product is having a positive effect on our total on-net ARPU.

Our on-net ARPU, which includes both corporate and NetCentric customers was $465 for the quarter, a decrease of 1.1% from last quarter, but an increase of 1% from the third quarter of 2020. We expect that our on-net ARPU will continue to increase due to changes in our product mix. Our off-net ARPU, which is predominantly comprised of corporate customers was $982 for the quarter, a decrease of 1.2% from last quarter and a decrease of 5.9% from the third 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 local loop costs are passed on to our corporate customers.

Churn rates. Both our on-net and off-net connection churn rates, both improved this quarter. Our on-net unit churn rate was 0.9% for the quarter as compared to 1% last quarter. Our off-net unit churn was 1.1% for this quarter as compared to 1.2% 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 they are considering terminating their service with us. Due to the commodity nature of NetCentric services, the vast majority of our move, add or change or MAC 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 2,500 customer connections, increasing their total revenue commitment to Cogent by over $24.2 million.

EBITDA and EBITDA margins. 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, including the reset 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 increased by $0.6 million sequentially and increased by $3.2 million year-over-year. Our EBITDA increased sequentially, primarily due to a reduction in our SG&A expenses as a result of lower headcount and the impact of our cost reduction programs. Our EBITDA increased year-over-year primarily due to the $6.0 million increase in our on-net revenue and the impact of our cost reduction programs, in particularly related to circuit cost savings.

Our quarterly EBITDA margin was 39.0%, which was an increase of 30 basis points on a sequential basis and a 60 basis point increase on a year-over-year basis.

Earnings per share. Our basic and diluted income per share for the quarter was $0.29 and $0.28, respectively, compared to a loss per share of $0.05 last quarter and $0.11 for the third quarter of 2020. Unrealized gains and losses on the translation of our 2024 Euro notes into USD are the primary contributor to the variability in our net income and consequently, our income loss or loss per share.

Foreign currency impact. Our revenue earned outside of the United States is reported in U.S. dollars was 25.5% of our total quarterly revenues. Approximately 17.6% of our revenues this quarter were based in Europe, and 7.9% 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 negative $0.7 million and the year-over-year foreign exchange impact was a positive $0.6 million. Our quarterly revenue growth rate on a constant currency basis was 0.5% sequentially and 3.6% year-over-year.

Variability in foreign exchange rates primarily impacts our NetCentric revenues. The average Euro to U.S. dollar rate so far this quarter is $1.16, and the average Canadian dollar exchange rate is $0.80. Should these average foreign exchange rates remain at the current average levels for the remainder of the fourth quarter, we estimate that the FX conversion impact on our sequential quarterly revenues for the fourth quarter would be a negative $0.4 million and the year-over-year FX conversion impact on our quarterly revenues would be a negative $0.5 million.

Customer concentration. We believe that our revenue and customer base is not highly concentrated. Consistent with prior quarters, our top 25 customers represented less than 6% of our revenues for this quarter.

Capital expenditures. Our capital -- our quarterly capital expenditures increased by $4.7 million sequentially and increased by $8.7 million year-over-year, primarily due to accepting accelerated shipments of network equipment in order to attempt to alleviate supply chain issues. Our capital expenditures were $22 million this quarter compared to $17.2 million for quarter 2, 2021 and $13.3 million for quarter 3, 2020.

Finance lease and finance lease payments. Our finance lease IRU obligations are for the 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 $239.5 million at September 30, 2021. At quarter end, we had IRU contracts with a total of 286 different dark fiber suppliers.

Our finance lease principal payments declined both sequentially and year-over-year. Our finance lease principal payments were $4.9 million for the quarter compared to $9.5 million for the third quarter of 2020 and $6.2 million for the second quarter of 2021. Our finance lease principal payments combined with our capital expenditures were $26.8 million this quarter compared to $23.4 million last quarter and $22.8 million for the third quarter of 2020.

Cash and operating cash flow. As of September 30, 2021, our cash and cash equivalents totaled $355 million. For the quarter, our cash decreased by $19 million, primarily from an increase in our capital expenditures related to network equipment purchases and an increase in our quarterly dividend. Our quarterly cash flow from operations increased sequentially by 19.3% to $47.4 million, the largest amount in our history. Our quarterly cash flow from operations increased by 43.8% year-over-year.

Debt and debt ratios. Our total gross debt at par, including our finance lease IRU obligations, was $1.1 billion at September 30, 2021, and our net debt was $792.1 million. Our total gross debt to trailing last 12 months EBITDA as adjusted ratio was 5.07 at September 30, 2021, and our net debt ratio was 3.50. Our consolidated leverage ratio, as calculated under our note indenture agreements, was 5.02 and our net leverage ratio was 3.47.

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 USD exchange rate. The unrealized foreign exchange -- unrealized gain on our Euro notes was USD 10.2 million this quarter or $0.22 per share compared to an unrealized loss of USD 5.3 million last quarter or $0.05 per share loss and an unrealized loss of USD 17.3 million or a loss of $0.11 per share for the third quarter of 2020.

As a result of the change in the value of the Euro since June 30, 2020, when the Euro to U.S. dollar rate was 1.12, our consolidated leverage ratio increased by 6 basis points. On a constant currency basis, our consolidated leverage ratio under our indentures would have been 4.97 versus 5.02 at quarter end.

I will now turn it back to Dave.

David Schaeffer: Thanks, Sean. I'd like to highlight a few of the operational strengths in our business, our network, our customer base and our sales force.

NetCentric performance. As I stated earlier, we continue to see strength in our NetCentric business as revenues increased by 26.3% year-over-year. Streaming service providers are aggressively targeting overseas markets, and we are a direct beneficiary of this growth. We have positioned our network on our capabilities to support the growth in streaming on a global basis, and I'd like to highlight some of these important characteristics.

At quarter's end, we connected to 1,332 carrier-neutral data centers as well as 54 Cogent-operated data centers. We connect to more data centers than any other carrier globally as mentioned by independent third parties. The breadth of this coverage enables our NetCentric customers to better optimize our networks and reduce latency. We expect that we will widen our lead in this market as we are planning to add approximately an additional 100 carrier-neutral data centers per year to our network each year over the next several years.

At quarter's end, we directly connected to 7,590 networks. This was an increase of 5.2% from a year earlier. This collection of ISPs, telephone companies, cable networks, mobile telephone operators and other carriers allow us to provide access to a significant majority of the world's broadband and mobile phone users. This critical mass of eyeballs makes us an extremely attractive service provider to streaming providers looking to directly connect their customers improving video quality and download speeds.

At quarter's end, we had a sales force of 218 professionals focused primarily on the NetCentric market. We believe this group of professionals is the largest and most sophisticated of such sales teams in the industries.

Now for some of our corporate trends. We are seeing some improvement in our corporate office environment as the number of employees returning to office has increased and subleasing activity and direct leasing activity begin to rebound from the depths of the pandemic in 2020 and early 2021. However, the end of the third quarter, many important office KPIs, especially in the northern markets remained substantially below historical levels. While we believe that many North American cities will continue to get back to more normal levels of office activity, we will then see our corporate sales improve. This pace of returning to office is slower than it was initially anticipated.

For a few additional details on the sales force and its performance. As described earlier, our entire sales force had been working remotely since March of 2020. In October of 2021, we completed the transition of our entire U.S. sales force to a required work-in-office environment. As a result of this back-to-office transition, we strive to identify and exit underperforming reps. During the transition back to office, a modest number of performing reps decided due to lifestyle reasons or their beliefs in not being vaccinated to not return to the office and leave the company. Due to the combination of these two factors, we experienced a higher level of sales force turnover in the quarter.

On a sequential basis, our rep headcount decreased to 516 quota-bearing reps. Year-over-year, our rep headcount decreased by 81 or 13.6%. Our sales force turnover was 8.7% per month for the quarter, an increase from the 5.6% per month in the second quarter of 2021. We believe this increased turnover in the quarter was primarily due to the transition of our U.S. workforce from migrating from working remotely to the required return to office and our implementation of a mandatory vaccination policy. This increased level of scrutiny on the part of sales management helped us identify underperforming sales reps. The decline in sales professionals was primarily in the corporate side where we lost 36 net reps versus a much smaller decline in our NetCentric sales force of only 13 reps. This reflects a greater uncertainty around our corporate segment and an additional focusing of resources on our NetCentric business as that continues to grow at above historic rates.

Overall, we are encouraged by the opportunity to build and manage our sales force in an office environment where we have a greater opportunity to train and mentor our team. Our rep productivity declined to 4.3 installed orders per rep per month for the third quarter from 4.5 installed orders per rep per month in the last quarter, but this was, however, a significant improvement from the 3.7 installed orders we experienced in Q3 2020.

Overall, we continue to be encouraged by the professionalism and performance of our sales force in what has been a particularly difficult environment. We are optimistic that with the transition of our sales force in the U.S. back to the office behind us, we will have the opportunity to better manage and drive productivity with the sales force.

In summary, we remain optimistic about our unique position in serving small and medium-sized businesses that are located in the central business districts of major North American cities. With 1,816 multi-tenant office buildings directly attached to our network, comprising over 984 million square feet of renewable space. Currently, key indicators of office activity, including workplace reentry and leasing activity do remain significantly below pre-pandemic levels. However, we are encouraged that many tenants are indicating a return to office in early 2022 and leasing activities or commercial office space has improved over the past six months. We are optimistic that the combination of in-office sales teams and a more normalized office environment, we will benefit from our ability to sell to corporate customers who have long delayed many of their network transformation decisions.

We also believe that we will benefit from the opportunity to sell our services to new tenants as they are backfilling vacant space in many of the buildings that are directly connected to the Cogent network. Our Board of Directors has improved our 37th consecutive sequential increase in our regular dividend, increase in our dividend to $0.025 a share to $0.83 a share for the quarter. This represents an increase of 13.7% in our quarterly dividend on a year-over-year basis. Our consistent increase in dividend confirms the optimism we have around the ability of our business to continuously generate increasing amounts of cash flow for the benefit of our shareholders.

With that, I'd like to now open the floor for questions.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions) Our first question comes from the line of Sami Badri with Credit Suisse.

George Engroff: It's George on for Sami. I have two questions. So can you provide any additional color on return to office timelines for your customers and how that may impact the timing of Cogent's return to sequential growth in the corporate segment, obviously, in light of the slower-than-anticipated central business district leasing?

And then my second question is in regards to the ongoing labor shortage and how, if at all, that may impact your previously stated sales force growth aspirations given the large quarterly headcount decline?

David Schaeffer: Yes, sure, George. So with regard to return to office, a number of commercial real estate firms surveyed the market consistently. They provide third-party data around 15 key KPIs measuring the health of the commercial office market. Probably the two that are most relevant to Cogent are badge entries or security entries per day and the pace of leasing activity, both primary and subleasing. What we have seen is that in the northern cities, we're still running at around 35% employee entrances per day versus pre-pandemic levels in Q1 of 2019.

In the southern cities, those numbers are up to between 60% and 70% of badge entries per day versus pre-pandemic levels. Those numbers are continuing to increase, and we think this is maybe the most important indicator. It's also important to remember that we sell our corporate product on an unmetered basis. So whether there's 10 employees in their office or 100, the customer pays us the same. And the majority of our corporate customers have historically had VPNs that are aggregated through their firewall in their corporate office.

A positive trend that we have begun to notice as companies define a hybrid work schedule for their employees. We have seen some corporate customers taking additional port from Cogent in a carrier-neutral data center solely for that VPN aggregation function. This should present an additional opportunity for us to sell more ports to those corporate customers, offsetting the decline in office-to-office VPNs as companies reduce the number of offices.

When we put these various puts and takes together, we believe that our corporate business is still probably several quarters away from returning to its historic sequential growth rate. Again, to remind investors, this is a business over 16 years that averaged better than 2% sequential growth.

The only other period of negative growth was two quarters and the great financial recession. We're now dealing with six quarters of negative growth in the pandemic. And based on the delta variant and the pacing of return to office, we're still probably a couple of quarters away from reverting back to a consistent positive growth rate sequentially in our corporate business, but we'll remain underpenetrated in our footprint, and our footprint is actually benefiting from office footprint reductions, giving us more addressable market per building as we have more tenants to sell to.

I'm going to now pivot to your other question, which is maybe the great resignation and the current state of the employment market. Cogent remains a very competitive place for new market entrants, and we have no shortage of candidates who are interviewed at Cogent. We continue to see about 13 applicants for each offer that is extended or starting base salary, which is base salary plus targeted commission is about $80,000 per year. And for our targeted universe of candidates, this is in a very attractive position for them.

What we have seen though are really two headwinds to that. One, employees making lifestyle decisions where they don't want to work in an office environment. We are a firm believer that we better mentor, train and grow our sales force in an office. And as a result of that, many of the employees that we hired during the pandemic working remotely who had committed to returning to the office when required to do so decided not to.

In fact, over 2/3 of the reps that we hired since the beginning of the pandemic are no longer with Cogent. The second point is that we, prior to the federal government requiring companies of over 100 people implemented a mandatory vaccine program in early August. We received a significant amount of pushback from some of our existing employees and other employees. As a result, we did lose some employees who were either politically or morally imposed being vaccinated, but we felt that was critical to maintaining a healthy and safe work environment.

Operator: Our next question comes from the line of Phil Cusick with JPMorgan.

Philip Cusick: So can we dig into the corporate gross adds funnel sort of customers picking up the phone? And as you think about your headcount turnover, should we think of smaller sales forces slowing sales for a decent period here as those new reps train up? Or is that not an issue?

David Schaeffer: Phil, thanks for the questions. I'll take those in reverse order. The reps that we have been managing out have been the less productive reps. Actually, our average rep tenure at Cogent had the largest increase sequentially quarter-over-quarter, going from about 31 months to 33 months. So we've been able to retain good reps and our model, while it sounds easy to just pick up the phone and sell Internet is very hard, and it requires a certain amount of organizational and discipline among our applicants.

We've always experienced high sales force turnover at over 5% of the base per month. The elevated turnover at [age] seven, I think, is a transitory event due to the mandatory vaccinations and the return-to-office requirement, while some employees had acknowledged they were willing to do so when they will require to chose not to. And then we became much more disciplined about looking at underperformance. We realized the status of the underlying market. And for that reason, our corporate sales force declined by about 9%. It just did not pay to carry marginal reps. We, however, do expect to continue to grow the sales force coming out of the pandemic.

With regard to the NetCentric sales force, the decline was much smaller at about 5%. And again, many of the same reasons, but much less underperformance and quite honestly, a healthier underlying market demand.

Now I'm going to pivot to your first question, which is what we're seeing from corporate customers. And I have to admit, as a CEO of an operating business, I believe the impact of the pandemic was going to both be shallower and shorter than what turned out. We saw virtually all of our customers mirror our behavior on remote work. And they initially had anticipated return to office sometime in 2020. That got pushed out due to multiple waves of infection. And I think with the deployment of widespread available vaccines, we started to see companies aggressively plan to return to the office only to see those plans further delayed by the surge of the delta variant.

The federal government's decision to acquire under OSHA, companies of greater than 100 employees to require vaccination has, I think, given most employers comfort in putting in those mandatory vaccine programs and as a result, I think we're seeing an expectation of our customers that what they had originally anticipated to be a post-Labor

Day return to office is now a post New Year's return to office. And we really are seeing a significant uptick in proposals being issued and companies making these network changes that they have been putting off for years.

We also though have seen vacancy rates increase. So therefore, there are less tenants in our buildings. If we look across our footprint, vacancies, which normally had hovered around 4% are about triple that at this point. And as those vacant spaces get backfilled, we think that the typical floor plate of a business will be smaller to support a hybrid workforce therefore allowing us to see an increase in our total addressable market from the 51 businesses in a building maybe to 55 to 60, giving us ultimately a greater number of connections to sell.

And then finally, these two additional trends of migrating to gigabit connections over 100 megabit and I think, change in corporate network architectures to now kind of prepare for a hybrid world, putting some VPN concentration in data centers gives us the ability to sell more connections to each business. Sean?

Sean Wallace: And I'll just add some color to Dave's comments. If we look at the three quarters before the pandemic and then three quarters of this year, quarter one, two, three, and look at the components, gross adds, churn and ARPU, ARPU has been right where we thought it would be. It's been very consistent. Churn has actually improved and is actually -- we're at better levels than where we were pre-pandemic.

And as Dave has mentioned, because of deferred openings of offices and deferred filling of vacancies, our gross adds are still below where we were on the pre-pandemic basis. So we're optimistic that as the world opens up and offices -- corporates go back into offices and begin to reconfigure their networks and as new tenants go into buildings, we'll get back to a more historical level.

Operator: Our next question comes from Colby Synesael with Cowen.

Colby Synesael: Great. Two modeling questions, if I may. One on cash flow from operations CFO. You flagged that it was particularly strong in the quarter. Anything worth flagging and whether or not we should see a little step down in the fourth quarter?

And then secondly, I guess, similarly on CapEx, you mentioned you pulled forward some purchases. Should we see a corresponding reduction in the fourth quarter? Should fourth quarter look like a more normalized level? And if fourth quarter looks like a more normalized level, should we expect then a more notable reduction as we go into 2022?

David Schaeffer: So let me take those on. The cash flow, I think we expect it to be consistent, although the DSOs at 21 days are the best in the company's history. We see no indication that's going to deteriorate, but that does have an impact on our cash flow statistics that we report. But we do expect kind of a similar type of elevated level of cash flow from operations for the fourth quarter.

In terms of equipment purchases, I'll be honest, I don't have perfect visibility to that answer. And the reason is as the chip shortage has continued and I think morphed and become more widespread, we are dependent on a single vendor, Cisco. We have daily conversations with them about equipment availability. Typically, we would be able to order equipment and expect delivery within a month. Now we're going to six-month forecast for delivery with virtually all products experiencing daily volatility and expected ship date. So it's very common for the items that we have on order to get daily reports saying they're being pulled in and then they're being pushed out.

We tried to get ahead of this. We did pull in several million dollars of orders. We did pull additional orders in. But I can't tell you when that equipment is actually going to arrive in our warehouses based on the inability of our vendor to do that. When we look at the base level of capital, it's about flat with where we were last year, but the elevated level is due to these accelerated orders now rather than having orders pending for 30 days. Cogent has six months of orders outstanding with its vendor and could they show up early and therefore, elevate CapEx in the fourth quarter? Possibly. Could they be delayed even further than the six months, and therefore, CapEx will be substantially below. I just don't want to represent to investors something that's out of our control.

Colby Synesael: So Dave, I guess, just to be clear, you not only made orders, but you actually received in your warehouse in the third quarter, some of those shipments that presumably were made, I guess, a quarter or two ago that resulted in the higher CapEx this specific quarter. And I guess, to your point, you've also made incremental elevated orders, which could result potentially in elevated CapEx, whether it's in the fourth quarter, some future quarter, you're not sure. Is that -- am I hearing that correctly?

David Schaeffer: You are hearing that absolutely correctly, Colby, because we record the CapEx upon receipt of the equipment.

Colby Synesael: Got it. And then just one quick one, if I may. On leverage, you're not at the high end of your target, 2.5 to 3.5. Could that potentially have any limiting factor on dividend growth going forward?

David Schaeffer: We do not anticipate that. We also note that about 6 or 7 basis points of that is due to foreign exchange distortion. So under the indenture it’s [3.47], if we took the FX out, we'd be at about [3.4]. Yes, that's above the midpoint, but still below the high end. That high end is an internally set goal by Cogent. It's something that's reviewed with the Board as we did a sensitivity analysis for the Board earlier this week. We feel very comfortable that we're going to be in a position to continue to grow our dividends for the foreseeable future.

Operator: Our next question comes from Nick Del Deo with MoffettNathanson.

Nicholas Del Deo: First, since the return to office trend has been a bit different in, you call it, coastal cities or northern cities versus some in the South, are there trends you can observe for metros with higher in-person office attendance versus those with lower rates?

Yes, that might give us a sense for how the corporate business should recover as we start to see the cities that are behind start to look more like the cities that are further along.

David Schaeffer: Yes, sure, Nick. Great question. So our sales force sells nationally. So we can't look where the sale originated because a salesperson in New York may actually sell a customer in Phoenix or a salesperson in Houston may sell a customer in Seattle. But we can look at where the orders are installed, and we have seen a better performance, lower churn and higher installs in those southern cities. Is it enough to really give us confidence that, that's where New York and Toronto and Chicago were going? I'm not sure. These are smaller markets. They tend to have a different type of business.

So for example, if we look at our footprint in the Texas market, while it's a broadly diverse economy, it's much more heavily dependent on energy. New York is heavily dependent on financial services. That tends to be a positive for us because financial services tends to be an industry vertical that is more prone to aggressive return to office than some of the consulting and service businesses. Legal, however, tends to be an industry that's a laggard in return to office.

So I think we look at the data both by endpoint geography and by SIC code of the customer. When we put all of that data together, I think we're pretty encouraged that as badge swipes increase and leasing activity increase our corporate sales rate in those buildings will increase.

Nicholas Del Deo: Okay. Okay. That's helpful. And then a couple of questions or clarifications on the sales force front. First, it looked like your full-time equivalent reps went up in the quarter despite the total number going down quite a bit. Just mathematically, how does that work? And then second -- sorry, go ahead.

David Schaeffer: I'm laughing. I actually -- I went to [Kesha], who does our financial modeling and asked the same question. And the reason is the FTE is a weighted number over the month and the number of reps reported is an ending number. So we had a significant amount of terms on the last couple of days, 9/30 of the month. So we ended up with an ending number that was actually below the FTE number. That's just because why the two numbers are calculated.

Nicholas Del Deo: Okay. That makes sense. And then last one, as your overseas sales force goes back to the office by the end of the year, should we expect another step down in the sales headcount? Or is that a sufficiently small portion of the total sales force that it won't be as noticeable?

David Schaeffer: So first of all, it's a small portion of the sales force. Second, they are all NetCentric. Third, while there is some anti-vaccination sentiment in some of the countries, the acceptance of vaccines when available in Europe seems to be higher than the U.S. And we -- when we implemented voluntary return to office, we actually got a much higher take rate literally across each of our European markets.

Now we have not yet tested the Singapore sales office as the government does not allow voluntary return yet. And then we had a bit of a setback yesterday in Netherlands where we went to voluntary, we actually had 100% participation in people returning to the office only to have an order by the Dutch government requiring companies not to allow people to work in the office until the end of the year, more than 50% of the time. So we're going to be in compliance with every local regulation, Europe is not monolithic.

Spanish rules are different than Swedish rules. And we're going to comply. I actually had a call Friday with the U.K. teams and talked to them about just their sentiment. And there is a real increase in reported case volumes, again, in the U.K. And while there is not any governmental mandate against coming to the office, it may happen. So again, we literally monitor each of these jurisdictions daily.

Operator: Our next question comes from Walter Piecyk with LightShed.

Walter Piecyk: Dave, that status is pretty incredible to 2/3 of your hires leaving. I'm just curious, I might be misremembering this, but I thought during the pandemic, you had talked about how people were as productive, yet some software working out of the office than in, maybe you said something differently, so you probably correct me on that, but why not just let them work from home and do their sales there? Why do you need to force them back in the office in order to maintain their jobs?

David Schaeffer: So what I had said previously of remote work is we quickly pivoted. We quickly modified our hiring and training, and we were as effective in hiring people remotely as we were in the office. Secondly, later in the pandemic, if you remember, it was August of 2020, we implemented a more -- a disciplined approach of managing out the underperformers, and we had several quarters of additional elevated sales force turnover and then it began to revert to normal.

I think there are really three parts to answering your last question around remote work. Some employees left because they refused to be vaccinated. And the OSHA requirement doesn't give you a dispensation for people who work at home. If your company has 100 employees, you're supposed to require people to be vaccinated absent religious or medical exemptions.

Two, there are a number of employees who have, I think, rethought their lifestyle and prefer to work remotely. That does not fit the Cogent model well. Again, to remind investors, our U.S. sales force is compensated hourly. We concluded that they are not exempt employees under the Federal Fair Labor Standards Act, and it's highly unusual to have remote workers hourly.

And then the third point is that we have seen a difference in rep productivity in the office versus remote due to the ability to mentor those less mature reps by mature reps and managers physically in the same environment. While our reps could do their job remotely, their productivity was lower during the pandemic. Now some of that was as a result of the market, but some of that is a result of those reps not accelerating in their training as quickly as they would in the office. So most of our elevated turnover has been of the very newest reps. In fact, most of the turnover were reps that never had set foot in a Cogent office. And we believe that they will be more effective. We do have a program for tenured reps that do allow them to work remotely if they meet their sales objectives.

Nicholas Del Deo: Got it. That kind of dovetails into my next question, which is, if that's somewhat reflective of the fact that this is not relatable to 2008, meaning that it's changed how people work, when your own employees, 2/3 of them are leaving, whether they're anti-vaccinated or it sounds like more of a lifestyle choice, then just in this -- I know that this is difficult to predict, you and I have been engaging on this -- on past calls.

But when you talk about a couple of quarters away to get back to a consistent positive growth, do you think this business ever gets back to 2% sequential growth because that -- because your comment from the prepared comments was -- or maybe it was in the Q&A, a couple of quarters to get back to consistent positive growth, but does it get to 2% sequential growth, Dave, ever?

David Schaeffer: I think the answer is yes, Walt. And the reason is we have 16 years of history, and we know that we still have a significant amount of addressable market in our footprint that we are not serving. The value proposition that we deliver is increasingly differentiated from our competitors due to the fact that we're offering a symmetric service that is not oversubscribed and non-bought. If companies are more dependent on the Internet, they are more likely to buy from Cogent than a cable company or a phone company or a competitive provider due to the fact our services install faster and are 3x more reliable with 60x the throughput. So the value proposition is there.

The issue that we are facing is twofold. One, there are less businesses in the buildings now, vacancy is almost 3x higher than it was pre-pandemic. And secondly, companies are struggling with the exact time line of their new normal. But as long as the buildings return to at least equal or better occupancy, our growth rate can easily achieve the 2% sequential that we've historically delivered.

Walter Piecyk: Got it. And Dave, one last question. In the past, when we talked about gig service, I remember years ago, we used to joke about the fact that there was maybe some hedge funds that would buy gig service, and they would only use 12 meg, right? They were just over purchasing, but you were benefiting. But clearly, people understand the importance of connectivity now. And I would totally understand how all new customers are coming on a gig, but has your revenue been helped by the fact that over the past two to three years, you've had people that were 100 meg service effectively upgrading to gig service. And does that tailwind kind of peter out in the years ahead, so that ARPU benefit that you may have been getting from someone shifting from 100 mg or 200 meg up to 1 gig is no longer there?

David Schaeffer: So the answer is yes. We did have a tailwind, and that tailwind will diminish as the installed base increases. But there are two, I think, more important offsetting factors. Ironically, we're actually starting to see an uptick in corporate customers wanting 10 gigabit connections such as your former employer, who is a Cogent customer, taking all of their 1-gig connections and upgrading them to 10 gig, again, recognizing the importance of bandwidth in trading operations.

And then secondly, we have faced a two-year headwind to VPN growth. Roughly, 25% of corporate revenues, 17% of total revenues come from VPN sales. Those sales basically stopped and churn increased as companies pruned their office footprint, but existing MPLS networks were not migrating to VPNs. We are now seeing a reacceleration of that VPN growth, which becomes, I think, even a bigger tailwind in terms of aggregate revenue than the 100 meg to gig upgrade cycle. So we end up, I think, net positive as people return to office. Sean?

Sean Wallace: Can I just add a little bit to that, Walt? I mean, from an atomic basis of how you're looking at how we're selling for a small premium, we're going to sell contracted service that is bidirectional 1 gig service to our customers. These are customers that have, on average, 8,000 square feet. They're paying close to $50 a square foot. So they might be paying $400,000 a year in rent.

The idea that they're going to have service from a cable company or others that is not contractually committed to provide that 100 meg service. We are beginning to see that 1 gig is a big differentiator for a very small price. We can really dominate that service. And that is where the business is going.

Operator: Our next question comes from Michael Rollins with Citi.

Michael Rollins: So two questions to follow up. The first is, if you look at the NetCentric growth constant currency year-over-year, is there a way to unpack what's happening domestically, what's happening internationally as you've been expanding your reach in your network, maybe the impact, whether it's on revenue or profitability from doing more on-net?

And I realize maybe it's hard to do because some of these things might overlap with one another. But just trying to appreciate how to unpack the growth and think about maybe some of those factors in the future.

And then just secondly, you mentioned that the gross adds are down in corporate relative to pre-pandemic levels. Just curious how much of it do you think is the pandemic. And is there a risk that some of that erosion of gross adds could be competitive, just as other companies could be using this opportunity to invest or try to get more aggressive at the market that you focus on?

David Schaeffer: Yes, sure. So let me take the NetCentric one first. We have benefited from multiple underlying trends. Growth in NetCentric revenue is driven by increase in traffic, increase or decrease in price per megabit and the percentage of traffic that is two sided. We have seen outsized NetCentric growth after a period of underperformance in

NetCentric due to the factors of smaller customers growing faster than the bigger customers, giving us a more diversified customer base; two, the percentage of traffic that is both originating and terminating on the Cogent network.

So it's why our revenue growth at 25% was equal to our traffic growth, whereas in a completely normalized world where these other trends are not taking place, and there's a 23% year-over-year price reduction, we would actually see flat revenue. So we have benefited.

In terms of internationalization, there's a couple of parts to answer that. Content is still predominantly a U.S. product that's exported to the rest of the world. That's not totally true, but it's more heavily U.S. centric. And then on the access side, the U.S. has more access networks that are global peers and less paying customers as a percentage of the access space. We have many access customers in the U.S., but globally, most of the international markets buy Trans. So we get a higher percentage of two-sided traffic.

Now the traffic may actually -- the content may originate in the U.S. and terminate in Asia or it may actually be European hosted, but then terminating in South America. It's totally dependent on language. Again, we think of the Internet is an English language phenomena. But you have to remember, the vast majority of people that use the Internet don't speak English and yet Internet traffic growth is growing.

So for example, we do very well. We're the number two provider in Brazil, all of that traffic is Portuguese, and it's there because most of the people in Brazil don't speak English. So I think we benefit, but it's extremely hard to kind of further granularly look at that.

What we do look at, though, on a regular basis is for every customer, where that traffic enters our network, where it physically exits the network and to what customer base is it's going. We actually share that information with our NetCentric customers, which they view as a valuable engineering tool to help them design their network. But it's a little hard because it's a usage-based service to make exact predictions of traffic flows.

Then to the gross adds competition versus market conditions. When we look at our decline in corporate connections, the percentage decline is actually much lower than the percentage increase in vacancy in the buildings. So that's kind of indicating that we're maintaining our market share. Secondly, when we look at the number of connections that are declining, it's usually the second connection. So going into the pandemic, 50% of our corporate customers took a VPN service. That number has declined throughout the pandemic. We do think that will return. But short term, that has hurt us.

And to the point that Sean made earlier about the quality differentiator, I think our network architecture, the fact that we prewired the buildings, and we can both quickly install and then deliver services over a ring that gives us 3x the reliability of our competitors who have linear networks with single points of failure is a huge differentiator as the Internet has become more important. So you never want to be complacent about competition, but I don't think our gross adds issue is a competitive issue. I really do believe it is an underlying demand issue as businesses kind of figure out what the new normal is.

Sean Wallace: Yes. Let me just add a little bit to what Dave is saying. We were nervous about what we have had elevated churn during the pandemic. So we went and looked at a series of buildings, which had higher levels of churn, the Graymark building, for example, in New York, which we saw eight circuits leave. They were, for the most part, all FE that is 100 megabits per second. And we asked them four questions as we do: Did you move? Did you close the office? Did you got a business? Or did you got a competitor? In the Graymark building, all of them were one of those answers except for going to a competitor.

And I think anecdotally, we do see on the 100 meg side, I think it was a retailer that did doughnuts that was competing with us, we're competing with a cable operator and the price got so low. I think Dave didn't approve the pricing. That's -- in the low end, we do see that where it's very price competitive. On the 1 gig side, we think we're in very, very fine shape.

Operator: Our next question comes from Frank Louthan with Raymond James.

Unidentified Participant: It's [Rob] on for Frank here. So just a quick one from me. So when do you guys see the bottom in the off-net disconnects? And are you seeing any new pockets of off-net demand that could potentially offset that as population and work shifts have sort of rebounded?

David Schaeffer: Yes. So a positive for the off-net business is the fact that over 55% of the square footage in North America office space is now available with fiber provided services from one of our 90 different vendors. So we have over 4 million square feet that we can sell into. That's the positive.

The negative is that it's very expensive to sell just off-net. The competitive differentiation is not large enough. So our off-net sales are almost always catalyzed by an on-net relationship. We also know that because there are oftentimes multiple off-net choices per endpoint in those 7,500 buildings where we sell those 12,500 connections, we have the ability to compete them against one another and drive down prices. So ARPUs have gone down.

I think as we look at off-net, it's almost exclusively corporate. As the corporate on-net rebounds, the corporate off-net will rebound and companies will take secondary connections and therefore we'll get back to growth that more or less mirrors unit-wise, the on-net growth and the only drag will be ARPU. So rather than kind of being a 2% grower, it's kind of like a 1% to 1.5% sequential grower.

Sean Wallace: Yes. I would just add into that. And again, this is the Gigi theme, but we rolled out Compass, which is our CRM system last year. We created an ability for salespeople, particularly new salespeople to get between 30 and 50 leads every morning. This would be a potential customer in a building that we service through the 4 million buildings that Dave spoke about. And we are finding real success.

First of all, it's really good training for the new sales people. But that product, the Gigi off-net, despite its pricing, which Dave talked about, we are up over 20% year-on-year in that unit growth. So that product, inside that, we're having challenges on VPN, as Dave talked about. But for that product itself, we are seeing very, very strong growth.

Operator: Our next question comes from Brandon Nispel with KeyBanc Capital Markets.

Evan Young: It's Evan on for Brandon Nispel. Two questions. Are you guys seeing any impact to your customers related to supply chain or inflation that could potentially flow into impacting you guys? And with the VPN, are you seeing any decision changes from your customers for taking an alternative product? Or are they still pretty set on taking VPN?

David Schaeffer: Yes. So two very different questions. Fortunately, we do not have much exposure to manufacturing as a sector. Virtually all of our customers are white collar in an office building by definition. And there, I think there's been much less supply chain issues. And as Sean pointed out, with the average customer spending $400,000 on rent for a location, spending $6,000 a year on Internet is a trivial expense.

And while they may experience inflation in other areas, technology has always been deflationary, and I think customers expect that. And we deliver on that by delivering bigger pipes at a much lower cost per megabit, whether it be the migration from 100 to gig, 1 gig to 10 gig. So I just don't see a lot of supply chain issues really impacting us.

In terms of the VPN question, there, I think, companies have kicked the can down the road on MPLS replacement. They know it's antiquated, but they are waiting for 2 things: one, better VPN solutions, which may or may not come from the vendors. But two, exactly what locations they want that VPN to work in as they figure out how many branch offices they will close.

I do think we're starting to see a reacceleration and interest in VPNs, and most of those are either SD-WAN or VPLS, and there's really not a lot of alternatives. And as I stated earlier, we've seen the additional benefit of companies now adding an extra node that didn't exist previously for their remote work VPN concentration in data centers. So all in all, we think that we'll see VPN business reaccelerate the growth rates similar to DIA.

Operator: I'm showing no further questions at this time. I would now like to turn the conference back to Mr. Dave Schaeffer.

David Schaeffer: I'd like to thank everyone for their interest. I know it's a long call, but a lot of excellent questions. Take care, everyone. Stay safe. Thanks. Bye-bye.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect.