Cogent Communications Holdings, Inc. NasdaqGS:CCOI

Earnings Call

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Presentation

Operator

Good morning, and welcome to the Cogent Communications Holdings Fourth Quarter 2022 and Full Year 2022 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 Cogent's 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. Please go ahead, sir.

David Schaeffer
Founder, Chairman, CEO & President

Thank you, and Good morning, everyone. Welcome to our fourth quarter 2022 and Full Year 2022 Earnings conference call. I'm Dave Schaeffer, Cogent's CEO and with me on this morning's call is Thad Weed, our Chief Financial Officer. Hopefully, you've had a chance to review our earnings press release. Our press release includes a number of historical quarterly metrics and we present these in a consistent way each quarter.

Now for a couple of comments on our results. Our revenue growth accelerated this quarter and our corporate revenues increased by 0.3%. Our revenue for the quarter increased sequentially by 1.3% to $152 million, an increase of 3.2% year-over-year. Our revenue increased by 1.7% for full year to $599.6 million. On a constant currency basis, our quarterly revenue grew year-over-year by 5.5%. And for full year, on a constant currency basis, our revenue growth was 3.9%. On a constant currency basis and also adjusting for the negative impact of universal service fee revenues on our revenue quarter-over-quarter or year-over-year on a quarterly basis, our revenues grew by 5.7% and for full year 2022 grew by 4.4%.

Our corporate business continues to be influenced by real estate activity in central business district. Key statistics that we look at are building entries as measured by security card swipes in buildings and leasing activities that year-to-date indicate that while the central business district markets have seen some improvement, this improvement continues at a slow pace and is still not at pre-pandemic levels. We continue to remain cautious about the outlook for our corporate revenue growth given the uncertain economic environment and other challenges as a result of emerging from the pandemic.

Our NetCentric business continues to benefit from accelerating continued growth in video, traffic and streaming. For the quarter, our network traffic was up 11% sequentially and traffic growth accelerated on a full year basis to 25% year-over-year. For full year, our network traffic growth continues to improve. On a U.S. GAAP basis, our NetCentric revenue growth grew sequentially by 2.6% and grew by 9.6% year-over-year. On a constant currency basis, our NetCentric revenue growth for the quarter increased by 15.2% from the fourth quarter of 2021 and for full year 2022 grew by 16.7%.

Our sales force rep productivity was impacted by the rapid expansion of our sales force. Our rep productivity was 3.8 orders installed per full time equivalent per month. We increased the number of sales reps this quarter by 26 or 5%. We ended the quarter with 548 reps and 503 full-time equivalents. This is an increase of 8.2% in full-time equivalent sales reps. For full year 2022, we increased our sales force by a net number of $58 million or 11.8%. Our average rep tenure decline due to this rapid pace of sales force expansion and did have a negative impact on full-time equivalent sales rep productivity.

Now I'd like to take a moment and talk about our progress in closing our pending merger for the Sprint T-Mobile wireline business. We are diligently working to close our acquisition of the Sprint Wireline business with T-Mobile. We have received all material approvals from regulatory agencies globally, including in the U.S., the FCC and the California Public Service Commission. We anticipate this acquisition will close in the second quarter of 2023. We did incur approximately $200,000 in professional fees associated with this acquisition in the quarter and for full year 2022, approximately $2.2 million in fees associated with the acquisition.

We anticipate Sprint wireline revenues at year-end 2021 were $560 million. We also anticipate that the run rate at time of closing will be an annual number of approximately $450 million. We ultimately expect the number of Sprint wireline products to be reduced dramatically from approximately 30 unique products or SKUs today down to 4. We have begun to sell the wavelength service this quarter to our customers through a commercial resale agreement with T-Mobile.

Over the next 3 years, we expect to continue to achieve significant cost savings through the integration of our networks, approximately reducing the network expense of the Sprint wireline network in North America by $180 million, achieving approximately $25 million in savings in the rest of the world on the Sprint wireline network; and then finally, achieving $15 million of savings for Cogent in its operation and maintenance expense for its North American network. We anticipate also additional SG&A savings and other cost and revenue synergies over the next several years. With all of the regulatory approvals now in hand, we do feel the transaction is imminent to close in the second quarter of 2023.

Now for a comment on our dividend and buyback strategy. During the quarter, we returned $44 million to our shareholders through our regular quarterly dividend. And for full year 2022, we returned $169.9 million to shareholders through our regular quarterly dividend payments. Our Board of Directors, which reflected on our strong cash-generating capabilities, investment opportunities and the pending merger with Sprint decided to increase our quarterly dividend yet again by $0.01 sequentially this quarter, raising our quarterly dividend from $0.915 per share to $0.925 per share. This represents the 42nd consecutive sequential quarter of growing our regularly dividend and the annualized growth rate in this dividend is now approximately 4.4%.

Now for a couple of expectations about our long-term guidance. Once we have combined with the Sprint wireline businesses, we anticipate an annual revenue growth rate of between 5% and 7% and an annual EBITDA margin expansions on the combined business of approximately 100 basis points per year. Our revenue and EBITDA guidance targets are intended to be multiyear goals and are not intended to be used as quarterly or even annual guidance.

Now I'd like to turn the call over to Tad Weed for safe harbor language and provide a further review of some of our operating performance in the quarter. And then I will read the way and following these remarks, we will open the floor for questions and answers. Tad?

Thaddeus G. Weed
CFO and Senior VP – Audit & Operations

Yes. Thank you, Dave, and Good morning, everyone. This earnings conference call includes forward-looking statements, and 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 and 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 corresponding GAAP measurement in our earnings releases, which are posted on our website at cogentco.com. Like many companies, we continue to be impacted by the COVID-19 pandemic and our risks related to COVID-19 and other risk factors are described in more detail in our annual report on Form K for 2022 that will be filed this week, end of this week, and in our quarterly reports on Form 10-Q.

On corporate NetCentric revenue and customer connections, we analyze our revenues based upon network connection type, which are on-net, off-net and noncore, and we also analyze our revenues based upon customer type. We classify all of our customers into 2 types, NetCentric customers and corporate customers. Our corporate customers buy bandwidth from us in large multi-tenant office buildings or in carrier-neutral data centers. These customers are typically professional services firms, financial services firms and educational institutions located in multi-tenant office buildings or connected to our network through our carrier-neutral data center 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 consumer and business customers. Our corporate business represented 56.4% of our revenues this quarter and 57.1% of our revenues for 2022. Our quarterly corporate revenue declined year-over-year by 1.2% to $85.8 million from the fourth quarter of 2021, but as Dave mentioned, increased sequentially by 0.3%.

For full year 2022, our corporate revenues declined by 4.4% to $342.6 million. We had 44,844 corporate customer connections on our network at year-end. That was a sequential decrease of 0.7% and a year-over-year decline of 1.3%. Our total revenues and our corporate revenues were negatively impacted by changes in the USF tax rates on a year-over-year basis. For the quarter, the impact of USF on our revenues was flat, but there was a negative year-over-year impact of about $300,000 from the fourth quarter of last year. And for the full year, the negative impact of USF was $3.1 million.

On a constant currency basis, and if you adjust for the year-over-year decline in USF revenues, our total revenues for the full year increased by 4.4%, substantially better than the comparable 2.4% constant currency in USF tax adjusted revenue growth rate from 2020 to 2021. Our NetCentric business, which represented 43.6% of our revenues this quarter, had another solid quarter and grew by 2.6% to $66.2 million sequentially and by 9.6% year-over-year. For the full year, our NetCentric revenue grew by 11.1% to $257 million. Again, as Dave mentioned, the volatility in foreign exchange primarily impacts our NetCentric revenues -- so on a constant currency basis, our quarterly NetCentric revenue decreased year-over-year by 15.2% and sequentially by 2.5%. And for the full year, NetCentric on a currency basis grew by 16.7%.

We had 51,670 NetCentric customer connections on our network at quarter end. That was a sequential increase of 1% and a year-over-year increase of 7%. Our on-net revenue was $114.9 million for the quarter, a sequential increase of 1.5% and a year-over-year increase of 3.8%. Our on-net revenue increased by 2.2% for the full year to $452.8 million. Our on-net customer connections were 82,620 at year-end. And we serve these on-net customers in our 3,155 total on-net multi-tenant office and carrier-neutral data center buildings. We continue to succeed in selling larger 100 gigabit connections and 400 gigabit connections in selected locations, which has increased our on-net ARPU.

Our off-net revenue was $36.9 million for the quarter. That was a sequential increase of 0.7% and year-over-year of 1.6%. Our off-net revenues are impacted by incorporated the cost savings we obtained for lower local loop prices into our pricing to our customers. Our off-net customer connections were $13,531 at the end of the year, and we serve these off-net customers in about 8,300 off-net buildings that are primarily in North America.

The average price per megabit for our installed base declined sequentially by 2.8% to $0.26 and the year-over-year by 19.6%. However, this annual rate of decline for our installed base was better than our historical long-term average of 21.5%. The average price per megabit for new contracts for the quarter was $0.13, sequential decline of 13.5% and year-over-year of 24%. Selling larger connections results in a change in our connection mix and has the effect of lowering our average price per megabit at a greater rate than changes in our ARPU.

Regarding ARPU. Our on-net ARPU for the quarter increased and our off-net ARPU continued to decline but at a modest rate. From the lower pricing, again, we're obtaining for our off-net circuit vendors that we pass on to our off-net customers. Our on-net ARPU, which includes both corporate and NetCentric customers increased sequentially by 1.3% from $458 to $464. Our off-net ARPU, which is predominantly corporate customers, declined sequentially by 0.7% from $920 to $914. Our churn remains strong. Our sequential quarterly churn rates for our on-net and off-net connections were relatively stable and continue to hover around 1%. Our on-net unit churn rate was 1% for the quarter, a slight improvement from 1.1% last quarter and our off-net churn rate was 1.1% for this quarter compared to 1% last quarter.

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

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 2,150 customer connections and that increased their revenue commitment to Cogent by over $20 million. Some comments on EBITDA and EBITDA margin. Again, we reconcile our EBITDA to our cash flow from operations in each of our quarterly earnings press releases. Seasonal factors that typically impact our EBITDA and predominantly our SG&A expenses include the resetting of payroll taxes in the U.S. at the beginning of each year, annual cost of living or CPI increases, seasonal vacation periods, year-end bonuses paid to our employees and the timing and level of audit and tax services and now Sprint acquisition costs and also annual benefit plan cost increases.

We incurred $2.2 million of Sprint acquisition costs for the full year and about $200,000 in the fourth quarter. Our EBITDA for the quarter, inclusive of the Sprint acquisition costs decreased sequentially by $0.7 million and decreased by $0.3 million year-over-year. Our EBITDA for full year 2022, inclusive of these costs increased sequentially by 1.2% to $230.6 million. Our fourth quarter and full year 2022 EBITDA results were impacted by the increase in our sales rep headcount, increased circuit costs related to our international expansion; and a year and $1.5 million onetime bonus that we granted to our eligible employees to help to offset the impact of inflation.

Our quarterly EBITDA margin inclusive of Sprint costs decreased sequentially by 100 basis points to 37.6% and year-over-year by 140 basis points. For the full year, our EBITDA margin inclusive of Sprint decreased sequentially by 10 basis points to 38.5%. Excluding Sprint acquisition costs, for the full year, our EBITDA increased by 2.2%, and our margin decreased sequentially by 220 basis points to 37.8% for the quarter and year-over-year by 120 basis points. For the full year 2022, our EBITDA margin, excluding Sprint increased sequentially by 20 basis points to 38.8%.

Comments on foreign currency. Our revenue earned outside of the United States is reported in U.S. dollars and was approximately 25% of our total quarterly revenues this quarter. About 16% of our revenues this quarter were based in Europe and 9% of our revenues were related to our Canadian, Mexican, Asia Pacific, South American and African operations. Our average euro to USD rate so far this quarter is about $1.08 and the Canadian average rate to USD is about $0.75. If these average rates remain for the remainder of the quarter, the first quarter of 2023, the foreign exchange estimated impact on sequential revenues would be positive by $1.4 million, but year-over-year would be negative by the same amount, $1.4 million. We believe that our revenue and customer base is not highly concentrated. Our top 25 customers represented again about 6% of our revenues this quarter.

Our quarterly CapEx expenditures decreased sequentially to $19.6 million and were $79 million for the full year. Supply chain uncertainty and purchases in anticipation of the closing of our Sprint acquisition caused us to shift our typical purchasing schedule for network equipment. These anticipatory investments are designed to ensure that we have satisfactory inventory levels of network equipment to accommodate our growth plans, including new wavelength product offerings as a result of the Sprint acquisition and the interconnection of our 2 networks together in multiple locations to meet our customer needs.

Some balance sheet comments. 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 longest term lease is for 44 years. Our current IRU finance lease obligations totaled $304.2 million at year-end. We have a very diverse set of IRU suppliers, and we have IRU contracts with a total of 308 different dark fiber suppliers.

At quarter end, our cash and cash equivalents and restricted cash was $275.9 million. $52.1 million of restricted cash is tied to the estimated fair value of our interest rate swap agreement. Our cash flow from operations was $36.3 million for the quarter and $173.7 million for the year. Our total gross debt at par, including IRU obligations, was $1.3 billion at year-end, and our net debt was $978.3 million. Our total gross debt to trailing last 12 months EBITDA adjusted for Sprint costs, the ratio was 5.39x at quarter end, and our net debt was $4.2 million. Our consolidated leverage ratio, as calculated under our indentures, slightly different, 5.32% and our secured leverage ratio was 3.41%, and our fixed coverage ratio as calculated under the indentures was 3.49.

We are party to an interest rate swap agreement that modifies our fixed interest rate obligation with our $500 million 2026 notes to a variable interest rate obligation based on the secured overnight financing rate for the remaining term of these notes. We record the estimated fair value of the swap agreement at the end of each reporting period, and we incur corresponding noncash gains or losses due to changes in market interest rates. At quarter end, the fair value of the swap agreement decreased from last quarter by $2.6 million to $52.1 million. We are required to maintain a restricted cash balance with the counterparty equal to the liability, the settlement payments under the swap agreement are made each November and May.

Under our initial payment made in November 2021, we achieved a net cash savings, interest savings of $0.6 million and for the next payment for the period of August 21 to October 2021. The next payment, I'm sorry, under the payment that we made in May 2022 was additional savings of $1.2 million for the period for November 21 to April 30, 22. The -- and under the previous settlement payment that we made in November 22, we had a net cash cost of $3.4 million for the period from May to October 2022.

Finally, some comments on bad debt and day sales, which were excellent for the year and for the quarter. Our bad debt expense was only 0.5% of our revenues for the quarter and 0.4% of our revenues for the year. That was an improvement of 0.6% of our revenues from last year. Our days sales outstanding is very consistent and excellent at 22 days at year-end. We want to thank and recognize as always, our worldwide billing and collections team members for continuing to do just a fantastic job in serving our customers and collecting from these customers.

And with that, I will turn the call back over to Dave.

David Schaeffer
Founder, Chairman, CEO & President

Thanks, Tad. I'd like to highlight a couple of strengths of our network, our customer base and our sales force. We've achieved excellent revenue growth in our NetCentric business. We are a direct beneficiary of increased over-the-top video and streaming services, particularly in international markets. At quarter's end, we are on net in 1,458 carrier-neutral data centers. We also have 54 Cogent-owned data centers, bringing our total on-net data center footprint to 1,512 data centers, more than any other carrier globally is measured by independent third-party research. The breadth of this coverage enables our NetCentric customers to better optimize their networks and reduce latency. We expect to continue to widen this lead over the market as we project to connect an additional 100 carrier-neutral data centers per year to our network over the next several years, and we will be also adding approximately 45 Sprint data centers to our network footprint.

At quarter end, we directly connect to 7,792 unique networks. The collection of ISP's, telephone companies, cable systems, mobile operators and other carriers give us direct access to the vast majority of the world's broadband subscribers and mobile phone users. At quarter end, we had a sales force of 216 professionals who focus solely on this NetCentric market. We believe this group of professionals is the largest and most sophisticated sales team focused on this market segment. This sales force will also primarily be responsible for the sale of our wavelength products as we close the Sprint transaction.

Now for a couple of comments on the corporate market segment. We are seeing positive trends in our corporate business as work from home environment becomes established as part of the way in which people work in an office. We believe our corporate customers will continue to look to upgrade their Internet access infrastructure to larger capacity connections and more diverse connections. Our corporate customers are aggressively integrating some of the new applications that became part of the work-from-home environment, such as video conferencing. This usage will require high bandwidth connections both inside and outside of the premise. Our aggressive push to lower bandwidth costs and provide greater coverage has begun to boost corporate demand for our robust bidirectional symmetric 1 gig and 10 gigabit ports. Corporate customers are increasingly buying connections in carrier-neutral data centers for redundancy and to support the ad hoc VPNs that their hybrid workforce requires.

We remain focused in our sales force productivity and sales force growth and continue to improve our sales training programs and manage out underperforming sales reps. On a sequential basis, our total sales

rep headcount increased by a net of 26 or 5% sequentially and by 11.8% year-over-year to 548 quota-bearing reps. Our number of full-time equivalent reps, those reps that have been in the seat for more than 3 months increased to 503 from 465. Our sales force turnover rate improved again to 4.7% per month from last quarter when that number was 5.5% per month. This is down substantially from a peak during the pandemic of 8.7% turnover per month and that was, in fact, the worst sales force turnover rate in our corporate history. But we are now operating below historic averages, with sales force turnover rate averages over the past 17 years, averaging 5.7%.

So in summary, 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 1,837 large multi-tenant office buildings on net representing over one billion square feet of rentable space, an average building size of approximately 550,000 square feet. We are excited about adding large enterprise customers to our customer base through the Sprint acquisition and are most excited about our ability to sell wavelengths or optical transport networking services, a new product to Cogent that we are adding to our portfolio and expanding into all of our U.S. data center footprint.

Currently, key indicators of office activity, including workplace reentry and leasing activities are improving but do remain below pre-pandemic levels. We are encouraged that many tenants have indicated that they are returning to office, they are leasing new space, and they are now settling on what their new network architectures will work like. As certain corporations elect to downsize our office space requirements, multi-tenant office buildings, this increases the opportunity for new tenants to move into those buildings and allows us to increase our total addressable market and on-net corporate buildings.

Under our indenture agreements, including the $250 million general restricted payments basket carve-out, we have a cumulative amount available for dividends and stock buybacks that actually exceeds the $275 million of cash that we have on hand. We are diligently working to close the Sprint wireline transaction. We are excited and very optimistic about the cash flow generating capabilities of the combined company with our expanded product set and footprint. We expect the transaction to close in the second quarter of 2023. With that, I'd like to now open the floor for questions.

Question and Answer

Operator

Thank you. [Operator Instructions] We'll take our first question from Frank Louthan at Raymond James.

Frank Garrett Louthan
Raymond James & Associates, Inc., Research Division

Great. Just to be clear, do you think this is going to close more towards the beginning of the quarter towards the end? And can you give any updates on how the revenue and the EBITDA going to are going to be -- you're going to be able to recognize that from any updates to the accountants.

David Schaeffer
Founder, Chairman, CEO & President

Yes. Thanks for both questions, Frank. So while we have all regulatory approvals in hand, and we have been working diligently with over 30 working groups on the integration, the longest lead item remaining is the successful completion of our transition services agreement. While we have the framework of that agreement and we'll have identified all of the requisite items to be included, the negotiation of that is continuing. I would say probably mid-quarter is the most likely closing date. But we feel highly confident it will close during the quarter. It is probably unlikely that we will close at the very beginning of the quarter, just based on the fact we only have 5 weeks to complete that transition service negotiation. And there are over 200 discrete items that have to be addressed and agreed to by both parties. While I would characterize the negotiations as very constructive, and both parties are determined to get this done, there is just a lot of detail work that needs to occur.

Now to the question about the transit services agreement that we entered into with T-Mobile as part of this transaction. In consultation with Ernst & Young, our auditors, we feel comfortable that we will be able to recognize the vast majority of that $700 million stream of revenue as revenue for Cogent and therefore, will be included in our reporting and in our financials.

Operator

We'll go next to James Breen at William Blair.

James Dennis Breen
William Blair & Company L.L.C., Research Division

Just a follow-up on that. You talked about sort of the run rate of revenue at close. I think you said around $450. Any sort of thoughts on -- is that sort of the bottom there and you've taken it down to the bare minimum and it grows from there, or do you think you'll see more revenue attrition once the deal closes?

David Schaeffer
Founder, Chairman, CEO & President

Yes. Thanks for your question, Jim. So 2 points. We do project the stable revenue run rate of the acquired enterprise customer base to be approximately $450 million because the transaction is probably going to close sooner than we had initially anticipated, it is our expectation that at closing in the second quarter, the annualized run rate will actually be above $450 million. There was a requirement in most of the acquired customers' contracts to give them adequate notice about the end-of-life product sets. So we will probably see some of those end-of-life products at closing being acquired and then over the next several months, we'll probably get down to that $450 million run rate.

We've also identified a team of individuals, primarily Sprint sales professionals, but also some Cogent sales professionals will be focused on that customer base of about 1,200 large enterprises with the goal of improving the quality of their service, modernizing their networks and preserving that revenue initially and the ultimate expectation is that we will be able to grow the enterprise revenue base at about 1% to 2%

per year. We think we're probably a year or 2 away from that, but we do expect to plateau at about $450 million of large enterprise revenue.

James Dennis Breen
William Blair & Company L.L.C., Research Division

Great. And then just on the cash flow side, around the transaction, the first payment that you get from T-Mobile, would that come right as the deal closes? Or is there a lag period between when the deal closed and when you receive that payment?

David Schaeffer
Founder, Chairman, CEO & President

It comes at the end of the month, first month after closing, and that payment is slightly over $29 million a month for the first 12 months and then reduces down to approximately $9 million per month for the next 42 months. Because this is going to be able to be treated as recognized revenue, we will probably end up having to straight-line that contract value. So we will have some initial deferred revenue that will then burn off over the life of the lease.

Operator

We'll move next to Brandon Nispel at KeyBanc Capital Markets.

Evan Lewis Young
KeyBanc Capital Markets Inc., Research Division

It's Evan Young on for Brandon. Did you talk about your SG&A expenses for the quarter and your sales rep hiring going forward, do you think that that's going to continue impacting expenses?

David Schaeffer
Founder, Chairman, CEO & President

Yes. So for the quarter, Evan, we, first of all, elected to do a $1.5 million bonus to our global workforce as in lieu of a larger CPI increase, we felt that much of the impact of inflation was a onetime shot. While there is a continuing component, we did not want to be locked into that continuing higher expense. So that was an extraordinary expense in the quarter and was roughly 100 basis points of margin hit through that bonus. Second of all, to address the headcount number, we were very clear that pre-pandemic, we had about 600 total reps, about 550 quota-bearing FTEs. And the pandemic was particularly hard on our headcount.

We actually experienced headcount decline of approximately 18%. As we have emerged from the pandemic, we have accelerated our hiring to the fastest pace in the company's history in order to regain that lost brand. we anticipate getting back to that pre-pandemic level of about 600 quota-bearing reps, about 550 full-time equivalent quota-bearing reps. These numbers are not inclusive of the roughly 60 quota-bearing individuals that will come from the Sprint transaction. So they are additive. So off of that base of about 660 million total reps, and with the Sprint team, almost the entire team is an FTE since our average tenure is quite long.

We expect to grow the sales force head count on a going forward basis at a much more normalized rate of about 7% per year. So once we get to that roughly 660 head count, we expect our hiring pace to decelerate. We hope that our turnover rate will continue to be below historic averages. We think the training programs that we put in place have helped quite a bit. And with that, the total sales force should grow at about 7% per year or about 45 net reps, a lower pace than we're growing today.

Operator

We'll move next to Nick Del Deo at SVB MoffatNathanson.

Michael Srour
MoffettNathanson LLC

This is Michael Srour on for Nick. On your last earnings call, you shared how you had received expressions of interest for wavelengths and dark fiber from customers you spoke with at NANOG shortly after the deal was announced. And that was obviously very encouraging. And now you've mentioned that you began to sell wavelengths through a commercial resale agreement with T-Mobile. I was wondering if you could give us an update on the degree to which that's continued. And what it might mean for the speed with which you might start recognizing wavelengths and dark fiber revenue after closing?

David Schaeffer
Founder, Chairman, CEO & President

Yes. Sure, Michael. Thanks for the questions. So we needed to negotiate that commercial agreement that we could allow us to sell wavelengths pre-closing. That agreement was put in place last month. Actually, in February, we began training our sales engineers and training staff at the beginning of the month to sell wavelengths and then actually just last week, formally launched the product to the sales team through a series of teach-ins around the world. In the initial period, the process is actually more complicated than it would be after the deal closes in the next couple of months. It does require us to enter into arm's length agreements to then resell.

We also have a much smaller number of locations that we can sell in today than what we ultimately anticipate. So just to refresh your memory, Sprint had trialed this product and was only able to sell it in about 25 locations. By integrating the networks, we have added an additional 50 locations immediately. So today, wavelengths are available at Cogent or Sprint can resell our metro footprint in about 80 locations. Over the next 60 days we expect that number to go from 80 to approximately 200. It probably will take another year before the wavelength product is standard across our 800 locations. We have already booked initial orders. We do have a great deal of interest. I would say the initial order count at this point from the Cogent side is probably about a dozen wavelengths. I think that's pretty good for less than a week of selling. I think the Sprint side using our metro network since they could formally do that also beginning last week is also in that same kind of roughly 10 or so. So these are pretty encouraging discussions.

In terms of dark fiber sales, we have a memorandum of understanding with one counterparty on one route. We have been cautious in trying to sell dark fiber in advance of the transaction closing for 3 reasons: one, it's not a product that Sprint has ever sold. 2, there's not a lot of precedent for arm?s length pricing. So if we were reselling it, we would need to demonstrate arm?s length prior to the deal closing, and we didn't want to take any regulatory risk. And then finally, we wanted to make sure that the value of monies received from a sale would accrue to Cogent and not T-Mobile, so we would not want a dark fiber sale to be completed until after the transaction is closed. I think realistically, we're going to focus on wavelengths first, dark fiber second, and I think by the time we report third quarter, we should be in a position to give much more color on the dark fiber market opportunity.

Michael Srour
MoffettNathanson LLC

Got it. And one more, if I can. Can you talk about the cadence of corporate sales activity from Q3 into Q4 and how it's trended into the first quarter and the overall state of the funnel? Yes. I would say that it has continued to improve. And in fact, the sequential 0.3% growth is much better than what we had been experiencing during the pandemic. But I also want to temper that by saying we're far from the pre-pandemic kind of 2% sequential growth rate, so we have averaged. And when we look at all of the leading indicators, whether it be proposals, orders, ARPU, all of those are giving us encouraging indications that there'll be continued sequential corporate improvement. But as I've tried to counsel on the last couple of earnings calls, we anticipated a more rapid return to our normalized corporate growth rate. And now we're really taking a wait and see. Again, we're encouraged, but I think it's going to still be more than a year before we're back to that kind of 2% sequential corporate growth rate.

Operator

[Operator Instructions] We'll go next to David Barden at BofA Securities.

John Crawford
BofA Securities, Research Division

You got John Crawford, on for Dave. Just curious about leverage. So it's continuing to grow over the past few quarters above that 2.5% to 3.5% range. Can you tell me what direction you're expecting that to head in 2023? And if your mindset about discouraging excess cash has changed since last you spoke on it?

David Schaeffer
Founder, Chairman, CEO & President

So thanks for the question and a correction on Dave's name, it's Dave Barden. But I think we've had a consistent policy of utilizing our balance sheet and slowly discouraging cash through a systematic increase in the dividend. I think we are going to remain committed to that strategy. It is true that our leverage did increase in the quarter primarily due to our elevated capital lease principal payments and our increase in CapEx. Much of this is an effort to tie the networks together. As I indicated earlier, we've got an additional 50 data centers connected to the Sprint network. Each of those had a capital expenditure associated with that. We have another 150 in process where we have also already spent that capital. I think we will see our leverage on a net basis, maybe go up a little from here, but not much and then start to come down.

And remember, the recognition of the $700 million in cash payments from T-Mobile as revenue flows directly through to EBITDA because our transient product is a 100% gross margin product. The locations that we have reserved port capacity for T-Mobile to utilize that service if they choose to would have no incremental OpEx cost for Cogent. So with that additional revenue stream and margin, we will rapidly delever.

John Crawford
BofA Securities, Research Division

Got it. And then another, if I can. So I know you mentioned that the NetCentric team would be working on wavelength sales. I was wondering if your philosophy on headcount rationalization from that transaction has changed since you announced it, like the number of people you're hoping to bring over?

David Schaeffer
Founder, Chairman, CEO & President

It really has not. Remember, the Sprint organization at the day we signed the deal, had 1,320 employees and only 60 of those were in sales. All of those salespeople remain, there have been a number of voluntary reductions in force that have occurred under T-Mobile stewardship and T-Mobile has been very generous in the severance packages that they have offered employees. That headcount today is slightly below 1,100 employees. We expect that number to continue to decline through the use of these severance packages.

All of the employees are expected to become Cogent employees, and we have realigned our organizational structure with both senior Sprint people and management roles as well as Cogent, but following the Cogent organizational structure. My guess is there will be some additional fallout post-closing as some individuals choose not to take those new assignments. We negotiated an additional $25 million pool of capital above and beyond the $700 million with T-Mobile. So we can mirror their severance program post-closing. I would say that we anticipate at closing to be somewhere around 1,000 employees, additional to the about 1,075 that Cogent has. So just over 2,000, and we would expect some additional operational attrition post-closing, offset in part by our growth in the sales force. So we anticipate the combined company's head count to be between 200 and 2,100.

Operator

We'll go next to Bora Lee at RBC Capital Markets.

Bora Lee-Marks
RBC Capital Markets, Research Division

So can you remind us where you're expanding internationally and how you're thinking about those efforts and CapEx while integrating the Sprint wireline assets?

David Schaeffer

Founder, Chairman, CEO & President

Yes. Thanks for the question, Bora. So Cogent today operates in 51 countries around the world. Our most recent expansion was Peru, and we are constructing through IRU acquisition, multiple rings in Lima as our initial market. So when we go into an international market, we typically buy dark fiber, intercity and then also dark fiber intracity and look to connect to all significant data centers in those markets. We are in the process of several other countries that Cogent is organically adding. And in addition to that, we will be acquiring 3 new markets where Cogent had intended to go but has had significant regulatory lags that being India, Thailand and Malaysia. Sprint already has the requisite licenses in each of those markets. So they will come on net quickly. So I would suspect in 2023, we will add those 3 markets and probably about another 5 or 6 additional countries that Cogent organically is working on. That is factored into our expectation of adding approximately 100 carrier neutral data centers a year.

And just to remind investors, the Sprint network outside of the U.S., inclusive of Canada and Mexico was entirely based on lit rented capacity. The Cogent network is entirely based on owned dark fiber. So we are in the process of converting over those Sprint intercity networks and data center connectivity onto the Cogent-owned network. About 15 of those international data centers have already been brought on net. We have about another 30 in process, and then we'll continue that effort until we have completely eliminated the least Sprint international network, and that is anticipated to result in about a $25 million a year annual savings rate.

Bora Lee-Marks
RBC Capital Markets, Research Division

And one more if I could. So you somewhat alluded to this in your answer to my question. But in terms of the long-term guidance of 5% to 7% revenue growth and more specifically, 100 basis point margin expansion per year. How are you thinking of the sources of that margin expansion between COGS and SG&A?

David Schaeffer
Founder, Chairman, CEO & President

Yes. Historically, Cogent has gotten its 200 basis points of margin expansion, almost equally from COGS efficiency and SG&A efficiency, roughly a 50-50 split, if you go back and look at the past 17 years of public filings. I think going forward, we would expect about the same. When we looked at our EBITDA performance, we actually had the very best gross margin quarter, I think, in the company's history, it's 62.5% in the fourth quarter, continued improvement. The smaller rate of EBITDA margin expansion year-over-year was really impacted by SG&A and it was really this rapid rehiring of our sales force post pandemic. I think we'll be through that by midyear this year, and we should get back to kind of a cadence of about half of our EBITDA margin improvement coming from gross margin pickup and about half of it coming from SG&A efficiency.

Operator

And we'll take our next question from Michael Rollins at Citi.

Michael Ian Rollins
Citigroup Inc., Research Division

I'm curious if you think about the process of taking share in each of the Corporate and the NetCentric segment, how does the practice of taking share generally compare with your expectations of that pace when you create the multiyear business plan and update that every so often. And what are the factors that you find cause the variance, whether it's a positive variance or negative variance? And is there something to learn from that as we try to consider the opportunities to take share from these products that you're going to expand with this upcoming acquisition?

David Schaeffer
Founder, Chairman, CEO & President

Yes. Sure, Mike. Thanks for the question. And I think going forward, there'll actually be a third category, which is large enterprise, which really is a very different customer base than our traditional corporate customer, which tends to be a small or medium-sized business. I think when we look at the corporate segment, our gain in market share is as a result of more footprint and better penetration in that footprint. I think the variance came as a direct result of the pandemic. The increase in vacancy rate in that footprint and the, I think, paralysis of decision-making by the remaining tenants with the uncertainty around their office configurations.

As we are emerging from that and companies are kind of settling on a work plan, whether it be hybrid or entirely in the office, we're seeing an improvement, but because there is still elevated vacancy, and those work plan implementations are not universally adopted yet. I think we've seen a slower-than-expected rebound in the corporate business. It is rebounding. It is clearly much better than it was during the pandemic, but it is not back to kind of the pre-pandemic consistency that we had. And I think we're trying to be realistic about that. We look at all of the leading indicators as well as actual performance and then modify our plan. And that's why earlier in the call, I said we're probably at least a year away from that 2% sequential growth just based on the data we have.

Moving over to the NetCentric business. There, we look at actual traffic patterns on a daily basis. We look at the need of our customers to have multiple connections to reduce latency in their applications, and we look at aggregate traffic growth. And there, we were probably too conservative in our modeling around the NetCentric business. I think we're very accurate in a rate of price decline, and I think that will continue, and we've been very consistent in that messaging. But in terms of the rate of traffic growth and the gain in market share, we were probably too conservative. We continue to grow our NetCentric business on a year-over-year basis, constant currency at about 60% faster than our long-term average. We expect that outpaced growth to continue for longer than we expected, but we also think that it will, at some point, begin to moderate.

The final piece, which we have less empirical date on other than the diligence materials we've reviewed inside of Sprint is that large enterprise customer base. And the fact that they've been with Sprint for 30 years is extremely encouraging. They've been through multiple technology refresh cycles, and we can improve margins and quality by bringing those services on net we think that we're being pretty conservative in our belief that we will see the $560 million run rate decline of $450 million that will plateau for a year or 2 and then only grow at a modest 1% to 2%. So that's kind of the thinking that goes into each of those assumptions, and they are literally revisited every quarter, and we adjust our projections to the Board each and every quarter based on real-world inputs in each of these categories.

Operator

And next, we'll go to Walter Piecyk at LightShed.

Joe Galone

Dave, this is Joe, on for Walt. Apologies if I missed this earlier, but I guess, capital intensity remains elevated. So is there a way to think about kind of what's maintenance versus growth and what's kind of baked in from an acquisition standpoint going forward? Because this year, I guess, at least in Q4, there was the large capital lease principal repayment?

David Schaeffer
Founder, Chairman, CEO & President

Yes. So we have been very clear about the 3 categories. The first being the maintenance number for Cogent as kind of its organic business. That number needs to be about $35 million a year, and we anticipate that number continuing. What we would be spending above and beyond that would be expansion. We have added about 120 buildings at an average cost of about $125,000 a building, or about $15 million in building connectivity, and then we also add additional metro fiber, either in new markets that we expand into or densifying markets that we are in. Above and beyond that, we have said that we will spend $50 million one time for the integration of the Sprint and Cogent networks. Some, actually a significant part, of that capital lease was to get the fiber to begin to integrate those networks.

The Sprint locations were oftentimes, not in central business districts and needed to be connected in and we've spent a significant portion. There is still some more to spend on that onetime integration expense. And then the third bucket of capital intensity, which will be higher for the combined company is that the Sprint business that we are acquiring, inclusive of the capital needed to support the wavelength product is about $30 million a year. So the way to think about the business once this one time integration effort is complete is $35 million for the Cogent business, $30 million for Sprint, so $65 million of recurring CapEx, and then whatever footprint expansion we're going to do. And that's probably right now running in the neighborhood of about $30 million to $35 million, about $15 million of that is buildings. And as we said, we'll be adding about 100 carrier neutrals and that the necessary either intercity or metro fiber in these new markets.

Operator

And that does conclude our Question-and-Answer Session. I would like to turn the conference back over to Dave Schaeffer for any closing remarks.

David Schaeffer
Founder, Chairman, CEO & President

I'd like to thank everyone. Hopefully, we've been complete in answering all of their investors' questions. And most importantly, we look forward to closing the Sprint transaction quickly, making sure that we have a fully negotiated transition services agreement that protects both parties, and we feel quite confident that will happen in the second quarter. Take care, everyone, and we'll talk soon. Bye-bye.

Operator
And this concludes today's conference call. Again, thank you for your participation. You may now disconnect.

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