Cogent Communications(Q2 2020 Earnings)

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Corporate Speakers:

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

Participants:

- George Engroff; Credit Suisse; Analyst
- Colby Synesael; Cowen and Company, LLC; Research Division, MD & Senior Research Analyst
- Michael Rollins; Citigroup Inc.; Research Division, MD & U.S. Telecoms Analyst
- Frank Louthan; Raymond James & Associates, Inc.; Research Division, MD of Equity Research
- Nicholas Del Deo; MoffettNathanson LLC; Analyst
- Walter Piecyk; LightShed Partners; Partner & TMT Analyst
- Brandon Nispel; KeyBanc Capital Markets Inc.; Research Division, Research Analyst
- Bora Lee-Marks; RBC Capital Markets; Research Division, Assistant VP
- Philip Cusick; JPMorgan Chase & Co; Research Division, MD and Senior Analyst

PRESENTATION

Operator^ Good morning, and welcome to the Cogent Communications Holders Second Quarter 2020 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.

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

David Schaeffer^ Thank you, and good morning to everyone. Welcome to our second quarter 2020 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.

We continue to be optimistic about the underlying strength in our business. The growing importance and breadth of our network. And most importantly, the increasing profitability of our operations.

We remain confident in our outlook for 2020 and beyond even with the continuing impact and uncertainty due to the COVID-19 pandemic. On a constant currency basis, we achieved sequential quarterly revenue growth of 0.2% and year-over-year revenue growth for the second quarter of 5.1% on a constant currency basis. A reduction in universal service fees, excise taxes and the rate associated with them this quarter reduced our sequential quarterly revenues by $450,000.

On a constant currency basis and adjusting for the impact of this change in USF rate, our sequentially quarterly revenue growth would have been 0.5%. We continue to take advantage of the operating leverage in our network. We managed also to moderate our SG&A expense growth.

Our network scale helped our quarterly gross margins reach yet another company record of 62%. This margin was sequentially 150 basis points higher and 220 basis points higher than a year-over-year number for the quarter ending in June 2020. Our EBITDA margin at 37.8% also improved, and was sequentially 100 basis points higher and 290 basis points higher on a year-over-year basis.

Our cash flow from operations grew sequentially by 45%. Our customer performance and metrics continue to be strong in spite of the impact of COVID-19. Customer churn, bad debt and days sales outstanding all performed within historical norms and our cash collections in the month of June were an all-time record.

We believe that these statistics indicate the strong credit quality of our customer base and the importance of Cogent service to these organizations. We continue to see strong growth in traffic across our network as quarterly traffic growth accelerated from 36% year-over-year in the first quarter to 49% this quarter, and sequentially, traffic grew from the first quarter of 2020 to the second quarter by 10%.

The rapid growth in traffic was driven by increased streaming applications, a full quarter of the work-from-home phenomena and gaming and other applications that have seen an increase in usage due to the pandemic.

During the quarter, we returned $31.7 million to our shareholders through our regular quarterly dividend. We did not purchase any common stock during the quarter. At quarter end, we have a total of $34.9 million available in our stock buyback authorization program, which has been authorized to continue through the end of the year by our Board.

In June, we demonstrated our continued ability to access the capital markets where we issued a tack on offering of EUR 215 million to our existing EUR 135 million euro denominated unsecured notes. The net proceeds from this offering were $240.3 million.

A portion of those proceeds were used to redeem at par or $189.2 million of its outstanding unsecured 2021 notes. This also provided us additional cash. As a result of these transactions, our average interest rate fell, we extended the duration of our indebtedness and we were able to transfer $117 million in our builder basket from our operating company to our holding company.

Our cash at Cogent Holdings was $166.5 million at quarter end. This cash is unrestricted and available for dividends and stock buybacks. Cash hold at our operating companies, in addition to that held at the holding company, was $250.5 million, giving Cogent a combined cash balance of $417 million at quarter end.

Our gross leverage ratio increased to 5.08 from 4.78 from last quarter and our net leverage ratio increased to 3.07 from 2.92. Our consolidated leverage, as calculated under the note indentures was for 4.92 at quarter's end.

After careful consideration, our Board of Directors are evaluated the strength and growth in our business as well as its cash-generating capabilities and investment opportunities for the company.

We decided to increase our quarterly dividend at the rate of $0.025 this quarter, therefore, raising our dividend from $0.68 per share last quarter to $0.705 in the third quarter. This increase represents the 32nd consecutive sequential increase in our growth of our quarterly dividend, and this increase is larger than the roughly $0.02 increase in Q2 of 2020.

Now I'd like to turn the call over to Sean Wallace, welcoming Sean as our CFO, and Sean will read both our safe harbor language and give some overview of our response to COVID 19.

Sean Wallace^ Thank you, David, and good morning, everybody. This earnings conference call includes forward-looking statements. These forward-looking statements are based on our current intent, beliefs and expectations. These forward-looking statements and all other statements that may be made on this call that are not historical facts are subject to a number of risks and uncertainties, and actual results may differ materially.

Please refer to our SEC filings for more information on the factors that could cause actual results to differ. Cogent undertakes no obligation to update or revise our forward-looking statements, if we use non-GAAP financial measures during this call, you will find these reconciled to the GAAP measurement in our earnings release, which is posted on our website at www.cogentco.com.

A few words on the COVID-19 update. Like many other companies, Cogent continues to be impacted by the COVID-19 pandemic and the accompanying responses by governments around the world. Our entire workforce continues to work remotely. I want to thank the entire Cogent workforce and in particular, our IT department for their hard work during these challenging times.

I also want to thank our field engineers and other employees who continue to work on the front lines, installing new customers and maintaining and upgrading our network so that we can continue to serve our customers. During the second quarter of 2020, the impact of the COVID-19 pandemic on Cogent was somewhat limited.

We did experience a decrease in our sales productivity, particularly in sales to corporate customers. Traffic on our network continues to grow at an accelerated rate compared to our historical growth rates. However, the traffic growth rate for the quarter was slower than the traffic growth rate at the end of the first quarter.

The ultimate impact of the pandemic on Cogent is unknown as a significant amount of uncertainty and volatility remains. We do not know the scope and duration of the pandemic what actions governments may take in the future in response to the pandemic and how the pandemic will impact the economies of the world.

While Cogent is working remotely, we have no assurance that this will be sufficient to protect our workforce and our key employees. Moreover, our results of operations may be adversely affected in the future as the pandemic and the related government restrictions continue.

We may see slowdowns in new customer orders, find it difficult to collect from customers who are experiencing financial distress, encounter difficulties accessing the buildings and locations where we install new customers and serve existing customers or have difficulties procuring shipping or installing necessary equipment on our network.

We may also find that our largest customer base, which is served primarily in our multi-tenant office buildings may be adversely affected by falling demand for commercial office space and central business districts as companies located in these buildings elect not to return to their office space, either on a temporary or even on a permanent basis.

The global economic impact of the COVID-19 pandemic may have a prolonged effects that impact our business well into the future. These and other risks are described in more detail in our quarterly report on Form 10-Q for the quarter that will be filed shortly after this call and in our annual report on Form 10-K for the year ended December 31, 2019, and in our quarterly report on Form 10-Q for the quarter ended March 31, 2020.

Throughout this discussion, we will highlight several operational statistics, I will review in greater detail certain operational highlights and trends, Dave will provide additional details on the network and following our remarks, we will open the call up for Q&A. Now I'd like to turn it back to Dave.

David Schaeffer^ Hey, thanks, Sean. Hopefully, you've had a chance to review our earnings press release. Our press release includes a number of historical quarterly metrics that help investors understand trends in our business. Our corporate business, which represents 69% of our revenues this quarter, grew on a year-over-year basis by 5.1% from the second quarter of 2019.

And our NetCentric business, which has been underperforming compared to our long-term historical averages, resumed accelerated growth and grew 3.6% from the second quarter of 2019. For the quarter, our corporate business grew sequentially 1%, and our NetCentric business was essentially flat.

A reduction in universal service fund tax rates, again, negatively impacted our corporate revenues, both on a sequential and year-over-year basis. The USF tax rate changes quarterly, and we cannot predict the future impact of USF rates and changes on our revenue.

Volatility in foreign exchange primarily impacts our NetCentric business. On a constant currency basis, our NetCentric business grew 5.1% from the second quarter of 2019. And on a sequential basis from the first quarter of 2020, our NetCentric business on a constant currency basis grew 0.50%. Our long-term EBITDA margin expansion guidance is an annual improvement of 200 basis points.

Our multiyear constant currency long-term revenue growth targets are 10%, our revenue and EBITDA guidance are meant to be multiyear and not intended to be specific quarterly or even annual guidance. Now Sean will give you some additional color on our operating results for the quarter. And then I'll return to give you some additional network color.

Sean Wallace^ Thanks, Dave. Let's talk about corporate and net centric revenue and customer connections. We analyze our revenues based upon network type, off-net, off-net and noncore, and we also analyze our revenues based upon customer type.

We classify all of our customers in 2 types: NetCentric customers and corporate customers. Our corporate customers buy bandwidth from us in large multi-tenant office building as well as carrier-neutral data centers. Our NetCentric customers buy significant amounts of bandwidth from us in carrier-neutral data centers.

Let's talk about revenue and customer connections by customer type. Revenue from our corporate customers for the quarter grew sequentially by 0.1% to $97 million and grew year-over-year by 5.1%. We believe that the slowdown in the growth rate of our corporate connections was impacted by the continuing concerns raised by the COVID-19.

While we continue to have significant dialogue with our existing and potential customers, some customers are delaying buying decisions due to economic uncertainty. We had 48,305 customer connections -- corporate customer connections on our network at quarter end, which is a decline of 0.4% versus the first quarter and an increase of 1.4% over the second quarter of 2019.

In addition to the impact of COVID-19, our corporate revenue and connections were adversely affected by the lower USF tax rate, lower off-net local loop pricing and the reduction of VPN sales. Due to the pandemic, certain corporate customers are reducing their aggregate number of locations.

Quarterly revenue from our NetCentric customers was flat at $44 million and increased by 3.6% year-over-year. We had 39,807 NetCentric customer connections on our network at quarter end, an increase of 9.3% over the second quarter.

Our NetCentric revenue growth experiences significantly more volatility than our corporate revenues due to the impact of foreign exchange, larger customer size and other seasonal factors.

While traffic grew in our network by 49% annually, primarily as a result of increased NetCentric traffic, this increase in traffic only partially created a corresponding increase in revenues as volume discounts and traffic mix, particularly for some of our largest customers, offset a great deal of this traffic growth.

Let's talk about revenue and customer connections by network type. Our on-net revenue was $103.8 million for the quarter, a sequential quarterly increase of 0.3% and a year-over-year increase of 6.5%. Our on-net customer connections increased by 1% sequentially and increased by 4.8% year-over-year.

We ended the quarter with 75,927 on-net customer connections on our network in our 2,854 total on-net multi-tenant office and carrier-neutral data center buildings. Our off-net revenue was $37.0 million for the quarter, a sequential quarterly decrease of 0.7% and a year-over-year decrease of 0.4%.

Our off-net revenues were adversely affected by the reduction in USF taxes and a reduction in our off-net ARPU, which primarily was due to lower local loop prices from our off-net vendors. Our off-net customers connections increased sequentially by 1.1% and increased by 4.6% year-over-year. We ended the quarter serving 11,846 off-net customer connections in over 6,820 buildings, off-net buildings. These off-net buildings are primarily located in North America.

Let's talk about pricing on a per megabit basis. Consistent with historical trends, our average price per megabit of our installed customer base decreased. However, the average price per megabit of our new customer contracts actually increased for the quarter.

The average price per megabit for our installed base declined sequentially by 10.2% to $0.47 per megabit and declined by 25.1% from the second quarter of 2019. The average price per megabit for our new customer contracts for the quarter increased sequentially by 17.2% to $0.23 per megabit and declined by close to 40% from the second quarter of 2019.

ARPU. Our on-net and off-net ARPU both decreased sequentially for the quarter. However, year-over-year, our off-net ARPU decreased, but our on-net ARPU increased. This year-over-year increase in our on-net ARPU reflects the growing importance of our 1 gigabit product versus our 100 megabit product.

Our 1 gigabit product has outsold our 100 megabit product for the third straight quarter. Our on-net ARPU, which includes both corporate and NetCentric customers, was $458 for the quarter, a decrease of 0.6% from last quarter. Our on-net ARPU increased by 1.1% from the second quarter of 2019.

Our off-net ARPU, which is comprised of predominantly corporate customers, was $1,048 for the quarter, a decrease of 1.5% from last quarter. Our off-net ARPU decreased by 5.1% from the second quarter of 2019.

Churn rates. Our on-net and off-net churn rates both improved sequentially for the quarter. Our on-net unit churn rate was 1.0% for this quarter, an improvement from 1.1% last quarter and our off-net unit churn rate was 1.1% for this quarter, an improvement from 1.2% last quarter.

NetCentric Mac orders. In order to reduce our customer turnover, we employ a dedicated sales group, which works primarily to retain customers who have indicated that they're considering terminating their services.

We typically offer pricing discounts to these customers in order to induce them to purchase more services and/or to extend the term of their contracts. Due to the commodity nature of Netcentric services, the vast majority of these move, add or change orders are related to our NetCentric customers.

During the quarter, certain of our NetCentric customers took advantage of our volume and contract term discounts and entered into long-term contracts with us for over 2,600 customer connections, increasing their total revenue commitment to Cogent by close to $25 million.

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

These seasonal factors typically increase our SG&A expenses in our first quarter from our fourth quarter. Our EBITDA improved sequentially, primarily a result of a $2.1 million reduction in our cost of network operations and a $0.8 million reduction in our SG&A expenses.

Our quarterly EBITDA increased by 5.9% sequentially to $53.3 million. Our quarterly EBITDA increased year-over-year by $6.2 million or by 13.3%. Our quarterly EBITDA margin increased by 200 basis points sequentially to 37.8% and increased at a higher rate year-over-year by 290 basis points.

Earnings per share. Our basic income per share was $0.19 for the quarter compared to $0.20 last quarter and $0.16 for quarter 2 2019. Our diluted income per share was $0.18 for the quarter compared to $0.20 last quarter and $0.16 for quarter 2 2019.

Unrealized Gains and losses on the translation of our 2024 euro notes into U.S. dollars contribute to variability in our net income and consequently, our income per share.

Let's talk about foreign currency. Our revenue earned outside the United States is reported in U.S. dollars and was approximately 23% of our total quarterly revenues. Approximately 17% of our revenues this quarter were based in Europe, and about 6% of our revenues related to our Canadian, Mexican, Asia-Pacific and Latin American operations.

We do not hedge our foreign currency obligations, including our payments, on our euro notes. Our foreign operations generate sufficient cash to fund their obligations, which we believe provides a natural hedge for these liabilities. Continued volatility in foreign currency exchange rates can materially impact our quarterly revenue results and our overall financial results.

The foreign exchange impact on our reported quarterly sequential revenue was a negative $0.2 million and the year over foreign exchange impact on our reported quarterly revenue was a negative $0.7 million. Our quarterly revenue growth rate on a constant currency basis was 0.2% sequentially and 5.1% year-over-year. Variability in foreign exchange rates primarily impacts our NetCentric revenues.

The average euro to USD rate so far for this quarter is 1.15 and the average Canadian dollar exchange rate is 0.74. Should these average foreign exchange rates remain at the current average levels for the remainder of the third quarter, we estimate that the FX conversion impact on our sequential quarterly revenues for our third quarter will be a positive $1.1 million and the year-over-year FX conversion impact on our quarterly revenues will be a positive $0.6 million.

Customer concentration. We believe that our revenue and customer base is not highly concentrated. Our top 25 customers represent less than 6% of our revenues this quarter.

CapEx. Our quarterly capital expenditures increased by $1.1 million sequentially and increased by $2.2 million year-over-year. Our capital expenditures were $13.9 million this quarter, compared to $11.7 million for quarter $29.0 million and $12.9 million for the first quarter of 2020.

Let's talk about financial leases and our financial lease payments. Our finance lease IRU obligations are for long-term dark fiber leases and typically have initial terms of 15 to 20 years or longer, and often include multiple renewal options after the initial term. Our finance lease IRU fiber lease obligations totaled $203.8 million as of June 30, 2020.

We renewed a major regional segment IRU agreement this quarter, resulting in an increase to our finance lease obligations of $30.4 million and a sequential reduction to our network operation expense of $1.2 million. There were no payments required to be made in connection with this renewal.

Under U.S. GAAP, the future monthly payments under this IRU associated with operations and maintenance were required to be reclassified as a finance lease obligation at the renewal date. There was no change in the level or amount of cash payments to be made on this contract as a result of the renewal and reclassification.

At the quarter end, we had IRU contracts with a total of 256 different dark fiber suppliers. Our finance lease principal payments were $3.4 million for the quarter compared to $2 million for quarter 2 2019 and $6.2 million for quarter 1 2020.

Our finance lease principal payments combined with our capital expenditures were $17.6 million this quarter, compared to $19 million last quarter, a sequential decline of 7.3% and were $13.7 million for the second quarter of 2019.

Cash and operating cash flow. As of June 30, 2020, our cash and cash equivalents totaled $417 million. For the quarter, our cash increased by 41.2 -- $41.9 million from an increase in our operating cash flow and a net cash increase from our financing activities. Our quarterly cash flow from operations increased sequentially by over 45% due to an improvement of $8.4 million in working capital, including $5.5 million from an improvement in our days sales outstanding and our accounts receivable.

Our quarterly cash flow from operations increased by 1.7% year-over-year. Our year-over-year cash flow from operations increased -- increase was impacted by a $10.2 million year-over-year increase in interest paid on our note obligations. Our cash flow from operations was $41.3 million for the quarter, compared to $40.6 million for quarter 2 2019 and $28.5 million for quarter 1 2020.

Let's talk about debt and our debt ratios. Our total gross debt at par, including our finance lease IRU obligations, was $1.1 billion at the end of the quarter, and our net debt was $637.6 million.

Our total gross debt to trailing last 12 months EBITDA as adjusted ratio was 5.8 -- 5.08 at June 30, 2020, and our net debt ratio was 3.07. Our consolidated leverage ratio, as calculated under our debt indenture agreement was 4.92 at the end of the quarter. Our EUR 350 million notes are reported in U.S. dollars and converted to U.S. dollars at each month ending using the month end euro to USD exchange rate.

The unrealized foreign exchange unrealized loss on our Euro notes was $3.4 million this quarter compared to an unrealized gain of $2.9 million last quarter and an unrealized gain of $0.2 million for the quarter -- second quarter of 2019.

We issued our EUR 215 million of 2024 senior secured euro notes on June 3, 2020, at a euro to U.S. dollar rate of 1.12 and we contracted to receive our cash in U.S. dollars on June 9 at $0.0133 to the U.S. dollars. As a result of this transaction, we realized a $2.5 million foreign exchange gain in June 2020.

Bad debt and days sales outstanding. Our bad debt expense as a percentage of revenues improved year-over-year but increased slightly from last quarter.

Our bad debt expense was 0.9% of our revenues for the quarter compared to 0.8% of our revenues for quarter 1 2020 and 1% in quarter 2 2019. Our days sales outstanding, or DSO, for worldwide accounts receivable was 22 days for the quarter, a 2-day improvement from 24 days outstanding last quarter.

I want to thank and recognize our worldwide billing and collections team for continuing to do a fantastic job in serving our customers and collecting our customers bills during very challenging times. And with that, let me turn it back over to Dave.

David Schaeffer^ Thanks, Sean. I'd like to highlight a few of our operational strengths concerning our network, our customer base and our sales force. The size and scope and scale of our network continues to grow. We recently added Johannesburg, South Africa to the Cogent network just last week.

This means that Cogent has a physical presence in 47 countries globally. We believe this will further increase our position as a leading provider of Internet connectivity in the African continent, an increasingly important market that is growing rapidly.

We're selling Internet connectivity in multiple locations across Asia, Latin America, and we're beginning to see meaningful growth in these markets. Internet traffic is growing faster outside of the United States than within the United States, and we are positioned to benefit from that growth.

In North America, we have 962 million square feet of multi-tenant office space directly attached to the Cogent network with full distribution in those buildings. We operate 54 Cogent data centers with a total raise floor footprint of 606,000 square feet. And we're operating those facilities at approximately 32% utilization.

Our network consists of over 36,400 fiber miles in metro markets and 58,000 route miles of intercity fiber. We continue to be focused on developing our level of interconnection, and Cogent remains the most interconnected network in the world. Today, we connect to over 7,130 networks directly compared to 6,762 connected networks at the same time last year. This collection of telephone companies, Internet service providers, cable companies, mobile operators and other carriers give us access to the vast majority of the world's broadband subscribers and mobile phone users.

This large collection of eyeballs positions Cogent as the go-to network for new Internet applications. We saw an increased level of traffic as streaming continues to grow, and consumers continue to cut and shape the cord and choose over-the-top video solutions as opposed to linear solutions. For the quarter, we achieved sequential traffic growth of 10%.

And on a year-over-year basis, our traffic growth was 49%,up from 36% year-over-year growth number that we reported in the first quarter. This traffic growth rate is above our long-term average that we've seen over the past 5 years. We are pleased on how well Cogent's network handled this unprecedented surge in traffic in March and early April, without any interruptions, disruptions, latency issues or any requirements to increase capital spending.

Our sales force continues to grow. We ended the quarter with 572 reps selling our service, an all-time high, an increase of 5.5% from the 542 reps that we had at the end of Q1 2020. We ended the quarter with 533 full-time equivalents. These are reps that have been on the job for 3 or more months and therefore, carry a full quota.

And this represents a 2.1% increase sequentially from the 522 full-time equivalent reps that we had at the end of last quarter. Our sales force turnover rate declined to 3.5% for the quarter, this was significantly better than our long-term average rate of sales force turnover of 5.6%.

Our quarterly sales rep productivity did decline to 4 units per full-time equivalent rep per month below our long-term average of 5.1 units per full-time equivalent per month and our 4.1 units reported last quarter. Our sales rep productivity was adversely affected by a modest slowdown in corporate sales as a result of lengthening sales cycles and most significantly, a reduction in our VPLS and VPN products due to the fact that many of our customers shuttered remote offices and the number of locations that some of our customers are operating in has been reduced as a result of the pandemic.

Our NetCentric sales productivity was impacted by an increasing tendency of customers to buy larger ports and minimize their cross-connect expense. We continue to see a significant uptick in the sale of 100-gig interfaces as opposed to the 10-gig interfaces, which still make up the majority of our NetCentric connections.

And finally, our sales rep productivity was impacted by the fact that our reps were trained on a new CRM system, which will improve our productivity going forward, but did have a slight negative impact in the quarter. We are seeing great candidates in the marketplace who want to sell Cogent services, and we are quite confident that we will meet our hiring goals for 2020.

We are remotely supporting all of our employees and customers and continue to monitor our customers' network quality and our sales force productivity, utilizing a number of the historic metrics that we track sales productivity on repreparing fact in the office.

Some additional comments about our customer performance in the quarter. Our churn, bad debt and DSOs were all within historical norms and, in fact, showed improvement on an annual and sequential basis.

We saw an acceleration in the number of customers who elected to pay us electronically versus paper checks which indicates our customers have a very strong desire to remain current with Cogent and understand that our services are a necessary utility for the operation of their business. We believe that these statistics indicate the credit quality of our customer base in these challenging times.

And the most important fact is how important Internet access is to the continued operation of their businesses. Cogent is the low-cost provider of Internet access transit services, and our value proposition remains unmatched in the industry. Our business remains completely focused on Internet, IP connectivity and data center co locations, all of which are utilities to our customers.

We remain optimistic about our unique position in serving small and medium-sized businesses in multi-tenant buildings and central business districts of major cities. These businesses are increasingly integrating their IT infrastructure into data center architectures needing greater connectivity, higher reliability and quicker install times. All of these are things that are Cogent strengths and winning customers. We are clarified by how strong our customer reaction has been to our superior levels of customer service and network quality.

We consistently measure our customers on a net promoter survey system. Cogent's Net Promoter scores are 64, some of the highest in the industry and much higher than industries across many other segments. Our multiyear constant currency revenue growth of 10% and our EBITDA margin expansion rate is 200 points per year. While we have fallen slightly short on the revenue growth in the pandemic, we have overachieved on our margin expansion.

Our Board of Directors carefully considered the growth and trajectory of the business and authorized a 32nd consecutive increase in our regular quarterly dividend. They increased the rate at which we are growing this dividend to $0.025 per share bringing our dividend for the third quarter to $0.705.

Our consistent dividend increase demonstrates our confidence and optimism in the increasing cash capabilities of our business. We believe this drives management to be highly disciplined in the choices we make and how we allocate capital how we grow our top line, how we view the M&A market and how we manage our operating expenses.

We will continue to be opportunistic about the purchases of common stock in the open market. At quarter's end, we have $34.9 million remaining in our current buyback authorization which is in place through December 2020.

I hope everyone remains safe and healthy during these challenging times. We value the safety of all of our employees we shifted to a work-from-home policy and continue to have virtually all of our employees working remotely. We are taking all the necessary protections and precautions to make sure that our workforce remains healthy.

We believe that we are a net beneficiary of stayed home models, quarantine in place and the need for greater access to the Internet for streaming, gaming and other applications. Our growth and profitability targets remain intact, even in light of the current economic volatility, and we are committed to returning a growing amount of capital to our shareholders on a regular and methodical basis. Now I'd like to open the floor for questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) And our first question comes from Sami Badri of Credit Suisse.

George Engroff^ This is George on for Sami actually. So I guess in light of some of your previous commentary, now that you intend to increase the quarterly dividend by $0.025 next quarter. Should we expect that to be your target going forward?

David Schaeffer^ So George, Board deliberated very carefully and decided that our growth in free cash flow was accelerating and at a $0.02 sequential rate just because of the arithmetic of our dividend getting larger the growth rate in our dividend was decelerating.

So the decision was made even in light of economic volatility to increase that rate of growth to $0.025. The Board will evaluate that each and every quarter. But we did take this seriously and believe that this is an appropriate rate of growth and returning cash flow to shareholders.

George Engroff ^ Got it. Okay. And could you provide a little bit more color on the impact of COVID on corporate customer sales? I just want to understand if the issue is something that might improve despite the ongoing cove issues.

David Schaeffer^ Yes. So there have really been 3 impacts because of COVID. The first is the need for greater bandwidth at your major location. Most of our customers have the majority of their workforce working remotely. They are running ad-hoc VPNs as people tunnel into those office locations.

We have seen a significant acceleration in 1-gigabit sales, both to new customers where as Sean mentioned, for 3 quarters in a row, more new sales were gigabit than 100 meg, i.e., 10x the bandwidth and higher ARPUS. And then secondly, existing customers have increasingly been increasing their connections. These are positive for us. The second trend is a negative trend.

Roughly half of our corporate customers take a second product, a virtual private network to connect offices running either SD-WAN or VPLS over that connection. Because many of our customers have shuttered their remote locations, those offices sit empty, and there's no need for VPN concentration in those offices, we've seen a reduction in the sale of our VPN services.

Now there is still a very large base of MPLS-based VPNs that will be replaced and will migrate to these lower cost, more flexible technologies. But I think in this environment, we are selling less VPNs than we did 6 months ago.

We think that is a temporary trend, not a permanent change as we think, over time, these remote offices will be reopened and a MPLS or SD-WAN solution will be a far better solution than the MPLs that many of these companies have in place today.

And then finally, corporate customers are like all consumers. They're concerned about their health, their longevity, their viability. And because of these concerns, we have seen sales cycles elongated. It's not that we're not talking to customers. We're actually having more customer conversations, more opportunities than we ever have, partially because we have more salespeople, partially because the customers are willing to engage as they realize how important this service is.

But we also have seen a higher level of caution on the part of customers to make new BI decisions. So we have seen our sales cycles lengthen. We think that is a transitory phenomenon. And we think that the greater number of salespeople, coupled with the greater number of conversations that those people are having with potential customers will result in accelerating sales.

George Engroff ^ Got it. That's helpful. And I guess just one quick follow-up. So in reference to the lengthening sales cycles, so what drove that new customer contracts average price per megabit up quarter-over-quarter? Is that something that's replicable? Or I guess what happened there?

David Schaeffer^ Yes. So I think there are 2 things that are driving on net customer connection costs up. On the corporate side, we're selling far more gigabit than 100-megabit connections, which are typically a couple of hundred dollars more per connection. That is pulling ARPU off.

And then on the NetCentric, on net ARPUS, they're going up because customers are taking more 100-gig interfaces than 10-gig interfaces. But once they take that interface, they do pay on a usage basis, and we did see an increase in usage.

A lot of it from some very large customers but the fact that our new NetCentric sales on a per megabit basis increase is a strong indication on the widening of our customer base and the sale to a lot of smaller NetCentric customers, some of which are experiencing very rapid growth.

Operator^ Our next question comes from Colby Synesael of Cowen.

Colby Synesael^ Wanted to focus first off on the commentary on IRUs and the one contract, I think, in particular, that you mentioned you renewed. Did I hear you correctly that, that benefited your COGS, and I guess, consequently, gross profit in EBITDA? Can you remind me what that number was?

And then is that an indication of others like that, that we should expect over the next few quarters? I mean, when you think about the how old Cogent is as a company and the term of these IRUs being 15 to 20 years and kind of where we are. Over the next few years, should we start to see more of these? And what do you think that the net impact is as it relates to both leverage and I guess times like we may have seen this quarter?

And then secondly, just wanted to go back to that question on commercial. I think, Sean, in your prepared remarks, you mentioned a variety of different risks. One of them was risk of large commercial buildings and people perhaps not using those as much. And then obviously, we saw that in this particular quarter, you saw a reduction in some of your VPN type services.

I appreciate what you just said, Dave, as it relates to trying to fix that with just adding to the sales force. But is that also a trend that you are concerned about or one where we could start to see that become a bigger risk perhaps over the next few quarters?

David Schaeffer^ Okay. 3 or 4 questions here, Colby. I'm going to start, and Sean will help me out on some of these finance questions, but let's start with the IRUS. So the IRUs used to be classified as capital leases. Under the new accounting pronouncements, they are now reclassified as finance leases.

As part of that reclassification, new IRUs would take the operation and maintenance expense and treat that as a finance lease the same way as of what the underlying fiber. In the case of this 1 large intercity agreement, we were able to renew it at no charge. So the renewal of the underlying IRU was a unique decision by us.

It was unilaterally by us to take another 5 years, and we have one more 5-year option at no cost available to us in the future. But because we made a decision to do that, we now are incurring 5 years of operation and maintenance expense on that.

That 5 years ended up creating a capital lease or finance lease obligation and -- of about $34 million and a reduction of about $1.2 million in COGS that were in the quarter. I'm going to let Sean take a little more on kind of future IRUs and a little more color on the account?

Sean Wallace^ Yes. Let's just -- let's go through the numbers. For the quarter, our O&M and colocation cash expense of $1.2 million, it moved from the COGS line down below the line as it became sort of an interest expense versus an operating expense. Going forward, we will benefit $1.8 million per quarter going forward.

That $34 million, which you talk about, that is the net present value of those payments on a monthly basis, O&M of $600,000 for the next 5 years discounted at around 5%. We have a portfolio of thousands of circuits that we have put together over the last 20 years as we built this network.

We will consistently have a portfolio of them come out, where we don't believe we have any particular part of our network that is coming due at any particular time. We have hundreds -- well over 250 dark fiber and circuit providers that we can turn to.

So this is just part of a normal BAU and we expect that we will -- we not only renewed this 5 year, but we'll renew this one at the next -- at the end of the 5 years coming up as well. And again, this was a -- sorry, Dave, this was a noncash. There was no change. We didn't have to pay anything up. It's just a simple movement of that from the cost of goods sold line to the low line.

David Schaeffer^ Yes. And as Sean said, those 256 providers have over 2,500 unique agreements with Cogent, all with different terms. We've commented that our average remaining life of these agreements is about 17 years.

As particular agreements mature, they are then subject to this new accounting treatment that is different than it was previously, whereas GAAP required us to treat the capital leases only for the fiber and the maintenance and expense. Now it's all treated as a finance lease.

Now to your question about VPN services and sales efficacy and building occupancy, I think there are kind of 3 different questions there. Let's start with VPNs. In the intermediate term, companies will need less office-to-office connectivity, as many branch offices are completely vacant.

They will still need some VPN connectivity from headquarters offices to data centers. There is a large base of VPNs that are deployed over MPLS. As those MPLS contracts mature, those customers are going to migrate to these lower cost, more modern, more flexible technologies of SD-WAN and VPLS.

So we will be a beneficiary, but it's something that's not top of mind to customers at this point. What is important to corporate customers is making sure that where their work from home VPNs aggregate, that port is large enough to support all of those concurrent work-from-home users. And that's why we're selling so many more 1-gigabit connections.

Now for our sales force, we had a plan to grow our sales force 7% to 10% this year. We're on track to do that. We're actually right at the high end of that range. We're doing a very good job of pivoting on hiring salespeople and training those people remotely.

We had already developed a very full set of online training tools that people were using in the office and could quickly pivot those to training from homes. I will admit that one of the areas we need to improve on is actually remote firing.

Our sales force turnover rate declined from an average of 5.6% and to 3.5%. Part of it's the younger sales force, part of it is the difficulty in making that decision without having a face-to-face conversation with the party that is underperforming. Now we're working on that, but we think that we will both grow the size of the sales force and we will be able to compensate for the lack of VPN sales by having more salespeople and better productivity out of those individuals.

And then the final point about will people ever return to their offices? I know that's a vigorous debate in the public forum. Will our economy permanently shift to work-from-home? Or will we go back into offices? I believe for the next year or 2, the office will look different.

There will be a slow return to offices, but I do not believe that large buildings in the centers of city are going to go dark and people will never return to them. Now how quickly that happens is really dependent on how quickly people feel safe in getting back to those offices.

Sean Wallace^ Yes. And Colby, let me just add 1 thing. We don't have perfect visibility as to what's going to happen with that. What we do know and what we're tracking very closely is our bad debt expense, our churn, our day sales outstanding and our cash collections, which are all within historical norms, and in fact, June was a record month for cash collection.

So in spite of all the uncertainty, it's very clear that our customers view their locations as they're still going to be there. And maybe just -- most importantly for us is that having Internet connectivity is a very important part of their doing business.

Operator^ Our next question comes from Michael Rollins of Citi.

Michael Rollins^ I was curious if you could unpack a bit more in the corporate market how you're seeing the opportunity to upgrade to those higher 1 gig speeds penetration, the incremental revenues you're able to get from those customers how you see that evolving as you look forward based on the sales data that you have?

And then secondly, just taking a step back to the capital allocation discussion. Can you frame maybe a little bit more just how the Board is thinking about the cash position on the balance sheet today? And I recognize that the Board makes these decisions. But if you could share any maybe observations or insights that drove the Board's decision this quarter on the dividend?

David Schaeffer^ Yes. Let me start with the 1-gig trend. For on-net locations, for the past 3 quarters, we have seen more gigabit sales than Fast Ethernet. In fact, that trend accelerated materially in mid-March and continues, where today, the majority -- a significant majority of new sales, approximately 85% of sales are on gig interfaces. Secondly, we've been able to go back to the existing base.

And for those locations that are their main location where their work from home employees are tunneling into there's been a great deal of receptivity to increasing those locations, size of port from 100 meg to gig, and that's the reason why our ARPUs have actually gone up.

Now for the branch offices, which tend to be a mix of on-net and off-net, there has been much less interest in either buying new locations who are upgrading those locations. So we've not seen a pickup in port sizes off net. And in fact, we've seen our off-net revenues declined percent of our corporate revenues are off-net, 20% of our corporate connections are off net.

And those branch office locations are a result of us delivering superior service at the on-net location and then the customer looking for that similar service in those locations. They're just not as interested that in this environment.

With that said, there are some customers who do have more expensive MPLS networks to those remote locations. And even though those locations may temporarily not be using a lot of bandwidth, as those contracts for sure, we are able to sell some of those connections.

I'm going to switch now to your capital allocation question. And I would say the debate at our last Board meeting and this Board meeting was probably more vigorous than it's been in past, in large part because of the macro uncertainty. Not because of anything related to Cogent, but related to the world around us.

Board members are humans, too. They have friends that have suffered, they're quarantining or are in shelter in place. They're not able to get out and travel. In fact, our last 2 board meetings have been completely telephonic. So they look at a world in which there's a great deal of economic uncertainty.

That says, hold on the cash, be more conservative and maybe have more cash on your balance sheet than you would in other times. They also looked at the unprecedented central bank actions and said, we, as a company, should take advantage of that, that's why we went ahead and called our $189.2 million of unsecured U.S.-denominated notes and replaced them with a larger EUR 215 million issuance at a lower interest rate, effectively saving about 130 basis points in our cost of capital.

That's a real cash cost, with no real immediate use for that cash, but it did seem to make sense to bulk up. And then with regard to the dividend decision, it is probably the most important debate at every board meeting.

The Board takes that capital allocation strategy as its primary objective. And I think they had looked at the growth rate in free cash flow and the arithmetic decline in the growth rate of the dividend and felt that increasing the dividend growth rate, even in light of all this uncertainty, made some sense. I don't know, Sean, if you want to add any color?

Sean Wallace^ I just think it's from a relatively new member of the management team, I think one of the things that Cogent has -- and you heard it in Dave's remarks, is that there is a real strong discipline of evaluating where you're going to put the money either into the business or back to shareholders.

And there is great discipline around that. And that allocation of capital the conclusion came based on particularly the strong EBITDA growth in the last quarter made a pretty -- difficult decision, the right decision to increase the dividend.

Operator^ Our next question comes from Frank Louthan of Raymond James.

Frank Louthan^ So I wanted to unpack a little bit. Can you give us a little bit of an idea of sort of the amount of new sales that come from VPNs and so forth, and have you -- and to what extent have you had the corporate customers downgrade service and so forth.

And then, I guess, lastly, you're talking about the sales cycle elongating. When do you think that sort of normalizes out? Do we see another couple of quarters of weakness on the sales side before that starts to catch up? Or how long do you think it'll be before we see that sort of get a new baseline?

David Schaeffer^ All right. So I'm going to take the middle question first. We have seen very few downgrades. I'm not going to say we've seen none. There's always some churn. And in fact, our churn numbers declined sequentially and year-over-year. Customers are taking larger connections.

So it's not like we're losing connections or losing customers. Did we lose some corporate customers? Sure. We serve multi-tenant office buildings, basically skyscrapers. The average building has 51 opportunities. Usually 3 or 4 of those opportunities are located on the first 4 of those buildings, and they tend to be retail establishments. They can be bank branches, they can be food establishments.

And some of those have turned off service, and we're definitely not selling to that market. If you just walk down any street in any major city, you see very little retail activity. Now the good news is there's probably 40 office businesses sitting on top of those retail businesses.

Those 45-or-so office businesses have thousands of employees at home that need to get to able to work from home and get into their corporate network. So we're seeing an uptick in gigabit sales. So all in all, we think that our corporate on-net business is very durable, and we continue to see growth in demand.

Now with respect to VPNs as a specific product. Roughly half of our corporate customers take both products. We have seen a material deceleration in customers taking a second port for VPNs. I can't tell you when they're going to reopen those branch offices. I just don't have that visibility.

What I do have visibility to is how many conversations we're having with the roughly 75% of the businesses in those buildings that are not Cogent customers, the receptivity and the amount of time from initiation of discussions to order and we feel pretty comfortable that our corporate sales are going to continue to perform, primarily driven by DIA.

And over time, the VPN product will actually accelerate simply because the alternative, if you need a private network, is so unpalatable. MPLS is rigid, it's expensive and it provides virtually no monitoring capabilities, all of which our services deliver a significant benefit to.

And then in terms of when will sales cycles return to normal? That's hard to say. I mean, buyers are humans. They have psyche, and they see the news. And when you have 1,000 people a day dying, people are nervous.

Sean Wallace^ Yes, I would just give you some anecdotal stories about what the sales force is telling us. I think the question -- well is there been a fundamental change in our value proposition. And I think the answer is, what we're hearing from the sales force is they are spending time with the IT people.

It's taking longer, but we are winning the decision-making folks who are looking at technology and the service we're delivering. Where we are having challenges on getting the decision made when it goes up to the CFO in larger organizations, and they're just deciding that they want to slow down the cost increase in their business, and this is just 1 of the things that they're deleting off the list.

So we remain a very, very important business with fast speeds, superior reliability, fast insulation, but we're in an environment where people are having an abundance of caution.

Operator^ Our next question is from Nick Deltio of Moffitt Manson.

Nicholas Del Deo^ First, did the voluntary bit rate reduction, some of the big OTT and content players introduced in Europe have much of an effect on your traffic or revenue growth in and will Q3 be affected the other way as those start to roll off?

David Schaeffer^ So it was impactful. All of the companies that had agreed to those voluntary reductions are Cogent customers. And most of the European access networks are also Cogent customers.

So with a lower bit per second rate as a result of lower frame count, we did see a slower growth rate in traffic from some of those European customers on both sides. It's a little hard to tell what the reversal of that is going to look like in Q3. Quite honestly, we don't ask our customers on a regular basis, what they're doing in terms of their resolution quality. I think most of them are still adhering to those strategies.

But I think the key trend is we saw a material shift in a very short period of time in cord cutting and cord shaving and the displacement of linear video with over-the-top. We're not going back. The question is, how long will it take for the over-the-top players to return to a bit of an arms race where resolution quality as well as quality of content is one of the tools they use to win subscribers. We haven't seen that return yet, but we think that will.

Nicholas Del Deo^ Okay. That's helpful. And maybe turning back to the dividend. Sort of big picture, do you think you can sustain a low-teens annual growth rate in the dividend over a multiyear period, absent an acceleration in revenue growth from current levels?

Or I guess say it differently, is the current dividend trajectory kind of predicated on improving revenue growth? Or do you think there's a cushion there that you could sustain that pace even if growth underperforms?

Sean Wallace^ Look, we think we continue to maintain our long-term outlook on a 3 to 5-year basis that we'll have double-digit growth in the top line that will have improvement of 100 basis points on the network, 100 basis points on SGA to get 200 basis points in EBITDA.

I think as we look out, as we think about the numbers, we think about that, even with the moderation in growth, we think we have a lot of levers to pull in the business. We are scaling the network. We think we're -- have an ability to continue to improve the cost of goods sold line.

We think we have opportunities on the SG&A line to continue to improve the margin and you also -- if you look at CapEx over the past decade, it's moderated as a percent of revenue, continues to go down generically over time.

So we've looked at the numbers, we've looked at our opportunities to invest that capital, and we think the best use of that capital is to increase the dividend, and we will revisit this the next quarter based on the performance.

David Schaeffer^ Yes. And I think the Board did have us stress test that in a variety of growth scenarios that are more pessimistic than our long-term outlook and worse than our historical averages. I think secondly, we looked at a world where GDP was down 33% year-over-year and Cogent was up 5% year-over-year top line growth. And as Sean pointed out, we had the operating leverage.

We also arithmetically have 2 big cushions, one being the $417 million of cash, which is far more than we need to operate the business. And then secondly, the rapid expansion in our borrowing capacity due to the fact that we are underlevered. So even with more moderate growth, we can do quite well in growing our returns of capital.

And as I've said repeatedly, I go to the Board and if I saw inorganic opportunities that I was convinced would produce better returns, I would ask for the allocation of capital to that. And we have worked at literally hundreds of potential transactions. And as Sean said, the highest and best use is to give the money to the shareholders.

Operator^ Our next question is from Walter Piecyk of LightShed.

Walter Piecyk^ Dave, when you guys talk about corporate connections, the customer subscriber connections, I assume that if there's a guy that has a central office and a branch office that the connection is the branch offices is that reduction. Do I have that description of what a corporate connection or customer means?

David Schaeffer^ Yes. So a customer can buy 2 products from us. They can buy a connection for Internet access or a connection for VPN. If they're buying both same location, they're buying 2 connections.

Walter Piecyk^ Got you. Okay. I understood. So you described this as the connections, the so when we're looking at that subscriber, the connection loss during the second quarter, is it entirely remote locations? Or have you lost any core offices? And do you see that as a risk in the second half of the year given the fact that the economy is getting crushed right now.

David Schaeffer^ So I commented on, we did lose some retail customers. We had very small retail exposure, but it's not that we have 0. If you go to any of the buildings that we're in, you can go to our website and see what buildings we're in, you walk down the street. You see there's usually some --

Walter Piecyk^ It not retail, Dave. I just went back to my rework last week to pick up some monitors, and there's no retail companies there. And most of the people had moved out of the floor that we were on. So it's not just a retail risk that the economy has in terms of people vacating their office space.

David Schaeffer^ So we do so to rework at probably over 100 locations.

Walter Piecyk^ I was using that as a representative, not to say we work specifically, but just representative of the fact that it's not just a retail cable node on type of risk that there's obviously corporations moving out of their offices.

David Schaeffer^ And we have not seen an uptick in corporate churn. We have not lost any significant corporate customer because they have went out of business and shuttered their main location. Maybe -- I can't forget whether people 3 years from now will be back in offices.

Walter Piecyk^ Yes, I'm not talking about 3 years from now. I'm just on a -- in the near term. So for example, on May 12, when you were speaking at market's conference, you said there's a lot of moving parts here, but I think corporate business will return to growth similar to historical averages in Q2, which I think in most people's minds is a double-digit growth rate. Obviously, you came in far below that during the quarter.

That was halfway during the quarter that all of these remote office disconnections occur in the last 45 days of the quarter?

David Schaeffer^ So our corporate growth rate was about half of our historic average. It was a combination of less VPN sales and historically average disconnects. We did not see an uptick in churn or disconnects. And it did not

Walter Piecyk^ -- why did you say on May 12, then that you thought that you would return to growth similar to historical averages?

David Schaeffer^ Well, for a couple of reasons. One, we had a historically average number of salespeople. We looked at their sales funnels. And if you go back to May 12, you saw most local governments were lifting their shelter-in-place orders and an expectation that we would be in a much lower infection rate and many fewer states would effectively be in the condition they're in.

I have no visibility to predicting the virus' transmission rate and the infection rate. I do believe that our corporate customers will continue to buy, and the 3/4 of the businesses and the buildings that we have on net that don't buy from Cogent are as likely to continue to buy from us in the future as they have been in the past.

Operator^ Our next question is from Brandon Nispel of KeyBanc Capital Markets.

Brandon Nispel^ Great. I have one question and one follow-up. Dave, I was hoping you could talk about demand from some of your larger media customers. Are you seeing these customers -- and are you continuing to have active discussions with them where you're seeing them really building out their own capabilities in terms of content distribution.

Second, for Sean, can you help us understand what percentage of your IRUs are accounted for as a finance versus capital lease? And how should we think about this changing the gross margins going forward? And really does it warrant a disclosure from you guys similar to your gain on asset sales as these happen so we can compare the models on an apples-to-apples basis?

David Schaeffer^ Yes. So let me -- I'll take the over-the-top piece of it. We are seeing and continue to see many new over-the-top applications being launched. Two, virtually all of those applications are Cogent customers because we have more access networks connected to us in more locations than anyone in the world, and we provide that connectivity at the lowest price rate.

With that said, most of the new applications do not have the technical acumen to build their own distribution networks for the scale that they are trying to achieve initially. So many of them use CDNs as their interim media distribution method. Those CDNs are also Cogent customers.

But as they build out their own infrastructure, they will increasingly in-source meaning they will have their own CDN, and they will become direct purchasers of bandwidth. So we typically see as an application matures, a greater percentage of their business comes directly to their transit providers and through the intermediaries like AWS or hosting companies or CDNS. I'm going to let Sean now take the capital lease question.

Sean Wallace^ Thanks, Dave. So for the quarter, our cost of goods sold went down by $1.2 million as a result of reclassification, and this went from being an operating lease to a finance lease, and the finance lease used to be called a capitalized lease.

So it is going, if you will, below the line, and going forward, that will reduce our cost of goods sold by $1.8 million a quarter. Those are cash payments for O&M and colocation services.

If you try to -- and I'll confirm this number, but if you try to look at the difference between our capital or finance leases as a percentage of leases versus operating lease, about 95% are capital or finance leases and 5% are operating lease. Does that answer your question?

Operator^ Our next question is from Bora Lee of RBC Capital Markets.

Bora Lee-Marks^ So just switching to international. You've been adding markets over the last year or so. Can you just talk a bit more about your international expansion strategy? And perhaps relatedly, there was an increase in CapEx this quarter. Just wondering if that was a onetime increase related to the Johannesburg launch. And should we in the long term, basically expect CapEx to return to that much trajectory?

David Schaeffer^ So first of all, I'll start with the downward structuring, you should expect our CapEx as a percentage of revenue and in absolute terms to continue to decline. Two, we continue to evaluate markets around the world. Most international markets that we are not in have 1 of 2 reasons we're not there, either a very hostile regulatory environment or a lack of aggregate demand.

We do have additional markets on our radar to expand, and our country count will go up. Traffic growth is substantially faster outside of the U.S. than inside of the U.S. Now, in last quarter, Q1, we actually had a significant uptick in a capital lease expenditure. It was a cash expenditure for dark fiber internationally. Some of the CapEx is now for equipment to light that fiber.

The Johannesburg expansion was not that material. What was much more material was our terrestrial expansion in Latin America. So we have purchased and litigation long-haul fiber in Brazil, and we are substantially expanding our Mexican network. We did also expand into Bogata, Colombia last quarter.

We continue to evaluate additional markets, but many of the countries just don't have a regulatory structure that welcomes a foreign ownership of an open Internet and our kind of 2 immutable criteria are: one, we're not going to go into JVs or partnerships. We need to be the complete owner; and two, we will not succumb to sensorship or restrictions on the Internet.

We are a major provider of Internet connectivity in Turkey and in China actually, but we do that outside of China. We have a significant presence in Hong Kong, for example. We have been closely monitoring the changes in the security law in Hong Kong. To date, it has not negatively impacted our ability to sell to Chinese customers. But going forward, we will continue to evaluate other markets where we can win customers.

Bora Lee-Marks^ Great. And just for a quick follow-up. Last quarter, you mentioned there were difficulties accessing corporate buildings for installations. Can you just give an update on how that's been going during second quarter relative to first quarter? And if you -- and if the orders are still staying in the pipeline and they're just getting pushed out based on timing?

David Schaeffer^ Yes. I think the building access issues have basically gone away. Out of 2,854 buildings or maybe a half a dozen globally data center and/or multi-tenant buildings where there are still challenges, we've done a pretty good job of clearing out the backlog.

Our provisioning times are about what they were prepandemic on-net. They are still elongated off-net because we are dependent on that off-net provider. But in general, we've done a pretty good job of getting things installed.

Operator^ Our next question is from Phil Cusick of JPMorgan.

Philip Cusick^ I wanted to follow-up first on Sean's comments on DSOS. Is that 22 days sustainable? Or could that be improved as fewer people pay by check?

Sean Wallace^ It may improve somewhat by paying by check. But at the end of the day, I think we're trying to be -- our target is actually around 25. So we're actually -- we're well below our target.

I think the reason why we repeated that I want to show that is, this is the best -- these statistics bad debt churn, days sales outstanding are the best things to tell you about the reliability and strength of our customer base, and it all is within historical norms. And we're pleased with where we are right now.

Philip Cusick^ Yes. Yes, it sounds like yes, everybody is, for the most part, current. And then, Dave, thinking about that IRU renewal, as we see fiber construction from a number of telcos and a big effort from Verizon I'm curious what you see in the pace of buildings being lit up by other carriers, either the first connection or maybe second or third? And what that could mean for your own pace of on-net buildings and maybe cost reduction on leases from here?

David Schaeffer^ So there's two parts to the answer that question, Phil. First of all, for our own fiber, we continue to buy from more diverse sources. We ended the quarter at 256 different suppliers.

We keep identifying new constructors in markets around the world that we have never done business with. We do buy some dark fiber from incumbents, but generally, not a lot. Most of it is from alternate providers, whether it be small cell constructors or just competitive carriers. And we think that will continue.

The second thing is that for our 90 different off-net vendors in North America, we have seen a significant uptick in the number of buildings that they have built fiber into. That number is over 2 million buildings that we can buy fiber or buy lit services that they have built in that are delivered on fiber.

The third point is maybe the most significant. We have contractual commitments from multiple providers to build into near net buildings that they preidentified if we secure an order. So we have nearly another 2 million buildings that have been identified with our 90 different suppliers as near net.

They are guaranteeing to build in at a fits price at pricing identical on a monthly recurring basis that -- to their on-net buildings. And they're guaranteeing to do that within 120 days. That is longer than our typical off-net guarantee of 90 days from our vendors, but it does show that there is a huge push by both cable companies and telcos to expand their footprint, which gives us a bigger off-net footprint.

So both in our on-net footprint, we continue to find new suppliers and can get into virtually every building we want to go after. And to Sean's comment about capital allocation, we have capital. We can build in thousands more buildings if we choose, but we have concluded that they don't generate a good enough return.

So for that reason, we're comfortable in using these off-net solutions in those more marginal buildings. And the fact that we've nearly doubled the addressable market really shows: one, how many buildings there are still to serve; two, how aggressive the providers are and wanting to build; and I think the third number, when I'm not trying to speak ill with my suppliers, how they're deploying capital at rates of return that are suboptimal. I'm more than happy to buy services from someone who deploys capital at a rate of return below their cost of capital. Our Board would fire me if I did that.

Sean Wallace^ Phil, I would just add to the point, we added 2 multi-tenant buildings this quarter, and I spent time with the real estate team. We have a pretty sophisticated algorithm that looks at a number of customers that are available, the distance of that building and really looks at the ROI, it's very disciplined on how we're going to do it or not.

And the benefit is if we have fewer MTOBs that's going to bring our CapEx numbers down over time. But we still have a lot of penetration to go in our existing portfolio of the close 1,800 buildings we have on that.

David Schaeffer^ And for NetCentric, we continue to see data center proliferation and added nearly 30 carrier neutral data centers last quarter, and it looks like we'll add a similar number this quarter.

Sean Wallace^ Which are less expensive to get into because they're designed to bring in multiple carriers. So they're easier, faster, cheaper to get into that.

David Schaeffer^ They usually have content already out to a manhole.

Sean Wallace^ Yes.

Philip Cusick^ Do you see any changes to the positive? Just to take the other side for a second. Do you see any changes to the positive in the return on capital on some of those construction efforts either in terms of more potential tenants or what tenants are willing to pay for those companies that are deploying capital for fiber?

David Schaeffer^ Let me put it this way. Past as prologue, and this is an industry that has destroyed capital for 20-plus years. There's actually a heightened level of competition driven by the pandemic, cheap access to capital and new applications such as pure broadband businesses and backhaul businesses.

With heightened competition and low-cost of capital, I think returns on capital on telecom or declining, and they were all running negative. I know that was not what people wanted to hear.

Sean Wallace^ I mean, in -- it's not surprising though. From a historical perspective, 20 years ago, we -- a lot of the investment was on competitive CLEC, which we're going after customers -- small, medium-sized customers selling voice and data services. It's now a construction bench where we see dozens and dozens of fiber operators building fiber around cities, and we have a large sophisticated sales force.

We have our own tenants in our own buildings. And those hopefully, 4 million buildings we're going to have only increases the number of locations we can service and gets us into the ability to go not just to small and medium-sized businesses, but larger customers who've got more locations. It's a big opportunity for us.

Operator^ And we have no further questions at this time. I would now like to turn the call back to Mr. Dave Schaeffer.

David Schaeffer^ I just want to thank everyone. I hope everyone stays well in these challenging times. And again, thanks for your questions and support. Take care, and we'll talk in. Bye-bye.

Operator^ Ladies and gentlemen, this concludes today's conference call. Thank you for participating, and you may now disconnect.