Cogent Communications Holdings, Inc. (Q4 2021 Earnings)

February 24, 2022

Corporate Speakers:

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

Participants:

- Frank Louthan; Raymond James & Associates, Inc.; MD of Equity Research
- Phil Cusick; JPMorgan Chase & Co; MD and Senior Analyst
- Evan Young; KeyBanc Capital Markets Inc.; Research Analyst
- Michael Srour; MoffettNathanson LLC; Research Associate
- Michael Rollins; Citigroup Inc.; MD & U.S. Telecoms Analyst

PRESENTATION

Operator: Good morning, and welcome to the Cogent Communications Holdings Fourth Quarter 2021 and Full Year 2021 Earnings Conference Call. As a reminder, this conference call is being recorded, and it will be available for replay at www.cogentco.com. A transcript of this conference call will be posted on 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, Inc. Please go ahead.

Dave Schaeffer: Thank you, and good morning to everyone. Welcome to our fourth quarter 2021 and full year 2021 earnings conference call. I'm Dave Schaeffer, Cogent's Chief Executive Officer. And with me on this morning's call is Sean Wallace, our Chief Financial Officer. First of all, I'd like to start with our thoughts go out to our Ukrainian colleagues, and we hope that they remain safe and are able to continue their efforts. Now for some comments on our results. For the focus of the pandemic-related efforts has continued to shift a broad reopening of the U.S. and global economies and most large businesses have developed plans to reopen their offices.

We've seen signs of an improvement in our corporate business climate. This includes greater leasing activity and subleasing activity, increased back office activity as indicated by building use data and an improved sales funnel which indicates that Cogent's corporate customers and prospects are beginning to consider new services and upgrades.

Despite these improvements, and as a result of the introduction of the Omicron variant, we did notice another delay in many companies back to work plans in the fourth quarter and our overall corporate business remains below historical averages. Our NetCentric

business continued to benefit from greater-than-expected growth in streaming subscribers and the continued internationalization of the Internet and streaming where our global footprint positions Cogent as the best network in order to deliver services on an end-to-end basis globally.

For the fourth quarter, traffic grew sequentially on our network and accelerated to 7% sequential growth from the 1% sequential growth in the previous quarter, and increased by 17% on a year-over-year basis. For full year 2021, traffic grew on the Cogent network by 25%. On a U.S. GAAP basis, our annual revenues increased by 3.8% year-over-year to $589.8 million. In the fourth quarter, our revenues declined slightly, primarily due to the impact of foreign exchange and the reduction of USF taxes by 0.5% to $147.2 million in the quarter.

On a constant currency basis, we experienced year-over-year revenue growth of 2.9% and sequential quarterly revenue growth of 0.1%. We saw a modest decline in quarterly productivity in our sales force from 4.3 installed orders per month to 4.2 orders installed per full-time equivalent sales rep. We experienced higher-than-normal turnover in our sales force at 7% per month primarily due to our requirements to have our entire workforce vaccinated and boosted and our return to office requirements implemented in the quarter.

We continue to have success in identifying and hiring incremental salespeople in order to rebuild and strengthen our sales team and continue the growth in our aggregate sales associates. We continue to operate an extremely efficient network which serves a growing number of markets and buildings. Our network is able to handle continued growth in traffic and a fixed cost. We have experienced year-over-year growth on a non-GAAP gross profit, non-GAAP gross profit margin, EBITDA margin and our EBITDA margin as adjusted.

Our non-GAAP gross profit increased by 4.5% to $366 million. Our non-GAAP gross margin percentage improved by 50 basis points to 62.1%. Our EBITDA increased by 6.5% on a year-over-year basis to $227.9 million. And our EBITDA margin for the full year increased by 90 basis points to 38.6%. Our EBITDA margin in the fourth quarter was 39%. During the quarter, we returned $39.6 million to our shareholders through our regular dividend.

Our dividends for the full year were $150.3 million. This year, approximately 79.3% of our dividends will be treated as return of capital to our shareholders, and that is compared to 63.1% in 2020 being treated as a return of capital. We did not repurchase any shares during the fourth quarter of 2021. And as of January 3, 2022, we have $30.4 million available for stock buybacks under our buyback program, which our Board has authorized to continue through December of 2022.

Our cash at Cogent Holdings is $147.4 million at year-end. That cash is unrestricted and available immediately for the use of dividends or buybacks. Cash held at our operating companies are $181.2 million and our total consolidated cash was $328.6 million at year-

end. Our gross leverage ratio decreased from 5.07% in the third quarter of 2021 to $5.02 million at year-end, and our net leverage ratio increased slightly to 3.58 from 3.50. Our consolidated gross leverage, as calculated under our indentures is 4.98. Now for a couple of comments on dividends.

Our Board of Directors, which reflects on the business' ability to generate strong cash flows, investment opportunities on our ability to organically continue to grow has decided to increase our quarterly dividend by another $0.025 per quarter, raising our quarterly dividend from $0.83 per share to [$0.855] per share per quarter.

This increase represents our 38 consecutive sequential quarterly increase in our regular dividend and an annual growth rate in our dividend of 13.2%. We have now returned over $1 billion to our shareholders via a combination of stock buybacks and dividends. We are continuing to maintain a disciplined approach to returning capital to our shareholders, and we are committed to continually increasing that return of capital.

Now I'd like Sean to read some safe harbor language give a little update on the COVID-19 impact on our business and review a few of our operating results.

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

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

Quick update on COVID-19. Like many other companies, Cogent continues to be impacted by the COVID-19 pandemic and the accompanying responses by governments around the world. The majority of our workforce continues to work remotely. Effective March 1, our U.S. and Canadian employees will be returning to their offices. I want to thank the entire Cogent workforce and, in particular, our IT department for their continued hard work during these very challenging times.

I also want to thank our field engineers, contractors, billing and collection staff and other Cogent employees who continue to work on the front lines, installing our new customers and maintaining and upgrading our network so that we can continue to grow our business and serve our customers. The ultimate impact of the pandemic on Cogent is unknown and a significant amount of uncertainty and volatility remains.

We do not know the scope and duration of the pandemic with what actions governments may take in the future in response to the pandemic and how the pandemic will impact the

economies of the world. We believe it is safe to bring our employees back into our offices and that we have taken sufficient measures to safeguard their health. However, 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 also find that our corporate customers, our largest customer base, which is served primarily in our on-net multi-tenant office buildings, may be adversely affected by falling demand for commercial office space in central business districts. We have also seen a reduction in customer additions of satellite office locations as customers either disconnect certain offices or elect not to purchase DIA that's Direct Internet Access or virtual private network connections for their smaller office locations.

We may also see delays in the shipping of network equipment and the installation of services we purchased from other companies as those companies are impacted by the continuing pandemic. These and other risks are described in more detail in our annual report on Form 10-K for 2021 and in our quarterly reports on Form 10-Q for the quarters ended September 30, 2021, June 30, 2021 and March 31, 2021.

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

Dave Schaeffer: Hey. Thanks, Sean. Hopefully, you've had a chance to review our earnings press release. Our press release includes a number of historical metrics that hopefully you find helpful in understanding the performance of our business. Now for a little bit of overview of our expectations against our long-term guidance targets. Our targeted long-term multiyear EBITDA annual margin expansion guidance is for an additional 200 basis points per year of margin improvement.

Our long-term multiyear constant currency revenue growth rate was approximately a 10% target. Our long-term revenue and EBITDA targets are intended to be multiyear goals and are not intended to be used for specific quarterly or annual guidance. Our recent results are below these long-term rates largely due to the impact of COVID-19 on our corporate business.

Our corporate business, which represents 59% of our revenues at the end of the quarter. Our corporate revenues declined year-over-year by 7.4% from the fourth quarter of 2020 and declined by 2.5% from the third quarter of 2021, a decrease in the universal service fund tax rate for the quarter had a negative impact of $500,000 on our sequential corporate revenues. The U.S. tax rate USF tax rate changes quarterly, and we cannot predict the impact of future USF changes on our revenues.

The USF rate for the first quarter of 2022 will be reduced to 25.2% from the fourth quarter rate of 29.1%. These taxes are applied primarily to our VPN services. Our on-net -- or NetCentric business, which represents 41% of our revenues, experienced another

strong quarter and grew 2.6% sequentially and 20.3% on a year-over-year basis from the fourth quarter of 2020. Volatility in foreign exchange rates primarily impacts our NetCentric business is -- over half of that business is outside of the U.S.

On a constant currency basis, our NetCentric business increased by 22.2% from the fourth quarter of 2020 and by 4% sequentially from the third quarter of 2021. And for the full year, grew by 22.4% from the full year 2020. Our NetCentric business grew by 25.3% and Sean can now provide some additional details on our quarter.

Sean Wallace: Thanks, Dave. Good morning, again, everybody. Let's talk about corporate and NetCentric revenue and customer connections. We analyze our revenues based upon network type, off-net, on-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 use our bandwidth to support their businesses but do not incorporate bandwidth into the products or services that they sell.

Our corporate customers buy bandwidth from us in large multi-tenant office buildings or in carrier-neutral data centers. These corporate customers are typically professional service firms, financial services firms and educational institutions located in multi-tenant office buildings or connecting to our network through our CNDC footprint. Our NetCentric customers buy significant amounts of bandwidth from us in carrier-neutral data centers and include streaming companies and content distribution service providers as well as ISPs who serve the consumers of content.

Revenue and customer connections by type. Our 2 types of customers and businesses experienced vastly different results. For full year 2021, our corporate business declined by 6.5%. However, our NetCentric business increased by 25.3% to $358.4 million, our best growth rate for this business in over a decade. Revenue from our corporate customers for the quarter declined sequentially by 2.5% to $86.8 million and declined year-over-year by 7.4%. We had 45,423 corporate customer connections on our network at year-end, which was a decline of 0.3% versus the third quarter of 2021 and a decrease of 3.0% -- 3.7% from the fourth quarter of 2020. On a sequential basis, our corporate business experienced a reduction in customer turnover and continued gross sales lower than our historical average.

This performance correlates with the activity of the central business district commercial real estate market, which has seen a decline in new vacancies, but continued weakness in new leasing activity. A positive trend in our corporate business is the continued momentum in our selling of off-net circuits. Our comprehensive footprint of over 4 million off-net fiber serve corporate buildings across North America enhances our ability to service corporate customers with multiple locations. The growing base of these off-net circuits drives lower local loop costs, which we pass on to new off-net customers. These savings reduced our off-net ARPU and our overall off-net revenue growth while improving our competitive position in the marketplace. On a year-on-year basis, our number of off-net 1 gigabit circuits grew by 25%.

As Dave mentioned earlier, continued growth in international traffic and streaming services contributed to our NetCentric business growth in our fourth quarter. Quarterly revenue from our NetCentric customers increased sequentially by 2.6% to $60.4 million and increased year-over-year by 20.3%. Revenue from our NetCentric customers was $231.4 million for full year 2021. We had 48,303 NetCentric customer connections on our network at year-end, an increase of 1.8% from the third quarter and an increase of 13.9% over the fourth quarter of 2020. Our NetCentric business benefited from continued strong demand for our larger 10 gigabits per second, 100 gigabits per second and now 400 gigabits per second ports.

Our NetCentric revenue growth can experience volatility due to the impact of foreign exchange, larger customer size and certain seasonal factors, primarily related to usage. Traffic grew in our network by 7% sequentially and grew by 17% year-over-year, primarily a result of increased NetCentric traffic. Revenue and customer connections by network type. Our on-net revenue was $110.7 million for the quarter, a sequential quarterly decrease of 0.3% and a year-over-year increase of 3.4%. Our on-net revenue was $442.8 million for the full year, an increase of 5.6% over full year 2020. Our on-net customer connections increased by 0.7% sequentially and increased by 4.4% year-over-year. We ended the quarter with 80,723 on-net customer connections on our network in our 3,035 total on-net multi-tenant office and carrier-neutral data center buildings.

Our off-net revenue was $36.3 million for the quarter, a sequential quarterly decrease of 1% and a year-over decrease of 1% as well. Our off-net revenue was $146.4 million for the full year of 2021, a decrease of 1.2% over full year 2020. When we sell new off-net circuits, we incorporate the cost savings from the lower local loop prices into our pricing and the introduction of these customers into our base, lowers our off-net ARPU, which declined by 2.1% this quarter. Our off-net customer connections increased sequentially by 1.4% and increased 5.8% year-over-year. Our off-net customers are predominantly corporate customers. We ended this year serving 12,669 off-net customer connections in over 7,650 off-net buildings. These off-net buildings are primarily in North America.

Pricing per megabit. Consistent with historical trends, our average price per megabit of both our installed customer base and our new customer contracts decreased for the quarter. The average price per megabit for our installed base for the fourth quarter declined sequentially by 4.3% to $0.33 and declined by 19.5% from the fourth quarter of 2020. The average price per megabit for our new customer contracts for the fourth quarter declined by 13.4% to $0.17 from the third quarter of 2021 and declined by 8% from the fourth quarter of 2020. As we continue to succeed in selling larger 10 gigabit, 100 gigabit and 400 gigabit connections to our customers, this change in our connection mix change will have the effect of lowering our price per megabit at a greater rate than the changes in our price per connection.

ARPU. Our quarterly on-net ARPU and our off-net ARPU decreased sequentially and decreased year-over-year. Our on-net ARPU, which includes both our corporate and our NetCentric customers was $459 for the quarter, a decrease of 1.3% from last quarter and

a decrease of 1.3% from the fourth quarter of 2020. Our off-net ARPU, which is predominantly comprised of our corporate customers was $960 for the quarter, a decrease of 2.1% from the third quarter of 2021 and a decrease of 6.3% from the fourth quarter of 2020. We expect that our off-net ARPU will continue to decline as we take advantage of volume and time-based discounts in order to lower the cost of our local loops. These reductions in costs are passed on to our corporate customers and are making us more competitive in this market.

Churn rates. Our sequential quarterly on-net and off-net connection churn rates were stable. Our on-net unit churn rate was 1% for this quarter and was 0.9% last quarter. Our off-net unit churn rate was 1.1% for this quarter and unchanged from last quarter. NetCentric MAC orders. In order to reduce our customer turnover, we employ a dedicated sales group, which works primarily to retain our NetCentric customers who have indicated that they are considering terminating or not upgrading their services with us. We may offer pricing discounts to these customers in order to induce them to purchase additional services and/or to extend the term of their contracts with us.

Due to the commodity nature of NetCentric services, the vast majority of these move, add or change or MAC 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 2,190 customer connections. This increased our total revenue commitment to Cogent by over $24.5 million.

EBITDA, our 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 and consequently our EBITDA, include the resetting of payroll taxes in the United States at the beginning of each year, annual cost of living or CPI increases, seasonal vacation periods, the timing and level of audit and tax services, our annual sales meeting costs and our benefit plan annual cost increases. Most of our contractual obligations that contain CPI provisions include account on any potential CPI increases.

Earnings per share. Our basic and diluted income per share for the quarter were $0.40 and $0.39, respectively, compared to basic and diluted income per share of $0.29 and $0.28, respectively, for the third quarter of 2021. Our basic and diluted loss per share was $0.14 for the fourth quarter of 2020. Unrealized gains and losses on the translation of our 2024 Euro notes into U.S. dollars as well as nonrealized gains and losses on our fixed rate interest rate swap contribute to the variability in our net income and consequently, our net income and loss per share.

Foreign currency impact. Our revenue earned outside of the United States is reported in U.S. dollars and was approximately 25.5% of our total quarterly revenues. Approximately 17.5% of our revenues this quarter were based in Europe, and about 8% of our revenues were related to our Canadian, Mexican, Asia Pacific, South American and African operations. We have not entered into hedges for our foreign currency revenues and obligations, including our payments on our Euro notes.

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 $0.8 million and the year-over-year foreign exchange impact on our reported quarterly revenue was a negative $0.9 million. Our quarterly revenue increased on a constant currency basis by 0.1% sequentially and increased by 2.9% on a year-over-year basis.

Adjusting for the negative impact of foreign exchange and the reduction in USF on our revenues for the quarter, our revenues would have increased by 0.4% on a sequential basis. The foreign exchange impact on our reported annual revenue was a positive $5.3 million our annual revenue growth rate on a constant currency basis was 2.9%. Variability in foreign exchange rates primarily impacts our NetCentric revenues.

The average Euro to U.S. dollar rate so far this quarter is $1.13 and the average Canadian dollar exchange rate is $0.79. Should these average foreign exchange rates remain at the current average levels for the remainder of our first quarter of 2022, we estimate that the FX conversion impact on our sequential quarterly revenues for first quarter would be a negative $0.2 million and the year-over-year foreign exchange conversion impact on our quarterly revenues would be a negative $1.6 million.

Customer concentration. We believe that our revenue and customer base is not highly concentrated. Our top 25 customers represented less than 6% of our revenues, both this quarter and for the full year of 2021.

Capital expenditures. Our capital expenditures were $15.3 million this quarter compared to $15.9 million for the fourth quarter of 2020 and $22 million for the third quarter of 2021. Our full year 2021 capital expenditures were $69.9 million and were $56 million for 2020. Supply chain uncertainty is causing us to shift our equipment purchasing schedule. The increase in our capital expenditures reflects our investments in expanding the geographic scope of our network and network capacity, new building investments and anticipatory investments designed to ensure that we have satisfactory inventory levels of network equipment, finance leases and finance lease payments.

Our finance lease IRU obligations are for long-term dark fiber leases with a diverse group of suppliers and typically have initial terms of 15 to 20 years or longer. These leases often include multiple renewal options after their initial term. Our finance lease IRU fiber lease obligations totaled $245.9 million at December 31, 2021. At year-end, we had IRU contracts with a total of 295 different dark fiber suppliers.

Our finance lease principal payments were $6.2 million for the quarter and primarily include leases for dark fiber in international markets. Our finance lease principal payments were $4.6 million for the fourth quarter of 2020 and $4.9 million for the third quarter of 2021. Our finance lease principal payments for full year 2021 decreased by $0.9 million and were $23.1 million compared to $24.0 million last year. Our finance lease principal payments combined with our capital expenditures were $21.5 million this

quarter compared to $26.8 million last quarter and were $20.5 million for the fourth quarter of 2020.

Our financial lease principal payments combined with our capital expenditures were $93 million this year compared to $80 million last year. Cash and operating cash flow. As of December 31, 2021, our cash and cash equivalents totaled $328.6 million. Our cash flow from operations was $36 million for the quarter compared to $37.6 million for the fourth quarter of 2020 and $47.4 million for the third quarter of 2021. Our cash flow from operations increased by 21.3% for the year to $170.3 million for the year compared to $140.3 million for full year 2020.

Debt and debt ratios. Our total gross debt at par, including our finance lease IRU obligations, was $1.1 billion at December 31, 2021, and our net debt was $815 million. Our total gross debt to trailing 12 months EBITDA, as adjusted, the ratio was 5.02 at December 31, 2021, and our net debt ratio was 3.58. Our consolidated leverage ratio, as calculated under our debt indenture agreements was 4.9 at December 31, 2021. We are comfortable with being slightly above our long-term range of net leverage due to the unprecedented impact of COVID-19 on our corporate business.

Our [350 million] Euro notes are reported in U.S. dollars and converted to USD at each month end using the month end Euro to USD exchange rate. The unrealized foreign exchange gain on our Euro notes was $8.8 million this quarter or $0.19 per share compared to an unrealized gain of $10.2 million last quarter and an unrealized loss of $19.2 million for the fourth quarter of 2020. The unrealized foreign exchange gain on our Euro notes was $32.5 million this year or $0.70 per share compared to an unrealized loss of $37 million last year or $0.75 per share.

Bad debt and days sales outstanding on accounts receivable. Our customer cash collections and bad debt expense results were excellent for the year -- for the quarter. Our bad debt expense as a percentage of our revenues improved sequentially and for the full year. Our bad debt expense was 0.5% of our revenues for the quarter, which was an improvement from 0.7% for our revenues for the third quarter of 2021.

Our bad debt expense was 0.6% of our revenues for full year 2021, an improvement from 0.7% of our revenues for full year 2020. Our days sales outstanding, or DSO, for worldwide accounts receivable was 22 days for the quarter, a slight increase of 1 day from last quarter, but an improvement of 2 days from the end of last year. I want to thank and recognize our worldwide billing and collection team members for continuing to do a fantastic job in serving our customers and collecting from our customers.

With that, I'll turn it back to Dave.

Dave Schaeffer: Okay. Thanks, Sean. I'd like to now provide some additional details on the strength of our NetCentric business, the performance of our sales force and some trends that have been impacting our corporate business. In our NetCentric business, as I had stated earlier, we continue to see strength in that business with full year NetCentric

revenues increasing 25.3%. Streaming service providers are aggressively targeting overseas markets, and we are a continued beneficiary of this trend.

We are positioned with our network and our capabilities to support growth in streaming on a global basis, and I'd like to highlight some of these key characteristics. At year-end, we connected to 1,359 carrier-neutral data centers and 54 Cogent data centers for a total of [1,413] data centers globally connected to our network. We are connected to more data centers than any other carrier as measured by independent third-party research.

This breadth of coverage allows our NetCentric customers to better optimize our networks, improve the quality of their service and reduce latency in delivering those services. We expect that we will widen our gap and lead with other providers as we are anticipating adding approximately 100 carrier-neutral data centers per year to our network over the next several years.

At year-end, we directly connected to over 7,560 networks. This is a 3.1% increase from a year earlier. This collection of Internet service providers, telephone companies, cable companies, mobile phone operators and other carriers allow Cogent to directly access the vast majority of the world's broadband subscribers and mobile phone users. Our connectivity to mobile operators is an advantage for us in this industry as experts predict that more and more programming will be consumed on mobile phones particularly in the Asia Pacific region and in Africa.

At year-end, we had a sales force of 207 professionals focused entirely on the NetCentric market. We believe this group of seasoned sales professionals is one of the largest and most sophisticated sales teams focusing on this market segment. Now for some trends in our Corporate business. Our corporate business is focused on multi-tenant office buildings in the central business districts of major North American cities. Our product offering positions us well as businesses begin to have their employees return to office, and we believe this will allow our corporate business to reaccelerate to its historic growth rate.

For example, performance in our Corporate segment over the past 7 quarters has been impacted by the pandemic and the resulting declines in occupancy rates in commercial office buildings in the central business districts. Based on industry vacancy data, we are encouraged that these declines have moderated and, therefore, the declines in our connections will also moderate. And we are monitoring the return to office activity, we are optimistic as this leasing activity resumes, new tenants begin designing their corporate networks and moving into these buildings that we will win a disproportionate share of these new opportunities. Typically, when Cogent submits a proposal to a customer, we win 40% of the time.

Another exciting corporate trend is the increase in port size demand as we have seen customers migrate from our legacy 100-megabit product to 1 gigabit and now increasingly 10 gigabit circuits for their corporate networks. Corporations are also increasingly locating some are all of their infrastructure and carrier-neutral data centers to

store critical data. In order to better leverage this infrastructure, many of our corporate customers are choosing to create circuits between their corporate locations and these data centers to reduce latency. Our ability to provide multi-location coverage with 1 in 10 gigabit circuits differentiates us in the marketplace versus other service providers who cannot deliver this breadth of locations or these levels of speed and capacity.

At the end of 2021, Cogent was able to provide 1 gigabit service to over 4 million fiber served off-net locations across North America. In addition to the approximately 1 billion square feet of office space that is directly connected to the Cogent network. Now for some details on our sales force and their performance. In October of 2021, we completed the transition of our entire U.S. workforce to back in-office status. As part of this return to office transition, we intended to identify those underperforming sales reps and transition them out of Cogent's sales force.

During this transition period, some of our reps who were performing decided not to return to office due to lifestyle or a desire not to be vaccinated and did not return to the company. Due to the combination of these 2 factors, we experienced a higher level of sales force turnover in the fourth quarter. On a sequential basis, our sales rep head count decreased by 26 to 490 [quota-bearing] reps at quarter end. Year-over-year, our sales rep head count decreased by 79% or 13.9%.

Our sales force turnover in the quarter was 7% per month versus our long-term average sales force turnover of 5.7% per month. This rate of decline in our sales force was primarily related to our corporate sales reps and reflects greater uncertainty around our corporate segment, and a purposeful shift by Cogent to divert resources to our growing NetCentric segment.

Overall, we are encouraged by the opportunity to build and manage the sales force in an office environment as we return to offices and have a greater opportunity to train and mentor our salespeople. Despite recent volatility, we are optimistic that we can continue to identify and hire new sales reps, increasing the aggregate size of our sales force. We hired an unprecedented number of sales reps in 2021 and that accelerated rate of hiring is continuing into 2022.

Our productivity of full-time equivalent reps declined slightly to 4.2 in the fourth quarter from 4.3 in the third quarter of 2021. It was unchanged from the fourth quarter of at 4.2 reps. Overall, we are encouraged by the professionalism, the commitment, the performance of our sales force drive what has been a very challenging operating environment for our corporate business.

We are encouraged with the transition of our salesforce once again, back to offices. Our 70 sales teams that are located in the 40 Cogent sales offices globally will become more productive in their return-to-work environment and we can better manage, train and mentor the sales force, reducing turnover and increasing productivity.

In summary, we remain optimistic about our unique position in the market serving small- and medium-sized businesses located in central business districts with major North American cities with 1,817 on-net multi-tenant office buildings containing just about 1 billion square feet of rentable space. Currently, key indicators of office activity indicate a return to the workplace and an increase in leasing and subleasing activities However, these levels are still below pre-pandemic levels. We are encouraged that many of our customers have indicated they are intending to return to office in 2022.

And we are also encouraged that new leasing activity has increased in these offices over the past 6 months. We are optimistic that the combination of having our sales teams in office, where we can provide more robust training and mentorship coupled with a normal return to work environment among our customers will allow us to aggressively grow our corporate business and an opportunity to sell our services to new tenants as landlords work to fill their office space in the U.S. and in Canada as the Omicron surge continues to fade.

We remain encouraged that our NetCentric business has remained strong due to the global growth in streaming. These trends are continuing, and we continue to see strength in this segment of our business. Our Board of Directors has approved our 38th consecutive sequential increase to our regular dividend, increasing that dividend by $0.025 a share to $0.885 a share. This represents a 13.2% annual increase in our quarterly dividend. Our consistent dividend increases demonstrate our continued optimism about the growth in our business, the operating leverage the ability to increase cash flow and our commitment to continue to increase our returns of capital to shareholders.

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

QUESTIONS AND ANSWERS

Operator: (Operator Instructions) I show our first question comes from the line of Frank Louthan from Raymond James.

Frank Louthan: Great. Can you give us an idea of -- are you seeing any cannibalization within (technical difficulty) and then where do you think you are from an average 10-year standpoint with your reps now with the hiring you've done and some of the dislocation you had at the end of the year versus 12 months ago? And how long do you think it will take you to get back to a more standard level of tenure within your sales force.

Dave Schaeffer: Yes, Frank, you cut out on cannibalization. If you could repeat that part of your question and then I'll answer.

Frank Louthan: Yes, you mentioned earlier on the call about moving up some larger ports. Are you seeing any cannibalization as folks take larger ports taking fewer of them and change that is out having any impact with it.

Dave Schaeffer: Yes. So our corporate product is sold on an all-you-can-eat basis in a location. Companies realize that in a hybrid work environment, having better connectivity is critical to making those employees productive. So we have seen a trend of customers having 100 megabit services, trade those out for 1 gigabit or 10 gigabit services increasing their payments for those locations. We also see new customers coming on electing to take these larger services. And we have actually end-of-life the sale of our 100-megabit product to corporate customers unless there is a special request to do so, we will consider those on an individual case basis. As a result of this, there is no real cannibalization occurring in our corporate segment.

Now pivoting over to the NetCentric trend towards large reports. The larger the port size, the more capacity the customer can use. And since that service is predominantly sold on a metered basis. having greater capacity available then gives customers the ability to burst to that level and Cogent to generate revenue. Remember, our revenues are based on their peak utilization over the course of the month. And having these large reports, 100-gig and now 400-gig ports is helpful to our NetCentric revenue growth, meaning the customers have big enough capacity to meet their surge requirements.

Now to your tenure question, Virtually all of the turnover in our sales force has been among new hires, typically hired during the pandemic and had actually never set foot in a Cogent office. On the third quarter earnings call, I commented on this trend. And many of those remotely hired reps did not transition well into Cogent offices. As a result of this, our tenured reps who had been productive in a remote environment and continue to be productive and increase our productivity coming back to the office have remained with Cogent. And our average rep tenure has increased by over 10% year-over-year going up from just under 28 months to over 31 months of tenure.

Sean Wallace: Also how we're going to get back up to normal?

Dave Schaeffer: And in terms of growing the sales force, we continue to see an adequate flow of candidates, and we had record hiring even during the great resignation and through the turbulence of working from home. That record hiring is continuing. But what we firmly believe is that now we're coming back to the office again on March 1 in North America those reps that have been hired over the past several months will get the added benefit of in-office training, and that will allow us to better equip these reps to be successful and reduce our turnover in sales force. So we think our sales force turnover has peaked and should continue to decline to historic levels or even below.

Operator: I show our next question comes from the line of Phil Cusick from JPMorgan.

Phil Cusick: You talked about this a little bit already, but can you dig more into the indications of interest from customers coming in sort of return-to-office? Does that include New York and San Francisco? What's the sort of funnel look like in terms of ordering? How should we think about that?

Dave Schaeffer: Yes. So when we look at where we've lost customers, it is highly correlated to increases in vacancy rate. In fact, across our footprint, there is 84% correlation with increases in vacancy and declines in Cogent customers. What we have seen is in the South and Southwest, the very best performance where we've continued to increase our penetration and growth rates in places like San Francisco and New York have definitely performed the worst. I think that many companies in both of those markets have now made the decision to firmly return to office as we transition from a pandemic environment to an endemic environment.

Companies are solidifying their hybrid work strategy, but they know that they are going to have employees in offices. So we've seen increased leasing activity and subleasing activity in markets like San Francisco and New York. And that should result in increased corporate growth rates because as new businesses come into the building, that is our best opportunity to win those customers. And I think we should see that our corporate rate of decline peaked in the fourth quarter with the Omicron surge, and we would see an increase in growth, allowing us to get to positive growth in '22. We're not prepared to say it's going to be positive in the first quarter, but we are comfortable in saying that the rate of decline will be less than it is in the fourth quarter of last year.

Phil Cusick: Okay. And then 1 more, if I can. Leverage running at this point, above target you raised the dividend regardless and you said you're comfortable slightly above. What should we be thinking here on what the company does going forward?

Dave Schaeffer: Yes. So we have been very clear with investors that we have the intention over time of discouraging the excess cash that we maintain on our balance sheet. In a low interest rate environment, the negative carry of keeping that cash was relatively benign we took steps to further mitigate that with our fixed to floating swap that we talked about on the third quarter earnings call. Going forward, we anticipate a growth in free cash flow, a reacceleration in revenue growth and continued margin expansion.

As we look at what was probably the toughest year in Cogent's history in 2021 because of the pandemic, we were disappointed in top line growth. 4.4% on a constant currency basis is less than half of our historical average. But we had these extraordinary circumstances impacting our corporate business as we return to a more normalized environment, we think our growth rate will accelerate. We are comfortable in returning incremental capital and having slightly higher leverage in the short term as our corporate business rebound.

Sean Wallace: Yes. I'll just add to what Dave said is that at the end of year 2020, we had $371 million of cash. We finished up this last year with $329 million. So we reduced our number of about $42 million. That's a pretty significant cushion and gives us a lot of breathing room over the next several quarters to see the business, particularly on the corporate side, begin to regrow and perform. And as that grows, we hopefully will continue to grow EBITDA, et cetera, and get back into the leverage levels that we are more comfortable with.

Phil Cusick: And I understand that this is a board decision, but it sounds like 3.5 turns is something that you're not inclined to raise going forward. Is that the right read? Or is that taking it too far?

Dave Schaeffer: I think, Phil, arithmetically, we're going to be above that for a couple of quarters. The Board is comfortable with that. They actually consider raising the range but felt that, that was premature at this point because they felt that the under performance of the Corporate segment was temporary, and we would end up going below the range just through natural growth and margin expansion.

Operator: I show our next question comes from the line of Brandon Nispel from KeyBanc Capital.

Evan Young: This is Evan Young on for Brandon. First, are you guys seeing or foresee any negative impacts from any geopolitical risks in the NetCentric business? And then with the speed upgrades, are you -- how much runway do you see of your 100-megabyte customers upgrading to higher speeds? And are you seeing any of the older 1 gig clients bumping up to a 10 gig [stream]?

Dave Schaeffer: Yes. So 3 different questions there. Let's start with the geopolitical question. While we do have network inside of the Ukraine, and our network extends all the way to the Russian border and [Kirk] off, it is a relatively small market for Cogent. We do sell to most of the Russian carriers, including the national incumbent. We do sell to them outside of Russia in part because of political tensions, if sanctions were put in place, we would no longer sell to those customers, honoring those sanctions.

They also represent a very small portion of Cogent's total traffic and NetCentric revenues. We have virtually no corporate business in either of those markets. So I don't think there's going to be any real direct impact that's material to Cogent. We do have 2 sales reps based in those reps have asked to relocate into the EU or at least one of them has, and we're assisting with that. But we don't see any major impact from the geopolitical uncertainty as it exists today.

Pivoting now to the port question, I really need to answer that differently for corporate and NetCentric. On the corporate side, customers are paying an incremental on average, $200 to get a larger port. In many cases, they do not need that incremental capacity but feel it is a good insurance policy, particularly as they are recognizing they will have some permanent hybrid work strategy. We've also seen many corporate customers look to add second ports at their primary location or at another location just to be able to support that hybrid work environment. So virtually all of the new sales having gigabit.

We have seen some customers go directly from 100 gigabit to 10 gigabit, and we've seen some 1 gigabit customers go to 10 gigabit. There are virtually no corporate customers that need that much bandwidth, but we do offer the service. And some of our customers are not particularly price-sensitive and are really focused on the quality that our network

delivers and are willing to pay that incremental fee to go to a 10 gigabit connection even though they don't today need it.

On the NetCentric side, the port capacity upgrades have really been an anticipation of increased traffic flows and an attempt to reduce cross-connect fees. The bigger the port size, the more you can put through it and, therefore, the less cross connects for the same amount of traffic. So just as we saw several years ago, a grooming exercise of taking multiple 10-gig interfaces and converting the 100. We're now starting to see some of our largest customers groom multiple hundreds into 400 gig interfaces. And we think that trend will continue.

Sean Wallace: I would also add just on the NetCentric side. 10-gig and 100-gig circuits across the board in 2021 given the massive growth -- unprecedented growth we had in that business, [all] grew pretty robustly.

Operator: I show our next question comes from the line of Nick Del Deo from MoffettNathanson.

Michael Srour: This is Michael Srour on for Nick. Sean, you noted a shift in your CapEx purchasing schedule. Could you discuss whether you had any issues securing here at this point? And do you feel like your inventories provide you with a sufficient buffer at this point? And how much worse would things have to get before they impacted the business?

Sean Wallace: There's no doubt that the supply chain is more difficult than it was. We have been, I think, a little bit smart, maybe a little bit lucky in that we have gone out and increased our purchases in order to get the stuff that we need. There are -- it used to be -- we could get equipment in a matter of weeks. Sometimes it's a little bit longer now, but we feel pretty comfortable given our inventory and given our constant dialogue with our vendor that we're going to be in good shape. I don't know if you want to add.

Dave Schaeffer: Yes. I think, Mike, 2 things. One, we reactivated some additional warehouse space to accommodate incremental equipment. We did spend $13 million more in 2021 and in order to bulk up that inventory in anticipation of challenges with equipment supplies. We feel very comfortable that we have an appropriate cushion.

There are still items that we're looking to increase warehouse inventory just because of the uncertainty of availability but we do not anticipate any equipment challenges to our ability to deliver service. Our backbone is only 27% utilized. We have ample metro transport capacity, but there are incremental buildings that we're adding, and we do need equipment to support those -- and then for the [pluggable] optics to support incremental customers, we've done a good job of building up a big enough inventory that we feel we can meet any of our growth projections.

Michael Srour: Got it. And 1 more, Dave, could you update us on your thinking regarding share repurchases. In the past, you've said that you launched your stock down and the market down. Are we getting closer to levels that are appetizing?

Dave Schaeffer: So we are absolutely getting closer by the day. Mr. [Putin] seems to be helping us in that regard in terms of the market. We are committed to returning capital. As we commented, we crossed the $1 billion return of capital threshold, which we think is meaningful for a company our size. We're very cognizant of tax efficiency.

The fact that we went from 63% to 79% being characterized as return of capital kind of skews us more towards dividends because that gives the recipient, the ability to defer those taxes, much in the same way a buyback does. We'll continue to evaluate it. We have an authorization. As Sean said, we have excess liquidity on the balance sheet, and we have access to incremental capital. So as markets are volatile, we will be observing that volatility and trying to monetize it.

Sean Wallace: Our last purchase as disclosed is around $57 a share, we're somewhere around close to $60. We'll see what happens.

Operator: I show our next question comes from the line of Michael Rollins from Citi.

Michael Rollins: A couple of follow-ups, if I could. First, as your corporate customers begin returning to the office, they were turning into an environment that has some macro inflation factors. I'm just curious if you're looking at trying to incorporate some of those issues into your pricing, I realize over time, Dave, you've been very consistent about this being a deflationary business.

But curious, given the environment, if there's an opportunity to adjust pricing? And then just secondly, also on the corporate segment, if you could just give us an update on the competitive landscape and how you're seeing different companies potentially change their focus as we're hearing a little bit more rumblings of SMB focus and leveraging fiber that's passing existing buildings?

Dave Schaeffer: Yes. Mike, first of all, thanks for the questions. telecom, like many technologies is long-term deflationary on a per bit basis. And that trend will continue. However, our corporate customers do not buy the service on a per bit basis. They buy it on a per connection basis. And we do experience increased ARPU when the customer moves to a 1 gig or 10 gig connection. So we are effectively raising prices by giving customers bigger ports and creating the perception that, that bigger port gives them more flexibility in a hybrid environment. It's also important to note to your competitive question, we are uniquely positioned in 2 respects. One, we have already prewired the [riser] with fiber.

So it makes the ability to deliver 1 gig and 10 gig services much easier for Cogent than our competitors. Secondly, many of our competitors have not entered into building license agreements, such as we have and invested the capital to prewire. So even if they have fiber passing in front of building, the $50,000, $60,000 expense for riser work coupled with the need to secure a license agreement [disincents] them from prewiring the

building, and our ability to quickly turn up 1 gig and 10 gig services is a true competitive differentiator.

We've seen most broadband competition from cable and that tends to be in our suburban off-net locations. In fact, we buy a lot of services from cable where their plant is strong. But in the central business districts, cable has been not very aggressive in pre-wire buildings and converting the fiber, they are still trying to get additional returns out of their HFC plant and that coax is just not conducive to 1 gig and 10 gig services even with DOCSIS 3.1. And of course, it's an asymmetric service and usually metered. And cable companies don't generally have the best reputation for customer service.

We pride ourselves in the fact that we have a Net Promoter Score from our customers in the mid-60s. We answer phones with a domestic engineer in less than 20 seconds. These are key differentiators. As fiber overbuilds occur, some of the phone companies, they have been more focused on the residential market. So we just have not seen the level of competition in our corporate footprint that concerns us. Our biggest concern is just getting businesses back to their offices. Thanks.

Operator: I'm showing no further questions in the queue. At this time, I would like to turn the call back to Mr. Dave Schaeffer, Chairman and Chief Executive Officer for closing remarks. Please go ahead.

Dave Schaeffer: First of all, I want to thank everyone for their time. I hope everyone continues to stay safe. And we look forward to being able to give you better results on our corporate business as businesses begin to have their teams return to the office. Take care, everyone, and stay safe. Bye-bye.

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