

VONAGE HOLDINGS CORP  
Form 10-K  
February 12, 2016  
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION • WASHINGTON, D.C. 20549

FORM 10-K

|   |    |   |
|---|----|---|
| <input checked="" type="checkbox"/> Annual Report Pursuant to Section 13 or<br>15(d) of The Securities Exchange Act of<br>1934<br><br>For the fiscal year ended December 31, 2015 | or | <input type="checkbox"/> Transition Report Pursuant to Section 13 or<br>15(d) of The Securities Exchange Act of<br>1934<br><br>For the transition period from            to |
|---|----|---|

Commission file number 001-32887  
VONAGE HOLDINGS CORP.

(Exact name of registrant as specified in its charter)

|   |  |
|---|--|
| Delaware<br>(State or other jurisdiction of<br>incorporation or organization) | 11-3547680<br><br>(I.R.S. Employer Identification No.) |
|---|--|

|   |                         |
|---|-------------------------|
| 23 Main Street, Holmdel, New Jersey<br>(Address of principal executive offices) | 07733<br><br>(Zip Code) |
|---|-------------------------|

Registrant's telephone number, including area code: (732) 528-2600

|   |   |
|---|---|
| Securities registered pursuant to Section 12(b) of the Act: |   |
| Title of each class   | Name of each exchange on which registered |
| Common Stock, Par Value \$0.001 Per Share                   | The New York Stock Exchange               |
| Securities registered pursuant to Section 12(g) of the Act: |   |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Edgar Filing: VONAGE HOLDINGS CORP - Form 10-K

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Check one:

Large accelerated filer  Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant at June 30, 2015 was \$853,221,593 based on the closing price of \$4.60 per share.

The number of shares outstanding of the registrant's common stock as of January 31, 2016 was 213,978,306.

Documents Incorporated By Reference

Selected portions of the Vonage Holdings Corp. definitive Proxy Statement, which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2015, are incorporated by reference in Part III of this Form 10-K.

---

Table of Contents

VONAGE HOLDINGS CORP.  
 FORM 10-K  
 FOR THE FISCAL YEAR ENDED December 31, 2015

## TABLE OF CONTENTS

|   | Page       |
|---|------------|
| PART I  |            |
| Item 1. <u>Business</u>   | <u>2</u>   |
| Item 1A. <u>Risk Factors</u>  | <u>9</u>   |
| Item 1B. <u>Unresolved Staff Comments</u>   | <u>17</u>  |
| Item 2. <u>Properties</u>   | <u>18</u>  |
| Item 3. <u>Legal Proceedings</u>  | <u>19</u>  |
| Item 4. <u>Mine Safety Disclosures</u>  | <u>21</u>  |
| PART II   |            |
| Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | <u>22</u>  |
| Item 6. <u>Selected Financial Data</u>  | <u>24</u>  |
| Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>                        | <u>33</u>  |
| Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | <u>45</u>  |
| Item 8. <u>Financial Statements and Supplementary Data</u>  | <u>46</u>  |
| Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | <u>46</u>  |
| Item 9A. <u>Controls and Procedures</u>   | <u>46</u>  |
| Item 9B. <u>Other Information</u>   | <u>47</u>  |
| PART III  |            |
| Item 10. <u>Directors, Executive Officers and Corporate Governance</u>  | <u>48</u>  |
| Item 11. <u>Executive Compensation</u>  | <u>48</u>  |
| Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>              | <u>48</u>  |
| Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>                                   | <u>48</u>  |
| Item 14. <u>Principal Accountant Fees and Services</u>  | <u>48</u>  |
| PART IV   |            |
| Item 15. <u>Exhibits, Financial Statement Schedules</u>   | <u>49</u>  |
|   | <u>54</u>  |
|   | <u>F-1</u> |

## FORWARD-LOOKING STATEMENTS

VONAGE ANNUAL REPORT 2015

---

Table of Contents

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains statements and other information which are deemed to be “forward-looking” within the meaning of the Private Securities Litigation Reform Act of 1995 (the “Litigation Reform Act”). These forward-looking statements and other information are based on our beliefs as well as assumptions made by us using information currently available.

The words “plan,” “anticipate,” “believe,” “estimate,” “expect,” “intend,” “will,” “should” and similar expressions, as they relate to us, are intended to identify forward-looking statements. Such statements reflect our current views with respect to

future events, are subject to certain risks, uncertainties, and assumptions, and are not a guarantee of future performance. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in such forward-looking statements or information.

In light of the significant uncertainties in these forward-looking statements, you should not place undue reliance on these forward-looking statements. The forward-looking statements and information contained in this Annual Report on Form 10-K relate to events and state our beliefs and the assumptions made by us only as to the date of this Annual Report on Form 10-K. We do not intend to update these forward-looking statements, except as required by law.

In accordance with the provisions of the Litigation Reform Act, we are making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors that could cause actual results to differ materially from those contemplated by the forward-looking statements contained in this Annual Report on Form 10-K, any exhibits to this Form 10-K and other public statements we make. Such factors include, but are not limited to: the competition we face; the expansion of competition in the unified communications market; our ability to adapt to rapid changes in the market for voice and messaging services; our ability to retain customers and attract new customers; the risk associated with developing and maintaining effective internal sales teams; the risk associated with developing and maintaining effective distribution channels; risks related to the acquisition or integration of future businesses; security breaches and other compromises of information security; risks associated with sales of our UCaaS services to medium-sized and enterprise customers; our dependence on third party facilities, equipment, systems and services; system disruptions or flaws in our technology and systems; our ability to scale our business and grow efficiently; our reliance on third party hardware and software; our dependence on third party vendors; the impact of fluctuations in economic conditions, particularly on our small and medium business customers; our ability to obtain or maintain relevant intellectual property licenses; intellectual property and other litigation that have been and may be brought against us; failure to protect our trademarks and internally developed software; obligations and restrictions associated with data privacy; uncertainties relating to regulation of VoIP services; results of regulatory inquiries into our business practices; fraudulent use of our name or services; our ability to establish and expand strategic alliances; risks associated with operating abroad; liability under anti-corruption laws; governmental regulation and taxes in our international operations; our dependence upon key personnel; our dependence on our customers' existing broadband connections; restrictions in our debt agreements that may limit our operating flexibility; our ability to obtain additional financing if required; any reinstatement of holdbacks by our vendors; our history of net losses and ability to achieve consistent profitability in the future; and other factors that are set forth in the “Risk Factors” section and other sections of this Annual Report on Form 10-K, as well as in our Quarterly Reports on Form 10-Q and Current Reports on Form 8-K.

FINANCIAL INFORMATION PRESENTATION

For the financial information discussed in this Annual Report on Form 10-K, other than per share and per line amounts, dollar amounts are presented in thousands, except where noted. All trademarks are the property of their owners.



Table of Contents

PART I

ITEM 1. Business

OVERVIEW AND STRATEGY

OVERVIEW

We are a leading provider of cloud communications services for businesses and consumers, offering a robust suite of feature-rich consumer and business communication solutions that offer flexibility, portability and ease-of-use across multiple devices.

Business Services

For our business services customers, we provide innovative, cloud-based Unified Communications as a Service, or UCaaS, solutions, comprised of integrated voice, text, video, data, collaboration, and mobile applications over our flexible, scalable Session Initiation Protocol (SIP) based Voice over Internet Protocol, or VoIP, network. Our products and services permit these customers to communicate with their customers and employees through any cloud-connected device, in any place, at any time without the often costly investment required with on-site equipment. We have a robust set of product families tailored to serve the full range of the business market, including the small and medium business, or SMB, mid-market, and enterprise segments. We provide customers with multiple deployment options, designed to provide the reliability and quality of service they demand. Through our cloud-based middleware solution, gUnify, we provide customers the ability to integrate our cloud communications platform with many SaaS business applications, including Google for Work, Zendesk, Salesforce's Sales Cloud, Clio, and other CRM solutions.

During 2015, we organized our business solutions to support the full range of business customer, using two product families: Vonage Essentials, based on our proprietary call processing platform that is purpose-built for SMB and mid-market customers; and Vonage Premier, based on Broadsoft's call processing platform in combination with other Vonage cloud based solutions, which serves larger customers, from mid-market businesses through large enterprises. We also organized our salesforce to address the full business market, delivering the right products to the right customer. We believe operating two platforms at scale enables us to deliver the right products and solutions to address the needs of diverse customers while maximizing our subscriber economics regardless of segment served. Revenues are generated primarily through the sale of subscriptions for our UCaaS services. Our revenue generation efforts are focused on customer acquisition and retention as well as providing additional services to existing customers as they grow and scale.

Our diverse customer base spans multiple industries, including manufacturing, automotive, legal, information technology, financial services, construction, real estate, engineering, healthcare, and non-profit.

**Vonage Essentials.** Vonage Essentials customers subscribe to our cloud-based communication services, delivered through our proprietary platform that is purpose-built for SMB and mid-market customers. Essentials provides a cost-effective, scalable, feature-rich solution, delivered over-the-top of a customer's broadband, typically month-to-month without a commitment. Vonage Essentials is sold primarily through our direct telesales and online channels, and is increasingly sold through our channel partners and field sales teams. We believe the strength of the Vonage brand directly contributes to a lower-cost customer acquisition model and provides attractive subscriber economics.

**Vonage Premier.** Our Vonage Premier offerings are tailor-made for the large mid-market and enterprise segments. Vonage Premier is a feature-rich/fully managed solution that utilizes Broadsoft

Inc.'s ("Broadsoft") enterprise-grade call processing platform, in combination with other Vonage cloud services like advanced contact center, video conferencing, speak2dial, infrastructure as a service (IaaS), and Virtual Desktop Infrastructure (VDI), and can be provided with high-level QoS, which is generally delivered over our national MPLS network, with 21 network Points of Presence (POPs) across the country. Customers value our proprietary provisioning

and feature-management tool, named Zeus, which enables the rapid deployment of solutions directly by Vonage while giving full visibility to our channel partners and our customers. Further differentiating Vonage is our robust service delivery team comprised of team members specializing in project management, voice and data provisioning, and line number porting. This team is intensely focused on providing an outstanding customer experience, and is rapidly becoming a competitive differentiator.

Our Vonage Premier offering is sold through our channel partners, and our field and enterprise sales teams, and generally requires a three-year contract. We are a preferred provider for many of the largest master agents in the country, harnessing a network of over 20,000 sub agents selling both Vonage Premier and Vonage Essentials. We believe we have one of the largest multi-channel distribution sales platforms in our industry to serve the full range of business customers. We plan to capitalize on the growing adoption of cloud-based communications and collaboration solutions by continuing to expand our salesforce, expand into new markets, and enhance our relationships with existing customers to provide additional functionality and overall business value that can be achieved with our UCaaS platform.

#### Consumer Services

For our consumer services customers, we enable users to access and utilize our UCaaS services and features, via a single “identity,” either a number or user name, regardless of how they are connected to the Internet, including over 3G, LTE, Cable, or DSL broadband networks. This technology enables us to offer our consumer services customers attractively priced voice and messaging services and other features around the world on a variety of devices.

Our consumer services strategy is focused on the continued penetration of our core North American markets, where we will continue to provide value in international long distance and target under-served ethnic segments.

International long distance. As a part of our strategy, our primary focus in our domestic markets is serving the under-served ethnic segments in the United States with international calling needs. The markets for international long distance allow us to leverage our VoIP network by providing customers a low-cost and feature-rich alternative to services offered by telecom, cable, and international calling card providers. With our Vonage World product, we have successfully grown our international calling customer base in multiple ethnic markets.

To increase the visibility of our long distance plans, we have shifted an increasing portion of our marketing budget from broad national advertising as we target attractive segments of the international long distance market. We have inside sales channels where customers can subscribe to our services on-line or through our toll-free number, as well as a retail distribution channel through regional and national retailers.

For both our North American and international customers we provide mobile capability through our patented Vonage Extensions mobile app. Our mobile applications enable consumer services customers to make and receive phone calls on their mobile devices from anywhere they have a Wi-Fi or cellular data connection. Our customers have found value in our ability to deliver high-quality voice solutions coupled with useful features and services.

## Table of Contents

We generate revenue through the acquisition and retention of consumer services customers. We are focused on optimizing the consumer services business by increasing profitability to improve the strong cash flows of the business. Our focus on operations during the past five years has led to a significantly improved cost structure. We have implemented operational efficiencies throughout our business and have substantially reduced domestic and international termination costs per minute, as well as customer care costs. We achieved these structural costs reductions while concurrently delivering significantly improved network call quality and customer service performance. These improvements in customer experience have contributed to the stabilization in churn over recent periods. During 2015, we continued our disciplined focus on marketing efficiency by shifting customer acquisition spend to our higher performing channels, improving the quality of customers we acquire and driving lower churn, all of which drive higher customer life-time value. This focus has led to a reallocation of certain marketing spend to direct response and digital platforms and away from our assisted selling channel, which utilized direct face-to-face selling across multiple retail chains and community and event venues.

The result of these initiatives has been to create a strong cash flow business which provides financial stability, as well as cost synergies and structural advantages to our business serving the UCaaS business market.

Services outside of the United States. We currently have operations in the United States, United Kingdom, and Canada and believe that our low-cost Internet based communications platform enables us to cost effectively deliver voice and messaging services to other locations throughout the world. In December 2014 we announced plans to exit the Brazilian market for residential telephony services and wind down our joint venture operations in the country. The Company completed this process at the end of the first quarter of 2015. This decision underscores the Company's focus on providing UCaaS solutions to domestic consumer services and SMB, medium and large enterprise customers, which offer higher investment return opportunities.

Information on our revenues, operating income, and identifiable assets appears in Note 1 to our consolidated financial statements included in Item 8 hereof.

We had approximately 2.5 million combined consumer subscriber lines and business seats as of December 31, 2015, of which 93% were in the United States. We also have customers in Canada and the United Kingdom.

## SERVICE OFFERINGS

### Business Services

We provide a robust feature-rich range of communication services enabling businesses to interact with their customers, prospects and partners in a more efficient and effective manner. We provide services ranging from basic dial tone to services such as call queue, conferencing, call groups, mobile functionality, CRM integration, and detailed analytics - allowing our customers a high level of visibility into their business at prices that are often significantly lower than that of traditional on premises solutions. These services can be delivered over-the-top of the customers' existing connectivity or bundled through our private MPLS connectivity service. Today more than over 514,000 business seats rely on Vonage to meet their communication needs, putting Vonage in a leading position within the UCaaS space. Our services are delivered through either proprietary networks or through trusted third parties to ensure our offerings provide all of the critical functions business needed for one of their most important business tools.

Vonage Essentials. Vonage Essentials is targeted to smaller customers and utilizes our proprietary call processing platform, which is purpose built for SMB customers to deliver cloud-based communication services. It provides a cost-effective, scalable, feature-rich solution, delivered over-the-top of a customer's broadband. We

offer a number of service plans which include basic metered extensions to unlimited calling plans. Our standard lines come fully functional with numerous standard features. Unlimited Extensions is our most popular business service plan. Under this plan businesses can make flat rate, unlimited domestic calls (U.S. and Canada) each month. As of December 31, 2015, over 95% of our business customers were on an unlimited usage domestic calling plan. SMBs may also choose metered extension plans under which they are charged per-minute usage for both domestic and international calls. This plan is primarily used by customers with temporary or seasonal workers to save resources where phones are not heavily used during the workday.



Our standard features include: Admin Portal, Call Announce, Call Continuity, Call Screening, Call Waiting, Caller ID, Directory Assistance (411), Dynamic Caller ID, Emergency Assistance (911), Do Not Disturb, Multiple Devices on One Extension, Set Caller ID, Seven-Digit Dialing, Voicemail, Call Continuity, Work From Anywhere, Cell Phone Integration, Vonage Business Mobile, Never Miss a Call, Web Portal Interface, and Call Pass.

In addition to our standard functionality we have a number of add-on services for an additional monthly fee, including: Paperless Fax, Call Group, Call Queue, Conference Bridge, Main Company Number, Toll Free Number, Local or Geographic Number, Voicemail Transcription, On-Demand or Company Call Recording Service, Call Monitoring Services with Listen, Whisper and Barge, and Paging Groups.

All of our Vonage Essentials offerings allow free access to our mobile application. The mobile application allows users to choose WiFi, 3G and 4G and the extended features provide caller ID as if the user were calling from their office. Additional features include the ability to update account profiles, manage devices, and contact call logs directly from their mobile devices. We also offer virtual extensions, which connects employees to a business phone number through their mobile phones. A virtual extension is an additional dedicated direct dial number forwarded to the employee's mobile phone number, allowing employees to be reached from anywhere.

Vonage Premier. Vonage Premier is a purpose-built cloud based platform for mid-market and enterprise customers, providing a complete set of enhanced unified communication and collaboration services, including: voice, data, video, mobile and contact center services. We focus on customers for whom guaranteed quality of service and uniformity of services across all locations is critical. We deliver services to this customer base over our private, nation-wide, fully redundant, secure IP MPLS network using 21 network POPs that allow us to deliver dedicated, secure and private bandwidth utilizing all forms of last mile technologies including T1, NxT1, EoC and Fiber and bandwidth ranging from 1.5Mbps to 1Gbps. Services we deliver include Wide Area Networking (WAN), Internet Access, MPLS VPN, Managed Firewall, Hosted UCaaS, Hosted Video Conferencing, Web Collaboration, Secure Instant Messaging & Presence, Mobility and Fixed Mobile Convergence, and Hosted Contact Center.

Vonage Premier services include advanced features such as Single Number Reach (which provides each user one number, available over numerous devices including desk phones, tablets and smartphones), Shared Line Appearance, Busy Lamp Field, Phone Paging, Outlook Integration, IM, Presence, and Video. Vonage also delivers Session Initiation Protocol (SIP) Trunking, over the same network, to customers using premises PBXs, with the ability to overlay UCaaS features where the premises PBX is deficient or for disaster recovery and business continuity requirements. This product also supports a hybrid deployment where some locations may be fully hosted and others may continue to use the premises PBX. Vonage Premier customers also have the ability to utilize our gUnify middleware layer to integrate communications with the core, Software-as-a-Service (SaaS)-based business applications that companies use as part of their every-day workflow, such as Google for Work, Salesforce, Zendesk, and others.

Vonage Premier customers also receive access to a custom-built portal through which they can fully administer all services, online bill pay, manage trouble tickets, manage bandwidth and services, access detailed Call Analytics, and execute Moves, Adds and Changes.

## Table of Contents

### Consumer Services

Our home telephone replacement services are offered to customers through several service plans with different pricing structures. The service plans include basic features such as voicemail, call waiting, and call forwarding as well as unique features such as Simulring, Visual Voicemail and Extensions. We also charge for local and international calling outside of plan limits.

We have two primary consumer services offerings: Vonage World and Vonage North America. For a flat monthly fee, Vonage World customer plans include unlimited domestic calling (U.S., Canada, and Puerto Rico) and unlimited calling to landline phones in more than 60 countries, including India, Mexico, and China, and unlimited calling to mobile phones in certain of those countries. The Vonage North America plan includes unlimited calling across the U.S., Canada, Mexico and Puerto Rico. Each of our consumer services calling plans provides a number of basic features including call waiting, caller ID with name, call forwarding, and voicemail. Our plans also include unlimited Vonage Visual Voicemail, which is “readable voicemail” delivered via email or SMS text message, Vonage Extensions, which extends the plan, and in-bound calling, to additional phone numbers and devices, and selective call block, which allows users to block unwanted calls. We also offer, in some cases for additional fees, features such as area code selection, virtual phone number, and web-enabled voicemail.

Our mobile services include enhancements to our consumer services calling plans as well as mobile applications that can be initially downloaded for iPhone ® , iPad ® , iPod touch ® , and Android ® OS devices for free.

In order to access our consumer services, a customer need only connect a standard telephone to a broadband Internet connection through a small Vonage-enabled device. In order to access our SMB services, a customer need only connect through a VoIP-enabled telephone. After connecting the device, our customers can use their telephone to make and receive calls. Vonage-enabled devices allow customers to use the Internet connection for their computer and telephones at the same time while ensuring a high quality calling experience. We also offer a cordless multi-phone system solution. Our plug-and-play Vonage-enabled devices permit portability as customers can take their Vonage device to different locations where broadband service is available. We generally have not charged new customers for the adapters permitting use of our service.

### NETWORK OPERATIONS

The Vonage network uses our customer’s existing high-speed broadband Internet service to allow calls over the Internet either from a standard telephone through a Vonage-enabled device or through soft phone software or mobile client applications. Our UCaaS services are not dependent on any specific type or provider of Internet service, and our customers are free to change their Internet service provider in response to a competitive alternative, or because they have moved to a different location. For many of our Vonage Premier customers, our UCaaS services are delivered over the Company’s private, nation-wide, fully redundant, secure IP MPLS network under multi-year contracts to provide the high level of interconnection quality and the ability to offer service level agreements (SLA) guaranteeing certain levels of voice service performance.

Our network is scalable and geographically distributed for robustness, high availability, and reliability across multiple call processing sites, using regional data interconnection points, where calls to non-Vonage customers are interconnected with the public switched telephone network. We periodically assess the locations of our regional data connection points in connection with efforts to improve the quality of and efficiency in delivering our service. In 2015, we consolidated certain interconnection points, increasing efficiencies. Our interconnections with the public switched telephone network, or IP/SIP networks, are made pursuant to commercial agreements we have with several telecommunications providers. Under these agreements, we transfer calls originated by our customers to other carriers who connect

the call to the called party or connect peer to peer. We have a varying degree of settlement arrangements with our carrier partners for indirect third party or direct termination of our calls. The calls are routed from our network to other carriers’ interconnected circuits at co-location facilities in which we lease space. This method of connecting to the public switched telephone or IP/SIP networks allows us to expand capacity quickly, as necessary to meet call volume, and to provide redundancy within our network. In 2015, we continued to enhance our call routing platform, increasing

our control over call routing which lowered costs and improved call quality.

Because Vonage's system is not constrained to use any specific broadband service provider to connect to our customers, we can centrally manage and share resources across our customer base to minimize capital investment when entering new markets.

The following are also important in supporting our network operations:

- Network Operations Center. We currently maintain a network operations center at our headquarters with monitoring redundancies at several points within our network. The network operations center monitors and manages the status and health of our network elements, allowing us to manage our network in real time, respond to alert notifications, and re-route network traffic as needed. We pursue a multi-faceted approach to managing our network to ensure high call quality and reliable communications services to our customers. For business services customers, we have operational centers on-site to monitor and manage network access traffic. We may consolidate these network operations centers in the future if greater efficiencies can be obtained.

- Back Office Systems. In addition to our network management systems, we have developed a number of software systems that enable us to manage our network and service offerings more efficiently and effectively. Key aspects of these systems include:

- Network Quality Metrics. We have implemented a suite of advanced Big Data analysis tools that allow us to monitor and troubleshoot the performance of our calling and data network, customer premises equipment, and other associated calling elements in near real-time. This suite is proprietary and was developed specifically to address the needs that Vonage has in monitoring, analyzing, understanding, troubleshooting, maintaining, and operating a world-class consumer VoIP platform.

- Web Portal. We provide a fully functional customer Web portal that allows our customers to configure and manage almost all aspects of their service on the Internet without requiring intervention of a customer-care representative. The portal permits customers to add and change features and phone numbers, update billing information, and access call usage and billing details.

- Emergency Calling Service and Enhanced 911 Service. We have deployed E-911 service to approximately 99.99% of our U.S. consumer and small and home office customer base that is comparable to the emergency calling services provided to customers of traditional wireline telephone companies in the same area. Our E-911 service does not support the calls of our soft phone software users. The emergency calls of our soft phone software users are supported by a national call center. Not all Vonage products require 911 service capabilities, such as our mobile client products but we are fully compliant with FCC E911 requirements for VOIP Interconnected providers. To enable us to effectively deploy and provide our E-911 service, we maintain an agreement with a provider that assists us in delivering emergency calls to an emergency service dispatcher at the public safety answering point, or PSAP, in the area of the customer's registered location and terminating E-911 calls. We also contract for the national call center that operates 24 hours a day, seven days a week to receive certain emergency calls and for the maintenance of PSAP databases for the purpose of deploying and operating E-911 services. The databases include contact, technical infrastructure, boundary, and routing information for delivery of calls to a PSAP or emergency service providers in the United States.

## Table of Contents

- Local Number Portability. Our system allows our telephone replacement customers to port telephone numbers, which allows new customers to retain their existing telephone numbers when subscribing to our services. We rely on agreements with two service providers to facilitate the transfer of customer telephone numbers. In addition, we have engaged a provider that performs the third party verification of pertinent local number portability information from our subscribers prior to porting a customer from a local telephone company to us.
- Security. We have developed a service architecture and platform that uses industry-standard security techniques and allows us to remotely manage customer devices. Any Vonage-enabled device used by our customers can be securely managed by us, and these devices use authentication mechanisms to identify themselves to our service in order to place and receive calls. We regularly update our protocols and systems to protect against unauthorized access. As discussed in "Item 1A Risk Factors", security breaches and other cybersecurity or technological risks could compromise our information, systems and network and expose us to liability, which could have a material adverse effect on our business, financial condition, and operating results.
- Internet Protocol (IP) Addresses. Every machine on the Internet has a unique identifying number called an Internet Protocol address or IP address. Though there has been recent publicity surrounding the exhaustion of IP addresses under the current Internet Protocol version, we have procured a supply of addresses that we believe will cover our needs for the foreseeable future.

## MARKETING

Our marketing objective is to grow subscriber lines and seats by cost-effectively acquiring and retaining customers. We employ an integrated multi-channel approach to marketing, whereby we evaluate and focus our efforts on efficient marketing vehicles to accomplish our goals. To do this, we make use of both broad-reaching and highly-targeted media channels in the general market and for specific international long distance markets, including television, direct mail, online, alternative media, telemarketing, partner marketing, and customer referral programs. We regularly evaluate the cost per acquisition by media vehicle and reallocate budgets to identify more effective media mixes. For our business customers our primary marketing activities include: search engine marketing and advertising, user conferences and launch events, trade shows and industry events, use of social network solutions such as LinkedIn and YouTube, and field marketing events.

We make use of marketing research to gain consumer insights into brand, product, and service performance, and utilize those learnings to improve our messaging and media plans. Market research is also leveraged in the areas of testing, retention marketing, and product marketing to ensure we bring compelling products and services to market for our customers.

We believe our brand is a meaningful factor for customers as they consider UCaaS services. We invest in our brand in order to retain and expand our customer base and to position Vonage as a technology leader that delivers innovative, unified communication services, serving the full range of businesses and Enterprises. We expect these investments to continue as we further establish Vonage as a leading business services brand.

## SALES AND DISTRIBUTION

### Inside Sales

Customers can subscribe to our consumer services at our websites, <http://www.vonage.com>, <http://www.vonage.ca>, <http://www.vonage.co.uk> and several affiliate websites, or through multiple toll free numbers including 1-877-4VONAGE. Business customers can subscribe to our Essentials and Premier services at our websites,

including <https://business.vonage.com/>, <http://www.vonagebusiness.com>, and <https://enterprise.vonage.com>, or through toll free numbers including 1-877-862-2562 and 1- 855-593-7326.

### Field Sales

We utilize our team of over 145 sales agents, primarily based in geographic territories comprising customers and prospects, which we refer to as our field sales team, to market and sell our UCaaS business services. These field sales agents utilize a consistent, automated, highly-structured sales process to effectively educate prospective customers regarding our UCaaS services. We have developed a scalable model applicable to both existing and new markets. We

now have sales offices throughout the United States,.

#### Channel Sales

In addition to inside sales and our field sales team, we also have a dedicated team focused on channel sales who work with our channel partners to market and sell our UCaaS business services, which helps to broaden our sales distribution. In 2015, we continued to develop and expand this channel program by adding new senior management, channel managers, and additional national master agents. We now have a broad and deep coverage of the U.S. market through a network of over 20,000 sub agents and resellers.

#### Enterprise Sales

In order to continue to expand in the Enterprise segment, which we define as businesses larger than 1,000 seats, in 2015 we implemented our enterprise sales organization to directly address this growing market, as it increasingly shifts to UCaaS products and services. We are uniquely positioned to provide high quality UCaaS services for Enterprise, through our fully managed solution, which utilizes BroadSoft's enterprise-grade call processing platform, with a broad portfolio of products delivered over our own private, national MPLS network, with 21 Points-of-Presence (POPs) across the country and our own team of service delivery project managers using our proprietary provisioning tool Zeus.

We now have an experienced, skilled, team to focus exclusively on addressing this growing segment of the UCaaS market.

#### Retail Sales

In addition to our inside sales channel, we also offer our consumer services through our retail channel. In 2015, as part of our continued efforts to lowering customer acquisition costs, we shifted our retail strategy to a grab-and-go strategy within large retailers to better leverage the strength of the Vonage brand. We believe that the availability of our services through premier retailers, with well-located shelf placement increases our ability to acquire mainstream consumers by reaching them in a familiar and interactive shopping environment. National and regional retailers provide Vonage with a wide footprint to distribute our service. Concurrently, we have also reduced our use of the assisted-selling face-to-face channel, which had a higher customer acquisition cost.

#### Customer Support

**Consumer Services.** We offer our customers support 24 hours a day, seven days a week through both our comprehensive online account management website and our toll free number. Many customers use our self-service website when they have a question or problem with their service and are able to resolve their concerns online without needing to speak to a customer care representative. Our customers can manage almost all aspects of their accounts online. This capability empowers our customers through self-service and reduces our customer care expenses. Customers who cannot or do not wish to resolve their questions through our website may contact a customer care representative through our toll free number. We staff our customer care organization through a combination of our own employees and outsourced customer care representatives. All new customer care representatives are trained through an established program developed by Vonage. We also have a separate team that provides advanced

## Table of Contents

technical support for resolving customers' complex issues. We use extensive monitoring of call quality and customer satisfaction scores to determine additional training or coaching requirements for individual associates and to drive continuous improvement in our processes, policies, and technology. We offer support in English, Spanish, Tagalog and French Canadian.

**Small and Medium Businesses.** We have specialized teams of customer care representatives to work with customers in every stage of their life cycle, including porting specialists to transfer (port) existing phone numbers, an order entry team to help customers bring their new phone system online, as well as billing and product specialists. Customers can also utilize our extensive online support resources, complete with cataloged feature descriptions, how-to videos and other key resources to help them enable the many system features.

Additionally, our representatives have ready access to a full support team - from technical support pros and billing specialists, to engineers and product experts.

**Medium and Large Enterprise.** Our larger business customers benefit from a robust service delivery team comprised of team members specializing in project management, voice and data provisioning, and line number porting.

### **Billing**

All customer billing for our communication services is automated. We bill in advance for monthly recurring services and fees. We collect all fees from our customers' credit card, debit card, checks, wire transfer, ACH or electronic check payment ("ECP"). All usage related charges are billed no more than 30 days in arrears. By collecting monthly subscription fees in advance and certain other charges within the same billing cycle as they are incurred, we are able to reduce the amount of accounts receivable that we have outstanding, thus allowing us to have lower working capital requirements. Collecting in this manner also helps us mitigate bad debt exposure, which is recorded as a reduction to revenue. If a customer's payment is declined or returned we generally suspend services. Historically, in most cases, we are able to correct the problem with the customer within the current monthly billing cycle. Generally, for our consumer services, if the customer's credit card, debit card or ECP cannot be successfully processed during three billing cycles (i.e. the current and two subsequent monthly billing cycles), we terminate the account. For customers in grace or suspend status we have enabled one-time cash payments through an arrangement with MoneyGram.

Generally, for our Essentials customers, we will make several attempts to collect payment. If after approximately, fifteen days we have not successfully collected the balance due, the customer's account services are suspended. If after 30 days the account is still in a suspended status, the account is cancelled. Generally, for our Premier customers, if after 60 days we have not successfully collected the balance due, the customer's account services are suspended. If after 7 additional days the account is still in a suspended status, the account is cancelled.

### **INTELLECTUAL PROPERTY**

We believe that our technological position depends primarily on the experience, technical expertise, and creative ability of our employees. We routinely review our technological developments with our technology staff and business units to identify the aspects of our technology that provide us with a technological or commercial advantage and file patent applications as necessary to protect our technology in the United States and internationally. Our company policies require our employees to assign their intellectual property rights to us and to treat proprietary know-how and materials as our confidential information.

In addition to developing technology and intellectual property, we evaluate for potential licensing and acquisition technology and intellectual property of third parties to identify opportunities that may provide us with a strategic or commercial advantage in exchange for royalties or other consideration. As a result of these efforts, we have

acquired multiple U.S. and foreign patents, and obtained licenses to numerous other patents. From time to time we receive letters from third parties inviting us to obtain patent licenses that might be relevant to our business. From time to time, we also have become involved in litigation alleging that our products or services infringe on third party patents or other intellectual property rights. See "Item 3. - Legal Proceedings-IP Matters."

We are the owner of numerous United States and international trademarks and service marks and have applied for registration of our trademarks and service marks in the United States and abroad to establish and protect our brand names as part of our intellectual property strategy. Examples of our registered marks include Vonage®, Vonage

Mobile®, and Vonage Extensions®.

We endeavor to protect our internally developed systems and technologies and maintain our trademarks and service marks. Typically, we enter into confidentiality agreements with our employees, consultants, customers, and vendors in an effort to control access to and distribution of our technology, software, documentation, and other information.

#### COMPETITION

We face continued strong competition from traditional telephone companies, cable companies, wireless companies, and alternative communication providers in the consumer, mobile, SMB and enterprise markets. Because most of our target customers are already purchasing communications services from one or more of these providers, our success is dependent upon our ability to attract these customers away from their existing providers. We believe that the principal competitive factors affecting our ability to attract and retain customers are price, call quality, brand awareness, customer service, network and system reliability, service features and capabilities, scalability, usability, simplicity and mobile integration.

##### Traditional telephone and cable companies

The traditional telephone and cable companies are our primary competitors for our broadband telephone services. Traditional telephone companies in particular have historically dominated their regional markets. These competitors include AT&T, Verizon and CenturyLink, as well as rural incumbents such as Frontier Communications. Cable company competitors include companies such as Cablevision, Charter Communications, Comcast Corporation, Cox Communications, and Time Warner Cable. These traditional phone and cable company competitors are substantially larger and better capitalized than we are and have the advantage of a large existing customer base. Many of these competitors are continuing to make substantial investments in delivering broadband Internet access, VoIP phone service, and cable television to their customers and they often have larger product development and marketing budgets than us. Providing home phone, Internet access, and cable television to many of our existing and potential customers may enhance their image as trusted providers of services.

The traditional phone and cable companies own networks that include a “last mile” connection to substantially all of our existing and potential domestic customers as well as the places our customers call domestically. As a result, the vast majority of the calls placed by a Vonage customer are carried over the “last mile” by a traditional phone company, and we indirectly pay access charges to these competitors for each of these calls. In contrast, traditional wireline providers do not pay us when their customers call our customers.

Cable companies and, in many cases traditional phone companies, are also aggressively using their existing customer relationships to bundle services. For example, they bundle Internet access, cable television, and home phone service with an implied price for the phone service that may be significantly below ours. In addition, such competitors may in the future require new customers or existing customers making changes to their service to purchase voice services when purchasing high speed Internet access. Certain traditional phone companies are also able to bundle wireless telephone service. Many of

Table of Contents

these competitors are able to advertise on their local access channels with no significant out-of-pocket cost and through mailings in bills with little marginal cost. They also receive advertising time as part of their relationships with television networks and are able to use this time to promote their telephone service offerings.

Traditional phone and cable companies' ownership of Internet connections to our customers could enable them to detect and interfere with the completion of our customers' calls. While we are not aware of any such occurrence, it is unclear whether current regulations would permit these companies to degrade the quality of, give low priority to or block entirely the information packets and other data we transmit over their lines. In addition, these companies may attempt to charge their customers more for using our services.

Many traditional phone and cable companies routinely send technicians to customers' premises to initiate service. Although this is expensive, it also can be more attractive to customers than installing their own router. In addition, these technicians may install an independent source of power, which can give customers assurance that their phone service will not be interrupted during power outages.

The traditional phone and cable companies have long-standing relationships with regulators, legislators, lobbyists, and the media. This can be an advantage for them because legislative, regulatory or judicial developments in our rapidly evolving industry could have a negative impact on us.

In many cases, we charge prices that are lower than prices charged by the traditional phone and cable companies. We believe that we also currently compete successfully with the traditional phone and cable companies on the basis of the features we offer that they may not (such as area code selection, portable service, virtual phone numbers, and readable voice mail). We offer many of these features at no extra charge.

**Wireless telephone companies**

We also compete with wireless phone companies, such as AT&T, Sprint, T-Mobile, and Verizon Wireless, for both our broadband telephone services, international long distance, and our mobile services. Some consumers use wireless phones, instead of VoIP phones, as a replacement for a wireline phone. Also, wireless phone companies increasingly are providing wireless broadband Internet access to their customers. As wireless providers offer more minutes at lower prices and other services that improve calling quality, their services have become more attractive to households as a competitive replacement for wireline service. In addition, wireless providers are also offering standalone wireless home services as well as the ability to link multiple devices for telephony service. Wireless telephone companies have a strong retail presence and have significant financial resources. We are developing next-generation services to meet the emerging needs of mobile and other connected device users by delivering easy-to-use applications that provide significant cost savings in large existing markets. We believe that our efforts will capitalize on favorable trends including the proliferation of low or no-cost Wi-Fi and other broadband around the world, accelerating smart phone adoption rates, and the growth of social communities.

**Alternative communications providers**

We also compete against alternative communication providers such as magicJack, Ooma, Skype, and Google Voice, some of which are larger than us and have the ability to devote greater resources to their communications services. Some of these service providers, including Internet product and software companies, have chosen to sacrifice telephony revenue in order to gain market share or attract users to their platform and have offered their services at low prices or for free. While not all of these competitors currently offer the ability to call or be called by anyone not using their service, line portability, E911 service, and customer service, in the future they may integrate such capabilities into their service offerings. As we continue the introduction of applications that integrate different forms of voice, video, messaging, and other services over multiple devices, we face competition from emerging competitors focused on similar integration, as well as from alternative communication providers.

There is a continuing trend toward consolidation of telecommunications companies, including the acquisition of alternative communication providers by Internet product and software companies with significant resources. In addition, certain of our competitors have partnered and may in the future partner with other competitors to offer products and services, leveraging their collective competitive positions. We also are subject to the risk of future disruptive technologies, which could give rise to significant new competition.



In connection with our emphasis on the international long distance market, we face competition from low-cost international calling cards and VoIP providers in addition to traditional telephone companies, cable companies, and wireless companies.

In connection with our SMB, mid-market, and enterprise segments, we face competition from the traditional telephone and cable companies discussed above, as well as from vendors of premises-based solutions and/or hosted solutions, including the following:

- Independent cloud services providers such as EvolveIP, Jive, Mitel, RingCentral, ShoreTelConnect, Thinking Phone, West Unified Communications Services, and 8x8;
- Premises-based business communication equipment providers such as Alcatel-Lucent, Avaya, Cisco, Huawei, Interactive Intelligence, Mitel, NEC, ShoreTel, and Unify;
- Hosted communication services providers based on technologies from Avaya, Broadsoft, Cisco, Microsoft, Mitel, Unify and other vendors of technology platforms;
- Traditional technology companies such as Microsoft and Google; and
- Emerging competitors in technology companies such as Amazon, Salesforce, and Facebook.

As the UCaaS market evolves, and the convergence of voice, video, messaging, mobility and data networking technologies accelerates, we may face competition in the future from companies that do not currently compete in the UCaaS market, including companies that currently compete in other sectors, companies that serve consumer rather than SMB customers, or companies which expand their market presence to include SMB communications.

#### SEGMENT INFORMATION

ASC 280 "Segment Reporting" establishes reporting standards for an enterprise's business segments and related disclosures about its products, services, geographic areas and major customers. Under ASC 280, the method for determining what information to report is based upon the way management organizes the operating segments within the Company for making operating decisions and assessing financial performance. Our chief operating decision-makers review financial information presented on a consolidated basis, accompanied by disaggregated information about revenues and marketing expenses for consumer services and business services for purposes of allocating resources and evaluating financial performance. Based upon the information reviewed by our chief operating decision makers, we have determined that we have two operating segments; however, we have one reportable segment as our two operating segments meet the criteria for aggregation since the segments have similar operating and economic characteristics.

#### FINANCIAL INFORMATION ABOUT GEOGRAPHIC AREAS

For information regarding the Company's revenues and long-lived assets attributable to our U.S. and foreign countries for the last three fiscal years see Note 13 to the Company's consolidated financial statements.

#### EMPLOYEES

As of December 31, 2015, we had 1,752 employees. None of our employees are subject to a collective bargaining agreement.

Table of Contents

AVAILABLE INFORMATION

We were incorporated in Delaware in May 2000 and changed our name to Vonage Holdings Corp. in February 2001. We maintain a website with the address [www.vonage.com](http://www.vonage.com). References to our website are provided as a convenience, and the information contained on our website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor's own Internet access charges, we make available free of charge through our website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we have electronically filed such material with, or furnished such material to, the U.S. Securities and Exchange Commission (SEC). Copies are also available, without charge, by writing to Vonage's Investor Relations Department at Vonage Holdings Corp., 23 Main Street, Holmdel, NJ 07733 or calling us at 732.365.1328 or sending an email through the Vonage Investor Relations website at <http://ir.vonage.com/>. Reports filed with the SEC may be viewed at [www.sec.gov](http://www.sec.gov) or obtained at the SEC Public Reference Room in Washington, D.C. Information regarding the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

8 VONAGE ANNUAL REPORT 2015

---

Table of Contents

ITEM 1A. Risk Factors

You should carefully consider the risks below, as well as all of the other information contained in this Annual Report on Form 10-K and our financial statements and the related notes included elsewhere in this Annual Report on Form 10-K, in evaluating our company and our business. Any of these risks could materially adversely affect our business, financial condition and results of operations and the trading price of our common stock.

For the financial information discussed in this Annual Report on Form 10-K, other than per share and per line amounts, dollar amounts are presented in thousands, except where noted.

If we are unable to compete successfully, we could lose market share and revenue.

The Unified Communications as a service, or UCaaS industry is highly competitive. We face intense competition from traditional telephone service providers, cable companies and alternative voice and video communication providers, including other providers of UCaaS services.

To the extent that UCaaS providers such as EvolveIP, Jive, Mitel, RingCentral, ShoreTelSky, Thinking Phone, West IP Communications, 8x8, and other companies strengthen their offerings to small and medium businesses, we may have to reduce our prices, increase promotions, or offer additional features, which may adversely impact our revenues and profitability.

Most traditional wireline and wireless telephone service providers, including AT&T, Verizon Communications, CenturyLink, Sprint, T-Mobile, and Verizon Wireless, and cable companies, such as Cablevision, Charter Communications, Comcast Corporation, Cox Communications, and Time Warner Cable, are substantially larger and better capitalized than we are and have the advantage of greater name and brand name recognition and a large existing customer base. Because most of our target consumer services customers are already purchasing communications services from one or more of these providers, our success is dependent upon our ability to attract target customers away from their existing providers. Our competitors' financial resources may allow them to offer services at prices below cost or even for free in order to maintain and gain market share or otherwise improve their competitive positions. Our competitors also could use their greater financial resources to develop and market telephony and messaging services with more attractive features and more robust customer service. In addition, because of the other services our competitors provide, they often choose to offer VoIP services as part of a bundle that includes other products, such as video, high speed Internet access, and wireless telephone service. These bundled offers may enable our competitors to offer VoIP service at prices with which we may not be able to compete or to offer functionality that integrates VoIP service with their other offerings, both of which may be more desirable. Any of these competitive factors could make it more difficult for us to attract and retain customers, reduce our market share and revenues, or cause us to lower our prices or offer additional features that may result in additional costs without commensurate price increases.

We also compete against alternative communication providers, some of which are larger than us, have greater name and brand recognition, and have the ability to devote greater resources to their communications services. Some of these service providers, including Internet product and software companies, have chosen to sacrifice telephony revenue in order to gain market share or attract customers to their platform or have lower cost structures and have offered their services at low prices or for free or are using different payment structures such as one-time or low annual fees. As we continue the introduction of applications that integrate different forms of voice and messaging services over multiple devices, we face competition from emerging competitors focused on similar integration, as well as from established alternative communication providers. In order to compete with such service providers, we may have to reduce our prices, which

would impair our profitability, or offer additional features that may cause us to incur additional costs without commensurate price increases.

In connection with our emphasis on the international long distance market for consumer customers, we face competition from low-cost international calling cards, digital calling cards and VoIP providers in addition to traditional telephone companies, cable companies, and wireless companies. To the extent that these providers target

marketing to the same ethnic segments that we target or strengthen their offerings to these segments, we may have to reduce our prices or increase promotions, which would impair our profitability, or offer additional features that may cause us to incur additional costs without commensurate price increase.

As a result of increasing competition, domestic and international telephony and messaging rates have generally decreased during the past few years, and we expect this trend to continue. Continued rate pressures or increasing cost to use our services could lessen or eliminate the pricing advantage that we maintain over certain competitors and cause customers or potential customers to select alternative providers or cause us to lower our prices, which would adversely impact our revenues and profitability.

As the UCaaS market evolves, and the convergence of voice, video, messaging, mobility and data networking technologies accelerates, we may face competition in the future from companies that do not currently compete in the UCaaS market, including companies that currently compete in other sectors, companies that serve consumer rather than business customers, or companies which expand their market presence to include business communications. In connection with our UCaaS markets, we face competition from the traditional telephone and cable companies, as well as from vendors of premises-based solutions and/or hosted solutions. As the UCaaS market evolves, combining voice, video, messaging and data networks, and information technology and communication applications, opportunity is created for new competitors to enter the UCaaS market and offer competing products. This new competition may take many forms, and may offer products and applications similar to ours. If these new competitors emerge, the UCaaS market will become increasingly competitive and we may not be able to maintain or improve our market position. Our failure to do so could materially and adversely affect our business and results of operations. If we fail to adapt to rapid changes in the market for UCaaS services, then our products and services could become obsolete.

The market for our products and services is constantly and rapidly evolving as we and our competitors introduce new and enhanced products and services and react to changes in the UCaaS industry and customer demands. We may not be able to develop or acquire new products and plans or product and plan enhancements that compete effectively with present or emerging UCaaS technologies or differentiate our products and plans based on functionality and performance. In addition, we may not be able to establish or maintain strategic alliances that will permit enhancement opportunities or innovative distribution methods for our products and plans.

To address these issues, we are targeting revenue growth in large, existing markets, which require us to enhance our current products and plans, and develop new products and plans on a timely basis to keep pace with market needs and satisfy the increasingly sophisticated requirements of customers. For example, in 2015 we acquired iCore Networks, Inc. to further increase our penetration of the UCaaS market. If we are unable to attract users of these services our net revenues may fail to grow as we expect.

UCaaS is complex, and new products and plans and enhancements to existing products and plans can require long development and testing periods. Any delays in developing and releasing new or enhanced products and plans could cause us to lose

Table of Contents

revenue opportunities and customers. Any technical flaws in products we release could diminish the innovative impact of the products and have a negative effect on customer adoption and our reputation.

We also are subject to the risk of future disruptive technologies. New products based on new technologies or new industry standards could render our existing products obsolete and unmarketable. If new technologies develop that are able to deliver competing voice and messaging services at lower prices, better or more conveniently, it could have a material adverse effect on us.

If we are unsuccessful at retaining customers or attracting new consumer or business customers we may experience a reduction in revenue or may be required to spend more money or alter our marketing approaches to grow our customer base.

Our rate of customer terminations for our UCaaS services could increase in the future if customers are not satisfied with the quality and reliability of our network, the value proposition of our products, and the ability of our customer service to meet the needs and expectations of our customers. We measure customer terminations for our consumer customers by average monthly customer churn and for our Essentials and Premier business customers by average monthly revenue churn. Competition from traditional telephone companies, cable companies, wireless companies, alternative communications providers, low-cost international calling cards, disruptive technologies, general economic conditions, and our ability to activate and register new customers on our networks, also influence our churn rate.

As we continue to emphasize the international long distance market for our consumer customers, we expect our churn to be impacted by the ethnic segments that we target. For example, we have found that certain ethnic segments have higher churn due to their inability to use our existing payment methods. We may not be able to educate these customers in these payment methods or offer alternative payment methods that serve the needs of these customers. In addition, higher proportions of certain ethnic segments that we target may be more likely to have poor or no credit history, indicating that they may have more difficulty affording the service, leading to higher churn for these customers.

Because of customer losses, we have to acquire new customers on an ongoing basis just to maintain our existing level of customers and revenues. As a result, marketing and sales expense, and the effectiveness of our marketing and selling expenses, is an ongoing requirement to maintain or grow our business. If our churn rate increases, we will have to acquire even more new customers in order to maintain our existing revenues. We incur significant costs to acquire new customers, and those costs are an important factor in maintaining profitability. Therefore, if we are unsuccessful in retaining customers, are required to spend significant amounts to acquire new customers beyond those budgeted, or our marketing and selling efforts are not effective in targeting specific customer segments, we may be forced to change marketing and sales approaches or vendors, our revenue could decrease or we could incur losses.

Our success in the UCaaS market depends in part on developing and maintaining effective distribution channels, including our internal direct sales team. The failure to develop and maintain a successful internal direct sales team could materially and adversely affect our business.

A portion of our business revenue is generated through our direct sales, or “field sales” team. This channel consists of sales agents that market and sell our products and services to customers. This channel may generate an increasing portion of our business revenue in the future. Our continued success requires that we continue developing and maintaining a successful sales organization. If we fail to do so, or if our sales agents are not successful in their sales efforts, our sales may decrease and our operating results would suffer.

Our success in the UCaaS market depends in part on developing and maintaining effective distribution channels, including with third-party resellers and value-added distributors. The failure to develop and maintain these relationships could materially and adversely affect our business.

A portion of our business revenue is generated through indirect channel sales. These channels consist of third-party resellers and value-added distributors that market and sell UCaaS products and services to customers. These channels may generate an increasing portion of our business revenue in the future. Generally, we do not have long-term contracts with these third-party resellers and value-added distributors, and the loss of or reduction in sales through these third parties could materially reduce our revenues. We also compete for preference amongst our current or potential resellers with our competitors. Our continued success requires that we continue developing and maintaining

successful relationships with these third-party resellers and value-added distributors. If we fail to do so, or if our resellers are not successful in their sales efforts, our sales may decrease and our operating results would suffer. We may face difficulties related to the acquisition or integration of businesses, which could harm our growth or operating results.

Beginning with our acquisition of Vocalocity in 2013, we have made five acquisitions related to the UCaaS market, including Simple Signal, Inc. and iCore Networks, Inc. in 2015. We may elect to acquire additional businesses or assets in the future. These activities require substantial management time and resources. We cannot predict or guarantee that we will be able to identify suitable acquisition candidates or consummate any acquisition. In addition, acquisitions of existing businesses, including Simple Signal and iCore, involve substantial risks, including the risk that we may not be able to integrate the operations, personnel, services, or technologies, the potential disruption of our ongoing businesses, the diversion of management attention, the maximization of financial and strategic opportunities, the difficulty in developing or maintaining controls and procedures, and the dilution to our existing stockholders from the issuance of additional shares of common stock. As a result of these and other risks, we may not produce anticipated revenue, profitability, or synergies.

Acquisitions may require us to issue equity securities, use our cash resources, incur debt or contingent liabilities, amortize intangibles, or write-off acquisition-related expenses. If we are unable to successfully integrate any acquired businesses or assets we may not receive the intended benefits of such acquisition. In addition, we cannot predict market reactions to any acquisitions we may make or to any failure to announce any future acquisitions.

Further, while we conduct due diligence in connection with acquisition and joint venture opportunities, there may be risks or liabilities that such due diligence efforts fail to discover, are not disclosed to us, or that we inadequately assess. The discovery of material liabilities associated with acquisitions or joint venture opportunities, economic risks faced by joint venture partners, or any failure of joint venture partners to perform their obligations could adversely affect our business, results of operations, and financial condition.

Security breaches and other cybersecurity or technological risks could compromise our information, systems and network and expose us to liability, including a failure to meet Payment Card Industry data security standards, which would cause our business and reputation to suffer and which could have a material adverse effect on our business, financial condition, and operating results.

There are several inherent risks to engaging in a technology business, including our reliance on our data centers and networks, and the use and interconnectivity of those networks. A significant portion of our operations relies heavily on our ability to provide secure processing, storage and transmission of confidential and other sensitive data, including intellectual property, proprietary business information, and personally identifiable information of our customers and employees, in our data centers and on our networks. The secure processing, storage, and transmission of this information is critical to our operations and business strategy. As seen in our industry and others, these activities have been, and will continue to be, subject to continually evolving cybersecurity or other technological risks. Targeted attacks, such as advanced persistent threat (APT) is prevalent throughout the Internet and associated with the theft of intellectual property and state-sponsored espionage. Due to the nature of our business and reliance on the Internet, we are susceptible to this type of attack. In addition,

Table of Contents

physical security of devices located within our offices, and/or remote devices, pose cybersecurity and other technological risks that could negatively impact our business and reputation.

We also operate Internet based, worldwide voice, video communications, and messaging services and electronic billing, which require the transmission of confidential information over public networks that may or may not support end to end security. Despite our security measures, which include the development, operation and maintenance of systems and processes that are designed to protect consumer information and prevent fraudulent credit card transactions and other security breaches, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to error, malfeasance or other disruptions by a current or former employee or third-party provider and our failure to mitigate such fraud or breaches may adversely affect our operating results. Any such breach could compromise our systems and network and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such access, disclosure or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, regulatory penalties, disruption to our operations, damage to our reputation, and a loss of confidence in our products and services, and our ability to keep personally identifiable information confidential, which could adversely affect our business.

We have been subject to cyber incidents from external sources including “brute force” and distributed denial of service attacks, as well as attacks that introduce fraudulent VoIP traffic. Although these incidents have not had a material adverse effect financially or on our ability to provide services, this may not continue to be the case going forward. There can be no assurance that cyber incidents will not occur in the future, potentially more frequently and/or on a more significant scale.

We have taken steps designed to improve the security of our networks and computer systems and our physical space. Despite these defensive measures, there can be no assurance that we are adequately protecting our information or that we will not experience future incidents. The expenses associated with protecting our information could reduce our operating margins. We maintain insurance intended to cover some of these risks, however, this insurance may not be sufficient to cover all of our losses from any future breaches of our systems. In addition, third parties with which we do business may also be sources of cybersecurity or other technological risks. We outsource certain functions, which results in the storage and processing of customer information by third parties. While we engage in certain actions to reduce the exposure resulting from outsourcing, unauthorized access, loss or destruction of data or other cyber incidents could occur, resulting in similar costs and consequences as those discussed above.

We make available on our website our privacy policy, which describes how we collect, use, and disclose our customers' personal information. To the extent we expand our operations into new geographies, we may become subject to local data security, privacy, data retention, and disclosure laws and regulations. It may be difficult for us to comply with these laws and regulations if they were deemed to be applicable to us. In addition, risks related to cybercrime and fraud increase when establishing a global presence.

We are subject to Payment Card Industry (“PCI”) data security standards, which require periodic audits by independent third parties to assess compliance. PCI data security standards are a comprehensive set of requirements for enhancing payment account data security that was developed by the PCI Security Standards Council including American Express, Discover Financial Services, JCB International, MasterCard Worldwide, and VISA Inc., to help facilitate the broad adoption of consistent data security measures. Failure to comply with the security requirements as identified in subsequent audits or rectify a security issue may result in fines. While we believe it is unusual, restrictions on accepting payment cards, including a complete restriction, may be imposed on companies that are not compliant. Further, the law relating to the liability of providers of online payment services is currently unsettled and states may enact their own rules with which we may not comply.

We rely on third party providers to process and guarantee payments made by Vonage and its affiliates' subscribers, up to certain limits, and we may be unable to prevent our customers from fraudulently receiving goods and services. Our liability risk will increase if a larger fraction of our Vonage transactions involve fraudulent or disputed credit card transactions. Any costs we incur as a result of fraudulent or disputed transactions could harm our business. In addition, the functionality of our current billing system relies on certain third party vendors delivering services. If these vendors are unable or unwilling to provide services, we will not be able to charge for our services in a timely or scalable

fashion, which could significantly decrease our revenue and have a material adverse effect on our business, financial condition and operating results.

Sales of our UCaaS services to medium-sized and enterprise customers involve significant risks which, if not managed effectively, could materially and adversely affect our business and results of operations.

As we continue to expand our sales efforts to medium-sized and larger businesses, we may incur higher selling expense and longer, more complex, sales cycles. Customers in this market segment may also require bespoke features and integration services, increasing the complexity and expense related to the sales and delivery process. As a result, we may devote greater sales and support to these customers, which may result in increased costs and a strain on our support resources. These factors could materially and adversely affect our results of operations and our overall ability to grow our customer base.

Our ability to provide our telephony service and manage related customer accounts is dependent upon third-party facilities, equipment, and systems, the failure of which could cause delays of or interruptions to our service, damage our reputation, cause us to lose customers, limit our growth, and affect our financial condition.

Our success depends on our ability to provide quality and reliable telephony service, which is in part dependent upon the proper functioning of facilities and equipment owned and operated by third parties and is, therefore, beyond our control. Unlike traditional wireline telephone service or wireless service, our telephony service typically requires our customers to have an operative broadband Internet connection and an electrical power supply, which are provided by the customer's Internet service provider and electric utility company, respectively, and not by us. The quality of some broadband Internet connections may be too poor for customers to use our telephony services properly. In addition, if there is any interruption to a customer's broadband Internet service or electrical power supply, that customer will be unable to make or receive calls, including emergency calls, using our telephony service.

We outsource several of our network functions to third-party providers. For example, we outsource the maintenance of our regional data connection points, which are the facilities at which our network interconnects with the public switched telephone network. If our third-party service providers fail to maintain these facilities properly, or fail to respond quickly to problems, our customers may experience service interruptions. Interruptions in our service caused by third-party facilities have in the past caused and may in the future cause us to lose customers or cause us to offer substantial customer credits, which could adversely affect our revenue and profitability. If interruptions adversely affect the perceived reliability of our service, we may have difficulty attracting new customers, and our brand, reputation, and growth will be negatively impacted.

In order to access our consumer services, a customer needs to connect a standard telephone to a broadband Internet connection through a Vonage-enabled device that we provide. Although we closely monitor inventory levels, if we are unable to procure a sufficient number of devices from our suppliers in a timely manner, including as a result of a failure by a component supplier, we would be delayed in activating new customers and may lose these customers. While we believe that relations with our current third party providers are good, and we have contracts in place with these vendors, there can be no guarantee that these third party providers will be able



Table of Contents

or willing to supply services to us in the future on commercially reasonable terms, or that we will be able to engage alternative or additional providers. We believe that we could replace our current third party providers, however, our ability to provide our UCaaS services may be impacted during any transition, which could have an adverse effect on our business, financial condition or results of operations.

We rely on third-party hardware and software that may be difficult to replace or may not perform adequately. In some cases we rely on purchased or leased hardware and software licensed from third parties in order to provide our UCaaS services. For example, Broadsoft, Inc. provides us with infrastructure, call termination and origination services, and other hardware and software in connection with our Premier offerings. We also integrate third-party licensed software components into our platform. This hardware and software may not continue to be available on commercially reasonable terms or pricing or may fail to continue to be updated to remain competitive. The loss of the right to use this third party hardware or software may increase our expenses or impact the provisioning of our services. The failure of this third party hardware or software could materially impact the performance of our UCaaS services and may cause material harm to our business or results of operations.

Flaws in our technology and systems or our failure to adapt our systems to any new Internet Protocol could cause delays or interruptions of service, which could damage our reputation, cause us to lose customers, and limit our growth.

Although we have designed our service network to reduce the possibility of disruptions or other outages, our service may be disrupted by problems with our technology and systems, such as malfunctions in our Vonage-enabled device that we provide to customers, software or facilities and overloading of our network. As we attract new subscribers, we expect increased call volume that we need to manage to avoid network interruptions. In particular, as we have marketed to different international long distance markets, we have seen international call volumes to targeted countries increase. During the next few years we expect wide-spread industry adoption of a new Internet Protocol, which is a set of standard communications and routing mechanisms. Customers may experience periodic delays of service caused by the industry transition to this new Internet Protocol. Interruptions have caused and may in the future cause us to lose customers and offer substantial customer credits, which could adversely affect our revenue and profitability. Network interruptions have also impaired our ability at times to sign-up new customers and the ability of customers to manage their accounts. If service interruptions or other outages adversely affect the perceived reliability of our telephony service or customer service, we may have difficulty attracting and retaining customers and our brand reputation and growth may suffer.

In addition, we utilize third-party Internet-based or “cloud” computing services in connection with some of our business operations. Any disruption to the internet or to our third-party Web hosting or cloud computing providers, including technological or business-related disruptions, could adversely impact the experience of our customers and have adverse effects on our operations. In addition, fires, floods, earthquakes, power losses, telecommunications failures, and similar “Acts of God” could damage these systems and hardware or cause them to fail completely. While we do maintain redundant systems consistent with industry best practices, including standby data centers, certain events could result in downtime for our operations and could adversely affect our business.

Our UCaaS business is growing rapidly, and any inability to scale our business and grow efficiently could materially and adversely harm our business and results of operations.

As our UCaaS business expands, we will need to continue to improve our application architecture, integrate our products and applications across our technology platforms, integrate with third-party systems, and maintain infrastructure performance. We expect the number of users, the amount of data transferred and processed, the number of locations where our service is being used, and the volume of communications over our networks to continue to expand. To address

this growth, we will need to scale our systems and customer services organization. Our ability to execute on these initiatives may impact system and network performance, customer satisfaction, and ultimately, sales and revenue. These efforts may also divert management resources. These factors may materially and adversely harm our business and results of operations.

We depend on third party vendors to supply, configure and deliver the phones that we sell. Any delays in delivery, or failure to operate effectively with our own servers and systems, may result in delay or failure of our services, which could harm our business, financial condition and results of operations.

We rely on Yealink Inc. and Polycom, Inc. to provide, and a single fulfillment agent to configure and deliver, the phones that we offer for sale to our customers that use our UCaaS services. If these third parties are unable to deliver phones of acceptable quality or quantity, or in a timely manner, we may be forced to offer replacements at a higher cost than what is currently contracted. In addition, these phones must interoperate with our servers and systems. If either of our providers changes the operation of their phones, we may be required to engage in development efforts to ensure that the new phones interoperate with our system. The failure of our vendor-supplied phones to operate effectively with our system could impact our customers' ability to use our services and could cause customers to cancel our services, which may cause material harm to our business or results of operations.

We market our products and services to small and medium-sized businesses, which may be disproportionately impacted by fluctuations in economic conditions.

We market our products to small and medium-sized businesses. Customers in this market may be affected by economic downturns to a greater extent, and may have more limited financial resources, than larger or more established businesses. If customers in our UCaaS markets experience financial hardship as a result of a weak economy, the demand for our services could be materially and adversely affected.

The storage, processing, and use of personal information and related data subjects us to evolving governmental laws and regulation, commercial standards, contractual obligations, and other legal obligations related to consumer and data privacy, which may have a material impact on our costs, use of our products and services, or expose us to increased liability.

Federal, state, local and foreign laws and regulations, commercial obligations and industry standards, each provide for obligations and restrictions with respect to data privacy and security, as well as the collection, storage, retention, protection, use, processing, transmission, sharing, disclosure and protection of personal information and other customer data. The evolving nature of these obligations and restrictions dictates that differing interpretations, inconsistency or conflicts among countries or rules, and general uncertainty impact the application to our business.

These obligations and restrictions may limit our ability to collect, store, process, use, transmit and share data with our customers, employees, and third party providers and to allow our customers to collect, store, retain, protect, use, process, transmit, share and disclose data with others through our products and services. Compliance with, and other burdens imposed by, such obligations and restrictions could increase the cost of our operations and impact our ability to market our products and services through effective segmentation.

Failure to comply with obligations and restrictions related to applicable data protection laws, regulations, standards, and codes of conduct, as well as our own posted privacy policies and contractual commitments could subject us to lawsuits, fines, criminal penalties, statutory damages, consent decrees, injunctions, adverse publicity, loss of user confidence in our services, and loss of users, which could materially harm our business. Additionally, third-party contractors may have access to customer or employee data. If these or other third-party vendors violate obligations and restrictions related to applicable data protection laws or our policies, such violations may also put our

Table of Contents

customers' or employees' information at risk and could in turn have a material and adverse effect on our business.

If we fail to protect our internally developed systems, technology, and software and our trademarks, we may become involved in costly litigation or our business or brand may be harmed.

Our ability to compete effectively is dependent in large part upon the maintenance and protection of systems and software that we have developed internally based on open standards. While we own more than 100 issued U.S. patents (and a number of foreign patents) and more than 220 pending U.S. patent applications (and a number of foreign patent applications), we cannot patent much of the technology that is important to our business. Our pending patent applications may not be granted. Any issued patent that we own may be challenged, narrowed, invalidated, or circumvented. To date, we have relied on patent, copyright and trade secret laws, as well as confidentiality procedures and licensing arrangements, to establish and protect our rights to this technology. We typically enter into confidentiality agreements with our employees, consultants, customers, and vendors in an effort to control access to and distribution of technology, software, documentation, and other information. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use this technology without authorization. Policing unauthorized use of this technology is difficult. The steps we take may not prevent misappropriation of the technology we rely on. In addition, effective protection may be unavailable or limited in some jurisdictions outside the United States, Canada, and the United Kingdom. Litigation may be necessary in the future to enforce or protect our rights or to determine the validity and scope of the rights of others. That litigation could cause us to incur substantial costs and divert resources away from our daily business, which in turn could materially adversely affect our business.

The unlicensed use of our brands by third parties could harm our reputation, cause confusion among our customers, and impair our ability to market our services. To that end, we have registered numerous trademarks and service marks and have applied for registration of our trademarks and service marks in the United States and abroad to establish and protect our brand names as part of our intellectual property strategy. If our applications receive objections or are successfully opposed by third parties, it may be difficult for us to prevent third parties from using our brand without our permission. Moreover, successful opposition to our applications might encourage third parties to make additional oppositions or commence trademark infringement proceedings against us, which could be costly and time consuming to defend against. If we decide to take limited or no action to protect our trademarks, our trademark rights may be diluted and subject to challenge or invalidation, which could materially and adversely affect our brand in the marketplace.

Third parties may fraudulently use our name to obtain access to customer accounts and other personal information, use our services to commit fraud or steal our services, which could damage our reputation, limit our growth, and cause us to incur additional expenses.

Our customers have been subject to "phishing," which occurs when a third party calls or sends an email or pop-up message to a customer that claims to be from a business or organization that provides services to the customer. The purpose of the inquiry is typically to encourage the customer to visit a bogus website designed to look like a website operated by the legitimate business or organization or provide information to the operator. At the bogus website, the operator attempts to trick the customer into divulging customer account or other personal information such as credit card information or to introduce viruses through "Trojan horse" programs to the customers' computers. This has resulted in identity theft from our customers and the unauthorized use of Vonage services. Third parties have also used our communications services to commit fraud. Although we have engaged a third party to assist in the shutdown of purported phishing sites, if we are unable to detect and prevent "phishing," use of our services for fraud, and similar activities, our brand reputation and growth may suffer and we may incur additional costs, including costs to increase security, or be required to credit significant amounts to customers.

Third parties also have used our communications services without paying, including by submitting fraudulent credit card information. This has resulted in our incurring the cost of providing the services, including incurring call termination fees, without any corresponding revenues. We have implemented anti-fraud procedures in order to limit the expenses resulting from theft of service. If our procedures are not effective, theft of service could significantly increase our expenses and negatively impact our profitability.

Certain rights to third party patents and technology may not be available, which may decrease the quality of our products or services or subject us to liability.

We may seek to obtain rights to third party technology in the future, but may not be able to agree upon commercially reasonable terms or at all with respect to obtaining such rights. If we are unable to extend existing licenses or are unable to obtain rights to other technology that may be commercially advantageous or necessary for our product and service offerings, we may experience a decrease in the quality of our products or services or we may lose the ability to provide our products and services on a non-infringing basis until alternative technology or suitable alternative products and services can be developed, identified, obtained (through acquisition, license or other grants of rights), and integrated.

We may be subject to damaging and disruptive intellectual property litigation that could materially and adversely affect our business, results of operations, and financial condition, as well as the continued viability of our company. There has been substantial litigation in the UCaaS, VoIP, telecommunications, hosted services, and related industries regarding intellectual property rights and, given the rapid technological change in our industry and our continual development of new products and services, we and/or our commercial partners may be subject to infringement claims from time to time. For example, we may be unaware of filed patent applications and issued patents that could include claims that might be interpreted to cover our products and services. We have been subject to patent infringement claims in the past, are currently named as a defendant in several proceedings that relate to alleged patent infringement, and from time to time we receive letters from third parties offering an opportunity for us to obtain licenses to patents that may be relevant to our business or alleging that our services infringe upon third party patents or other intellectual property. See “Item 3. - Legal Proceedings-IP Matters.”

Parties making claims of infringement may be able to obtain injunctive or other equitable relief that could effectively block our ability to provide our services and could cause us to pay substantial royalties, licensing fees, damages or settlement fees. The defense of any lawsuit could divert management’s efforts and attention from ordinary business operations and result in time-consuming and expensive litigation, regardless of the merits of such claims. These outcomes may:

- >result in the loss of a substantial number of existing customers or prohibit the acquisition of new customers;
- >cause us to accelerate expenditures to preserve existing revenues;
- >cause existing or new vendors to require prepayments or letters of credit;
- >cause our credit card processors to demand reserves or letters of credit or make holdbacks;
- >result in substantial employee layoffs;
- >materially and adversely affect our brand in the marketplace and cause a substantial loss of goodwill;
- >cause our stock price to decline significantly;
- > materially and adversely affect our liquidity, including our ability to pay debts and other obligations as they become due;

Table of Contents

- >cause us to change our business methods or services;
- >require us to cease certain business operations or offering certain products and services; and
- >lead to our bankruptcy or liquidation.

We rely on third parties to provide a portion of our customer service representatives, provide aspects of our E-911 service, which differs from traditional 911 service, and initiate local number portability for our customers. If these third parties do not provide our customers with reliable, high-quality service, our reputation will be harmed and we may lose customers.

We offer our customers support 24 hours a day, seven days a week through both our comprehensive online account management website and our toll free number. Our customer support is currently provided via United States based employees as well as third party partners located in the United States, Philippines, Costa Rica, Chile, Mexico, and India. We offer support in English, Spanish, and French Canadian. Our third-party providers generally represent us without identifying themselves as independent parties. The ability to support our customers may be disrupted by natural disasters, inclement weather conditions, civil unrest, and other adverse events in the locations where our customer support is provided.

We also contract for services required to provide E-911 services including assistance in routing emergency calls, terminating E-911 calls, operating a national call center that is available 24 hours a day, seven days a week to receive certain emergency calls, and maintaining PSAP databases for the purpose of deploying and operating E-911 services. Interruptions in service from our vendor could cause failures in our customers' access to E-911 services and expose us to liability and damage our reputation.

We also have agreements with companies that initiate our local number portability, which allow new customers to retain their existing telephone numbers when subscribing to our services.

If any of these third parties do not provide reliable, high-quality service, our reputation and our business will be harmed. In addition, industry consolidation among providers of services to us may impact our ability to obtain these services or increase our expense for these services.

Our services are subject to regulation in the United States, United Kingdom, and Canada, and future legislative, regulatory or judicial actions could adversely affect our business and expose us to liability.

Our business has developed in a relatively lightly regulated environment. However, the United States, United Kingdom, and Canada have applied some traditional telephone company regulations to VoIP and continue to evaluate how VoIP should be regulated. The effects of future regulatory developments are uncertain. At the federal level in the U.S., the Federal Communications Commission ("FCC") has imposed certain telecommunications regulations on VoIP services including:

- >Requirements to provide E911 service;
  - >Communications Assistance for Law Enforcement Act ("CALEA") obligations;
  - >Obligation to support Universal Service;
  - >Customer Proprietary Network Information ("CPNI") requirements;
  - >Disability access obligations;
  - >Local Number Portability requirements;
  - >Service discontinuance notification obligations;
  - >Outage reporting requirements; and
- >Rural call completion reporting and rules related to ring signal integrity.

In general, the focus of interconnected VoIP telecommunications regulation is at the federal level. On November 12, 2004, the FCC issued a declaratory ruling providing that our service is subject to federal regulation and preempted the Minnesota Public Utilities Commission from imposing certain of its regulations on us. While this ruling does not

exempt us from all state oversight of our service, it effectively prevents state telecommunications regulators from imposing certain burdensome and inconsistent market entry requirements and certain other state utility rules and regulations on our service. As such, Vonage is subject to relatively few state regulatory requirements including:

- > Payment of state and local E911 fees;
- > and

>State Universal Service support obligations.

In Canada, the Canadian Radio-television and Telecommunications Commission (“CRTC”) regulates VoIP service. CRTC VoIP regulations include:

- >Requirement to provide 911 service; and
- >Local Number Portability requirements.

In the UK, we are subject to regulation in the UK by the Office of Communications (“Ofcom”). Ofcom VoIP regulations include:

- >Requirement to provide 999/112 service; and
- >Number Portability requirements.

Vonage seeks to comply with all applicable regulatory requirements. We could, however, be subject to regulatory enforcement action if a regulator does not believe that we are complying with applicable regulations.

In addition, the regulatory framework for VoIP service is still evolving and it is possible that Vonage could be subject to additional regulatory obligations and/or existing regulatory obligations could be modified or expanded. The effects of future regulatory developments are uncertain. Future legislative, judicial or other regulatory actions could have a negative effect on our business. If we become subject to the rules and regulations applicable to telecommunications providers in individual states, we may incur significant litigation and compliance costs, and we may have to restructure our service offerings, exit certain markets, or raise the price of our services, any of which could cause our services to be less attractive to customers. In addition, future regulatory developments could increase our cost of doing business and limit our growth.

We may incur significant costs and harm to our reputation from lawsuits and regulatory inquiries related to our business practices, which may also divert the attention of our management from other aspects of our business.

We have been subject to periodic regulatory inquiries regarding our business practices, including an investigation settled in 2009 with a group of 32 states' attorneys general into certain of our business practices. There was no finding of any violation or wrongdoing by us, and the 32 states participating in the settlement released us and our affiliates from the matters investigated. On July 18, 2011, we entered into an amended settlement agreement initiated at our request to reflect revised business practices associated with our new “consumable” product offerings. Any similar claims or regulatory inquiries, whether successful or not, could require us to devote significant amounts of monetary or human resources to defend ourselves and could harm our reputation. We may need to spend significant amounts on our legal defense, senior management may be required to divert their attention from other portions of our business, new product launches may be deferred or canceled as a result of any proceedings, and we may be required to make changes to our present and planned products or services. If, as a result of any proceedings, a judgment is rendered or a decree is entered against us, it may materially and adversely affect our business, financial condition, and results of operations and harm our reputation.

Table of Contents

If we are unable to establish and expand effective strategic relationships our ability to grow revenues and offer new products under commercially attractive terms may be inhibited, which could adversely affect our business, results of operations, and financial condition.

An element of our strategy is to develop and maintain strategic relationships. We have or are pursuing relationships in the U.S. retail industry as well as with entities in the business markets. The continued development of these relationships may assist us in enhancing our brand, introducing our products and services to larger numbers and types of customers, developing and implementing new products and services, and generating additional revenue. We may not be able to enter into new relationships on economic terms favorable to us. In addition, if we lose any of our important strategic relationships or if strategic relationships fail to benefit us as expected, our ability to grow revenues and offer new products may be inhibited, which could adversely affect our business, results of operations, and financial condition. In addition, inefficiencies or fraud on the part of mass merchant retailers or vendors associated with our assisted selling programs could adversely affect our business, results of operations, and financial condition. Our international long distance business is subject to country-specific governmental regulation and related actions and taxes that may increase our costs or impact our product offerings.

In the United States, Canada, and United Kingdom, we are not a regulated telecommunications business. Our services are also in use in countries outside of the United States, Canada, and the United Kingdom, including countries where providing VoIP services is or may be illegal. We may need to change our service offerings to avoid regulation as a telecommunications business in a jurisdiction, or if we are treated as a regulated telecommunications business, we may be required to incur additional expenses. In addition, if governments believe that we are providing unauthorized service in their countries, they may pursue fines, penalties, or other governmental action, including criminal action, that may damage our brand and reputation. If we use a local partner to provide services in a country and the local partner does not comply with applicable governmental regulations, we may face additional regulation, liabilities, penalties or other governmental action, and our brand and reputation may be harmed.

In addition to the risk of being directly subjected to regulation, decisions by foreign regulators to increase the charge for terminating international calls into their countries may adversely impact our ability to attract and retain international long distance customers in the U.S., U.K., and Canada. For example, our Vonage World offering includes calling to over 60 countries. Regulatory actions in any of these countries, which has occurred in the past, could cause increased costs, impact margin, cause us to remove a country from Vonage World, and impact churn and gross line additions. These regulatory actions may be taken without notice and cause us to react quickly to changing market conditions. These efforts could divert management's efforts and attention from ordinary business operations which could materially and adversely affect our results of operations.

As a United States-based company, any foreign subsidiary or joint venture that we use for international operations may be subject to a variety of governmental regulations in the countries where we market our products, including tariffs and taxes. For example, distributions of earnings and other payments, including interest, received from our foreign subsidiaries may be subject to withholding taxes imposed by the jurisdiction in which such entities are formed or operating, which will reduce the amount of after-tax cash we can receive. In general, as a United States corporation, we may claim a foreign tax credit against our federal income tax expense for such foreign withholding taxes and for foreign income taxes paid directly by foreign corporate entities in which we own 10% or more of the voting stock. The ability to claim such foreign tax credits and to utilize net foreign losses is, however, subject to numerous limitations, and we may incur incremental tax costs as a result of these limitations or because we are not currently in a tax-paying position in the United States. We may also be required to include in our income for United States federal income tax purposes our proportionate share of certain earnings of those foreign subsidiaries that are classified as "controlled foreign corporations"

without regard to whether distributions have been actually received from such subsidiaries.

We are dependent on a small number of individuals, and if we lose key personnel upon whom we are dependent, our business will be adversely affected.

Many of the key responsibilities of our business have been assigned to a relatively small number of individuals. Our future success depends to a considerable degree on the vision, skills, experience, and effort of our senior management.

The loss of the services of these officers could have a material adverse effect on our business. In addition, our continued growth depends on our ability to attract and retain experienced key employees.

We are subject to risks that are inherent in operating abroad, including country-specific risks.

Some of our research and development personnel and facilities are located in Israel. Political, economic and military conditions in Israel directly affect our operations. For example, increased violence or armed conflict in the Middle East may disrupt travel and communications in the region, harming our operations there. Furthermore, some of our employees in Israel are obligated to perform up to 36 days of military reserve duty annually and may be called to active duty in a time of crisis. The absence of these employees for significant periods may cause us to operate inefficiently during these periods.

We may be exposed to liabilities under the Foreign Corrupt Practices Act, the UK Bribery Act, and similar laws, and any determination that we violated any of these laws could have a material adverse effect on our business.

We are subject to the Foreign Corrupt Practice Act ("FCPA"), the UK Bribery Act and other laws that prohibit improper payments or offers of payments to foreign governments and their officials and political parties by persons and entities for the purpose of obtaining or retaining business. We have operations, agreements with third parties, and make sales internationally. In addition, we plan to expand our international operations through potential joint ventures with local partners. Our international activities create the risk of unauthorized payments or offers of payments by one of our employees, consultants, partners, sales agents or distributors, even though these parties are not always subject to our control. It is our policy to prohibit these practices by our employees, consultants, partners, sales agents or distributors, however, our existing safeguards and any future improvements may prove to be less than effective, and our employees, consultants, partners, sales agents or distributors may engage in conduct for which we might be held responsible. Violations of the FCPA, the UK Bribery Act or other laws may result in severe criminal or civil sanctions, and we may be subject to other liabilities, which could negatively affect our business, operating results, and financial condition.

The success of our business relies on customers' continued and unimpeded access to broadband service. Providers of broadband services may be able to block our services or charge their customers more for also using our services, which could adversely affect our revenue and growth.

Our customers must have broadband access to the Internet in order to use our service. Some providers of broadband access, including outside of the United States, may take measures that affect their customers' ability to use our service, such as degrading the quality of the data packets we transmit over their lines, giving those packets low priority, giving other packets higher priority than ours, blocking our packets entirely or attempting to charge their customers more for also using our services.

In the United States, there continues to be some uncertainty regarding whether suppliers of broadband Internet access have a legal obligation to allow their customers to access and use our service without interference. On February 26, 2015, the FCC adopted neutrality rules that would protect against interference by suppliers of broadband Internet access. Several parties filed appeals which are pending at the



Table of Contents

D.C. Circuit Court of Appeals. Oral arguments at the D.C. Circuit Court of Appeals were held on December 4, 2015. If customers do not accept the differences between our service and traditional telephone service, they may choose to remain with their current telephone service provider or may choose to return to service provided by traditional telephone companies.

For certain users, aspects of our service are not the same as traditional telephone service. Our continued growth is dependent on the adoption of our services by mainstream customers, so these differences are important. For example:

> Both our E-911 and emergency calling services are different, in significant respects, from the 911 service associated with traditional wireline and wireless telephone providers and, in certain cases, with other VoIP providers.

In the event of a power loss or Internet access interruption experienced by a customer, our service is interrupted.

> Unlike some of our competitors, we have not installed batteries at customer premises to provide emergency power for our customers' equipment if they lose power, although we do have backup power systems for our network equipment and service platform.

> Our customers may experience lower call quality than they are used to from traditional wireline telephone companies, including static, echoes, and delays in transmissions.

> Our customers may experience higher dropped-call rates than they are used to from traditional wireline telephone companies.

> Customers who obtain new phone numbers from us do not appear in the phone book and their phone numbers are not available through directory assistance services offered by traditional telephone companies.

> Our customers cannot accept collect calls.

> Our customers cannot call premium-rate telephone numbers such as 1-900 numbers and 976 numbers.

If customers do not accept the differences between our service and traditional telephone service, they may choose to remain with their current telephone service provider or may choose to return to service provided by traditional telephone companies.

The debt agreements governing our financing contain restrictions that may limit our flexibility in operating our business or executing on our acquisition strategy.

On July 27, 2015, we entered into a credit agreement (the "2015 Credit Facility") consisting of a \$100,000 senior secured term loan and a \$250,000 revolving credit facility. The 2015 Credit Facility contains customary representations and warranties and affirmative covenants that limit our ability and/or the ability of certain of our subsidiaries to engage in specified types of transactions. These covenants and other restrictions may under certain circumstances limit, but not necessarily preclude, our and certain of our subsidiaries' ability to, among other things:

> consolidate or merge;

> create liens;

> incur additional indebtedness;

> dispose of assets;

> consummate acquisitions;

> make investments; or

> pay dividends and other distributions.

Under the 2015 Credit Facility, we are required to comply with the following financial covenants: specified maximum consolidated leverage ratio, specified minimum consolidated fixed coverage charge ratio, minimum cash position and maximum capital expenditures. Our ability to comply with such financial and other covenants may be affected by events beyond our control, so we may not be able to comply with these covenants. A breach of any such covenant could result in a default under the 2015 Credit Facility. In that case, the lenders could elect to declare due and payable immediately all amounts due under the 2015 Credit Facility, including principal and accrued interest.

The market price of our common stock has been and may continue to be volatile, and purchasers of our common stock could incur substantial losses.

Securities markets experience significant price and volume fluctuations. This market volatility, as well as general economic conditions, could cause the market price of our common stock to fluctuate substantially. The trading price of our common stock has been, and is likely to continue to be, volatile. Many factors that are beyond our control may significantly affect the market price of our shares. These factors include:

- >changes in our earnings or variations in operating results;
- >any shortfall in revenue or increase in losses from levels expected by securities analysts;
- >judgments in litigation;
- >operating performance of companies comparable to us;
- >general economic trends and other external factors; and
- >market conditions and competitive pressures that prevent us from executing on our future growth initiatives.

If any of these factors causes the price of our common stock to fall, investors may not be able to sell their common stock at or above their respective purchase prices.

If we require additional capital, we may not be able to obtain additional financing on favorable terms or at all.

We may need to pursue additional financing to respond to new competitive pressures, pay extraordinary expenses such as litigation settlements or judgments or fund growth, including through acquisitions. Because of our past significant losses and our limited tangible assets, we do not fit traditional credit lending criteria, which, in particular, could make it difficult for us to obtain loans or to access the capital markets. In addition, the credit documentation for our recent financing contains affirmative and negative covenants that affect, and in many respects may significantly limit or prohibit, among other things, our and certain of our subsidiaries' ability to incur, refinance or modify indebtedness and create liens.

Our credit card processors have the ability to impose significant holdbacks in certain circumstances. The reinstatement of such holdbacks likely would have a material adverse effect on our liquidity.

Under our credit card processing agreements with our Visa, MasterCard, American Express, and Discover credit card processors, the credit card processor has the right, in certain circumstances, including adverse events affecting our business, to impose a holdback of our advanced payments purchased using a Visa, MasterCard, American Express, or Discover credit card, as applicable, or demand additional reserves or other security. If circumstances were to occur that would allow any of these processors to reinstate a holdback, the negative impact on our liquidity likely would be significant. In addition, our Visa and MasterCard credit card processing agreement may be terminated by the credit card processor at its discretion if we are deemed

Table of Contents

to be financially insecure. As a significant portion of payments to us are made through Visa and MasterCard credit cards, if the credit card processor does not assist in transitioning our business to another credit card processor, the negative impact on our liquidity likely would be significant. There were no cash reserves and cash-collateralized letters of credit with any credit card processors as of December 31, 2015.

We have incurred cumulative losses since our inception and may not achieve consistent profitability in the future. While we achieved net income attributable to Vonage of \$22,655 for the year ended December 31, 2015, our accumulated deficit is \$655,020 from our inception through December 31, 2015, which included the release of \$325,601 of the valuation allowance recorded against our net deferred tax assets that we recorded as a one-time non-cash income tax benefit for the year ended December 31, 2011. Although we believe we will achieve consistent profitability in the future, we ultimately may not be successful. We believe that our ability to achieve consistent profitability will depend, among other factors, on our ability to continue to achieve and maintain substantive operational improvements and structural cost reductions while maintaining and growing our net revenues. In addition, certain of the costs of our business are not within our control and may increase. For example, we and other telecommunications providers are subject to regulatory termination charges imposed by regulatory authorities in countries to which customers make calls, such as India where regulatory authorities have been petitioned by local providers to consider termination rate increases. As we attract additional international long distance callers, we will be more affected by these increases to the extent that we are unable to offset such costs by passing through price increases to customers.

We may be unable to fully realize the benefits of our net operating loss (“NOL”) carry forwards if an ownership change occurs.

If we were to experience a “change in ownership” under Section 382 of the Internal Revenue Code (“Section 382”), the NOL carry forward limitations under Section 382 would impose an annual limit on the amount of the future taxable income that may be offset by our NOL generated prior to the change in ownership. If a change in ownership were to occur, we may be unable to use a significant portion of our NOL to offset future taxable income. In general, a change in ownership occurs when, as of any testing date, there has been a cumulative change in the stock ownership of the corporation held by 5% stockholders of more than 50 percentage points over an applicable three-year period. For these purposes, a 5% stockholder is generally any person or group of persons that at any time during an applicable three-year period has owned 5% or more of our outstanding common stock. In addition, persons who own less than 5% of the outstanding common stock are grouped together as one or more “public group” 5% stockholders. Under Section 382, stock ownership would be determined under complex attribution rules and generally includes shares held directly, indirectly (through intervening entities), and constructively (by certain related parties and certain unrelated parties acting as a group). We have implemented a Tax Benefits Preservation Plan intended to provide a meaningful deterrent effect against acquisitions that could cause a change in ownership, however this is not a guarantee against such a change in ownership.

Jeffrey A. Citron, our founder, non-executive Chairman, and a significant stockholder, exerts significant influence over us.

As of December 31, 2015, Mr. Citron beneficially owned approximately 9.8% of our outstanding common stock, including outstanding securities exercisable for common stock within 60 days of such date. As a result, Mr. Citron is able to exert significant influence over all matters presented to our stockholders for approval, including

election and removal of our directors and change of control transactions. In addition, as our non-executive Chairman, Mr. Citron has and will continue to have influence over our strategy and other matters as a board member. Mr. Citron’s interests may not always coincide with the interests of other holders of our common stock.

Our certificate of incorporation and bylaws, the agreements governing our indebtedness, and the terms of certain settlement agreements to which we are a party contain provisions that could delay or discourage a takeover attempt, which could prevent the completion of a transaction in which our stockholders could receive a substantial premium over the then-current market price for their shares.

Certain provisions of our restated certificate of incorporation and our second amended and restated bylaws may make it more difficult for, or have the effect of discouraging, a third party from acquiring control of us or changing our

board of directors and management. These provisions:

- > permit our board of directors to issue additional shares of common stock and preferred stock and to establish the number of shares, series designation, voting powers (if any), preferences, other special rights, qualifications, limitations or restrictions of any series of preferred stock;
- > limit the ability of stockholders to amend our restated certificate of incorporation and second amended and restated bylaws, including supermajority requirements;
- > allow only our board of directors, Chairman of the board of directors or Chief Executive Officer to call special meetings of our stockholders;
- > eliminate the ability of stockholders to act by written consent;
- > require advance notice for stockholder proposals and director nominations;
- > limit the removal of directors and the filling of director vacancies; and
- > establish a classified board of directors with staggered three-year terms.

In addition, a change of control would constitute an event of default under our 2015 Credit Facility. Upon the occurrence of an event of default, the lenders could elect to declare due and payable immediately all amounts due under our 2015 Credit Facility, including principal and accrued interest, and may take action to foreclose upon the collateral securing the indebtedness.

Under our 2015 Credit Facility, a “change of control” would result from the occurrence of, among other things, the acquisition by any person or group (other than Mr. Citron and his majority-controlled affiliates) of 35% or more of the voting and/or economic interest of our outstanding common stock on a fully-diluted basis.

Such provisions could have the effect of depriving stockholders of an opportunity to sell their shares at a premium over prevailing market prices. Any delay or prevention of, or significant payments required to be made upon, a change of control transaction or changes in our board of directors or management could deter potential acquirors or prevent the completion of a transaction in which our stockholders could receive a substantial premium over the then-current market price for their shares.

ITEM 1B. Unresolved Staff Comments

17 VONAGE ANNUAL REPORT 2015

---

Table of Contents

Not applicable.

## ITEM 2. Properties

The following is a summary of our offices and locations:

| Location                   | Business Use   | Square Footage | Lease Expiration Date |
|----------------------------|--|----------------|-----------------------|
| Holmdel, New Jersey        | Corporate Headquarters, Network Operations, Customer Services, Sales and Marketing, Administration | 350,000        | 2023                  |
| New York, New York         | Sales and Marketing  | 10,166         | 2025                  |
| Dallas, Texas              | Sales and Marketing  | 5,567          | 2021                  |
| Atlanta, Georgia           | Sales and Marketing, Administration, and Product Development                                       | 78,932         | 2020                  |
| Scottsdale, Arizona        | Network Operations, Customer Services, Administration  | 26,765         | 2021                  |
| Englewood, Colorado        | Sales and Marketing  | 9,573          | 2020                  |
| Minneapolis, Minnesota     | Sales and Marketing  | 2,206          | 2017                  |
| Murray, Utah               | Sales and Marketing  | 1,062          | 2017                  |
| Oak Brook, Illinois        | Sales and Marketing  | 4,890          | 2019                  |
| Dallas, Texas              | Sales and Marketing  | 2,776          | 2016                  |
| Denver, Colorado           | Network Operations, Customer Services, Sales and Marketing, Administration                         | 13,324         | 2016                  |
| McLean, Virginia           | Network Operations, Customer Services, Sales and Marketing, Administration                         | 24,343         | 2017                  |
| Columbia, Maryland         | Sales and Marketing  | 3,513          | 2016                  |
| Chicago, Illinois          | Sales and Marketing  | 450            | 2016                  |
| Philadelphia, Pennsylvania | Network Operations, Customer Services, Sales and Marketing   | 5,795          | 2020                  |
| London, United Kingdom     | Sales and Marketing, Administration  | 3,472          | 2020                  |
| Tel Aviv, Israel           | Application Development  | 7,158          | 2020                  |
|                            |  | 549,992        |                       |

We believe that the facilities that we occupy are adequate for our current needs and do not anticipate leasing any material additional space.

Table of Contents

## ITEM 3. Legal Proceedings

## Litigation

From time to time, in addition to those identified below, we are subject to legal proceedings, claims, investigations, and proceedings in the ordinary course of business, including claims of alleged infringement of third-party patents and other intellectual property rights, commercial, employment, and other matters. From time to time, we also receive letters or other communications from third parties inviting us to obtain patent licenses that might be relevant to our business or alleging that our services infringe upon third party patents or other intellectual property. In accordance with generally accepted accounting principles, we make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss or range of loss can be reasonably estimated. These provisions, if any, are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. We believe that we have valid defenses with respect to the legal matters pending against us and are vigorously defending these matters. Given the uncertainty surrounding litigation and our inability to assess the likelihood of a favorable or unfavorable outcome in the above noted matters and our inability to reasonably estimate the amount of loss or range of loss, it is possible that the resolution of one or more of these matters could have a material adverse effect on our consolidated financial position, cash flows or results of operations.

## IP Matters

Bear Creek Technologies, Inc. On February 22, 2011, Bear Creek Technologies, Inc. (“Bear Creek”) filed a lawsuit against Vonage Holdings Corp., Vonage America Inc., Vonage Marketing LLC, and Aptela Inc. (the latter two entities being former subsidiaries of Vonage Holdings Corp. now merged into Vonage America Inc. and Vonage Business Inc., respectively) in the United States District Court for the Eastern District of Virginia alleging that Vonage’s and Aptela’s products and services are covered by United States Patent No. 7,889,722, entitled “System for Interconnecting Standard Telephony Communications Equipment to Internet Protocol Networks” (the “’722 Patent”). The suit also named numerous other defendants. On August 17, 2011, the Court dismissed Bear Creek’s case against the Vonage entities and Aptela, and all but one of the other defendants. Later, on August 17, 2011, Bear Creek re-filed its complaint in the United States District Court for the District of Delaware against the same Vonage entities; and re-filed its complaint against Aptela in the United States District Court for the Eastern District of Virginia against Aptela. On May 2, 2012, the litigations against Vonage and Aptela were consolidated for pretrial proceedings with twelve other actions in the District of Delaware. Vonage filed an answer to Bear Creek’s complaint, including counterclaims of non-infringement and invalidity of the ‘722 patent. Aptela, which filed a motion to dismiss Bear Creek’s complaint on September 27, 2011, has not yet answered, as its motion remains pending. On November 5, 2012, Bear Creek filed an answer to Vonage’s counterclaims. On July 17, 2013, the Court stayed the case pending resolution of the reexamination of the ‘722 patent requested by Cisco Systems, Inc. (“Cisco”), described below. On May 5, 2015, the Court closed the case, with leave to reopen if further attention by the Court is required.

A request for reexamination of the validity of the ‘722 Patent was filed on September 12, 2012 by Cisco. Cisco’s request was granted on November 28, 2012. On March 24, 2014, the United States Patent and Trademark Office issued an Action Closing Prosecution, confirming its rejection of all claims of the ‘722 patent. On November 14, 2014, Bear Creek submitted its Appeal of the Action Closing Prosecution to the Patent Trial and Appeal Board. On December 29, 2015, Bear Creek’s Appeal was denied and the Examiner’s rejection of the ‘722 patent was affirmed. RPost Holdings, Inc. On August 24, 2012, RPost Holdings, Inc., RPost Communications Limited, and RMail Limited (collectively,

“RPost”) filed a lawsuit against StrongMail Systems, Inc. (“StrongMail”) in the United States District Court for the Eastern District of Texas alleging that StrongMail’s products and services, including its electronic mail marketing services, are covered by United States Patent Nos. 8,224,913, 8,209,389, 8,161,104, 7,966,372, and 6,182,219. On February 11, 2013, RPost filed an amended complaint, adding 27 new defendants, including Vonage America Inc.

RPost's amended complaint alleges willful infringement of the RPost patents by Vonage and each of the other new defendants because they are customers of StrongMail. StrongMail has agreed to fully defend and indemnify Vonage in this lawsuit. Vonage answered the complaint on May 7, 2013. On January 30, 2014, RPost informed the Court that it is ready for a scheduling conference; the Court has not yet scheduled a conference. On September 17, 2015, the Court ordered the consolidation for pre-trial purposes of this case with other cases by RPost against third-parties Epsilon Data Management, LLC., Experian Marketing Solutions, LLC, and Vocus, Inc. The lead case has been administratively closed and stayed since January 30, 2014 due to multiple pending actions by third parties regarding ownership of the patents at issue. On December 1, 2015, the parties in the consolidated actions filed their most recent joint notice regarding status of the co-pending actions. Plaintiffs requested that the stay be lifted, while defendants maintain that the stay should remain in place.

AIP Acquisition LLC. On January 3, 2014, AIP Acquisition LLC ("AIP"), filed a lawsuit against Vonage Holdings Corp., Vonage America, Inc., and Vonage Marketing LLC in the U.S. District Court for the District of Delaware alleging that Vonage's products and services are covered by United States Patent No. 7,269,247. Vonage filed an answer and counterclaims on February 25, 2014. AIP filed an amended complaint on March 18, 2014, which Vonage answered on April 4, 2014. On April 8, 2014, the Court ordered a stay of the case pending final resolution of non-party Level 3's inter partes review request of United States Patent No. 7,724,879, which is a continuation of the '247 patent. On October 8, 2014, the Patent Office issued a Final Written Decision, finding all challenged claims of the '879 patent to be invalid. On November 10, 2015, the Federal Circuit rejected AIP's appeal and affirmed the Patent Office's rejection of the '879 patent.

A second request for inter partes review of the '879 patent was made by Cisco on December 12, 2013 and granted by the Patent Office on May 27, 2014. On May 20, 2015, the Patent Office issued a Final Written Decision, finding all challenged claims of the '879 patent to be invalid. On July 17, 2015, AIP filed a Notice of Appeal to the Patent Office's rejection. AIP's request to voluntarily dismiss its appeal was granted on December 2, 2015.

Cisco petitioned for inter partes review of the '247 patent on November 25, 2014. On May 20, 2015, the Patent Office granted Cisco's request, setting oral argument for January 27, 2016.

#### Commercial Litigation

Merkin & Smith, et als. On September 27, 2013, Arthur Merkin and James Smith filed a putative class action lawsuit against Vonage America, Inc. in the Superior Court of the State of California, County of Los Angeles, alleging that Vonage violated California's Unfair Competition Law by charging its customers fictitious 911 taxes and fees. On October 30, 2013, Vonage filed a notice removing the case to the United States District Court for the Central District of California. On November 26, 2013, Vonage filed its Answer to the Complaint. On December 4, 2013, Vonage filed a Motion to Compel Arbitration, which the Court denied on February 4, 2014. On March 5, 2014, Vonage appealed that decision to the United States Court of Appeals for the Ninth Circuit. On March 26, 2014, the district court proceedings were stayed pending the appeal. Oral argument on the appeal took place on February 2, 2016.

#### Regulation

Telephony services are subject to a broad spectrum of state and federal regulations. Because of the uncertainty over whether Voice

## Table of Contents

over Internet Protocol (“VoIP”) should be treated as a telecommunications or information service, we have been involved in a substantial amount of state and federal regulatory activity. Implementation and interpretation of the existing laws and regulations is ongoing and is subject to litigation by various federal and state agencies and courts. Due to the uncertainty over the regulatory classification of VoIP service, there can be no assurance that we will not be subject to new regulations or existing regulations under new interpretations, and that such change would not introduce material additional costs to our business.

### Federal - Net Neutrality

Clear and enforceable net neutrality rules make it more difficult for broadband Internet service providers to block or discriminate against Vonage service. In addition, explicitly applying net neutrality rules to wireless broadband Internet service providers could create greater opportunities for VoIP applications that run on wireless broadband Internet service. In December 2010, the FCC adopted net neutrality rules that applied strong net neutrality rules to wired broadband Internet service providers and limited rules to wireless broadband Internet service providers. On January 14, 2014, the D.C. Circuit Court of Appeals vacated a significant portion of the 2010 rules. On May 15, 2014, the FCC issued a Notice of Proposed Rulemaking (NPRM) proposing new net neutrality rules. After public response to the NPRM, the FCC adopted new neutrality rules on February 26, 2015. These rules prohibit broadband Internet service providers from: (1) blocking or throttling lawful content applications, or services; (2) imposing paid prioritization arrangements; and (3) unreasonably interfering or unreasonably disadvantaging consumers or edge providers. In addition, broadband Internet service providers are required to make certain disclosures regarding their network management practices, network performance, and commercial terms. These net neutrality rules apply the same requirements to wired and wireless broadband Internet service providers. Several parties have filed appeals which are pending at the D.C. Circuit Court of Appeals. Oral arguments at the D.C. Circuit Court of Appeals were held on December 4, 2015.

### Federal - Universal Service Contribution Reform

On April 30, 2012, the FCC released a Further Notice of Proposed Rulemaking on reforming federal universal service fund (“USF”) contributions. Currently USF contributions are assessed on the interstate and international revenue of traditional telephone carriers and interconnected VoIP providers like Vonage. The level of USF assessments on these providers has been going up over time because of decreases in the revenue subject to assessment due to substitution of non-assessable services such as non-interconnected VoIP services. In addition, communications industry revenues, in general, have shifted away from USF assessable voice services to non-assessable broadband services. Both of these trends have reduced the USF contribution base and caused the assessment rate to increase to cover USF costs. In the order adopting the 2015 net neutrality rules, the FCC applied some universal service provisions to broadband internet service, but forbore from applying USF contribution obligations pending a recommendation from the Federal State Joint Board on Universal Service. If the FCC does reform USF contributions or add services to the contribution base, it is likely that Vonage’s contribution burden will decline.

### Federal - E-Rate Reform

On December 19, 2013, the FCC released a Second Report and Order and Order on Reconsideration modernizing the E-Rate program. The E-Rate program subsidizes voice and data services for schools and libraries and is one component of the federal universal service fund. The December 19 order increased the size of the E-Rate fund to \$3.9B in available annual funding. This represents an approximately \$1.5B annual (17%) increase in the overall size of the universal service fund. This increase in the size of the fund will likely lead to increased USF contribution levels for Vonage services subject to assessment for federal USF.

### Federal - Rural Call Completion Issues

On February 7, 2013, the FCC released a Notice of Proposed Rulemaking (NPRM) on rural call completion issues. The NPRM proposed new detailed reporting requirements to gauge rural call completion performance. Rural carriers have argued that VoIP provider call completion performance to rural areas is generally poor. On October 28, 2013, the FCC adopted an order on rural call completion imposing new reporting obligations and restricting certain call signaling practices. The call signaling rules went into effect on January 31, 2014. We filed for extensions of the rules, which the FCC granted, and as of April 17, 2014, we were compliant with the FCC call signaling rules. The effective



date for the reporting requirements was April 1, 2015 with the first report covering the 2nd quarter of 2015 due August 1, 2015. We could be subject to an FCC enforcement action in the future in the event the FCC took the position that our rural call completion performance is inadequate or we were not compliant with the FCC's order.

#### Federal - Numbering Rights

On April 18, 2013, the FCC issued a Notice of Proposed Rulemaking (NPRM) that proposed to modify FCC rules to allow VoIP providers to directly access telephone numbers. In addition, the FCC granted a waiver from its existing rules to allow Vonage to conduct a trial of direct access to telephone numbers. The trial would allow the FCC to obtain real-world data on direct access to telephone numbers by VoIP providers to inform consideration of the NPRM. Direct access to telephone numbers would facilitate IP to IP interconnection, which may allow VoIP providers to provide higher quality, lower cost services, promote the deployment of innovative new voice services, and experience reductions in the cost of telephony services. Vonage successfully completed the trial in certain markets and filed the required reports on the trial with the FCC. On January 31, 2014, the FCC Wireline Competition Bureau issued a positive report on the trial, concluding that Vonage's successful trial confirmed the technical feasibility of interconnected VoIP providers obtaining telephone numbers directly from the numbering administrators. On June 18, 2015, the FCC adopted an order that modifies its rules to allow interconnected VoIP providers to directly access telephone numbers. Part of the order requires approval from the Office of Management and Budget ("OMB") prior to the rule change becoming effective. On February 4, 2016, the FCC announced that OMB had approved the order and would begin accepting applications for authorization beginning on February 18, 2015. On December 23, 2015, the National Association of Regulatory Utility Commissioners filed an appeal of the June 18, 2015 FCC order at the D.C. Circuit Court of Appeals. This appeal is pending.

#### State Telecommunications Regulation

In general, the focus of interconnected VoIP telecommunications regulation is at the federal level. On November 12, 2004, the FCC issued a declaratory ruling providing that our service is subject to federal regulation and preempted the Minnesota Public Utilities Commission ("MPUC") from imposing certain of its regulations on us. The FCC's decision was based on its conclusion that our service is interstate in nature and cannot be separated into interstate and intrastate components. On March 21, 2007, the United States Court of Appeals for the 8th Circuit affirmed the FCC's declaratory ruling preempting state regulation of our service.

While this ruling does not exempt us from all state oversight of our service, it effectively prevents state telecommunications regulators from imposing certain burdensome and inconsistent market entry requirements and certain other state utility rules and regulations on our service. State regulators continue to probe the limits of federal preemption in their attempts to apply state telecommunications regulation to interconnected VoIP service. On July 16, 2009, the Nebraska Public Service Commission and the Kansas Corporation Commission filed a petition with the FCC seeking a declaratory ruling or, alternatively, adoption of a rule declaring that state authorities may apply universal service funding requirements to nomadic VoIP providers. We participated in the FCC proceedings on the petition. On November 5, 2010, the FCC issued a declaratory ruling that allowed states to assess state USF on nomadic VoIP providers on a going forward basis provided that the states comply with certain conditions to ensure that imposing state USF does not conflict with federal law or policy. More recently on July 28, 2015, the MPUC found that it has authority to regulate Charter's fixed, interconnected VoIP service.

Table of Contents

Charter challenged the MPUC's order at the U.S. District Court for Minnesota. This challenge is currently pending. We expect that state public utility commissions and state legislators will continue their attempts to apply state telecommunications regulations to nomadic VoIP service.

**State and Municipal Taxes**

In accordance with generally accepted accounting principles, we make a provision for a liability for taxes when it is both probable that a liability has been incurred and the amount of the liability or range of liability can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. For a period of time, we did not collect or remit state or municipal taxes (such as sales, excise, utility, use, and ad valorem taxes), fees or surcharges ("Taxes") on the charges to our customers for our services, except that we historically complied with the New Jersey sales tax. We have received inquiries or demands

from a number of state and municipal taxing and 911 agencies seeking payment of Taxes that are applied to or collected from customers of providers of traditional public switched telephone network services. Although we have consistently maintained that these Taxes do not apply to our service for a variety of reasons depending on the statute or rule that establishes such obligations, we are now collecting and remitting sales taxes in certain of those states including a number of states that have changed their statutes to expressly include VoIP. In addition, many states address how VoIP providers should contribute to support public safety agencies, and in those states we remit fees to the appropriate state agencies. We could also be contacted by state or municipal taxing and 911 agencies regarding Taxes that do explicitly apply to VoIP and these agencies could seek retroactive payment of Taxes. As such, we have a reserve of \$3,903 as of December 31, 2015 as our best estimate of the potential tax exposure for any retroactive assessment. We believe the maximum estimated exposure for retroactive assessments is approximately \$12,000 as of December 31, 2015.

**ITEM 4. Mine Safety Disclosures**

Not Applicable.

Table of Contents

## PART II

## ITEM 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## Price Range of Common Stock

Our common stock has been listed on the New York Stock Exchange under the ticker symbol “VG” since May 24, 2006. Prior to that time, there was no public market for our common stock. The

following table sets forth the high and low sales prices for our common stock as reported on the NYSE for the quarterly periods indicated.

|                | Price Range of<br>Common Stock |        |
|----------------|--------------------------------|--------|
|                | High                           | Low    |
| 2015           |                                |        |
| Fourth quarter | \$7.42                         | \$5.61 |
| Third quarter  | \$6.69                         | \$4.59 |
| Second quarter | \$5.20                         | \$4.44 |
| First quarter  | \$5.16                         | \$3.74 |
| 2014           |                                |        |
| Fourth quarter | \$3.96                         | \$3.10 |
| Third quarter  | \$4.01                         | \$3.17 |
| Second quarter | \$4.50                         | \$3.33 |
| First quarter  | \$4.96                         | \$3.25 |

## Holders

At January 31, 2016, we had approximately 445 stockholders of record. This number does not include beneficial owners whose shares are held in street name.

## Dividends

We have never paid cash dividends on our common stock, and we do not anticipate paying any cash dividends on our common stock for at least the next 12 months. We intend to retain all of our earnings, if any, for general corporate purposes, and, if appropriate, to finance the expansion of our business.

## Stock Performance Graph

The graph below compares the cumulative total return of

our common stock between December 31, 2010 and December 31, 2015, with the cumulative total return of (1) the S&P 500 Index, (2) the NASDAQ Telecom Index and (3) the NYSE Composite Index. This graph assumes the investment of \$100 on December 31, 2010 in our common stock, the S&P 500 Index, the NASDAQ Telecom Index and the NYSE Composite Index, and assumes the reinvestment of dividends, if any.

The graph below and related information shall not be deemed “soliciting material” or “filed” with the Securities and Exchange Commission or otherwise subject to the liabilities of Section 18 of the Securities Exchange Act of 1934 (the “Exchange Act”), nor shall such information be deemed incorporated by reference into any filing under the Securities Act of 1933 (the “Securities Act”) or the Exchange Act, except to the extent we specifically request that such information be treated as soliciting material or specifically incorporate such information by reference into a document

filed under the Securities Act or the Exchange Act.

22 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## COMPARISON OF THE CUMULATIVE TOTAL RETURN ON COMMON STOCK BETWEEN DECEMBER 31, 2010 AND DECEMBER 31, 2015

Among Vonage Holdings Corp., the S&amp;P 500 Index, the NASDAQ Telecom Index and the NYSE Composite Index.

|                       | December 31, |          |          |          |          |
|-----------------------|--------------|----------|----------|----------|----------|
|                       | 2011         | 2012     | 2013     | 2014     | 2015     |
| Vonage Holdings Corp. | \$109.38     | \$105.80 | \$148.66 | \$170.09 | \$256.25 |
| S&P 500 Index         | \$100.00     | \$113.40 | \$146.97 | \$163.71 | \$162.52 |
| NASDAQ Telecom Index  | \$87.38      | \$89.13  | \$110.54 | \$120.38 | \$111.36 |
| NYSE Composite Index  | \$93.89      | \$106.02 | \$130.59 | \$136.10 | \$123.91 |

## Common Stock repurchases

See Note 8 – Common Stock of the Notes to Financial Statements (Part IV of this Form 10-K) for information regarding common stock repurchases by quarter.

On February 7, 2013, Vonage's Board of Directors discontinued the remainder of the \$50,000 repurchase program, announced on July 25, 2012, effective at the close of business on February 12, 2013, with \$16,682 remaining, and authorized a new program to repurchase up to \$100,000 of the Company's outstanding shares. The 2013 \$100,000 repurchase program expired on December 31, 2014, with \$219 remaining.

On December 9, 2014, Vonage's Board of Directors authorized a new program for the Company to repurchase up to \$100,000 of its outstanding common stock. Repurchases under the 2014 \$100,000 repurchase program are expected to be made over a four-year period beginning in 2015. Under this program, the timing and amount of

repurchases will be determined by management based on its evaluation of market conditions, the trading price of the stock and will vary based on available capital resources and other financial and operational performance, market conditions, securities law limitations, and other factors. Repurchases may be made in the open market or through private transactions from time to time. The repurchases will be made using available cash balances. In any period, cash used in financing activities related to common stock repurchases may differ from the comparable change in stockholders' equity, reflecting timing differences between the recognition of share repurchase transactions and their settlement for cash.

During the three months ended December 31, 2015, we did not repurchase Vonage Holdings Corp. common stock. As of December 31, 2015, approximately \$84,805 remained of our 2014 \$100,000 repurchase program.

Table of Contents

ITEM 6. Selected Financial Data

The following table sets forth our selected historical financial information. The statement of operations and cash flow data for the years ended December 31, 2015, 2014, and 2013 and the balance sheet data as of December 31, 2015 and 2014 are derived from our audited consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. The statement of operations and cash flow data for the years ended December 31, 2012 and 2011 and the balance sheet data as of

December 31, 2013, 2012 and 2011 are derived from our audited consolidated financial statements and related notes not included in this Annual Report on Form 10-K. The results included below and elsewhere are not necessarily indicative of our future performance. You should read this information together with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the related notes included elsewhere in this Annual Report on Form 10-K.

Table of Contents

| (In thousands, except per share amounts)  | For the years ended December 31, |           |           |           |           |
|---|----------------------------------|-----------|-----------|-----------|-----------|
| Statement of Operations Data:   | 2015 (1)                         | 2014 (2)  | 2013 (3)  | 2012      | 2011      |
| Total revenues  | \$895,072                        | \$868,854 | \$829,067 | \$849,114 | \$870,323 |
| Operating Expenses:   |                                  |           |           |           |           |
| Cost of services (4) (5)  | 261,768                          | 231,383   | 237,244   | 259,224   | 267,338   |
| Cost of goods sold  | 34,210                           | 36,500    | 37,586    | 39,133    | 41,756    |
| Sales and marketing (5)   | 347,896                          | 373,737   | 366,307   | 340,130   | 319,851   |
| Engineering and development (5)   | 27,220                           | 20,869    | 14,794    | 17,304    | 16,089    |
| General and administrative (5)  | 109,153                          | 98,780    | 83,107    | 70,127    | 71,888    |
| Depreciation and amortization   | 61,833                           | 49,514    | 36,054    | 33,324    | 37,051    |
| Loss from abandonment of software assets  | —                                | —         | —         | 25,262    | —         |
|   | 842,080                          | 810,783   | 775,092   | 784,504   | 753,973   |
| Income from operations  | 52,992                           | 58,071    | 53,975    | 64,610    | 116,350   |
| Other Income (Expense):   |                                  |           |           |           |           |
| Interest income   | 89                               | 207       | 307       | 109       | 135       |
| Interest expense  | (8,786)                          | (6,823)   | (6,557)   | (5,986)   | (17,118)  |
| Change in fair value of embedded features within notes payable and stock warrant    | —                                | —         | —         | —         | (950)     |
| Loss on extinguishment of notes   | —                                | —         | —         | —         | (11,806)  |
| Other (expense) income, net   | (842)                            | 11        | (104)     | (11)      | (271)     |
|   | (9,539)                          | (6,605)   | (6,354)   | (5,888)   | (30,010)  |
| Income from continuing operations before income tax expense                         | 43,453                           | 51,466    | 47,621    | 58,722    | 86,340    |
| Income tax (expense) benefit  | (18,418)                         | (21,759)  | (18,194)  | (22,095)  | 322,704   |
| Income from continuing operations   | \$25,035                         | \$29,707  | \$29,427  | \$36,627  | \$409,044 |
| Loss from discontinued operations   | (1,615)                          | (10,260)  | (1,626)   | —         | —         |
| Loss on disposal, net of taxes  | (824)                            | —         | —         | —         | —         |
| Discontinued operations   | (2,439)                          | (10,260)  | (1,626)   | —         | —         |
| Net Income  | 22,596                           | 19,447    | 27,801    | 36,627    | 409,044   |
| Plus: Net loss from discontinued operations attributable to noncontrolling interest | \$59                             | \$819     | \$488     | \$—       | \$—       |
| Net income attributable to Vonage   | \$22,655                         | \$20,266  | \$28,289  | \$36,627  | \$409,044 |
| Net Income per common share - continuing operations:                                |                                  |           |           |           |           |
| Basic   | \$0.12                           | \$0.14    | \$0.14    | \$0.16    | \$1.82    |
| Diluted   | \$0.11                           | \$0.14    | \$0.13    | \$0.16    | \$1.69    |
| Net Loss per common share - discontinuing operations attributable to Vonage:        |                                  |           |           |           |           |
| Basic   | (0.01)                           | (0.04)    | (0.01)    | —         | —         |
| Diluted   | (0.01)                           | (0.04)    | (0.01)    | —         | —         |
| Net Income per common share - attributable to Vonage:                               |                                  |           |           |           |           |
| Basic   | 0.11                             | 0.10      | 0.13      | 0.16      | 1.82      |
| Diluted   | 0.10                             | 0.09      | 0.13      | 0.16      | 1.69      |
| Weighted-average common shares outstanding:   |                                  |           |           |           |           |
| Basic   | 213,147                          | 209,822   | 211,563   | 224,264   | 224,324   |
| Diluted   | 224,110                          | 219,419   | 220,520   | 232,633   | 241,744   |

25 VONAGE ANNUAL REPORT 2015

---



Table of Contents

| (dollars in thousands)  | For the years ended December 31, |            |            |           |            |
|---|----------------------------------|------------|------------|-----------|------------|
|   | 2015 (1)                         | 2014 (2)   | 2013 (3)   | 2012      | 2011       |
| Statement of Cash Flow Data:  |                                  |            |            |           |            |
| Net cash provided by operating activities   | \$ 129,731                       | \$92,542   | \$88,243   | \$119,843 | \$146,786  |
| Net cash used in investing activities   | (152,696 )                       | (118,528 ) | (120,985 ) | (25,472 ) | (37,604 )  |
| Net cash provided by (used in) financing activities   | 40,205                           | (14,239 )  | 21,891     | (56,257 ) | (130,138 ) |
|   | December 31,                     |            |            |           |            |
| (dollars in thousands)  | 2015 (1)                         | 2014 (2)   | 2013 (3)   | 2012      | 2011       |
| Balance Sheet Data:   |                                  |            |            |           |            |
| Cash, cash equivalents and marketable securities  | \$67,634                         | \$47,959   | \$84,663   | \$97,110  | \$58,863   |
| Property and equipment, net   | 49,483                           | 49,630     | 52,243     | 60,533    | 67,978     |
| Goodwill and intangible assets, net   | 360,305                          | 253,376    | 160,477    | 6,681     | 9,056      |
| Total deferred tax assets, including current portion, net   | 226,572                          | 247,016    | 264,900    | 306,113   | 325,601    |
| Restricted cash   | 2,587                            | 3,405      | 4,405      | 5,656     | 6,929      |
| Total assets  | 784,566                          | 674,460    | 642,158    | 547,042   | 565,312    |
| Total notes payable and indebtedness under revolving credit facility, including current portion (6) | 210,392                          | 156,032    | 121,075    | 42,153    | 69,930     |
| Capital lease obligations   | 7,761                            | 10,201     | 13,090     | 15,561    | 17,665     |
| Total liabilities   | 395,825                          | 330,963    | 304,122    | 225,627   | 265,745    |
| Redeemable noncontrolling interest  | —                                | —          | (38 )      | —         | —          |
| Total stockholders' equity  | 388,741                          | 343,497    | 338,074    | 321,415   | 299,567    |

(1) The year ended December 31, 2015 includes the impacts of the acquisition of iCore, which was completed in the third quarter and the acquisition of Simple Signal, which was completed in the second quarter.

(2) The year ended December 31, 2014 includes the impact of the acquisition of Telesphere Networks Ltd., which was completed in the fourth quarter.

(3) The year ended December 31, 2013 includes the impact of the acquisition of Vocalocity Inc., which was completed in the fourth quarter.

(4) Excludes depreciation and amortization of \$24,868 for 2015, \$19,405 for 2014, \$14,892 for 2013, \$15,115 for 2012, and \$15,824 for 2011.

(5) As the Company's business evolves, positioning us as a Unified Communications as a Service ("UCaaS") provider, we have made certain changes to our income statement presentation. Sales expenses have been separated from selling, general, and administrative expenses and combined with marketing in a new sales and marketing caption. A new caption, engineering and development, has also been reclassified from selling, general and administrative expenses. The remaining selling, general and administrative expenses, after the above reclassifications, have been renamed as general and administrative expenses. The reclassifications have been reflected in all periods presented.

(6) Certain reclassifications have been made to prior year's balance sheet in order to conform to the current year's presentation due to the adoption of ASU 2015-03 and ASU 2015-15 in the third quarter of 2015.



Table of Contents

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion together with "Selected Financial Data" and our consolidated financial statements and the related notes included elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements, which involve risks and uncertainties. Our actual results may differ materially from those we currently anticipate as a result of many factors, including the factors we describe under "Item 1A—Risk Factors," and elsewhere in this Annual Report on Form 10-K.

OVERVIEW

We are a leading provider of cloud communications services for businesses and consumers, offering a robust suite of feature-rich consumer and business communication solutions that offer flexibility, portability and ease-of-use across multiple devices.

Business Services

For our business services customers, we provide innovative, cloud-based Unified Communications as a Service, or UCaaS, solutions, comprised of integrated voice, text, video, data, collaboration, and mobile applications over our flexible, scalable Session Initiation Protocol (SIP) based Voice over Internet Protocol, or VoIP, network. Our products and services permit these customers to communicate with their customers and employees through any cloud-connected device, in any place, at any time without the often costly investment required with on-site equipment. We have a robust set of product families tailored to serve the full range of the business market, including the small and medium business, or SMB, mid-market, and enterprise segments. We provide customers with multiple deployment options, designed to provide the reliability and quality of service they demand. Through our cloud-based middleware solution, gUnify, we provide customers the ability to integrate our cloud communications platform with many SaaS business applications, including Google for Work, Zendesk, Salesforce's Sales Cloud, Clio, and other CRM solutions.

During 2015, we organized our business solutions to support the full range of business customer, using two product families: Vonage Essentials, based on our proprietary call processing platform that is purpose-built for SMB and mid-market customers; and Vonage Premier, based on Broadsoft's call processing platform in combination with other Vonage cloud based solutions, which serves larger customers, from mid-market businesses through large enterprises. We also organized our salesforce to address the full business market, delivering the right products to the right customer. We believe operating two platforms at scale enables us to deliver the right products and solutions to address the needs of diverse customers while maximizing our subscriber economics regardless of segment served. Revenues are generated primarily through the sale of subscriptions for our UCaaS services. Our revenue generation efforts are focused on customer acquisition and retention as well as providing additional services to existing customers as they grow and scale.

Our diverse customer base spans multiple industries, including manufacturing, automotive, legal, information technology, financial services, construction, real estate, engineering, healthcare, and non-profit.

Vonage Essentials. Vonage Essentials customers subscribe to our cloud-based communication services, delivered through our proprietary platform that is purpose-built for SMB and mid-market customers. Essentials provides a cost-effective, scalable, feature-rich

solution, delivered over-the-top of a customer's broadband, typically month-to-month without a commitment. Vonage Essentials is sold primarily through our direct telesales and online channels, and is increasingly sold through our channel partners and field sales teams. We believe the strength of the Vonage brand directly contributes to a

lower-cost customer acquisition model and provides attractive subscriber economics.

Vonage Premier. Our Vonage Premier offerings are tailor-made for the large mid-market and enterprise segments. Vonage Premier is a feature-rich/fully managed solution that utilizes Broadsoft Inc.'s ("Broadsoft") enterprise-grade call processing platform, in combination with other Vonage cloud services like advanced contact center, video conferencing, speak2dial, infrastructure as a service (IaaS), and Virtual Desktop Infrastructure (VDI), and can be provided with high-level QoS, which is generally delivered over our national MPLS network, with 21 network Points of Presence (POPs) across the country. Customers value our proprietary provisioning and feature-management tool, named Zeus, which enables the rapid deployment of solutions directly by Vonage while giving full visibility to our channel partners and our customers. Further differentiating Vonage is our robust service delivery team comprised of team members specializing in project management, voice and data provisioning, and line number porting. This team is intensely focused on providing an outstanding customer experience, and is rapidly becoming a competitive differentiator.

Our Vonage Premier offering is sold through our channel partners, and our field and enterprise sales teams, and generally requires a three-year contract. We are a preferred provider for many of the largest master agents in the country, harnessing a network of over 20,000 sub agents selling both Vonage Premier and Vonage Essentials. We believe we have one of the largest multi-channel distribution sales platforms in our industry to serve the full range of business customers. We plan to capitalize on the growing adoption of cloud-based communications and collaboration solutions by continuing to expand our salesforce, expand into new markets, and enhance our relationships with existing customers to provide additional functionality and overall business value that can be achieved with our UCaaS platform.

#### Consumer Services

For our consumer services customers, we enable users to access and utilize our UCaaS services and features, via a single "identity," either a number or user name, regardless of how they are connected to the Internet, including over 3G, LTE, Cable, or DSL broadband networks. This technology enables us to offer our consumer services customers attractively priced voice and messaging services and other features around the world on a variety of devices.

Our consumer services strategy is focused on the continued penetration of our core North American markets, where we will continue to provide value in international long distance and target under-served ethnic segments.

International long distance. As a part of our strategy, our primary focus in our domestic markets is serving the under-served ethnic segments in the United States with international calling needs. The markets for international long distance allow us to leverage our VoIP network by providing customers a low-cost and feature-rich alternative to services offered by telecom, cable, and international calling card providers. With our Vonage World product, we have successfully grown our international calling customer base in multiple ethnic markets.

To increase the visibility of our long distance plans, we have shifted an increasing portion of our marketing budget from broad national

## Table of Contents

advertising as we target attractive segments of the international long distance market. We have inside sales channels where customers can subscribe to our services on-line or through our toll-free number, as well as a retail distribution channel through regional and national retailers.

For both our North American and international customers we provide mobile capability through our patented Vonage Extensions mobile app. Our mobile applications enable consumer services customers to make and receive phone calls on their mobile devices from anywhere they have a Wi-Fi or cellular data connection. Our customers have found value in our ability to deliver high-quality voice solutions coupled with useful features and services.

We generate revenue through the acquisition and retention of consumer services customers. We are focused on optimizing the consumer services business by increasing profitability to improve the strong cash flows of the business. Our focus on operations during the past five years has led to a significantly improved cost structure. We have implemented operational efficiencies throughout our business and have substantially reduced domestic and international termination costs per minute, as well as customer care costs. We achieved these structural costs reductions while concurrently delivering significantly improved network call quality and customer service performance. These improvements in customer experience have contributed to the stabilization in churn over recent periods. During 2015, we continued our disciplined focus on marketing efficiency by shifting customer acquisition spend to our higher performing channels, improving the quality of customers we acquire and driving lower churn, all of which drive higher customer life-time value. This focus has led to a reallocation of certain marketing spend to direct response and digital platforms and away from our assisted selling channel, which utilized direct face-to-face selling across multiple retail chains and community and event venues.

The result of these initiatives has been to create a strong cash flow business which provides financial stability, as well as cost synergies and structural advantages to our business serving the UCaaS business market.

Services outside of the United States. We currently have operations in the United States, United Kingdom, and Canada and believe that our low-cost Internet based communications platform enables us to cost effectively deliver voice and messaging services to other locations throughout the world. In December 2014 we announced plans to exit the Brazilian market for residential telephony services and wind down our joint venture operations in the country. The Company completed this process at the end of the first quarter of 2015. This decision underscores the Company's focus on providing UCaaS solutions to domestic consumer services and SMB, medium and large enterprise customers, which offer higher investment return opportunities.

### Trends in Our Industry

A number of trends in our industry have a significant effect on our results of operations and are important to an understanding of our financial statements.

**Competitive landscape.** We face intense competition from traditional telephone companies, wireless companies, cable companies, and alternative communication providers. Most traditional wireline and wireless telephone service providers and cable companies are substantially larger and better capitalized than we are and have the advantage of a large existing customer base. In addition, because our competitors provide other services, they often choose to offer VoIP services or other voice services as part of a bundle that includes other products, such as video, high speed Internet access, and wireless telephone service, which we do not offer. In addition, such competitors may in the future require new customers or existing customers making changes to their service to purchase voice services when purchasing high speed Internet access. Further, as wireless providers offer more minutes at lower prices, better coverage, and companion landline alternative services, their services have become more attractive to

households as a replacement for wireline service. We also compete against alternative communication providers, such as magicJack, Skype, and Google Voice. Some of these service providers have chosen to sacrifice telephony revenue in order to gain market share and have offered their services at low prices or for free. As we continue to introduce applications that integrate different forms of voice and messaging services over multiple devices, we are facing competition from emerging competitors focused on similar integration, as well as from alternative voice communication providers. In addition, our competitors have partnered and may in the future partner with other competitors to offer products and services, leveraging their collective competitive positions. We also are subject to the risk of future disruptive technologies. In connection with our emphasis on the international long distance market in the

United States, we face competition from low-cost international calling cards and VoIP providers in addition to traditional telephone companies, cable companies, and wireless companies, each of which may implement promotional pricing targeting international long distance callers.

**Broadband adoption.** The number of United States households with broadband Internet access has grown significantly. On March 16, 2010, the Federal Communications Commission ("FCC") released its National Broadband Plan, which seeks, through supporting broadband deployment and programs, to encourage broadband adoption for the approximately 100 million United States residents who do not have broadband at home. We expect the trend of greater broadband adoption to continue. We benefit from this trend because our service requires a broadband Internet connection and our potential addressable market increases as broadband adoption increases.

**Regulation.** Our business has developed in a relatively lightly regulated environment. The United States and other countries, however, are examining how VoIP services should be regulated. A November 2010 order by the FCC that permits states to impose state universal service fund obligations on VoIP service, discussed in Note 6 to our financial statements, is an example of efforts by regulators to determine how VoIP service fits into the telecommunications regulatory landscape. In addition to regulatory matters that directly address VoIP, a number of other regulatory initiatives could impact our business. One such regulatory initiative is net neutrality. In December 2010, the FCC adopted a revised set of net neutrality rules for broadband Internet service providers. These rules made it more difficult for broadband Internet service providers to block or discriminate against Vonage service. On January 14, 2014, the D.C. Circuit Court of Appeals vacated a significant portion of the 2010 rules. On May 15, 2014, the FCC issued a Notice of Proposed Rulemaking (NPRM) proposing new net neutrality rules. After public response to the NPRM, the FCC adopted new neutrality rules on February 26, 2015. Several parties have filed appeals which are pending at the D.C. Circuit Court of Appeals. Oral arguments at the D.C. Circuit Court of Appeals were held on December 4, 2015. See also the discussion under "Regulation" in Note 10 to our financial statements for a discussion of regulatory issues that impact us.

#### Key Operating Data

Through our acquisitions of Vocalocity, Telesphere, Simple Signal, and iCore, our business has substantially evolved in recent quarters, with business customers now accounting for a substantial and growing portion of overall revenues. To reflect this evolution, we have made certain changes to our key operating data and income statement presentation to provide greater visibility into the operating metrics of the business. The key changes to the income statement include the combination of sales and marketing expenses into a new sales and marketing caption, separated from selling, general, and administrative expenses. A new line item entitled engineering and development has also been created, reflecting the cost of developing new products and technologies and supporting our service platforms. The remaining selling, general and administrative expenses after the above reclassifications have been renamed general and administrative expenses. The reclassifications have been reflected in all periods presented and had no impact on net earnings previously reported.

Table of Contents

The table below includes key operating data that our management uses to measure the growth and operating performance of the consumer focused portion of our business:

| Consumer                                     | For the Years Ended December 31, |           |           |
|--|----------------------------------|-----------|-----------|
|  | 2015                             | 2014      | 2013      |
| Revenues                                     | 676,046                          | 774,410   | 821,359   |
| Average monthly revenues per subscriber line | 27.58                            | 28.64     | 29.00     |
| Subscriber lines (at period end)             | 1,940,825                        | 2,144,681 | 2,361,131 |
| Customer churn                               | 2.3                              | % 2.6     | % 2.5     |

Revenues. Consumer revenues represents revenue from our consumer customers including revenues from our legacy business customers using Vonage VoIP products.

Average monthly revenues per subscriber line. Average monthly revenues per subscriber line for a particular period is calculated by dividing our revenues for that period by the simple average number of subscriber lines for the period, and dividing the result by the number of months in the period. The simple average number of subscriber lines for the period is the number of subscriber lines on the first day of the period, plus the number of subscriber lines on the last day of the period, divided by two. Our average monthly revenues per subscriber line decreased from \$28.64 for 2014 to \$27.58 for 2015 due to the “\$10 dollars a month for the first year” pricing structure implemented in 2015 and lower ILD pay-per-use revenue.

Subscriber lines. Our subscriber lines include, as of a particular date, all paid subscriber lines from which a customer can make an outbound telephone call on that date. Our subscriber lines include fax lines, including fax lines bundled with subscriber lines in our small office home office calling plans and soft phones, but do not include our virtual phone numbers and toll free numbers, which only allow inbound telephone calls to customers. Subscriber lines decreased from 2,144,681 as of December 31, 2014 to 1,940,825 as of December 31, 2015, reflecting planned actions to enhance the profitability of the assisted sales channel by eliminating lower performing locations and restructuring the pricing offers, and to shift investment to our business market. In addition, beginning October 1, 2014, the Company no longer charges for second line mobile Extensions provided to customers, which resulted in a decrease in subscriber lines of 78,949. Future period subscriber line metrics will continue to reflect the reduction in paid subscriber lines resulting from this benefit to customers.

Customer churn. Customer churn is calculated by dividing the number of customers that have terminated during a period by the simple average number of customers in a given period. The simple average number of customers during the period is the number of customers on the first day of the period, plus the number of customers on the last day of the period, divided by two. Terminations, as used in the calculation of churn statistics, do not include customers terminated during the period if termination occurred within the first month after activation. Other companies may calculate customer churn differently, and their customer churn data may not be directly comparable to ours. Customer churn decreased to 2.3% for 2015 from 2.6% for 2014. The decrease was due primarily to our decision to maximize customer value by focusing marketing spend on higher return channels and away from assisted selling channels which had higher early life churn. Customer churn was 2.2% for the three months ended December 31, 2015, compared to 2.3% for the three months ended September 30, 2015 and 2.4% for the three months ended December 31, 2014. The decrease was due primarily to our decision to maximize customer value by focusing marketing spend on higher return channels and away from assisted selling channels which had higher early life churn. We monitor customer churn on a daily basis and use it as an indicator of the level of customer satisfaction. Customers who have been with us for a year or more tend to have a lower churn rate than customers who have not. In addition, our customers who are international callers generally churn at a lower rate than customers who are domestic callers. Our customer churn will fluctuate over time due to economic conditions, competitive pressures including promotional pricing targeting international long distance callers, marketplace perception of our services, and our ability to provide high quality customer care and network quality and add future innovative products and services. Customer churn differs from our previously reported average monthly customer churn in that our business customers are no longer included in this metric. See the

discussion below for detail regarding churn impacting our business customers.

The table below includes key operating data that our management uses to measure the growth and operating performance of the business focused portion of our business:

| Business                          | For the Years Ended December 31, |         |         |
|-----------------------------------|----------------------------------|---------|---------|
|                                   | 2015                             | 2014    | 2013    |
| Revenues                          | 219,026                          | 94,444  | 7,708   |
| Average monthly revenues per seat | 42.79                            | 32.44   | N/A     |
| Seats (at period end)             | 541,884                          | 311,193 | 174,100 |
| Revenue churn                     | 1.2                              | % 1.2   | % N/A   |

Revenues. Business revenues includes revenues from our business customers from acquired entities and excludes revenues from our legacy business customers.

Average monthly revenues per seat. Average monthly revenues per seat for a particular period is calculated by dividing our revenues for that period by the simple average number of seats for the period, and dividing the result by the number of months in the period. The simple average number of seats for the period is the number of seats on the first day of the period, plus the number of seats on the last

day of the period, divided by two. Our average monthly revenues per seat increased from \$32.44 for 2014 to \$42.79 for 2015 due primarily to higher rate plan revenue from Telesphere which was acquired on December 15, 2014 and iCore, which was acquired on August 31, 2015.

Seats. Our seats include, as of a particular date, all paid seats from which a customer can make an outbound telephone call on that date and virtual seats. Our seats exclude electronic fax lines and toll free numbers, which do not allow outbound telephone calls by customers. Seats increased from 311,193 as of December 31, 2014 to 541,884 as of December 31, 2015. This increase is due to continued



## Table of Contents

growth in our business customers as we have increased marketing investment to attract these more profitable customers. It also includes 48,920 seats existing at Telesphere at the time of acquisition, 35,256 seats existing at Simple Signal at the time of acquisition, and 86,309 seats existing at iCore at the time of acquisition.

Revenue churn. Revenue churn is calculated by dividing the monthly recurring revenue from customers that have terminated during a period by the simple average of the total monthly recurring revenue from all customers in a given period. The simple average of total monthly recurring revenue from all customers during the period is the total monthly recurring revenue on the first day of the period, plus the total monthly recurring revenue on the last day of the period, divided by two. Terminations, as used in the calculation of churn statistics, do not include customers terminated during the period if termination occurred within the first month after activation. Other companies may calculate revenue churn differently, and their revenue churn data may not be directly comparable to ours. Revenue churn was flat at 1.2% for the year ended 2015 and 2014. Revenue churn was 1.1% for the three months ended December 31, 2015, 1.3% for the three months ended September 30, 2015, 1.5% for the three months ended December 31, 2014. The decrease in revenue churn was due to material improvements in customer retention within Essentials and Premier, as well as the addition of iCore's mid-market and enterprise customer base. We are continuing to invest in our overall quality of service, which includes customer care headcount and systems, billing systems, on-boarding processes and self-service options to ensure we scale our processes to our growth and continue to improve the overall customer experience.

## OPERATING REVENUES

Revenues consist of services revenue and customer equipment and shipping revenue. Substantially all of our revenues are services revenue. For consumer customers in the United States, we offer domestic and international rate plans, including a variety of residential plans and mobile plans. The "Vonage World" plan, available in the United States and Canada, offers unlimited calling across the United States and Puerto Rico, unlimited international calling to over 60 countries including India, Mexico, and China, subject to certain restrictions, and free voicemail to text messages with Vonage Visual Voicemail. Each of our unlimited plans other than Vonage World offers unlimited domestic calling as well as unlimited calling to Puerto Rico, Canada, and selected European countries, subject to certain restrictions. Each of our basic plans offers a limited number of domestic calling minutes per month. We offer similar plans in Canada. Under our basic plans, we charge on a per minute basis when the number of domestic calling minutes included in the plan is exceeded for a particular month. International calls (except for calls to Puerto Rico, Canada and certain European countries under our unlimited plans and a variety of countries under international calling plans and Vonage World) are charged on a per minute basis. These per minute fees are not included in our monthly subscription fees. Through our acquisitions of Vocalocity, Telesphere, Simple Signal, and iCore, we offer SMB, mid-market, and enterprise customers several service plans with different pricing structures and contractual requirements ranging in duration from month-to-month to three years. The service plans include an array of basic and enhanced features applicable to the needs of SMB and SOHO customers. In addition, we provide managed equipment to business customers for which the customers pay a monthly fee. Customers also have the opportunity to purchase premium features for additional fees.

In addition to our landline telephony business, we are leveraging our technology to offer services and applications for mobile and other connected devices to address large existing markets. We introduced our first mobile offering in late 2009 and in early 2012 we introduced Vonage Mobile, our all-in-one mobile application that provides free calling and messaging between users who have the application, as well as traditional paid international calling to any other phone. This mobile application works over WiFi, 3G and 4G and in more than 90 countries worldwide. The application consolidates the best features of our prior applications, while adding important functionality, value and ease of use including direct payment through iTunes.

We derive most of our services revenue from monthly subscription fees that we charge our customers under our service plans. We also offer consumer fax service, virtual phone numbers, toll free numbers and other services, and charge an additional monthly fee for each service. We automatically charge these fees to our customers' credit cards,

debit cards, or electronic check payments (“ECP”), monthly in advance. We also automatically charge the per minute fees not included in our monthly subscription fees to our customers’ credit cards, debit cards or ECP monthly in arrears unless they exceed a certain dollar threshold, in which case they are charged immediately.

By collecting monthly subscription fees in advance and certain other charges immediately after they are incurred, we are able to reduce the amount of accounts receivable that we have outstanding, thus allowing us to have lower working capital requirements. Collecting in this manner also helps us mitigate bad debt losses, which are recorded as a reduction to revenue. If a customer’s credit card, debit card or ECP is declined, we generally suspend international calling capabilities as well as the customer’s ability to incur domestic usage charges in excess of their plan minutes. Historically, in most cases, we are able to correct the problem with the customer within the current monthly billing cycle. If the customer’s credit card, debit card or ECP could not be successfully processed during three billing cycles (i.e., the current and two subsequent monthly billing cycles), we terminate the account.

In the United States, we charge regulatory, compliance, E-911, and intellectual property-related recovery fees on a monthly basis to defray costs, and to cover taxes that we are charged by the suppliers of telecommunications services. In addition, we recognize revenue on a gross basis for contributions to the Federal Universal Service Fund (“USF”) and related fees. All other taxes are recorded on a net basis.

In addition, historically, we charged a disconnect fee for customers who terminated their service plan within the first twelve months of service. Disconnect fees are recorded as revenue and are recognized at the time the customer terminates service. Beginning in September 2010, we eliminated the disconnect fee for new customers. In February of 2012, we re-introduced service agreements as an option for new customers.

Services revenue is offset by the cost of certain customer acquisition activities, such as rebates and promotions. Customer equipment and shipping revenue consists of revenue from sales of customer equipment to our wholesalers or directly to customers and retailers. In addition, customer equipment and shipping revenues include revenues from the sale of VoIP telephones in order to access our small and medium business services. Customer equipment and shipping revenue also includes the fees, when collected, that we charge our customers for shipping any equipment to them.

#### OPERATING EXPENSES

Operating expenses consist of cost of service, cost of goods sold, sales and marketing expense, engineering and development expense, general and administrative expense, and depreciation and amortization.

Cost of services. Cost of services primarily consists of fees that we pay to third parties on an ongoing basis in order to provide our services. These fees include:

Access charges that we pay to other telephone companies to terminate domestic and international calls on the public switched telephone network, with a portion of these payments ultimately being made to incumbent telephone companies. When a Vonage subscriber calls another Vonage subscriber, we do not pay an access charge.

The cost of leasing Internet transit services from multiple Internet service providers. This Internet connectivity is used to carry VoIP session initiation signaling and packetized audio media between our subscribers and our regional data centers.

Table of Contents

- > The cost of leasing from other companies the telephone numbers that we provide to our customers. We lease these telephone numbers on a monthly basis.
- > The cost of co-locating our regional data connection point equipment in third-party facilities owned by other companies, Internet service providers or collocation facility providers.
- > The cost of providing local number portability, which allows customers to move their existing telephone numbers from another provider to our service. Only regulated telecommunications providers have access to the centralized number databases that facilitate this process. Because we are not a regulated telecommunications provider, we must pay other telecommunications providers to process our local number portability requests.
- > The cost of complying with FCC regulations regarding VoIP emergency services, which require us to provide enhanced emergency dialing capabilities to transmit 911 calls for our customers.
- > Taxes that we pay on our purchase of telecommunications services from our suppliers or imposed by government agencies such as Federal USF and related fees.
- > License fees for use of third party intellectual property.
- > The personnel and related expenses of certain network operations and technical support employees and contractors.
- Cost of goods sold. Cost of goods sold primarily consists of costs that we incur when a customer first subscribes to our service. These costs include:
  - > The cost of the equipment that we provide to consumer customers who subscribe to our service through our direct sales channel in excess of activation fees when an activation fee is collected. Business customers' purchased equipment is recorded on a net basis. The remaining cost of customer equipment is deferred up to the activation fee collected and amortized over the estimated average customer life.
  - > The cost of the equipment that we sell directly to retailers.
  - > The cost of shipping and handling for customer equipment, together with the installation manual, that we ship to customers.
  - > The cost of certain products or services that we give customers as promotions.
- Sales and marketing expense. Sales and marketing expense includes:
  - > Advertising costs, which comprise a majority of our sales and marketing expense and include online, television, direct mail, alternative media, promotions, sponsorships, and inbound and outbound telemarketing.
  - > Creative and production costs.
  - > The costs to serve and track our online advertising.
  - > Certain amounts we pay to retailers for activation commissions.
  - > The cost associated with our customer referral program.
  - > The personnel and related expenses of sales and marketing employees and contractors.
  - > Transaction fees paid to credit card, debit card, and ECP companies and other third party billers such as iTunes, which may include a per transaction charge in addition to a percent of billings charge.
  - > The cost of customer support and collections.
  - > Systems and information technology support.
- Engineering and development expense. Engineering and development expense includes:
  - > The personnel and related expenses of developers responsible for new products and software engineers maintaining and enhancing existing products.
- General and administrative expense. General and administrative expense includes:
  - > Personnel and related costs for executive, legal, finance, and human resources employees and contractors.
  - > Share-based expense related to share-based awards to employees, directors, and consultants.
  - > Rent and related expenses.
  - > Professional fees for legal, accounting, tax, public relations, lobbying, and development activities.
  - > Acquisition related transaction and integration costs.
  - > Litigation settlements.

Depreciation and amortization expenses. Depreciation and amortization expenses include:

- > Depreciation of our network equipment, furniture and fixtures, and employee computer equipment.
  - > Depreciation of Company-owned equipment in use at customer premises.
  - > Amortization of leasehold improvements and purchased and developed software.
  - > Amortization of intangible assets (developed technology, customer relationships, non-compete agreements, patents, trademarks and trade names).
  - > Loss on disposal or impairment of property and equipment.
- Loss from abandonment of software assets. Loss from abandonment of software assets include:
- > Impairment of investment in software assets.

#### OTHER INCOME (EXPENSE)

Other Income (Expense) includes:

- > Interest income on cash and cash equivalents.
- > Interest expense on notes payable, patent litigation judgments and settlements, and capital leases.
- > Amortization of debt related costs.
- > Accretion of notes.
- > Realized and unrealized gains (losses) on foreign currency.
- > Gain (loss) on extinguishment of notes.
- > Realized gains (losses) on sale of marketable securities.

Table of Contents

## RESULTS OF OPERATION

The following table sets forth, as a percentage of consolidated operating revenues, our consolidated statement of income for the periods indicated:

|   | For the Years Ended December 31, |   |      |   |      |   |
|---|----------------------------------|---|------|---|------|---|
|   | 2015                             |   | 2014 |   | 2013 |   |
|   |                                  | % |      | % |      | % |
| Revenues  | 100                              |   | 100  |   | 100  |   |
| Operating Expenses:   |                                  |   |      |   |      |   |
| Cost of services (excluding depreciation and amortization)                          | 29                               |   | 27   |   | 29   |   |
| Cost of goods sold  | 4                                |   | 4    |   | 5    |   |
| Sales and marketing   | 39                               |   | 43   |   | 44   |   |
| Engineering and development   | 3                                |   | 2    |   | 2    |   |
| General and administrative  | 12                               |   | 11   |   | 10   |   |
| Depreciation and amortization   | 7                                |   | 6    |   | 4    |   |
|   | 94                               |   | 93   |   | 94   |   |
| Income from operations  | 6                                |   | 7    |   | 6    |   |
| Other Income (Expense):   |                                  |   |      |   |      |   |
| Interest income   | —                                |   | —    |   | —    |   |
| Interest expense  | (1                               | ) | (1   | ) | (1   | ) |
| Other expense, net  | —                                |   | —    |   | —    |   |
|   | (1                               | ) | (1   | ) | (1   | ) |
| Income from continuing operation before income tax expense                          | 5                                |   | 6    |   | 5    |   |
| Income tax expense  | (2                               | ) | (3   | ) | (2   | ) |
| Income from continuing operations   | 3                                |   | 3    |   | 3    |   |
| Loss from discontinued operations   | —                                |   | (1   | ) | —    |   |
| Loss on disposal, net of taxes  | —                                |   | —    |   | —    |   |
| Discontinued operations   | —                                | % | (1   | ) | %    | — |
| Net income  | 3                                | % | 2    | % | 3    | % |
| Plus: Net loss from discontinued operations attributable to noncontrolling interest | —                                | % | —    | % | —    | % |
| Net income attributable to Vonage   | 3                                | % | 2    | % | 3    | % |

Table of Contents

## Summary of Results for the Years Ended December 31, 2015, 2014, and 2013

| Revenues, Cost of Telephony Services and Cost of Goods Sold<br>(in thousands, except percentages) | For the years ended December 31, |           |           | Dollar Change | Dollar Change | Percent Change | Percent Change |    |  |
|---|----------------------------------|-----------|-----------|---------------|---------------|----------------|----------------|----|--|
|   | 2015                             | 2014      | 2013      | 2015 vs. 2014 | 2014 vs. 2013 | 2015 vs. 2014  | 2014 vs. 2013  |    |  |
| Revenues  | \$895,072                        | \$868,854 | \$829,067 | \$26,218      | \$39,787      | 3              | % 5            | %  |  |
| Cost of services (1)  | 261,768                          | 231,383   | 237,244   | 30,385        | (5,861)       | 13             | % (2)          | )% |  |
| Cost of goods sold  | 34,210                           | 36,500    | 37,586    | (2,290)       | (1,086)       | (6)            | )% (3)         | )% |  |

(1) Excludes depreciation and amortization of \$24,868, \$19,405, and \$14,892, respectively.

## 2015 compared to 2014

**Revenues.** Revenues increased \$26,218, or 3%, as a result of growth in Business revenue of \$124,583 due to an increase in the number of Business seats as we have shifted marketing investment to attract these more profitable customers and the impact of Telesphere, which was acquired on December 15, 2014, the impact of Simple Signal, which was acquired on April 1, 2015, and the impact of iCore, which was acquired on August 31, 2015. This growth in Business revenue was offset by a decrease of \$98,365 in Consumer revenue due to fewer subscriber lines reflecting planned actions to enhance the profitability of the assisted sales channel by eliminating lower performing locations and restructuring the pricing offers.

**Cost of services.** The increase in cost of service of \$30,385, or 13%, was primarily driven by higher technical care costs and network operations cost in support of growth in Business customers including the addition of Telesphere, Simple Signal, and iCore and higher USF and related fees imposed by government agencies, offset by a decrease in international usage costs.

**Cost of goods sold.** The decrease in cost of goods sold of \$2,290, or 6%, was primarily due to a decrease in equipment costs of \$7,901 and shipping and handling costs of \$2,540 for our consumer customers due to lower new customer additions offset by an increase in customer equipment costs of \$5,670 and installation costs of \$880 for our business customers due to higher new customer additions. In addition, we provided a reserve of \$1,358 related to inventory to be disposed of in the consumer business.

## 2014 compared to 2013

**Revenues.** The increase in revenues of \$39,787, or 5%, was a result of growth in Business revenue of \$86,736 due to the impact of VBS, which was acquired on November 15, 2013. This growth in Business revenue was offset by a decrease of \$46,949 in Consumer revenue due to fewer subscriber lines reflecting planned actions to enhance the profitability of the assisted sales channel by eliminating lower performing locations and restructuring the pricing offers.

**Cost of services.** The Company has reclassified certain personnel and related costs for network operations and customer care that are attributable to revenue generating activities from selling, general and administrative expense to cost of telephony services. The costs reclassified were \$23,582 for the year ended December 31, 2013.

The decrease in cost of services of \$5,861, or 2%, was primarily driven by a decrease in international usage of \$10,938. This decrease was offset by an increase in USF and related fees imposed by government agencies of \$1,231 and an increase of \$4,484 in network operations and customer care personnel and related costs due to inclusion of VBS costs.

**Cost of goods sold.** The decrease in cost of goods sold of \$1,086, or 3%, was primarily due to a decrease in equipment costs for our consumer customers due to lower new customer additions of \$3,469 offset by an increase in customer equipment costs of \$3,041 driven by VBS.



Table of Contents

| Sales and Marketing<br><br>(in thousands, except percentages) | For the years ended December 31, |           |           | Dollar Change | Dollar Change | Percent Change | Percent Change |
|---|----------------------------------|-----------|-----------|---------------|---------------|----------------|----------------|
|   | 2015                             | 2014      | 2013      | 2015 vs. 2014 | 2014 vs. 2013 | 2015 vs. 2014  | 2014 vs. 2013  |
| Sales and marketing   | \$347,896                        | \$373,737 | \$366,307 | \$(25,841)    | \$7,430       | (7)%           | 2%             |

## 2015 compared to 2014

Sales and marketing. Sales and marketing expense decreased by \$25,841, or 7%, due to a reduction in Consumer marketing reflecting planned actions to enhance the profitability of the assisted sales channel by eliminating lower performing locations offset by an increase in Business as we have shifted marketing investment to attract these more profitable customers.

## 2014 compared to 2013

Sales and marketing. Sales and marketing expense increased by \$7,430, or 2%, due to ramping up of the assisted sales channel and agent commissions driven by VBS.

| Engineering and Development<br><br>(in thousands, except percentages) | For the years ended December 31, |          |          | Dollar Change | Dollar Change | Percent Change | Percent Change |
|---|----------------------------------|----------|----------|---------------|---------------|----------------|----------------|
|   | 2015                             | 2014     | 2013     | 2015 vs. 2014 | 2014 vs. 2013 | 2015 vs. 2014  | 2014 vs. 2013  |
| Engineering and development   | \$27,220                         | \$20,869 | \$14,794 | \$6,351       | \$6,075       | 30%            | 41%            |

## 2015 compared to 2014

Engineering and development. Engineering and development expense increased by \$6,351, or 30%, due to incremental investment in new business products and services.

## 2014 compared to 2013

Engineering and development. Engineering and development expense increased by \$6,075, or 41%, due to incremental investment in new business products and services.

| General and Administrative<br><br>(in thousands, except percentages) | For the years ended December 31, |          |          | Dollar Change | Dollar Change | Percent Change | Percent Change |
|--|----------------------------------|----------|----------|---------------|---------------|----------------|----------------|
|  | 2015                             | 2014     | 2013     | 2015 vs. 2014 | 2014 vs. 2013 | 2015 vs. 2014  | 2014 vs. 2013  |
| General and administrative   | \$109,153                        | \$98,780 | \$83,107 | \$10,373      | \$15,673      | 11%            | 19%            |

## 2015 compared to 2014

General and administrative. General and administrative expense increased by \$10,373, or 11%, primarily due to the addition of Telesphere, Simple Signal, and iCore and incremental stock compensation of \$6,500, partially offset by the elimination of our international growth initiative to focus on our more profitable business customers of \$5,000 and lower legal fees of \$4,500.



## 2014 compared to 2013

General and administrative. General and administrative expense increased by \$15,673, or 19%, primarily due to the addition of VBS and incremental stock compensation of \$3,200 and higher legal fees of \$3,900, partially offset by the elimination of our international growth initiative to focus on our more profitable business customers of \$800.

| Depreciation and Amortization<br><br>(in thousands, except percentages) | For the years ended December 31, |          |          | Dollar<br>Change<br>2015 vs.<br>2014 | Dollar<br>Change<br>2014 vs.<br>2013 | Percent<br>Change<br>2015<br>vs. 2014 | Percent<br>Change<br>2014<br>vs. 2013 |
|---|----------------------------------|----------|----------|--------------------------------------|--------------------------------------|---------------------------------------|---------------------------------------|
|   | 2015                             | 2014     | 2013     |                                      |                                      |                                       |                                       |
| Depreciation and amortization   | \$61,833                         | \$49,514 | \$36,054 | \$12,319                             | \$13,460                             | 25 %                                  | 37 %                                  |

## 2015 compared to 2014

Depreciation and amortization. The increase in depreciation and amortization of \$12,319, or 25%, was primarily due to the amortization of acquisition-related intangibles from the acquisition of Telesphere in December 2014, Simple Signal in April 2015, and iCore in August 2015.

## 2014 compared to 2013

Depreciation and amortization. The increase in depreciation and amortization of \$13,460, or 37%, was primarily due to an increase in intangibles amortization of \$12,084 which included \$12,552 acquisition-related intangibles for VBS, an increase in software amortization of \$894, an increase in depreciation of network equipment, computer hardware, and furniture of \$412. There was also a reclassification of \$1,893 from depreciation and amortization to loss from discontinued operations in 2014 in connection with the discontinued operations from the Brazilian market that was completed in March 31, 2015.

Table of Contents

| Other Income (Expense)<br><br>(in thousands, except percentages) | For the years ended December 31, |           |           | Dollar Change | Dollar Change | Percent Change | Percent Change |
|--|----------------------------------|-----------|-----------|---------------|---------------|----------------|----------------|
|  | 2015                             | 2014      | 2013      | 2015 vs. 2014 | 2014 vs. 2013 | 2015 vs. 2014  | 2014 vs. 2013  |
| Interest income  | \$89                             | \$207     | \$307     | \$(118)       | \$(100)       | (57)%          | (33)%          |
| Interest expense   | (8,786)                          | (6,823)   | (6,557)   | (1,963)       | (266)         | (29)%          | (4)%           |
| Other income (expense), net                                      | (842)                            | 11        | (104)     | (853)         | 115           | (7,755)%       | 111%           |
|  | \$(9,539)                        | \$(6,605) | \$(6,354) |               |               |                |                |

## 2015 compared to 2014

Interest income. Interest income decreased \$118, or 57%.

Interest expense. The increase in interest expense of \$1,963, or 29%, was due mainly to additional funds we borrowed in connection with our refinancing in August 2014, the funds we borrowed from the 2014 revolving credit facility in December 2014 in connection with the acquisition of Telesphere and in April 2015 in connection with the acquisition of Simple Signal, and the funds we borrowed from the 2015 revolving credit facility in August 2015 in connection with the acquisition of iCore.

Other income (expense), net. Other income (expense), net changed by \$853 in 2015 compared to 2014 due to currency fluctuation.

## 2014 compared to 2013

Interest income. Interest income decreased \$100, or 33%.

Interest expense. The increase in interest expense of \$266, or 4%, was due mainly to the funds we borrowed from the 2013 revolving credit facility in November 2013 in connection with the acquisition of Vocalocity and our refinancing in August 2014.

Other income (expense), net. Other income (expense), net changed by \$115 in 2014 compared to 2013.

| Income Tax Expense<br><br>(in thousands, except percentages) | For the years ended December 31, |            |            | Dollar Change | Dollar Change | Percent Change | Percent Change |
|--|----------------------------------|------------|------------|---------------|---------------|----------------|----------------|
|  | 2015                             | 2014       | 2013       | 2015 vs. 2014 | 2014 vs. 2013 | 2015 vs. 2014  | 2014 vs. 2013  |
| Income tax expense   | \$(18,418)                       | \$(21,759) | \$(18,194) | \$3,341       | \$(3,565)     | 15%            | (20)%          |
| Effective tax rate   | 43%                              | 42%        | 38%        |               |               |                |                |

We recognize income tax expense equal to pre-tax income multiplied by our effective income tax rate. In addition, adjustments are recorded for discrete period items and changes to our state effective tax rate. In addition, adjustments are recorded for discrete period items related to stock compensation and changes to our state effective tax rate. In the first quarter of 2015 a discrete period tax benefit of \$1,058 was recorded in discontinued operations related to the write-off of intercompany loans associated with the wind down of our joint venture in Brazil.

The provision also includes the federal alternative minimum tax and state and local income taxes in 2015, 2014, and 2013.

The effective tax rate is calculated by dividing income tax expense by income before income tax expense.

Edgar Filing: VONAGE HOLDINGS CORP - Form 10-K

As of December 31, 2015, we had net operating loss carry forwards for United States federal and state tax purposes, including the NOLs of iCore, Simple Signal, Telesphere, and Vocalocity as of the date of acquisition, of \$625,802 and \$186,776, respectively, expiring at various times from years ending 2016 through 2035. In addition, we also had net operating loss carry forwards for United Kingdom tax purposes of \$45,159 with no expiration date.

| Discontinued Operations<br>Attributable to Vonage                               | For the years ended December<br>31, |             |            | Dollar<br>Change<br>2015<br>vs.<br>2014 | Dollar<br>Change<br>2014 vs.<br>2013 | Percent<br>Change<br>2015<br>vs. 2014 | Percent<br>Change<br>2014<br>vs. 2013 |      |    |
|---|-------------------------------------|-------------|------------|---|--------------------------------------|---------------------------------------|---------------------------------------|------|----|
|   | 2015                                | 2014        | 2013       |   |                                      |                                       |                                       |      |    |
| Loss from discontinued operations   | \$(1,615 )                          | \$(10,260 ) | \$(1,626 ) | \$8,645                                 | \$(8,634 )                           | 84                                    | %                                     | (531 | )% |
| Loss on disposal, net of taxes  | (824 )                              | —           | —          | (824 )                                  | —                                    | —                                     | %                                     | —    | %  |
| Discontinued operations   | (2,439 )                            | (10,260 )   | (1,626 )   | 7,821                                   | (8,634 )                             | 76                                    | %                                     | (531 | )% |
| Loss from discontinued operations<br>attributable to noncontrolling<br>interest | 59                                  | 819         | 488        | (760 )                                  | 331                                  | (93                                   | )%                                    | 68   | %  |
| Loss from discontinued operations<br>attributable to Vonage                     | (2,380 )                            | (9,441 )    | (1,138 )   | 7,061                                   | (8,303 )                             | 75                                    | %                                     | (730 | )% |

Table of Contents

2015 compared to 2014

Discontinued operations attributable to Vonage. The loss from discontinued operations attributable to Vonage decreased by \$7,061, or 75%. The loss from 2015 was due to \$500 of costs associated with the wind down of our Brazilian operations in the first quarter of 2015 related to contract terminations and severance-related expenses, a loss on disposal of \$824 related to the write-off of the noncontrolling interest of \$907, foreign currency loss on intercompany loan forgiveness of \$783, and residual cumulative translation of \$192, partially offset by a tax benefit of \$1,058 and a lower portion of loss attributable to noncontrolling interest due to a reduction in ownership percentage. The loss from 2014 was for the operating loss from our discontinued Brazilian market.

2014 compared to 2013

Discontinued operations attributable to Vonage. The losses from 2014 and 2013 were for the operating losses from our discontinued Brazilian market.

Table of Contents

## QUARTERLY RESULTS OF OPERATIONS

The following table sets forth quarterly statement of operations data. We derived this data from our unaudited consolidated financial statements, which we believe have been prepared on substantially the same basis as our audited consolidated financial statements. The operating results in any quarter are not necessarily indicative of the results that may be expected for any future period.

| (dollars in thousands, except operating data)                                       | For the quarter ended |                 |                 |                 |                 |                 |                 |
|---|-----------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|   | Mar 31,<br>2014       | Jun 30,<br>2014 | Sep 30,<br>2014 | Dec 31,<br>2014 | Mar 31,<br>2015 | Jun 30,<br>2015 | Sep 30,<br>2015 |
| Total revenues  | \$220,733             | \$218,878       | \$214,710       | \$214,533       | \$219,730       | \$221,858       | \$223,360       |
| Operating expenses:   |                       |                 |                 |                 |                 |                 |                 |
| Cost of services (1) (2)  | 59,420                | 58,942          | 56,475          | 56,546          | 61,853          | 64,209          | 67,193          |
| Cost of goods sold  | 9,739                 | 9,450           | 9,205           | 8,106           | 9,190           | 8,217           | 8,206           |
| Sales and marketing (2)   | 95,486                | 98,067          | 93,000          | 87,184          | 85,564          | 84,385          | 88,028          |
| Engineering and development (2)   | 5,405                 | 4,086           | 4,992           | 6,386           | 6,605           | 6,864           | 6,830           |
| General and administrative (2)  | 26,756                | 22,370          | 24,160          | 25,494          | 23,234          | 27,162          | 28,860          |
| Depreciation and amortization   | 12,326                | 12,445          | 12,275          | 12,468          | 13,945          | 14,463          | 15,446          |
|   | 209,132               | 205,360         | 200,107         | 196,184         | 200,391         | 205,300         | 214,563         |
| Income from operations  | 11,601                | 13,518          | 14,603          | 18,349          | 19,339          | 16,558          | 8,797           |
| Other income (expense):   |                       |                 |                 |                 |                 |                 |                 |
| Interest income   | 91                    | 31              | 37              | 48              | 20              | 21              | 24              |
| Interest expense  | (2,077)               | (1,434)         | (1,680)         | (1,632)         | (1,935)         | (2,088)         | (2,222)         |
| Other (expense) income, net   | (13)                  | 36              | (2)             | (10)            | (577)           | 32              | (50)            |
|   | (1,999)               | (1,367)         | (1,645)         | (1,594)         | (2,492)         | (2,035)         | (2,248)         |
| Income from continuing operations before income tax expense                         | 9,602                 | 12,151          | 12,958          | 16,755          | 16,847          | 14,523          | 6,549           |
| Income tax expense  | (4,118)               | (5,261)         | (5,631)         | (6,749)         | (6,998)         | (6,176)         | (3,116)         |
| Net income from continuing operations   | 5,484                 | 6,890           | 7,327           | 10,006          | 9,849           | 8,347           | 3,433           |
| Loss from discontinued operations   | (1,279)               | (1,507)         | (2,962)         | (4,512)         | (1,615)         | —               | —               |
| Loss on disposal, net of taxes  | —                     | —               | —               | —               | (824)           | —               | —               |
| Discontinued operations   | (1,279)               | (1,507)         | (2,962)         | (4,512)         | (2,439)         | —               | —               |
| Net income  | 4,205                 | 5,383           | 4,365           | 5,494           | 7,410           | 8,347           | 3,433           |
| Plus: Net loss from discontinued operations attributable to noncontrolling interest | 383                   | 135             | 191             | 110             | 59              | —               | —               |
| Net income attributable to Vonage   | \$4,588               | \$5,518         | \$4,556         | \$5,604         | \$7,469         | \$8,347         | \$3,433         |
| Net Income per common share - continuing operations:                                |                       |                 |                 |                 |                 |                 |                 |
| Basic   | 0.03                  | 0.03            | 0.04            | 0.05            | 0.05            | 0.04            | 0.02            |
| Diluted   | 0.02                  | 0.03            | 0.03            | 0.05            | 0.04            | 0.04            | 0.02            |
| Net Loss per common share - discontinuing operations attributable to Vonage:        |                       |                 |                 |                 |                 |                 |                 |
| Basic   | —                     | (0.01)          | (0.01)          | (0.02)          | (0.01)          | —               | —               |
| Diluted   | —                     | (0.01)          | (0.01)          | (0.02)          | (0.01)          | —               | —               |
| Net Income per common share - attributable to Vonage:                               |                       |                 |                 |                 |                 |                 |                 |

Edgar Filing: VONAGE HOLDINGS CORP - Form 10-K

|  |         |         |         |         |         |         |         |   |
|--|---------|---------|---------|---------|---------|---------|---------|---|
| Basic  | 0.02    | 0.03    | 0.02    | 0.03    | 0.04    | 0.04    | 0.02    | 0 |
| Diluted  | 0.02    | 0.02    | 0.02    | 0.03    | 0.03    | 0.04    | 0.02    | 0 |
| Weighted-average common shares<br>outstanding: |         |         |         |         |         |         |         |   |
| Basic  | 212,195 | 211,390 | 208,580 | 207,176 | 211,844 | 213,582 | 213,291 | 2 |
| Diluted  | 225,187 | 221,022 | 217,176 | 214,349 | 220,589 | 222,188 | 225,182 | 2 |

37 VONAGE ANNUAL REPORT 2015

---

Table of Contents

| (dollars in thousands, except operating data) | For the quarter ended |                 |                 |                 |                 |                 |          |
|---|-----------------------|-----------------|-----------------|-----------------|-----------------|-----------------|----------|
|   | Mar 31,<br>2014       | Jun 30,<br>2014 | Sep 30,<br>2014 | Dec 31,<br>2014 | Mar 31,<br>2015 | Jun 30,<br>2015 | Se<br>20 |
| <b>Operating Data:</b>                        |                       |                 |                 |                 |                 |                 |          |
| <b>Consumer</b>                               |                       |                 |                 |                 |                 |                 |          |
| Revenues                                      | 201,685               | 196,322         | 190,315         | 186,088         | 177,830         | 172,756         | 16       |
| Average monthly revenues per subscriber line  | 28.54                 | 28.02           | 27.60           | 28.06           | 27.97           | 27.79           | 27       |
| Subscriber lines (at period end)              | 2,350,352             | 2,320,900       | 2,276,442       | 2,144,681       | 2,094,365       | 2,049,424       | 1,9      |
| Customer churn                                | 2.6                   | % 2.6           | % 2.6           | % 2.4           | % 2.4           | % 2.2           | % 2.3    |
| <b>Business</b>                               |                       |                 |                 |                 |                 |                 |          |
| Revenues                                      | 19,048                | 22,556          | 24,395          | 28,445          | 41,900          | 49,102          | 57       |
| Average monthly revenues per seat             | 34.30                 | 36.36           | 35.39           | 34.28           | 43.05           | 42.28           | 41       |
| Seat (at period end)                          | 196,093               | 217,475         | 242,048         | 311,193         | 337,649         | 401,256         | 51       |
| Revenue churn                                 | 0.9                   | % 1.2           | % 1.3           | % 1.5           | % 1.4           | % 1.3           | % 1.3    |

Excludes depreciation and amortization of \$5,154, \$5,098, \$4,704, and \$4,449 for the quarters ended March 31, (1) June 30, September 30 and December 31, 2014, respectively, and \$5,724, \$6,005, \$6,415, and \$6,724 for the quarters ended March 31, June 30, September 30 and December 31, 2015, respectively.

As the Company's business evolves, positioning us as a Unified Communications as a Service ("UCaaS") provider, we have made certain changes to our income statement presentation. Sales expenses have been separated from (2) selling, general, and administrative expenses and combined with marketing in a new sales and marketing caption. A new caption, engineering and development, has also been reclassified from selling, general and administrative expenses. The remaining selling, general and administrative expenses, after the above reclassifications, have been renamed as general and administrative expenses. The reclassifications have been reflected in all periods presented.

**LIQUIDITY AND CAPITAL RESOURCES****Overview**

The following table sets forth a summary of our cash flows for the periods indicated:

| (dollars in thousands)                              | For the years ended December 31, |            |            |
|---|----------------------------------|------------|------------|
|   | 2015                             | 2014       | 2013       |
| Net cash provided by operating activities           | \$129,731                        | \$92,542   | \$88,243   |
| Net cash used in investing activities               | (152,696 )                       | (118,528 ) | (120,985 ) |
| Net cash provided by (used in) financing activities | 40,205                           | (14,239 )  | 21,891     |

For the three years ended December 31, 2015, 2014, and 2013 we generated income from operations. We expect to continue to balance efforts to grow our revenue while consistently achieving operating profitability. To grow our revenue, we continue to make investments in growth initiatives, marketing, application development, network quality and expansion, and customer care. Although we believe we will achieve consistent profitability in the future, we ultimately may not be successful and we may not achieve consistent profitability. We believe that cash flow from operations and cash on hand will fund our operations for at least the next twelve months.

**Acquisition of iCore**

iCore was acquired on August 31, 2015 for \$92,000 cash consideration, increased by \$689 of working capital excess as of the closing date, resulting in a total acquisition cost of \$92,689. We financed the transaction with \$10,689 of cash and \$82,000 from our 2015 revolving credit facility.

#### Acquisition of Simple Signal

Simple Signal was acquired on April 1, 2015 for \$25,250, reduced by \$198 of working capital shortfall as of the closing date and increased by \$526 for the increase in value of the 1,111 shares of Vonage common stock from the signing date to the closing date, resulting in a total acquisition cost of \$25,578. We financed the transaction by borrowing \$20,000 from our 2014 revolving credit facility.

#### Acquisition of Telesphere

Telesphere was acquired on December 15, 2014 for \$114,000, adjusted for \$676 of excess cash as of the closing date, a reduction for closing working capital of \$105, and the decrease in value of the 6,825 shares of Vonage common stock from the signing date to the closing date of \$241, resulting in a total acquisition cost of \$114,330. We financed the transaction through \$24,603 of cash (of which \$3,610 was paid in January 2015) and \$67,000 from our 2014 revolving credit facility.

#### Acquisition of Vocalocity

Vocalocity was acquired on November 15, 2013 for \$130,000, adjusted for \$2,869 of excess cash as of the closing date and the increase in value of the 7,983 shares of Vonage common stock from the signing date to the closing date of \$1,298, resulting in a total acquisition cost of \$134,167. We financed the transaction through \$32,981 of cash and \$75,000 from our 2013 revolving credit facility.

#### 2015 Financing

On July 27, 2015, we entered into a credit agreement (the "2015 Credit Facility") consisting of a \$100,000 term note and a \$250,000 revolving credit facility. The co-borrowers under the 2015 Credit Facility are the Company and Vonage America Inc., the



Table of Contents

Company's wholly owned subsidiary. Obligations under the 2015 Credit Facility are guaranteed, fully and unconditionally, by the Company's other United States material subsidiaries and are secured by substantially all of the assets of each borrower and each guarantor. The lenders under the 2015 Credit Facility are JPMorgan Chase Bank, N.A., Citizens Bank, N.A., Fifth Third Bank, MUFG Union Bank, N.A., Silicon Valley Bank, SunTrust Bank, Keybank National Association, Santander Bank, N.A., Capital One National Association, and First Niagara Bank, N.A. JPMorgan Chase Bank, N.A. is a party to the agreement as administrative agent, Citizens Bank, N.A. as syndication agent, and Fifth Third Bank, MUFG Union Bank, N.A., Silicon Valley Bank, SunTrust Bank as documentation agents. J.P. Morgan Securities LLC and Citizens Bank, N.A. acted as joint lead bookrunners, and J.P. Morgan Securities LLC, Citizens Bank, N.A., Fifth Third Bank, MUFG Union Bank, N.A., Silicon Valley Bank, and SunTrust Robinson Humphrey Inc. acted as joint lead arrangers.

Use of Proceeds

We used \$167,000 of the net available proceeds of the 2015 Credit Facility to retire all of the debt under our 2014 Credit Facility. Remaining proceeds from the term note and the undrawn revolving credit facility under the 2015 Credit Facility will be used for general corporate purposes. We also incurred fees of \$2,007 in connection with the 2015 Credit Facility, of which \$602 was allocated to the term note and \$1,405 was allocated to the revolving credit facility. The unamortized fees of \$1,628 in connection with the 2014 Credit Facility was allocated as follows: \$733 to the term note and \$895 revolving credit facility. In adopting ASU 2015-03, fees allocated to the term note were reported in the balance sheet as a direct deduction from the face amount of the liability and in adopting ASU 2015-15, fees allocated to the revolving credit facility were reported in the balance sheet as an asset. These fees are amortized to interest expenses over the life of the debt using the effective interest method for the term note and straight line method for the revolving credit facility.

2015 Credit Facility Terms

The following description summarizes the material terms of the 2015 Credit Facility:

The loans under the 2015 Credit Facility mature in July 2019. Principal amounts under the 2015 Credit Facility are repayable in quarterly installments of \$3,750 for the term note. The unused portion of our revolving credit facility incurs a 0.40% commitment fee. Such commitment fee will be reduced to 0.375% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00 and to 0.35% if our consolidated leverage ratio is less than 0.75 to 1.00.

Outstanding amounts under the 2015 Credit Facility, at our option, will bear interest at:

LIBOR (applicable to one-, two-, three-, six-, or twelve-month periods) plus an applicable margin equal to 2.50% if our consolidated leverage ratio is less than 0.75 to 1.00, 2.75% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 3.00% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last day of each relevant interest period or, if the interest period is longer than three months, each day that is three months after the first day of the interest period, or the base rate determined by reference to the highest of (a) the prime rate of JPMorgan Chase Bank, N.A., (b) the federal funds effective rate from time to time plus 0.50%, and (c) the adjusted LIBO rate applicable to one month interest periods plus 1.00%, plus an applicable margin equal to 1.50% if our consolidated leverage ratio is less than 0.75 to 1.00, 1.75% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 2.00% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last business day of each March, June, September, and December and the maturity date of the 2015 Credit Facility.

The 2015 Credit Facility provides greater flexibility to us in funding acquisitions and restricted payments, such as stock buybacks, than did the 2014 Credit Facility.

We may prepay the 2015 Credit Facility at our option at any time without premium or penalty. The 2015 Credit Facility is subject to mandatory prepayments in amounts equal to:

100% of the net cash proceeds from any non-ordinary course sale or other disposition of our property and assets for consideration in excess of a certain amount subject to customary reinvestment provisions and certain other exceptions and

> 100% of the net cash proceeds received in connection with other non-ordinary course transactions, including  
> insurance proceeds not otherwise applied to the relevant insurance loss.

Subject to certain restrictions and exceptions, the 2015 Credit Facility permits us to obtain one or more incremental term loans and/or revolving credit facilities in an aggregate principal amount of up to \$90,000 plus an amount equal to repayments of the term note upon providing documentation reasonably satisfactory to the administrative agent. The 2015 Credit Facility includes customary representations and warranties and affirmative covenants of the borrowers. In addition, the 2015 Credit Facility contains customary negative covenants, including, among other things, restrictions on the ability of us and our subsidiaries to consolidate or merge, create liens, incur additional indebtedness, dispose of assets, consummate acquisitions, make investments, and pay dividends and other distributions. We must also comply with the following financial covenants:

> a consolidated leverage ratio of no greater than 2.25 to 1.00, with a limited step-up to 2.75 to 1.00 for a period of  
> four consecutive quarters, in connection with an acquisition made during the first two years of the 2015 Credit Facility;

> a consolidated fixed coverage charge ratio of no less than 1.75 to 1.00 subject to adjustment to exclude up to  
> \$80,000 million in specified restricted payments;

> minimum cash of \$25,000 including the unused portion of the revolving credit facility; and

> maximum capital expenditures not to exceed \$55,000 during any fiscal year, provided that the unused amount of any  
> permitted capital expenditures in any fiscal year may be carried forward to the next following fiscal year.

In addition, annual excess cash flow increases permitted capital expenditures.

As of December 31, 2015, we were in compliance with all covenants, including financial covenants, for the 2015 Credit Facility.

The 2015 Credit Facility contains customary events of default that may permit acceleration of the debt. During the continuance of a payment default, interest will accrue on overdue amounts at a default interest rate of 2% above the interest rate which would otherwise be applicable, in the case of loans, and at a rate equal to the rate applicable to base rate loans plus 2%, in the case of all other amounts.

#### 2014 Financing

On August 13, 2014, we entered into a credit agreement (the "2014 Credit Facility") consisting of a \$100,000 term note and a \$125,000 revolving credit facility. The co-borrowers under the 2014 Credit Facility were us and Vonage America Inc., our wholly owned subsidiary. Obligations under the 2014 Credit Facility were guaranteed, fully and unconditionally, by our other material United States subsidiaries and are secured by substantially all of the assets of each borrower and each guarantor. The lenders under the 2014 Credit Facility were JPMorgan Chase Bank, N.A., Citizens Bank, N.A., Silicon Valley Bank, SunTrust Bank, Fifth Third Bank, Keybank National Association, and MUFG Union Bank, N.A. JPMorgan Chase Bank, N.A. was a party to the agreement as administrative agent, Citizens Bank, N.A. as syndication agent, and Silicon Valley Bank and SunTrust Bank as documentation agents. J.P. Morgan Securities LLC and Citizens Bank,

Table of Contents

N.A. acted as joint lead bookrunners, and J.P. Morgan Securities LLC, Citizens Bank, N.A., Silicon Valley Bank, and SunTrust Robinson Humphrey Inc. acted as joint lead arrangers.

Use of Proceeds

We used \$90,000 of the net available proceeds of the 2014 Credit Facility to retire all of the debt under our 2013 Credit Facility. Remaining proceeds from the senior secured term loan and the undrawn revolving credit facility under the 2014 Credit Facility were to be used for general corporate purposes. We also incurred \$1,910 of fees in connection with the 2014 Credit Facility, which was amortized, along with the unamortized fees of \$668 in connection with the 2013 Credit Facility, to interest expense over the life of the debt using the effective interest method.

2014 Credit Facility Terms

The following description summarizes the material terms of the 2014 Credit Facility:

The loans under the 2014 Credit Facility were to mature in August 2018. Principal amounts under the 2014 Credit Facility were repayable in quarterly installments of \$5,000 per quarter for the senior secured term loan. The unused portion of our revolving credit facility incurred a 0.40% commitment fee.

Outstanding amounts under the 2014 Credit Facility, at our option, bore interest at:

LIBOR (applicable to one-, two-, three-, six-, or twelve-month periods) plus an applicable margin equal to 2.875% if our consolidated leverage ratio is less than 0.75 to 1.00, 3.125% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 3.375% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last day of each relevant interest period or, if the interest period is longer than three months,

the base rate determined by reference to the highest of (a) the federal funds effective rate from time to time plus 0.50%, (b) the prime rate of JPMorgan Chase Bank, N.A., and (c) the adjusted LIBO rate applicable to one month interest periods plus 1.00%, plus an applicable margin equal to 1.875% if our consolidated leverage ratio is less than 0.75 to 1.00, 2.125% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 2.375% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last business day of each March, June, September, and December and the maturity date of the 2014 Credit Facility.

The 2014 Credit Facility provided greater flexibility to us in funding acquisitions and restricted payments, such as stock buybacks, than the 2013 Credit Facility.

We were able to prepay the 2014 Credit Facility at our option at any time without premium or penalty. The 2014 Credit Facility was subject to mandatory prepayments in amounts equal to:

100% of the net cash proceeds from any non-ordinary course sale or other disposition of our property and assets for consideration in excess of a certain amount subject to customary reinvestment provisions and certain other exceptions, and

100% of the net cash proceeds received in connection with other non-ordinary course transactions, including insurance proceeds not otherwise applied to the relevant insurance loss.

Subject to certain restrictions and exceptions, the 2014 Credit Facility permitted us to obtain one or more incremental term loans and/or revolving credit facilities in an aggregate principal amount of up to \$60,000 plus an amount equal to repayments of the senior secured term loan upon providing documentation reasonably satisfactory to the administrative agent. The 2014 Credit Facility included customary representations and warranties and affirmative covenants of the borrowers. In addition, the 2014 Credit Facility contained customary negative covenants, including, among other things, restrictions on the

ability of us and our subsidiaries to consolidate or merge, create liens, incur additional indebtedness, dispose of assets, consummate acquisitions, make investments, and pay dividends and other distributions. We were also required to comply with the following financial covenants:

> a consolidated leverage ratio of no greater than 2.25 to 1.00;

> a consolidated fixed coverage charge ratio of no less than 1.75 to 1.00 subject to adjustment to exclude up to \$80,000 in specified restricted payments;

> minimum cash of \$25,000 including the unused portion of the revolving credit facility; and

>

maximum capital expenditures not to exceed \$55,000 during any fiscal year, provided that the unused amount of any permitted capital expenditures in any fiscal year may be carried forward to the next following fiscal year. In addition, annual excess cash flow up to \$8,000 increased permitted capital expenditures.

The 2014 Credit Facility contained customary events of default that may permit acceleration of the debt. During the continuance of a payment default, interest would have accrued at a default interest rate of 2% above the interest rate which would otherwise be applicable, in the case of loans, and at a rate equal to the rate applicable to base rate loans plus 2%, in the case of all other amounts.

#### February 2013 Financing

On February 11, 2013 we entered into Amendment No. 1 to the 2011 Credit Agreement (as further amended by Amendment No. 2 to our 2011 Credit Facility, the "2013 Credit Facility"). The 2013 Credit Facility consisted of a \$70,000 term note and a \$75,000 revolving credit facility. The co-borrowers under the 2013 Credit Facility were us and Vonage America Inc., our wholly owned subsidiary. Obligations under the 2013 Credit Facility were guaranteed, fully and unconditionally, by our other United States subsidiaries and were secured by substantially all of the assets of each borrower and each of the guarantors. On July 26, 2013 we entered into Amendment No. 2 to our 2011 Credit Agreement, which amended our financial covenant related to our consolidated fixed charge coverage ratio by increasing the amount of restricted payments excluded from such calculation from \$50,000 to \$80,000.

#### Use of Proceeds

We used \$42,500 of the net available proceeds of the 2013 Credit Facility to retire all of the debt under our 2011 Credit Facility. Remaining net proceeds of \$27,500 from the term note and the undrawn revolving credit facility under the 2013 Credit Facility were to be used for general corporate purposes. We used \$75,000 from the 2013 revolving credit facility in connection with the acquisition of Vocalocity on November 15, 2013. We also incurred \$2,009 of fees in connection with the 2013 Credit Facility, which was amortized, along with the unamortized fees of \$670 in connection with the 2011 Credit Facility, to interest expense over the life of the debt using the effective interest method.

#### State and Local Sales Taxes

We also have contingent liabilities for state and local sales taxes. As of December 31, 2015, we had a reserve of \$3,903. If our ultimate liability exceeds this amount, it could affect our liquidity unfavorably. However, we currently do not believe that these contingent liabilities will significantly impair our liquidity.

#### Capital expenditures

For 2015, capital expenditures were primarily for the implementation of software solutions and purchase of network equipment as we continue to expand our network. Our capital expenditures for the year ended 2015 were \$34,006, of which \$14,183 was for software acquisition and development. The majority of these expenditures are comprised of investments in information technology and systems infrastructure, including an electronic data warehouse,

Table of Contents

online customer service, and customer management platforms. For 2016, we believe our capital and software expenditures will be in the approximately \$38,000. This number is net of Tenant Improvement capital dollars we are investing in our Holmdel, New Jersey headquarters which are being refunded by the building owner in connection with the long-term lease renewal we executed in the fourth quarter of 2015.

Operating Activities

Cash provided by operating activities increased to \$129,731 for the year ended December 31, 2015 compared to \$92,542 for the year ended December 31, 2014, primarily due to higher revenues and changes in working capital. Changes in working capital requirements include changes in accounts receivable, inventory, prepaid and other assets, other assets, accounts payable, accrued and other liabilities, and deferred revenue and costs. Cash used for working capital decreased by \$18,631 during the year ended December 31, 2015 compared to the year ended December 31, 2014.

Cash provided by operating activities increased to \$92,542 for the year ended December 31, 2014 compared to \$88,243 for the year ended December 31, 2013, primarily due to higher revenues and changes in working capital. Changes in working capital requirements include changes in accounts receivable, inventory, prepaid and other assets, other assets, accounts payable, accrued and other liabilities, and deferred revenue and costs. Cash used for working capital increased by \$7,962 during the year ended December 31, 2014 compared to the year ended December 31, 2013, primarily due to the timing of payments.

Investing Activities

Cash used in investing activities for 2015 of \$152,696 was attributable to the acquisition of businesses of \$116,927, capital expenditures of \$17,323, intangible assets of \$2,500, software acquisition and development of \$14,183, and purchase of marketable securities, net of sales of \$2,759, offset by a decrease in restricted cash of \$996 due primarily to the return of part of the security deposit on our leased office property in Holmdel, New Jersey.

Cash used in investing activities for 2014 of \$118,528 was attributable to the acquisition of Telesphere of \$88,098, capital

expenditures of \$12,436, software acquisition and development of \$11,819, and purchase of marketable securities of \$7,170, offset by a decrease in restricted cash of \$995 due primarily to the return of part of the security deposit on our leased office property in Holmdel, New Jersey.

Cash used in investing activities for 2013 of \$120,985 was attributable to the acquisition of Vocalocity of \$100,057, capital expenditures of \$9,889, and software acquisition and development of \$12,291, offset by a decrease in restricted cash of \$1,252 due primarily to the return of part of the security deposit on our leased office property in Holmdel, New Jersey.

Financing Activities

Cash provided by financing activities for 2015 of \$40,205 was primarily attributable to \$82,000 in net proceeds received from our 2015 revolving credit facility and \$20,000 in net proceeds received from our 2014 revolving credit facility, and \$7,172 in net proceeds received from the exercise stock options, partially offset by principal payments of \$30,000 for 2015 revolving credit facility, \$7,500 for 2015 term note, and \$10,000 for 2014 term note, as well as \$3,549 in capital lease payments, \$15,911 in common stock repurchases, and \$2,007 in 2015 Credit Facility debt related costs.

Cash used in financing activities for 2014 of \$14,239 was primarily attributable to \$41,666 in 2014 term note, 2013 term note, and 2013 revolving credit facility principal payments, \$2,889 in capital lease and other liability payments, \$49,338 in common stock repurchases, and \$1,910 in 2014 Credit Facility debt related costs, partially offset by \$67,000 borrowed under the 2014 revolving credit facility and \$10,000 in proceeds from our 2014 Credit Facility, and \$4,564 in net proceeds received from the exercise and cancellation of stock options.

Cash provided by financing activities for 2013 of \$21,891 was primarily attributable to \$75,000 borrowed under the 2013 revolving credit facility and \$27,500 in proceeds from our 2013 Credit Facility, and \$4,091 in net proceeds received from the exercise and cancellation of stock options partially offset by \$23,334 in 2013 term note principal payments, \$3,471 in capital lease and other liability payments, \$56,294 in common stock repurchases, and \$2,056 in

2013 Credit Facility debt related costs.

41 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## CONTRACTUAL OBLIGATIONS AND OTHER COMMERCIAL COMMITMENTS

The table below summarizes our contractual obligations at December 31, 2015, and the effect such obligations are expected to have on our liquidity and cash flow in future periods.

| (dollars in thousands)   | Payments Due by Period |                  |           |           |               |
|--|------------------------|------------------|-----------|-----------|---------------|
|  | Total                  | Less than 1 year | 2-3 years | 4-5 years | After 5 years |
|  | (unaudited)            |                  |           |           |               |
| Contractual Obligations:                                       |                        |                  |           |           |               |
| 2015 Credit Facility   | \$92,500               | \$15,000         | \$30,000  | \$47,500  | \$—           |
| 2015 Revolving Credit Facility                                 | \$119,000              | —                | —         | 119,000   | —             |
| Interest related to 2015 Credit Facility                       | 8,416                  | 3,035            | 4,488     | 893       | —             |
| Interest related to 2015 Revolving Credit Facility             | 12,934                 | 3,642            | 7,240     | 2,052     | —             |
| Capital lease obligations                                      | 8,541                  | 5,038            | 3,503     | —         | —             |
| Operating lease obligations                                    | 57,249                 | 6,817            | 15,407    | 17,227    | 17,798        |
| Purchase obligations   | 251,888                | 101,042          | 144,888   | 5,958     | —             |
| Other obligations  | 5,291                  | 2,534            | 1,216     | 1,314     | 227           |
| Total contractual obligations                                  | \$555,819              | \$137,108        | \$206,742 | \$193,944 | \$18,025      |
| Other Commercial Commitments:                                  |                        |                  |           |           |               |
| Standby letters of credit                                      | \$2,498                | \$2,498          | \$—       | \$—       | \$—           |
| Total contractual obligations and other commercial commitments | \$558,317              | \$139,606        | \$206,742 | \$193,944 | \$18,025      |

Credit Facility. On July 27, 2015, we entered into a credit agreement (the “2015 Credit Facility”) consisting of a \$100,000 senior secured term loan and a \$250,000 Revolving Credit Facility. See Note 6 in the notes to the consolidated financial statements.

Capital lease obligations. At December 31, 2015, we had capital lease obligations of \$8,541 mainly related to our corporate headquarters in Holmdel, New Jersey.

Operating lease obligations. At December 31, 2015, we had future commitments for operating leases for co-location facilities mainly in the United States that accommodate a portion of our network equipment, for office spaces leased in Holmdel, New Jersey for our headquarters, in Atlanta, Georgia, in Scottsdale, Arizona, Denver, Colorado, Minneapolis, Minnesota, and Murray, Utah, Oak Brook, Illinois, and Dallas, Texas, in McLean, Virginia, Columbia, Maryland, Chicago, Illinois, and Philadelphia, Pennsylvania, in New York City, New York and Dallas, Texas for field sales and administration offices, in Tel Aviv, Israel for application development, and in London United Kingdom

for our UK office, and for apartment space leased in New Jersey for certain executives.

Purchase obligations. The purchase obligations reflected above are primarily commitments to vendors who will provide local inbound services, customer care services, carrier operation, networks and telephone related services, license patents to us, provide marketing infrastructure and services, and partner with us in international operations, provide customer caller ID, and process LNP orders. In certain cases, we may terminate these arrangements early upon payment of specified fees. These amounts do not represent our entire anticipated purchases in the future, but represent only those items for which we are contractually committed. We also purchase products and services as needed with no firm commitment. For this reason, the amounts presented do not provide a reliable indicator of our expected future cash outflows or changes in our expected cash position. See also Note 10 to our consolidated financial statements.

## SUMMARY OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our significant accounting policies are summarized in Note 1 to our consolidated financial statements. The following describes our critical accounting policies and estimates:

#### Principles of Consolidation

The consolidated financial statements include the accounts of Vonage and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. We also consolidate a majority-owned entity in Brazil where we had the ability to exercise controlling influence. The ownership interest of the noncontrolling party is presented as noncontrolling interest. On March 31, 2015, the Company completed its previously announced exit from the Brazilian market for consumer telephony services and the associated wind down of its joint venture operations in the country. The results of Brazilian operations are presented as discontinued operations for all periods presented. The results of companies acquired or disposed of are included in the consolidated financial statements from the effective date of the acquisition or up to the date of disposal.

#### Use of Estimates

Our consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States, which require management to make estimates and assumptions that affect the amounts reported and disclosed in the consolidated financial statements and the accompanying notes. Actual results could differ materially from these estimates.

On an ongoing basis, we evaluate our estimates, including the following:

- >the useful lives of property and equipment, software costs, and intangible assets;  
assumptions used for the purpose of determining share-based compensation using the Black-Scholes option pricing
- >model and Monte Carlo simulation model (“Models”), and various other assumptions that we believe to be reasonable;  
the key inputs for these Models include our stock price at valuation date,



## Table of Contents

exercise price, the dividend yield, risk-free interest rate, life in years, and historical volatility of our common stock; and

>assumptions used in determining the need for, and amount of, a valuation allowance on net deferred tax assets; We base our estimates on historical experience, available market information, appropriate valuation methodologies, and on various other assumptions that we believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

### Revenue Recognition

Operating revenues consist of services revenues and customer equipment (which enables our services) and shipping revenues. The point in time at which revenues are recognized is determined in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, Revenue Recognition, and Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 605, Revenue Recognition.

At the time a customer signs up for our services, there are the following deliverables:

>Providing equipment, if any, to the customer that enables our telephony services; and

> Providing services.

The equipment is generally provided free of charge to our customers and in most instances there are no fees collected at sign-up. We record the fees collected for shipping the equipment to the customer, if any, as shipping and handling revenue at the time of shipment.

### Services Revenue

Substantially all of our revenues are services revenues, which are derived primarily from monthly subscription fees that customers are charged under our service plans. We also derive services revenues from per minute fees for international calls if not covered under a plan, including calls made via applications for mobile devices and other stand-alone products, and for any calling minutes in excess of a customer's monthly plan limits. Monthly subscription fees are automatically charged to customers' credit cards, debit cards or electronic check payments ("ECP"), in advance and are recognized over the following month when services are provided. Revenues generated from international calls and from customers exceeding allocated call minutes under limited minute plans are recognized as services are provided, that is, as minutes are used, and are billed to a customer's credit cards, debit cards or ECP in arrears. As a result of multiple billing cycles each month, we estimate the amount of revenues earned from international calls and from customers exceeding allocated call minutes under limited minute plans but not billed from the end of each billing cycle to the end of each reporting period and record these amounts as accounts receivable.

These estimates are based primarily upon historical minutes and have been consistent with our actual results.

We also provide rebates to customers who purchase their customer equipment from retailers and satisfy minimum service period requirements. These rebates in excess of activation fees are recorded as a reduction of revenues over the service period based upon the estimated number of customers that will ultimately earn and claim the rebates.

In the United States, we charge regulatory, compliance, E-911, and intellectual property-related fees on a monthly basis to defray costs, and to cover taxes that we are charged by the suppliers of telecommunications services. In addition, we charge customers Federal Universal Service Fund ("USF") fees. We recognize revenue on a gross basis for USF and related fees. We record these fees as revenue when billed. All other taxes are recorded on a net basis.

### Customer Equipment and Shipping Revenue

Customer equipment and shipping revenues consist of revenues from sales of customer equipment to wholesalers or directly to customers for replacement devices, or for upgrading their device at the time of customer sign-up for which we charge an additional fee. In addition, customer equipment and shipping revenues include revenues from the sale of VoIP telephones in order to access our small and medium business services. Customer equipment and shipping revenues also include the fees that customers are charged for shipping their customer equipment to them. Customer equipment and shipping revenues include sales to our retailers, who subsequently resell this customer equipment to customers. Revenues are reduced for payments to retailers and rebates to customers, who purchased their customer equipment through these retailers, to the extent of customer equipment and shipping revenues.

### Inventory

Inventory consists of the cost of customer equipment and is stated at the lower of cost or market, with cost determined using the average cost method. We provide an inventory allowance for customer equipment that has been returned by customers but may not be able to be reissued to new customers or returned to the manufacturer for credit.

#### Goodwill and Purchased-Intangible Assets

Goodwill acquired in the acquisition of a business is accounted for based upon the excess fair value of consideration transferred over the fair value of net assets acquired in the business combination. Goodwill is tested for impairment on an annual basis on October 1st and, when specific circumstances dictate, between annual tests. When impaired, the carrying value of goodwill is written down to fair value. The goodwill impairment test involves evaluating qualitative information to determine if it is more than 50% likely that the fair value of a reporting unit is less than its carrying value. If such a determination is made, then the traditional two-step goodwill impairment test described below must be applied. The first step, identifying a potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying value of the reporting unit exceeds its fair value, the second step would need to be conducted; otherwise, no further steps are necessary as no potential impairment exists. The second step, measuring the impairment loss, compares the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. Any excess of the reporting unit goodwill carrying value over the respective implied fair value is recognized as an impairment loss. There was no impairment of goodwill for the year ended December 31, 2015.

Intangible assets acquired in the settlement of litigation or by direct purchase are accounted for based upon the fair value of assets received.

Purchased-intangible assets are accounted for based upon the fair value of assets received. Purchased-intangible assets are amortized on a straight-line or accelerated basis over the periods of benefit, ranging from two to ten years. We perform a review of purchased-intangible assets whenever events or changes in circumstances indicate that the useful life is shorter than we had originally estimated or that the carrying amount of assets may not be recoverable. If such facts and circumstances exist, we assess the recoverability of purchased-intangible assets by comparing the projected undiscounted net cash flows associated with the related asset or group of assets over their remaining lives against their respective carrying amounts. Impairments, if any, are based on the excess of the carrying amount over the fair value of those assets. If the useful life of the asset is shorter than originally estimated, we accelerate the rate of amortization and amortize the remaining carrying value over the new shorter useful life. There was no impairment of purchased-intangible assets identified for the years ended December 31, 2015, 2014, or 2013.

#### Income Taxes

We recognize deferred tax assets and liabilities at enacted income tax rates for the temporary differences between the financial reporting bases and the tax bases of our assets and liabilities. Any effects of changes in income tax rates or tax laws are included in the provision for income taxes in the period of enactment. Our net deferred tax assets

Table of Contents

primarily consist of net operating loss carry forwards (“NOLs”). We are required to record a valuation allowance against our net deferred tax assets if we conclude that it is more likely than not that taxable income generated in the future will be insufficient to utilize the future income tax benefit from our net deferred tax assets (namely, the NOLs) prior to expiration. We periodically review this conclusion, which requires significant management judgment. If we are able to conclude in a future period that a future income tax benefit from our net deferred tax assets has a greater than 50% likelihood of being realized, we are required in that period to reduce the related valuation allowance with a corresponding decrease in income tax expense. This would result in a non-cash benefit to our net income in the period of the determination. In the fourth quarter of 2011, we released \$325,601 of valuation allowance (see Note 5. Income Taxes). We periodically review this conclusion, which requires significant management judgment. In the future, if available evidence changes our conclusion that it is more likely than not that we will utilize our net deferred tax assets prior to their expiration, we will make an adjustment to the related valuation allowance and income tax expense at that time. In subsequent periods, we would expect to recognize income tax expense equal to our pre-tax income multiplied by our effective income tax rate, an expense that was not recognized prior to the reduction of the valuation allowance.

**Net Operating Loss Carryforwards**

As of December 31, 2015, we had NOLs for United States federal and state tax purposes, including the NOLs of iCore, Simple Signal, Telesphere, and Vocalocity as of the date of acquisition, of \$625,802 and \$186,776, respectively, expiring at various times from years ending 2016 through 2035. In addition, we had NOLs for United Kingdom tax purposes of \$45,159 with no expiration date.

Under Section 382 of the Internal Revenue Code, if we undergo an “ownership change” (generally defined as a greater than 50% change (by value) in our equity ownership over a three-year period), our ability to use our pre-change of control NOLs and other pre-change tax attributes against our post-change income may be limited. The Section 382 limitation is applied annually so as to limit the use of our pre-change NOLs to an amount that generally equals the value of our stock immediately before the ownership change multiplied by a designated federal long-term tax-exempt rate. At December 31, 2015, there were no limitations on the use of our NOLs except for the NOLs of Vocalocity as of the date of acquisition.

**Business Combinations**

We account for business combinations using the acquisition method of accounting. The acquisition method of accounting requires that the purchase price, including the fair value of contingent consideration, of the acquisition be allocated to the assets acquired and liabilities assumed using the fair values determined by management as of the acquisition date. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of assets acquired and the liabilities assumed. While the Company uses its best estimates and assumptions as part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the acquisition date, the Company’s estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company records adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill to the extent the Company identifies adjustments to the preliminary purchase price allocation. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the consolidated statements of operations. We include the results of all acquisitions in our Consolidated Financial Statements from the date of acquisition.

Acquisition related transaction costs, such as banking, legal, accounting and other costs incurred in connection with an acquisition, are expensed as incurred in general and administrative expense.

Acquisition related integration costs include costs associated with exit or disposal activities, which do not meet the criteria of discontinued operations, including costs for employee, lease, and

contract terminations, facility closing or other exit activities. Additionally, these costs include expenses directly related to integrating and reorganizing acquired businesses and include items such as employee retention costs, recruiting costs, certain moving costs, certain duplicative costs during integration and asset impairments. These costs are expensed as incurred in general and administrative expense.

**Share-Based Compensation**

We account for share-based compensation in accordance with FASB ASC 718, "Compensation-Stock Compensation". Under the fair value recognition provisions of this pronouncement, share-based compensation cost is measured at the grant date based on the fair value of the award, reduced as appropriate based on estimated forfeitures, and is recognized as expense over the applicable vesting period of the stock award using the accelerated method. The excess tax benefit associated with stock compensation deductions have not been recorded in additional paid-in capital. When evaluating whether an excess tax benefit has been realized, share based compensation deductions are not considered realized until NOLs are no longer sufficient to offset taxable income. Such excess tax benefits will be recorded when realized.

#### Recent Accounting Pronouncements

In January 2016, Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities". This ASU provide guidance concerning certain matters involving the recognition, measurement, and disclosure of financial assets and financial liabilities. The guidance does not alter the basic framework for classifying debt instruments held as financial assets. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is not permitted, with some exceptions. The adoption of ASU 2016-01 will not have a material impact on our consolidated financial statements and related disclosures.

In November 2015, FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes". This ASU simplifies the presentation of deferred income taxes and requires deferred tax liabilities and assets be classified as non-current in a classified statement of financial position. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Earlier application is permitted for all entities as of the beginning of an interim or annual reporting period. This ASU may be applied either prospectively or retrospectively to all periods presented. We are currently evaluating the impact of adopting ASU 2015-17 on our consolidated financial statements and related disclosures.

In September 2015, FASB issued ASU 2015-16, "Simplifying the Accounting for Measurement-Period Adjustments". This ASU simplifies the accounting for adjustments made to provisional amounts recognized in a business combination and eliminates the requirement to retrospectively account for those adjustments. This ASU is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. This ASU should be applied prospectively to adjustments to provisional amounts that occur after the effective date of this ASU with earlier application permitted for financial statements that have not been issued. We are currently evaluating the impact of adopting ASU 2015-16 on our consolidated financial statements and related disclosures.

In August 2015, FASB issued ASU 2015-15, "Interest-Imputation of Interest". This ASU provides guidance not addressed in ASU 2015-03 related to the presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. The SEC staff stated that they would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. We adopted this ASU along with the adoption of ASU 2015-03 in the third quarter of 2015 and restated the prior periods presentation. The adoption of ASU

## Table of Contents

2015-15 did not have a material impact on our consolidated financial statements and related disclosures.

In July 2015, FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory". This ASU applies to inventory that is measured using first-in, first-out ("FIFO") or average cost. Under the updated guidance, an entity should measure inventory that is within scope at the lower of cost and net realizable value, which is the estimated selling prices in the ordinary course of business, less reasonably predicible costs of completion, disposal and transportation. Subsequent measurement is unchanged for inventory that is measured using last-in, first-out ("LIFO") or the retail inventory. This ASU is effective for annual and interim periods beginning after December 15, 2016, and should be applied prospectively with early adoption only permitted at the beginning of an interim and annual reporting period. We are currently evaluating the impact of adopting ASU 2015-11 on our consolidated financial statements and related disclosures.

In April 2015, FASB issued ASU 2015-05, "Customer's Accounting for Fees Paid in a Cloud Computing Arrangement". This ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new guidance does not change the accounting for a customer's accounting for service contracts. ASU 2015-05 is effective for interim and annual reporting periods beginning after December 15, 2015. We are currently evaluating the impact of adopting ASU 2015-05 on our consolidated financial statements and related disclosures. In April 2015, FASB issued ASU 2015-03, "Interest-Imputation of Interest". This ASU requires that debt issuance costs be

reported in the balance sheet as a direct deduction from the face amount of the related liability, consistent with the presentation of debt discounts. Prior to the amendments, debt issuance costs were presented as a deferred charge (i.e., an asset) on the balance sheet. This ASU is effective for annual reporting periods beginning after December 15, 2015 and interim periods within fiscal years beginning after December 15, 2016. The amendments must be applied retrospectively. All entities have the option of adopting the new requirements as of an earlier date for financial statements that have not been previously issued. Applicable disclosures for a change in an accounting principle are required in the year of adoption, including interim periods. We adopted this ASU in the third quarter of 2015 and conformed the prior period presentation. The adoption of ASU 2015-03 did not have a material impact on our consolidated financial statements and related disclosures.

In May 2014, FASB issued ASU 2014-09, "Revenue from Contracts with Customers". This ASU is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. In August 2015, FASB issued ASU 2015-14 deferring the effective date to annual and interim periods beginning on or after December 15, 2017, and early adoption will be permitted, but not earlier than the original effective date of annual and interim periods beginning on or after December 15, 2016, for public entities. We will adopt this ASU when effective. Companies may use either a full retrospective or modified retrospective approach to adopt this ASU and our management is currently evaluating which transition approach to use. We are currently evaluating the impact of adopting ASU 2014-09 on our consolidated financial statements and related disclosures.

## OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements.

## ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to financial market risks, including changes in currency exchange rates and interest rates.

### Foreign Exchange Risk

We sell our products and services in the United States, Canada, and the United Kingdom. Changes in currency exchange rates affect the valuation in our financial statements of the assets and liabilities of these operations. We also have a portion of our sales denominated in Euros, the Canadian Dollar, and the British Pound, which are also affected by changes in currency exchange rates. Our financial results could be affected by changes in foreign currency exchange rates, although foreign exchange risks have not been material to our financial position or results of operations to date.

We prepared a sensitivity analysis to determine the impact of hypothetical changes foreign currency exchange rates have on our results of operations. The foreign currency rate analysis assumed a uniform movement in currencies by 10% relative to the U.S. Dollar on our results. Based upon the results of this analysis, a 10% change in currency rates would have resulted in an increase or decrease in our earnings for the year ended December 31, 2015 of approximately \$200.

#### Interest Rate and Debt Risk

Our exposure to market risk for changes in interest rates primarily relates to our long-term debt.

Our 2015 Credit Facility consists of a \$100,000 term note and a \$250,000 revolving credit facility. We are exposed to interest rate risk

since amounts payable under the 2015 Credit Facility, at our option, bear interest at:

LIBOR (applicable to one-, two-, three-, six-, or twelve-month periods) plus an applicable margin equal to 2.50% if our consolidated leverage ratio is less than 0.75 to 1.00, 2.75% if our consolidated leverage ratio is greater than or >equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 3.00% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last day of each relevant interest period or, if the interest period is longer than three months, each day that is three months after the first day of the interest period, or

the base rate determined by reference to the highest of (a) the prime rate of JPMorgan Chase Bank, N.A., (b) the federal funds effective rate from time to time plus 0.50% , and (c) the adjusted LIBO rate applicable to one month >interest periods plus 1.00% , plus an applicable margin equal to 1.50% if our consolidated leverage ratio is less than 0.75 to 1.00, 1.75% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 2.00% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last business day of each March, June, September, and December and the maturity date of the 2015 Credit Facility.

As of December 31, 2015, if the interest rate on our variable rate debt changed by 1% on our 2015 term note, our annual debt service payment would change by approximately \$900. As of December 31, 2015, if the interest rate on our variable rate debt changed by 1% on

Table of Contents

our 2015 revolving credit facility, our annual debt service payment would change by approximately \$1,200.

ITEM 8. Financial Statements and Supplementary Data

The information required by this Item is contained on pages F-1 through F-32 of this Annual Report on Form 10-K and incorporated herein by reference.

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure  
N/A.

ITEM 9A. Controls and Procedures

Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2015. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”), as amended, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of December 31, 2015, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Management’s Report on Internal Control Over Financial Reporting.

February 12, 2016

To the Stockholders of Vonage Holdings Corp.:

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the company. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management, and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and

the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- > Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;
- > Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the

company are being made only in accordance with authorizations of our management and directors; and  
> Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or  
> disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2015. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (2013).

We acquired iCore in August 2015 and Simple Signal in April 2015. Our management has excluded the operations of these businesses from our evaluation of, and conclusion regarding, the effectiveness of our internal control over financial reporting as of December 31, 2015. These businesses represent 6% and 4% of our total assets and revenues, respectively, as of December 31, 2015. Our management plans to fully integrate the operations of these businesses into its assessment of the effectiveness of our internal control over financial reporting in 2016.

Based on our assessment, management concluded that, as of December 31, 2015, our internal control over financial reporting is effective based on those criteria.



Table of Contents

Our independent registered public accounting firm has issued an attestation report on our internal control over financial reporting. This report appears on page F-3.

/s/ ALAN MASAREK

Alan Masarek  
Director, Chief Executive  
Officer

/s/ DAVID PEARSON

David T. Pearson  
Chief Financial Officer and Treasurer  
(Principal Financial and Accounting Officer and Duly  
Authorized Officer)

Report of the Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting.

See Report of Independent Registered Public Accounting Firm on page F-3.

Changes in Internal Control Over Financial Reporting

There were no changes to controls during the quarter ended December 31, 2015 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

ITEM 9B. Other Information

None.

Table of Contents

PART III

ITEM 10. Directors, Executive Officers and Corporate Governance

The discussion under the headings “Election of Directors,” “Section 16(a) Beneficial Ownership Reporting Compliance,” “Director Nomination Process,” “Corporate Governance – Board Committees – Audit Committee”, and “Executive Officers of Vonage” in our Proxy Statement for the 2016 Annual Meeting of Stockholders is hereby incorporated by reference. We have adopted a Vonage Code of Conduct applicable to all of our directors, officers, and employees and a Vonage Finance Code of Ethics applicable to our chief financial officer and other employees

in our finance organization. The Vonage Code of Conduct and Vonage Finance Code of Ethics are posted in the Investor Relations section of our website, [www.vonage.com](http://www.vonage.com). We will provide you with print copies of our codes free of charge on written request to Vonage Investor Relations, 23 Main Street, Holmdel NJ, 07733. We intend to disclose any amendments to, or waivers from, provisions of our codes that apply to our principal executive officer, principal financial officer, principal accounting officer or controller, or any person performing in similar functions, on our website promptly following the date of such amendment or waiver.

ITEM 11. Executive Compensation

The discussion under the headings “Compensation”, “Director Compensation”, “Corporate Governance – Compensation Committee Interlocks and Insider Participation”, and “Corporate Governance – Compensation Committee Report” in our Proxy Statement for the 2016 Annual Meeting of Stockholders is hereby incorporated by reference.

The “Compensation Committee Report” contained in our Proxy Statement shall not be deemed “soliciting material” or “filed” with

the Securities and Exchange Commission or otherwise subject to the liabilities of Section 18 of the Securities Exchange Act of 1934 (the “Exchange Act”), nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 (the “Securities Act”) or the Exchange Act, except to the extent we specifically request that such information be treated as soliciting material or specifically incorporate such information by reference into a document filed under the Securities Act or the Exchange Act.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The discussion under the headings “Stock Ownership Information” and “Equity Compensation Plan Information” in our Proxy

Statement for the 2016 Annual Meeting of Stockholders is hereby incorporated by reference.

ITEM 13. Certain Relationships and Related Transactions, and Director Independence

The discussion under the headings “Election of Directors – Transactions with Related Persons”, and “Corporate Governance –

Board Determination of Independence” in our Proxy Statement for the 2016 Annual Meeting of Stockholders is hereby incorporated by reference.

ITEM 14. Principal Accountant Fees and Services

The discussion under the heading “Ratification of Independent Registered Public Accounting Firm” in our Proxy Statement for the 2016 Annual Meeting of Stockholders is hereby incorporated by reference.

48 VONAGE ANNUAL REPORT 2015

---

Table of Contents

PART IV

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

Vonage Holdings Corp.

Holmdel, New Jersey 07733

The audits referred to in our report dated February 12, 2016 relating to the consolidated financial statements of Vonage Holdings Corp., which is contained in Item 8 of this Form 10-K also included the audit of the financial statement schedule listed in the accompanying index. The financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement schedule based on our audits.

In our opinion such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

/s/ BDO USA, LLP

Woodbridge, New Jersey

February 12, 2016

49 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## ITEM 15. Exhibits, Financial Statement Schedules

- (a)
- (1) Financial Statements. The index to our financial statements is found on page F-1 of this Form 10-K.
- (2) Financial Statement Schedule. Schedule II—Valuation and Qualifying Accounts is as follows:

|                                      | Balance at<br>Beginning<br>of Period | Additions<br>Revenue | Expense | Less<br>Deductions | Other    | Balance<br>at End<br>of Period |
|--------------------------------------|--------------------------------------|----------------------|---------|--------------------|----------|--------------------------------|
| Allowance for Doubtful Accounts:     |                                      |                      |         |                    |          |                                |
| Year ended December 31, 2015         | \$607                                | \$492                | \$(8 )  | \$—                | \$—      | \$1,091                        |
| Year ended December 31, 2014         | 683                                  | 117                  | (193 )  | —                  | —        | 607                            |
| Year ended December 31, 2013         | 753                                  | 186                  | (256 )  | —                  | —        | 683                            |
| Inventory Obsolescence               |                                      |                      |         |                    |          |                                |
| Year ended December 31, 2015         | \$181                                | \$—                  | \$1,882 | \$(1,377 )         | \$—      | \$686                          |
| Year ended December 31, 2014         | 229                                  | —                    | 757     | (805 )             | —        | 181                            |
| Year ended December 31, 2013         | 268                                  | —                    | 663     | (702 )             | —        | 229                            |
| Valuation Allowance for Deferred Tax |                                      |                      |         |                    |          |                                |
| Year ended December 31, 2015         | \$17,451                             | \$—                  | \$3,005 | (1) \$—            | \$—      | 20,456                         |
| Year ended December 31, 2014         | 16,922                               | —                    | 4,865   | (1) —              | (4,336 ) | (2) 17,451                     |
| Year ended December 31, 2013         | 12,590                               | —                    | (4 )    | (1) —              | 4,336    | (3) 16,922                     |

- (1) Amounts charged (credited) to expense represent change in valuation allowance.
- (2) Represents reversal of estimated valuation allowance on Vocalocity's deferred tax assets at date of acquisition.
- (3) Represents estimated valuation allowance on Vocalocity's deferred tax assets at date of acquisition.

- (3) Exhibits.

Table of Contents

| Exhibit<br>Number | Description of Exhibit   |
|-------------------|--|
| 2.1               | Agreement and Plan of Merger, dated October 9, 2013, by and among Vonage, Vista Merger Corp., Vocalocity and the Representative (12).  |
| 2.2               | Agreement and Plan of Merger, dated November 4, 2014, by and among Vonage, Thunder Acquisition Corp., Telesphere and the Representative (23)   |
| 2.3               | Agreement and Plan of Merger, dated August 19, 2015, by and among Vonage Holdings Corp., Cirrus Acquisition Corp., iCore Networks, Inc. and Stephen G. Canton, as the Representative (18)  |
| 3.1               | Restated Certificate of Incorporation of Vonage Holdings Corp.(3)  |
| 3.2               | Amended and Restated By-Laws of Vonage Holdings Corp., effective as of December 10, 2015 (7)   |
| 4.1               | Form of Certificate of Vonage Holdings Corp. Common Stock(2)   |
| 4.2               | Tax Benefits Preservation Plan, dated as of June 7, 2012, by and between Vonage Holdings Corp. and American Stock Transfer & Trust Company, LLC, as Rights Agent, including as Exhibit A the form of Certificate of Designation of the Company's Series A Participating Preferred Stock and as Exhibit B the forms of Right Certificate and of Election to Purchase (17) |
| 10.1              | Vonage Holdings Corp. 2015 Equity Incentive Plan. (27)*  |
| 10.2              | Form of Nonqualified Stock Option Agreement for Employees under the 2001 Stock Incentive Plan(1)*  |
| 10.3              | Form of Nonqualified Stock Option Agreement for Outside Directors under the 2001 Stock Incentive Plan(1)*  |
| 10.4              | Vonage Holdings Corp. 2006 Incentive Plan (Amended and Restated through June 6, 2013)(10)*   |
| 10.5              | Form of Restricted Stock Unit Agreement under the Vonage Holdings Corp. 2006 Incentive Plan(4)*  |
| 10.6              | Form of Nonqualified Stock Option Agreement under the Vonage Holdings Corp. 2006 Incentive Plan(13)*   |
| 10.7              | Form of Restricted Stock Agreement under the Vonage Holdings Corp. 2006 Incentive Plan(4)*   |
| 10.8              | Form of Restricted Stock Agreement for Non-Executive Directors under the Vonage Holdings Corp. 2006 Incentive Plan (8)*  |
| 10.9              | Form of Nonqualified Stock Option Agreement for Non-Executive Directors (Quarterly Grants) under the Vonage Holdings Corp. 2006 Incentive Plan (8)*  |
| 10.10             | Form of Nonqualified Stock Option Agreement for Non-Executive Directors (Sign-on Grant) under the Vonage Holdings Corp. 2006 Incentive Plan (8)*   |
| 10.11             | Vonage Holdings Corp. 401(k) Retirement Plan(1)*   |
| 10.12             | Lease Agreement, dated March 24, 2005, between 23 Main Street Holmdel Associates LLC and Vonage USA Inc.(1)  |
| 10.13             | Amendment to Lease Agreement, dated November 1, 2006, between 23 Main Street Holmdel Associates LLC and Vonage USA Inc.(31)  |
| 10.14             | Amendment to Lease Agreement, dated December 1, 2015, between 23 Main Street Holmdel Associates LLC and Vonage USA Inc.(31)  |
| 10.15             | Amended and Restated Non-Compete Agreement dated as of October 17, 2008 by and between Vonage Holdings Corp. and Jeffrey A. Citron(9)  |
| 10.16             | Form of Nonqualified Stock Option Agreement for Jeffrey A. Citron under the Vonage Holdings Corp. 2006 Incentive Plan(28)*   |
| 10.17             | Letter Agreement, dated February 6, 2012, between Vonage Holdings Corp. and Graham McGonigal(16)*  |
| 10.18             | Employment Agreement dated as of April 25, 2013 by and between Vonage Holdings Corp. and David T. Pearson (20)*  |
| 10.19             | Letter Agreement, dated April 2, 2015, between Vonage Holdings Corp. and Edward M. Gilvar (22)*  |
| 10.20             | Employment Agreement dated as of December 2, 2013 by and between Vonage Holdings Corp. and Joseph Redling (29)*  |
| 10.21             | Letter Agreement dated as of June 9, 2015 by and between Vonage Holdings Corp. and Omar Javaid (15)*   |
| 10.22             | Letter Agreement, dated July 15, 2009, between Vonage Holdings Corp. and Kurt Rogers(11)*  |
| 10.23             |  |

Edgar Filing: VONAGE HOLDINGS CORP - Form 10-K

- Amendment to Letter Agreement, dated December 22, 2010, between Vonage Holdings Corp. and Kurt Rogers(14)\*
- 10.24 Second Amendment to Letter Agreement, dated March 27, 2012, between Vonage Holdings Corp. and Kurt Rogers(16)\*
- 10.25 Amendment to Letter Agreement between Vonage Holdings Corp. and Kurt Rogers (19)\*
- 10.26 Non-Executive Director Compensation Program (31)\*
- 10.27 Form of Indemnification Agreement between Vonage Holdings Corp. and its directors and certain officers(5)\*
- 10.28 Employment Agreement dated as of October 6, 2014 by and between Vonage Holdings Corp. and Alan Masarek (30)\*
- 10.29 Letter Agreement dated as of September 18, 2014 by and between Vonage Holdings Corp. and Pablo Calamera (24)\*
- 10.30 Letter Agreement dated as of November 4, 2014 by and between Vonage Holdings Corp. and Clark Peterson (30)\*
- 10.31 Letter Agreement dated as of October 19, 2015 by and between Vonage Holdings Corp. and Susan Quackenbush (31)\*
- 10.32 Settlement and Patent License Agreement, dated December 21, 2007, between Vonage Holdings Corp. and AT&T Corp.(6)
- 10.33† Route Management Services Addendum (the “Addendum”), by and between Vonage America Inc., a wholly-owned subsidiary of Vonage Holdings Corp., and Tata Communications (America) Inc., effective as of July 1, 2013. (20)
- 10.34 First Amendment to Employment Agreement by and between Vonage Holdings Corp. and Alan Masarek (31)\*
- 10.35† Amendment to Route Management Services Addendum (the “Addendum”), by and between Vonage America Inc., a wholly-owned subsidiary of Vonage Holdings Corp., and Tata Communications (America) Inc., effective as of December 23, 2015. (31)
- 10.36† Route Management Services Addendum (the “Addendum”), by and between Vonage America Inc., a wholly-owned subsidiary of Vonage Holdings Corp., and Tata Communications (America) Inc., effective as of July 1, 2016. (31)

Table of Contents

| Exhibit Number | Description of Exhibit  |
|----------------|---|
| 10.37          | Credit Agreement, dated as of July 29, 2011 among Vonage Holdings Corp. and Vonage America Inc., as borrowers, various lenders, JPMorgan Chase Bank, N.A., as Administrative Agent, and RBS Citizens, N.A., as Syndication Agent.(25)   |
| 10.38          | Amendment No. 1, dated February 11, 2013, by and among Vonage America Inc. and Vonage Holdings Corp., as borrowers, various lenders, and JPMorgan Chase Bank, N.A., as Administrative Agent, under that certain Credit Agreement dated as of July 29, 2011 by and among the Borrowers, the Lenders and the Administrative Agent (19)                  |
| 10.39          | Amendment No. 2, dated July 26, 2013, by and among Vonage America Inc. and Vonage Holdings Corp., as borrowers, various lenders, and JPMorgan Chase Bank, N.A., as Administrative Agent, under that certain Credit Agreement dated as of July 29, 2011 by and among the Borrowers, the Lenders and the Administrative Agent (21)                      |
| 10.40          | Credit Agreement, dated August 13, 2014, by and among Vonage America Inc. and Vonage Holdings Corp., as borrowers, various lenders, and JPMorgan Chase Bank, N.A., as Administrative Agent, Citizens Bank, N.A., as Syndication Agent, and Silicon Valley Bank and Suntrust Bank, as Documentation Agents (24)  |
| 10.41          | Amended and Restated Credit Agreement among Vonage America Inc., Vonage Holdings Corp., the Lenders from time to time party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent, Citizens Bank, N.A., as Syndication Agent, and Fifth Third Bank, MUFG Union Bank, N.A., Silicon Valley Bank and SunTrust Bank, as Documentation Agents. (26) |
| 21.1           | List of Subsidiaries of Vonage Holdings Corp.(31)   |
| 23.1           | Consent of BDO USA, LLP, independent registered public accounting firm(31)  |
| 31.1           | Certification of our Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002(31)  |
| 31.2           | Certification of our Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002(31)  |
| 32.1           | Certification of our Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(31)   |

(1) Incorporated by reference to Amendment No. 1 to Vonage Holdings Corp.'s Registration Statement on Form S-1 (File No. 333-131659) filed on April 7, 2006.

(2) Incorporated by reference to Amendment No. 5 to Vonage Holdings Corp.'s Registration Statement on Form S-1 (File No. 333-131659) filed on May 8, 2006.

(3) Incorporated by reference to Vonage Holdings Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on August 4, 2006.

(4) Incorporated by reference to Vonage Holding Corp.'s Annual Report on Form 10-K (File No. 001-32887) filed on April 17, 2007.

(5) Incorporated by reference to Vonage Holding Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on November 14, 2007.

(6) Incorporated by reference to Vonage Holding Corp.'s Annual Report on Form 10-K (File No. 001-32887) filed on March 17, 2008.

(7) Incorporated by reference to Vonage Holding Corp.'s Current Report on Form 8-K (File No. 001-32887) filed on December 11, 2015.

(8) Incorporated by reference to Vonage Holding Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on August 11, 2008.

(9)



Edgar Filing: VONAGE HOLDINGS CORP - Form 10-K

- Incorporated by reference to Vonage Holding Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on November 10, 2008.
- (10) Incorporated by reference to Vonage Holding Corp.'s Current Report on Form 8-K (File No. 001-32887) filed on June 6, 2013.
  - (11) Incorporated by reference to Vonage Holding Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on November 6, 2009.
  - (12) Incorporated by reference to the Current Report on Form 8-K (File No. 001-32887) filed by on October 10, 2013.
  - (13) Incorporated by reference to Vonage Holding Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on May 7, 2010.
  - (14) Incorporated by reference to Vonage Holding Corp.'s Annual Report on Form 10-K (File No. 001-32887) filed on February 17, 2011.
  - (15) Incorporated by reference to Vonage Holding Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on November 4, 2015.
  - (16) Incorporated by reference to Vonage Holding Corp.'s Current Report on Form 10-Q (File No. 001-32887) filed on May 3, 2012.
  - (17) Incorporated by reference to Vonage Holding Corp.'s Current Report on Form 8-K (File No. 001-32887) filed on June 8, 2012.
  - (18) Incorporated by reference to Vonage Holding Corp.'s Current Report on Form 8-K (File No. 001-32887) filed on August 20, 2015.
  - (19) Incorporated by reference to Vonage Holding Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on May 1, 2013.
  - (20) Incorporated by reference to Vonage Holding Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on July 31, 2013.
  - (21) Incorporated by reference to Vonage Holding Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on November 6, 2013.
  - (22) Incorporated by reference to Vonage Holding Corp.'s Annual Report on Form 10-Q (File No. 001-32887) filed on May 7, 2015.
  - (23) Incorporated by reference to Vonage Holding Corp.'s Current Report on Form 8-K (File No. 001-32887) filed on November 5, 2014.
  - (24) Incorporated by reference to Vonage Holding Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on November 5, 2014.
  - (25) Incorporated by reference to Vonage Holding Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on August 4, 2011.
  - (26) Incorporated by reference to Vonage Holding Corp.'s Quarterly Report on Form 10-Q (File No. 001-32887) filed on July 30, 2015.
  - (27) Incorporated by reference to Vonage Holding Corp.'s Current Report on Form 8-K (File No. 001-32887) filed on June 3, 2015.

Table of Contents

- (28) Incorporated by reference to Vonage Holding Corp.'s Current Report on Form 8-K (File No. 001-32887) filed on August 4, 2008.
- (29) Incorporated by reference to Vonage Holding Corp.'s Annual Report on Form 10-K (File No. 001-32887) filed on February 13, 2014.
- (30) Incorporated by reference to Vonage Holding Corp.'s Annual Report on Form 10-K (File No. 001-32887) filed on February 13, 2015.
- (31) Filed herewith.

Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission as part of an order or application for confidential treatment pursuant to the Securities Act of 1933, as amended or the Securities Exchange Act of 1934, as amended.

\*Management contract or compensatory plan or arrangement.

(b) Exhibits Filed Herewith

Refer to (a)(3) above.

(c) Financial Statement Schedule

Report of Independent Registered Public Accounting Firm

Schedule II – Valuation and Qualifying Accounts.

Table of Contents

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, in the city of Holmdel, State of New Jersey, on February 12, 2016.

## VONAGE HOLDINGS CORP.

Dated: February 12, 2016

By: /S/ DAVID PEARSON  
 David Pearson  
 David T. Pearson  
 Chief Financial Officer and Treasurer  
 (Principal Financial and Accounting Officer and Duly Authorized Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and as of the dates indicated.

| Signature                                  | Title   | Date              |
|--|---|-------------------|
| /S/ ALAN MASAREK<br>Alan Masarek           | Director, Chief Executive Officer<br>(principal executive officer)  | February 12, 2016 |
| /S/ DAVID T. PEARSON<br>David T. Pearson   | Chief Financial Officer<br>and Treasurer<br>(principal financial officer and principal<br>accounting officer) | February 12, 2016 |
| /S/ JEFFREY A. CITRON<br>Jeffrey A. Citron | Director, Chairman  | February 12, 2016 |
| /S/ NAVEEN CHOPRA<br>Naveen Chopra         | Director  | February 12, 2016 |
| /S/ STEPHEN FISHER<br>Stephen Fisher       | Director  | February 12, 2016 |
| /S/ CAROLYN KATZ<br>Carolyn Katz           | Director  | February 12, 2016 |
| /S/ DAVID C. NAGEL<br>David C. Nagel       | Director  | February 12, 2016 |
| /S/ JOHN J. ROBERTS<br>John J. Roberts     | Director  | February 12, 2016 |
| /S/ MARGARET M. SMYTH<br>Margaret M. Smyth | Director  | February 12, 2016 |
| /S/ CARL SPARKS                            | Director  | February 12, 2016 |

Carl Sparks

54 VONAGE ANNUAL REPORT 2015

---

Table of Contents

INDEX TO FINANCIAL STATEMENTS

|  | Page       |
|--|------------|
| <u>Report of Independent Registered Public Accounting Firm—BDO USA, LLP</u>  | <u>F-2</u> |
| <u>Report of Independent Registered Public Accounting Firm—BDO USA, LLP</u>  | <u>F-3</u> |
| <u>Consolidated Balance Sheets as of December 31, 2015 and 2014</u>  | <u>F-4</u> |
| <u>Consolidated Statements of Income for the years ended December 31, 2015, 2014 and 2013</u>  | <u>F-5</u> |
| <u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2015, 2014 and 2013</u>  | <u>F-6</u> |
| <u>Consolidated Statements of Cash Flows for the years ended December 31, 2015, 2014 and 2013</u>  | <u>F-7</u> |
| <u>Consolidated Statements of Stockholders' Equity (Deficit) and Redeemable Noncontrolling Interest for the years ended December 31, 2015, 2014 and 2013</u> | <u>F-8</u> |
| <u>Notes to Consolidated Financial Statements</u>  | <u>F-9</u> |

F-1

---

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Vonage Holdings Corp.

Holmdel, New Jersey

We have audited the accompanying consolidated balance sheets of Vonage Holdings Corp. as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, stockholders' equity (deficit) and redeemable noncontrolling interest and cash flows for each of the three years in the period ended December 31, 2015. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Vonage Holdings Corp. as of December 31, 2015 and 2014, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Vonage Holdings Corp.'s internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 12, 2016 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Woodbridge, New Jersey

February 12, 2016

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Vonage Holdings Corp.

Holmdel, New Jersey

We have audited Vonage Holdings Corp.'s (the "Company") internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Item 9A. Management's Report on Internal Control Over Financial Reporting." Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Item 9A, Management's Report on Internal Control over Financial Reporting", management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of iCore Networks, Inc., which was acquired on August 31, 2015 and Simple Signal Inc. which was acquired on April 1, 2015, and which are included in the consolidated balance sheets of Vonage Holdings Corp. as of December 31, 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity (deficit) and redeemable noncontrolling interest and cash flows for the year then ended. iCore Networks, Inc. and Simple Signal Inc. constituted 6% of total assets as of December 31, 2015 and 4% of revenues for the year then ended. Management did not assess the effectiveness of internal control over financial reporting of iCore Networks Inc. and Simple Signal Inc. because of the timing of the acquisitions. Our audit of internal control over financial reporting of Vonage Holdings Corp. also did not include an evaluation of the internal control over financial reporting of iCore Networks Inc. and Simple Signal Inc.

In our opinion, Vonage Holdings Corp. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Vonage Holdings Corp. as of December 31, 2015 and 2014 and the related consolidated statements of income, comprehensive income, stockholders' equity (deficit) and redeemable

noncontrolling interest, and cash flows for each of the three years in the period ended December 31, 2015 and our report dated February 12, 2016 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Woodbridge, New Jersey

February 12, 2016

F-3 VONAGE ANNUAL REPORT 2015

---



Table of ContentsVONAGE HOLDINGS CORP. CONSOLIDATED BALANCE SHEETS  
VONAGE HOLDINGS CORP. CONSOLIDATED BALANCE SHEETS

| (In thousands, except par value)   | December 31,<br>2015 | December<br>31, 2014<br>(revised) (1) |
|--|----------------------|---------------------------------------|
| Assets   |                      |                                       |
| Current assets:  |                      |                                       |
| Cash and cash equivalents  | \$57,726             | \$40,797                              |
| Marketable securities  | 9,908                | 7,162                                 |
| Accounts receivable, net of allowance of \$1,091 and \$607, respectively   | 19,913               | 17,832                                |
| Inventory, net of allowance of \$686 and \$181, respectively   | 5,542                | 10,081                                |
| Deferred customer acquisition costs, current   | 4,074                | 4,854                                 |
| Deferred tax assets, current   | 23,985               | 21,849                                |
| Prepaid expenses and other current assets  | 15,659               | 12,665                                |
| Total current assets   | 136,807              | 115,240                               |
| Property and equipment, net  | 49,483               | 49,630                                |
| Goodwill   | 222,106              | 142,544                               |
| Software, net  | 20,710               | 18,624                                |
| Deferred customer acquisition costs, non-current   | 431                  | 87                                    |
| Debt related costs, net  | 2,053                | 1,183                                 |
| Restricted cash  | 2,587                | 3,405                                 |
| Intangible assets, net   | 138,199              | 110,832                               |
| Deferred tax assets, non-current   | 202,587              | 225,167                               |
| Other assets   | 9,603                | 7,748                                 |
| Total assets   | \$784,566            | \$674,460                             |
| Liabilities and Stockholders' Equity   |                      |                                       |
| Liabilities  |                      |                                       |
| Current liabilities:   |                      |                                       |
| Accounts payable   | \$42,798             | \$42,564                              |
| Accrued expenses   | 96,127               | 84,322                                |
| Deferred revenue, current portion  | 32,605               | 35,570                                |
| Current maturities of capital lease obligations  | 4,398                | 3,365                                 |
| Current portion of notes payable   | 15,000               | 20,000                                |
| Total current liabilities  | 190,928              | 185,821                               |
| Indebtedness under revolving credit facility   | 119,000              | 67,000                                |
| Notes payable, net of debt related cost and current portion  | 76,392               | 69,032                                |
| Deferred revenue, net of current portion   | 851                  | 855                                   |
| Capital lease obligations, net of current maturities   | 3,363                | 6,836                                 |
| Other liabilities, net of current portion in accrued expenses  | 5,291                | 1,419                                 |
| Total liabilities  | 395,825              | 330,963                               |
| Commitments and Contingencies  | —                    | —                                     |
| Stockholders' Equity   |                      |                                       |
| Common stock, par value \$0.001 per share; 596,950 shares authorized at December 31, 2015 and December 31, 2014; 268,947 and 262,423 shares issued at December 31, 2015 and December 31, 2014, respectively; 214,280 and 211,994 shares outstanding at December 31, 2015 and December 31, 2014, respectively | 270                  | 264                                   |
| Additional paid-in capital   | 1,224,947            | 1,184,662                             |
| Accumulated deficit  | (655,020 )           | (677,675 )                            |
|  | (179,779 )           | (159,775 )                            |

Edgar Filing: VONAGE HOLDINGS CORP - Form 10-K

Treasury stock, at cost, 54,667 shares at December 31, 2015 and 50,429 shares at December 31, 2014

|   |           |   |           |   |
|---|-----------|---|-----------|---|
| Accumulated other comprehensive (loss) income | (1,677    | ) | (3,131    | ) |
| Noncontrolling interest                       | —         |   | (848      | ) |
| Total stockholders' equity                    | 388,741   |   | 343,497   |   |
| Total liabilities and stockholders' equity    | \$784,566 |   | \$674,460 |   |

(1) See Note 6 Long-Term Debt and Revolving Credit Facility and Note 11 Acquisition of Business.

The accompanying notes are an integral part of these financial statements

F-4 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## VONAGE HOLDINGS CORP. CONSOLIDATED STATEMENTS OF INCOME

| (In thousands, except per share amounts)   | For the years ended December 31, |           |           |
|--|----------------------------------|-----------|-----------|
|  | 2015                             | 2014      | 2013      |
| Total revenues   | \$895,072                        | \$868,854 | \$829,067 |
| Operating Expenses:  |                                  |           |           |
| Cost of services (excluding depreciation and amortization of \$24,868, \$19,405, and \$14,892, respectively) | 261,768                          | 231,383   | 237,244   |
| Cost of goods sold   | 34,210                           | 36,500    | 37,586    |
| Sales and marketing  | 347,896                          | 373,737   | 366,307   |
| Engineering and development  | 27,220                           | 20,869    | 14,794    |
| General and administrative   | 109,153                          | 98,780    | 83,107    |
| Depreciation and amortization  | 61,833                           | 49,514    | 36,054    |
|  | 842,080                          | 810,783   | 775,092   |
| Income from operations   | 52,992                           | 58,071    | 53,975    |
| Other Income (Expense):  |                                  |           |           |
| Interest income  | 89                               | 207       | 307       |
| Interest expense   | (8,786)                          | (6,823)   | (6,557)   |
| Other (expense) income, net  | (842)                            | 11        | (104)     |
|  | (9,539)                          | (6,605)   | (6,354)   |
| Income from continuing operations before income tax expense  | 43,453                           | 51,466    | 47,621    |
| Income tax expense   | (18,418)                         | (21,759)  | (18,194)  |
| Income from continuing operations  | 25,035                           | 29,707    | 29,427    |
| Loss from discontinued operations  | (1,615)                          | (10,260)  | (1,626)   |
| Loss on disposal, net of taxes   | (824)                            | —         | —         |
| Discontinued operations  | (2,439)                          | (10,260)  | (1,626)   |
| Net income   | 22,596                           | 19,447    | 27,801    |
| Plus: Net loss from discontinued operations attributable to noncontrolling interest                          | 59                               | 819       | 488       |
| Net income attributable to Vonage  | \$22,655                         | \$20,266  | \$28,289  |
| Net income per common share - continuing operations:   |                                  |           |           |
| Basic  | \$0.12                           | \$0.14    | \$0.14    |
| Diluted  | \$0.11                           | \$0.14    | \$0.13    |
| Net loss per common share - discontinued operations attributable to Vonage:                                  |                                  |           |           |
| Basic  | \$(0.01)                         | \$(0.04)  | \$(0.01)  |
| Diluted  | \$(0.01)                         | \$(0.04)  | \$(0.01)  |
| Net income per common share - attributable to Vonage:  |                                  |           |           |
| Basic  | \$0.11                           | \$0.10    | \$0.13    |
| Diluted  | \$0.10                           | \$0.09    | \$0.13    |
| Weighted-average common shares outstanding:  |                                  |           |           |
| Basic  | 213,147                          | 209,822   | 211,563   |
| Diluted  | 224,110                          | 219,419   | 220,520   |

The accompanying notes are an integral part of these financial statements



Table of Contents

## VONAGE HOLDINGS CORP. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| (In thousands)   | For the years ended December 31, |          |          |
|--|----------------------------------|----------|----------|
|  | 2015                             | 2014     | 2013     |
| Net income   | \$22,596                         | \$19,447 | \$27,801 |
| Other comprehensive income (loss):                               |                                  |          |          |
| Foreign currency translation adjustment                          | 493                              | (3,633)  | (2,058)  |
| Discontinued operations cumulative translation adjustment        | 974                              | —        | —        |
| Unrealized loss on available-for-sale securities                 | (13)                             | (8)      | —        |
| Total other comprehensive income (loss)                          | 1,454                            | (3,641)  | (2,058)  |
| Comprehensive income   | 24,050                           | 15,806   | 25,743   |
| Comprehensive loss attributable to noncontrolling interest:      |                                  |          |          |
| Comprehensive loss   | 59                               | 819      | 488      |
| Comprehensive loss from discontinued operations                  | —                                | (9)      | 5        |
| Total comprehensive loss attributable to noncontrolling interest | 59                               | 810      | 493      |
| Comprehensive income attributable to Vonage                      | \$24,109                         | \$16,616 | \$26,236 |

The accompanying notes are an integral part of these financial statements

F-6 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## VONAGE HOLDINGS CORP. CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In thousands)  | For the years ended December |            |            |
|---|------------------------------|------------|------------|
|   | 31,<br>2015                  | 2014       | 2013       |
| Cash flows from operating activities:   |                              |            |            |
| Net income  | \$22,596                     | \$19,447   | \$27,801   |
| Adjustments to reconcile net income to net cash provided by operating activities:           |                              |            |            |
| Depreciation and amortization and impairment charges  | 35,620                       | 34,464     | 31,208     |
| Amortization of intangibles   | 26,404                       | 16,943     | 4,858      |
| Deferred tax expense  | 13,949                       | 19,128     | 16,795     |
| Loss on foreign currency  | 1,358                        | —          | —          |
| Allowance for doubtful accounts   | (8                           | ) (193     | ) (256     |
| Allowance for obsolete inventory  | 1,882                        | 757        | 663        |
| Amortization of debt related costs  | 997                          | 1,072      | 1,515      |
| Share-based expense   | 27,541                       | 21,070     | 17,843     |
| Noncontrolling interest   | 907                          | —          | —          |
| Changes in operating assets and liabilities, net of acquisitions:                           |                              |            |            |
| Accounts receivable   | 185                          | 4,887      | 1,236      |
| Inventory   | 2,815                        | 36         | (5,835     |
| Prepaid expenses and other current assets   | (1,904                       | ) 4,106    | (662       |
| Deferred customer acquisition costs   | 421                          | 230        | 621        |
| Other assets  | (1,660                       | ) (5,790   | ) 1,970    |
| Accounts payable  | (3,830                       | ) (8,454   | ) (26,335  |
| Accrued expenses  | 4,768                        | (13,042    | ) 17,869   |
| Deferred revenue  | (3,682                       | ) (1,910   | ) (1,111   |
| Other liabilities   | 1,372                        | (209       | ) 63       |
| Net cash provided by operating activities   | 129,731                      | 92,542     | 88,243     |
| Cash flows from investing activities:   |                              |            |            |
| Capital expenditures  | (17,323                      | ) (12,436  | ) (9,889   |
| Purchase of intangible assets   | (2,500                       | ) —        | —          |
| Purchase of marketable securities   | (9,982                       | ) (7,170   | ) —        |
| Maturities and sales of marketable securities   | 7,223                        | —          | —          |
| Acquisition and development of software assets  | (14,183                      | ) (11,819  | ) (12,291  |
| Acquisition of business, net of cash acquired   | (116,927                     | ) (88,098  | ) (100,057 |
| Decrease in restricted cash   | 996                          | 995        | 1,252      |
| Net cash used in investing activities   | (152,696                     | ) (118,528 | ) (120,985 |
| Cash flows from financing activities:   |                              |            |            |
| Principal payments on capital lease obligations   | (3,549                       | ) (2,889   | ) (3,471   |
| Principal payments on notes and revolving credit facility                                   | (47,500                      | ) (41,666  | ) (23,334  |
| Proceeds received from draw down of revolving credit facility and issuance of notes payable | 102,000                      | 77,000     | 102,500    |
| Debt related costs  | (2,007                       | ) (1,910   | ) (2,056   |
| Common stock repurchases  | (15,911                      | ) (49,338  | ) (56,294  |
| Acquisition of redeemable noncontrolling interest   | —                            | —          | 455        |
| Proceeds from exercise of stock options   | 7,172                        | 4,564      | 4,091      |
| Net cash provided by (used in) financing activities   | 40,205                       | (14,239    | ) 21,891   |

Edgar Filing: VONAGE HOLDINGS CORP - Form 10-K

|   |          |           |           |
|---|----------|-----------|-----------|
| Effect of exchange rate changes on cash                                   | (311 )   | (3,641 )  | (1,596 )  |
| Net change in cash and cash equivalents                                   | 16,929   | (43,866 ) | (12,447 ) |
| Cash and cash equivalents, beginning of period                            | 40,797   | 84,663    | 97,110    |
| Cash and cash equivalents, end of period                                  | \$57,726 | \$40,797  | \$84,663  |
| Supplemental disclosures of cash flow information:                        |          |           |           |
| Cash paid during the periods for:   |          |           |           |
| Interest  | \$7,834  | \$5,252   | \$4,722   |
| Income taxes  | \$2,516  | \$2,491   | \$2,323   |
| Non-cash financing transactions during the periods for:                   |          |           |           |
| Common stock repurchases  | \$—      | \$661     | \$736     |
| Issuance of common stock in connection with acquisition of business       | \$5,578  | \$22,727  | \$26,186  |
| Purchase of intangible assets   | \$5,000  | \$—       | \$—       |
| The accompanying notes are an integral part of these financial statements |          |           |           |

F-7 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## VONAGE HOLDINGS CORP. CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT) AND REDEEMABLE NONCONTROLLING INTEREST

| (In thousands)                                   | Common Stock | Additional Paid-in Capital | Accumulated Deficit | Treasury Stock | Accumulated Other Comprehensive Income | Non-controlling interest | Total     | Redeemable non-controlling interest | Net Income |
|--|--------------|----------------------------|---------------------|----------------|--|--------------------------|-----------|-------------------------------------|------------|
| Balance at December 31, 2012                     | \$230        | \$1,088,186                | \$(726,230)         | \$(43,343)     | \$2,572                                | \$—                      | \$321,415 |                                     |            |
| Stock option exercises                           | 9            | 9,545                      |                     |                |  |                          | 9,554     |                                     |            |
| Stock option cancellation                        |              | (5,463)                    |                     |                |  |                          | (5,463)   |                                     |            |
| Share-based expense                              |              | 17,843                     |                     |                |  |                          | 17,843    |                                     |            |
| Share-based award activity                       |              |                            |                     | (1,311)        |  |                          | (1,311)   |                                     |            |
| Common stock repurchases                         |              |                            |                     | (56,386)       |  |                          | (56,386)  |                                     |            |
| Acquisition of business                          | 8            | 26,178                     |                     |                |  |                          | 26,186    |                                     |            |
| Investment by redeemable noncontrolling interest |              |                            |                     |                |  |                          | —         | 455                                 |            |
| Foreign currency translation adjustment          |              |                            |                     |                | (2,053)                                |                          | (2,053)   | (5)                                 |            |
| Net income                                       |              |                            | 28,289              |                |  |                          | 28,289    | (488)                               | 27,801     |
| Balance at December 31, 2013                     | 247          | 1,136,289                  | (697,941)           | (101,040)      | 519                                    | —                        | 338,074   | (38)                                |            |
| Stock option exercises                           | 10           | 4,554                      |                     |                |  |                          | 4,564     |                                     |            |
| Share-based expense                              |              | 21,070                     |                     |                |  |                          | 21,070    |                                     |            |
| Share-based award activity                       |              |                            |                     | (9,004)        |  |                          | (9,004)   |                                     |            |
| Common stock repurchases                         |              |                            |                     | (49,263)       |  |                          | (49,263)  |                                     |            |
| Acquisition of business                          | 7            | 22,749                     |                     | (468)          |  |                          | 22,288    |                                     |            |
| Foreign currency translation adjustment          |              |                            |                     |                | (3,642)                                | 9                        | (3,633)   |                                     |            |
| Unrealized loss on                               |              |                            |                     |                | (8)                                    |                          | (8)       |                                     |            |



|  |       |             |             |             |           |         |           |        |          |
|--|-------|-------------|-------------|-------------|-----------|---------|-----------|--------|----------|
| available-for-sale securities                    |       |             |             |             |           |         |           |        |          |
| Transfer of noncontrolling interest              |       |             |             |             |           | (706)   | (706)     |        | ) 706    |
| Net income                                       |       |             | 20,266      |             |           | (15)    | 20,115    | (668)  | ) 19,447 |
| Balance at December 31, 2014                     | 264   | 1,184,662   | (677,675)   | ) (159,775) | ) (3,131) | ) (848) | 343,497   | —      |          |
| Stock option exercises                           | 5     | 7,167       |             |             |           |         | 7,172     |        |          |
| Share-based expense                              |       | 27,541      |             |             |           |         | 27,541    |        |          |
| Share-based award activity                       |       |             |             | (4,754)     | )         |         | (4,754)   | )      |          |
| Common stock repurchases                         |       |             |             | (15,250)    | )         |         | (15,250)  | )      |          |
| Acquisition of business                          | 1     | 5,577       |             |             |           |         | 5,578     |        |          |
| Foreign currency translation adjustment          |       |             |             |             |           | 1,467   | 1,467     |        |          |
| Unrealized loss on available-for-sale securities |       |             |             |             |           | (13)    | ) (13)    | )      |          |
| Net income (loss)                                |       |             | 22,655      |             |           |         | 848       | 23,503 |          |
| Balance at December 31, 2015                     | \$270 | \$1,224,947 | \$(655,020) | \$(179,779) | \$(1,677) | ) \$—   | \$388,741 |        |          |

The accompanying notes are an integral part of these financial statements

Table of Contents

VONAGE HOLDINGS CORP.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(In thousands, except per share amounts)

Note 1. Basis of Presentation and Significant Accounting Policies

NATURE OF OPERATIONS

Vonage Holdings Corp. (“Vonage”, “Company”, “we”, “our”, “us”) is incorporated as a Delaware corporation. We are a leading provider of communications services connecting people through cloud-connected devices worldwide. Customers in the United States represented 93% of our combined subscriber lines and seats at December 31, 2015, with the balance primarily in Canada and the United Kingdom.

SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of Vonage and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. We also consolidate a majority-owned entity in Brazil where we had the ability to exercise controlling influence. The ownership interest of the noncontrolling party is presented as noncontrolling interest. On March 31, 2015, the Company completed its previously announced exit from the Brazilian market for consumer telephony services and the associated wind down of its joint venture operations in the country. The results of Brazilian operations are presented as discontinued operations for all periods presented. The results of companies acquired or disposed of are included in the consolidated financial statements from the effective date of the acquisition or up to the date of disposal.

Use of Estimates

Our consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States, which require management to make estimates and assumptions that affect the amounts reported and disclosed in the consolidated financial statements and the accompanying notes. Actual results could differ materially from these estimates.

On an ongoing basis, we evaluate our estimates, including the following:

- >the useful lives of property and equipment, software costs, and intangible assets; assumptions used for the purpose of determining share-based compensation using the Black-Scholes option pricing model and Monte Carlo simulation model (“Models”), and various other assumptions that we believe to be reasonable;
  - >the key inputs for these Models include our stock price at valuation date, exercise price, the dividend yield, risk-free interest rate, life in years, and historical volatility of our common stock; and
  - >assumptions used in determining the need for, and amount of, a valuation allowance on net deferred tax assets;
- We base our estimates on historical experience, available market information, appropriate valuation methodologies, and on various other assumptions that we believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Revenue Recognition

Operating revenues consist of services revenues and customer equipment (which enables our services) and shipping revenues. The point in time at which revenues are recognized is determined in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, Revenue Recognition, and Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 605, Revenue Recognition.

At the time a customer signs up for our services, there are the following deliverables:

- >Providing equipment, if any, to the customer that enables our telephony services; and
- > Providing services.

The equipment is generally provided free of charge to our customers and in most instances there are no fees collected at sign-up. We record the fees collected for shipping the equipment to the customer, if any, as shipping and handling revenue at the time of shipment.

#### Services Revenue

Substantially all of our revenues are services revenues, which are derived primarily from monthly subscription fees that customers are charged under our service plans. We also derive services revenues from per minute fees for international calls if not covered under a plan, including calls made via applications for mobile devices and other stand-alone products, and for any calling minutes in excess of a customer's monthly plan limits. Monthly subscription fees are automatically charged to customers' credit cards, debit cards or electronic check payments ("ECP"), in advance and are recognized over the following month when services are provided. Revenues generated from international calls and from customers exceeding allocated call minutes under limited minute plans are recognized as services are provided, that is, as minutes are used, and are billed to a customer's credit cards, debit cards or ECP in arrears. As a result of multiple billing cycles each month, we estimate the amount of revenues earned from international calls and from customers exceeding allocated call minutes under limited minute plans but not billed from the end of each billing cycle to the end of each reporting period and record these amounts as accounts receivable. These estimates are based primarily upon historical minutes and have been consistent with our actual results. We also provide rebates to customers who purchase their customer equipment from retailers and satisfy minimum service period requirements. These rebates in excess of activation fees are recorded as a reduction of revenues over the service period based upon the estimated number of customers that will ultimately earn and claim the rebates. In the United States, we charge regulatory, compliance, E-911, and intellectual property-related fees on a monthly basis to defray costs, and to cover taxes that we are charged by the suppliers of telecommunications services. In addition, we charge customers Federal Universal Service Fund ("USF") fees. We recognize revenue on a gross basis for USF and related fees. We record these fees as revenue when billed. All other taxes are recorded on a net basis.

#### Customer Equipment and Shipping Revenue

Customer equipment and shipping revenues consist of revenues from sales of customer equipment to wholesalers or directly to customers for replacement devices, or for upgrading their device at the time of customer sign-up for which we charge an additional fee. In addition, customer equipment and shipping revenues include revenues from the sale of VoIP telephones in order to access our small and medium business services. Customer equipment and shipping revenues also include the fees that customers are charged for shipping their customer

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

equipment to them. Customer equipment and shipping revenues include sales to our retailers, who subsequently resell this customer equipment to customers. Revenues are reduced for payments to retailers and rebates to customers, who purchased their customer equipment through these retailers, to the extent of customer equipment and shipping revenues.

Cost of Services

Cost of service consists of costs that we pay to third parties in order to provide services. These costs include access and interconnection charges that we pay to other companies to terminate domestic and international phone calls on the public switched telephone network. In addition, these costs include the cost to lease phone numbers, to co-locate in other companies' facilities, to provide enhanced emergency dialing capabilities to transmit 911 calls, and to provide local number portability. These costs also include taxes that we pay on telecommunications services from our suppliers or are imposed by government agencies such as federal universal service fund ("USF") contributions and royalties for use of third parties' intellectual property. In addition, these costs include certain personnel and related costs for network operations and technical support that are attributable to revenue generating activities.

Cost of Goods Sold

Cost of goods sold consists primarily of costs that we incur when a customer signs up for our service. These costs include the cost of customer equipment for customers who subscribe through the direct sales channel in excess of activation fees. In addition, these costs include the amortization of deferred customer equipment, the cost of shipping and handling for customer equipment, the installation manual that accompanies the customer equipment, and the cost of certain promotions.

Sales and Marketing Expenses

Sales and marketing expenses consist primarily of personnel and related costs for employees and contractors directly associated with our sales and marketing activities, internet advertising fees, radio and billboard advertising, public relations, commissions paid to employees, resellers and other third parties, trade shows, marketing and promotional activities, customer support, credit card fees, collections, and systems and information technology support.

Engineering and Development Expenses

Engineering and development expenses primarily include personnel and related costs for developers responsible for new products, and software engineers maintaining and enhancing existing products. These costs have been reclassified from selling, general and administrative expenses. Research and development costs related to new product development included in engineering and development were \$18,350, \$13,034, and \$5,948 for the years ended December 31, 2015, 2014, and 2013, respectively.

Costs for research, including predevelopment efforts prior to establishing technological feasibility of software expected to be marketed, are expensed as incurred.

Development costs are capitalized when technological feasibility has been established and anticipated future revenues support the recoverability of the capitalized amounts. Capitalization stops when the product is available for general release to customers. Due to the short time period between achieving technological feasibility and product release and the insignificant amount of costs incurred during such periods, we have not capitalized any software development, and have expensed these costs as incurred.

General and Administrative Expenses

General and administrative expenses primarily relate to our executive, finance, human resources, legal, and information technology organizations. General and administrative expenses primarily consist of personnel costs, stock compensation, board of directors' costs,

professional fees for legal, accounting, tax, compliance and information systems, travel, recruiting expense and, rent and related expenses.

#### Cash, Cash Equivalents and Marketable Securities

We maintain cash with several investment grade financial institutions. Highly liquid investments, which are readily convertible into cash, with original maturities of three months or less, are recorded as cash equivalents.

Management determines the appropriate classification of our investments in debt and marketable equity securities at the time of purchase and reevaluates such designation at each balance sheet date. Our debt and marketable equity securities have been classified and accounted for as available for sale. We may or may not hold securities with stated maturities until maturity. In response to changes in the availability of and the yield on alternative investments as well as liquidity requirements, we may sell these securities prior to their stated maturities. These securities are carried at fair value, with the unrealized gains and losses reported as a component of other comprehensive income (loss). Any realized gains or losses on the sale of marketable securities are determined on a specific identification method, and such gains and losses are reflected as a component of other income or expense.

#### Certain Risks and Concentrations

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash equivalents, marketable securities, and accounts receivable. They are subject to fluctuations in both market value and yield based upon changes in market conditions, including interest rates, liquidity, general economic conditions, and conditions specific to the issuers. Accounts receivable are typically unsecured and are derived from revenues earned from customers primarily located in the United States. A portion of our accounts receivable represents the timing difference between when a customer's credit card is billed and the subsequent settlement of that transaction with our credit card processors. This timing difference is generally three days for substantially all of our credit card receivables. We have never experienced any accounts receivable write-offs due to this timing difference. In addition, we collect subscription fees in advance, minimizing our accounts receivable and bad debt exposure. If a customer's credit card, debit card or ECP is declined, we generally suspend international calling capabilities as well as their ability to incur domestic usage charges in excess of their plan minutes. Generally, if the customer's credit card, debit card or ECP could not be successfully processed during three billing cycles (i.e., the current and two subsequent monthly billing cycles), we terminate the account. In addition, we automatically charge any per minute fees to our customers' credit card, debit card or ECP monthly in arrears. To further mitigate our bad debt exposure, a customer's credit card, debit card or ECP will be charged in advance of their monthly billing if their international calling or overage charges exceed a certain dollar threshold.

#### Inventory

Inventory consists of the cost of customer equipment and is stated at the lower of cost or market, with cost determined using the average cost method. We provide an inventory allowance for customer equipment that has been returned by customers but may not be able to be reissued to new customers or returned to the manufacturer for credit.

#### Property and Equipment

Property and equipment includes acquired assets and those accounted for under capital leases and consist principally of network equipment and computer hardware, software, furniture, and leasehold improvements. Company-owned equipment in use at customer premises is also included in property and equipment. In addition, the lease of our corporate headquarters has been accounted for as a capital lease and is included in property and equipment. Network equipment and computer hardware and furniture are stated at cost with depreciation provided using the straight-line method over the estimated useful lives

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

of the related assets, which range from three to five years. Leasehold improvements are amortized over their estimated useful life of the related assets or the life of the lease, whichever is shorter. The cost of renewals and substantial improvements is capitalized while the cost of maintenance and repairs is charged to operating expenses as incurred. Company-owned customer premises equipment is depreciated on a straight-line basis over three years.

Our network equipment and computer hardware, which consists of routers, gateways, and servers that enable our telephony services, is subject to technological risks and rapid market changes due to new products and services and changing customer demand. These changes may result in future adjustments to the estimated useful lives or the carrying value of these assets, or both.

Software Costs

We capitalize certain costs, such as purchased software and internally developed software that we use for customer acquisition and customer care automation tools, in accordance with FASB ASC 350-40, "Internal-Use Software".

Computer software is stated at cost less accumulated amortization and the estimated useful life is two to five years.

Goodwill

Goodwill acquired in the acquisition of a business is accounted for based upon the excess fair value of consideration transferred over the fair value of net assets acquired in the business combination. Goodwill is tested for impairment on an annual basis on October 1st and, when specific circumstances dictate, between annual tests. When impaired, the carrying value of goodwill is written down to fair value. The goodwill impairment test involves evaluating qualitative information to determine if it is more than 50% likely that the fair value of a reporting unit is less than its carrying value. If such a determination is made, then the traditional two-step goodwill impairment test described below must be applied. The first step, identifying a potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying value of the reporting unit exceeds its fair value, the second step would need to be conducted; otherwise, no further steps are necessary as no potential impairment exists. The second step, measuring the impairment loss, compares the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. Any excess of the reporting unit goodwill carrying value over the respective implied fair value is recognized as an impairment loss. There was no impairment of goodwill for the year ended December 31, 2015.

Intangible Assets

Intangible assets acquired in the settlement of litigation or by direct purchase are accounted for based upon the fair value of assets received.

Purchased-intangible assets are accounted for based upon the fair value of assets received. Purchased-intangible assets are amortized on a straight-line or accelerated basis over the periods of benefit, ranging from two to ten years. We perform a review of purchased-intangible assets whenever events or changes in circumstances indicate that the useful life is shorter than we had originally estimated or that the carrying amount of assets may not be recoverable. If such facts and circumstances exist, we assess the recoverability of purchased-intangible assets by comparing the projected undiscounted net cash flows associated with the related asset or group of assets over their remaining lives against their respective carrying amounts. Impairments, if any, are based on the excess of the carrying amount over the fair value of those assets. If the useful life of the asset is shorter than originally estimated, we accelerate the rate of amortization and amortize the remaining carrying value over the new shorter useful life. There was no impairment of purchased-intangible assets identified for the years ended December 31, 2015, 2014, or 2013.

Patents and Patent Licenses

Patent rights acquired in the settlement of litigation or by direct purchase are accounted for based upon the fair value of assets received.

Long-Lived Assets

We evaluate impairment losses on long-lived assets used in operations when events and changes in circumstances indicate that the assets might be impaired. If our review indicates that the carrying value of an asset will not be recoverable, based on a comparison of the carrying value of the asset to the undiscounted future cash flows, the impairment will be measured by comparing the carrying value of the asset to its fair value. Fair value will be determined based on quoted market values, discounted cash flows or appraisals. Impairments of property and equipment are recorded in the statement of income as part of depreciation expense.

#### Debt Related Costs

Costs incurred in raising debt are deferred and amortized as interest expense using the effective interest method over the life of the debt. A portion of these costs are netted against the underlying notes payable in accordance with ASU 2015-15, "Interest-Imputation of Interest".

#### Noncontrolling Interest and Redeemable Noncontrolling Interest

We consolidate a majority-owned entity where we have the ability to exercise controlling influence. The ownership interest of the noncontrolling party is presented as noncontrolling interest in the Consolidated Balance Sheet as Stockholders' Equity. If we are required to repurchase the noncontrolling interest at fair value, subject to adjustment, under a put option or other contractual redemption requirement, we will report the noncontrolling interest as redeemable in the Consolidated Balance Sheets between liabilities and equity. We adjust the redeemable noncontrolling interest to the redemption values on each balance sheet date with changes recognized as an adjustment to retained earnings, or in the absence of retained earnings, as an adjustment to additional paid-in capital when it becomes probable the noncontrolling interest will become redeemable.

#### Restricted Cash and Letters of Credit

We had a cash collateralized letter of credit for \$2,498 and \$3,311 as of December 31, 2015 and 2014, respectively, mainly related to lease deposits for our Holmdel office. In the aggregate, cash reserves and collateralized letters of credit of \$2,587 and \$3,405 were recorded as long-term restricted cash at December 31, 2015 and 2014, respectively.

#### Derivatives

We do not hold or issue derivative instruments for trading purposes. However, in accordance with FASB ASC 815, "Derivatives and Hedging" ("FASB ASC 815"), we review our contractual obligations to determine whether there are terms that possess the characteristics of derivative financial instruments that must be accounted for separately from the financial instrument in which they are embedded. We recognize these features as liabilities in our consolidated balance sheet at fair value each period and recognize any change in the fair value in our statement of operations in the period of change. We estimate the fair value of these liabilities using available market information and appropriate valuation methodologies.

#### Income Taxes

We recognize deferred tax assets and liabilities at enacted income tax rates for the temporary differences between the financial reporting bases and the tax bases of our assets and liabilities. Any effects of changes in income tax rates or tax laws are included in the provision for income taxes in the period of enactment. Our net deferred tax assets primarily consist of net operating loss carry forwards ("NOLs"). We are required to record a valuation allowance against our net deferred tax assets if we conclude that it is more likely than not that taxable income generated in the future will be insufficient to utilize the future income tax benefit from our net deferred tax assets (namely, the NOLs) prior to

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

expiration. We periodically review this conclusion, which requires significant management judgment. If we are able to conclude in a future period that a future income tax benefit from our net deferred tax assets has a greater than 50% likelihood of being realized, we are required in that period to reduce the related valuation allowance with a corresponding decrease in income tax expense. This would result in a non-cash benefit to our net income in the period of the determination. In the fourth quarter of 2011, we released \$325,601 of valuation allowance (see Note 5. Income Taxes). We periodically review this conclusion, which requires significant management judgment. In the future, if available evidence changes our conclusion that it is more likely than not that we will utilize our net deferred tax assets prior to their expiration, we will make an adjustment to the related valuation allowance and income tax expense at that time. In subsequent periods, we would expect to recognize income tax expense equal to our pre-tax income multiplied by our effective income tax rate, an expense that was not recognized prior to the reduction of the valuation allowance. Our effective rate may differ from the federal statutory rate due, in part, to our foreign operations and certain discrete period items.

We file income tax returns in the U.S. on a federal basis and in U.S. state and foreign jurisdictions. Our federal tax return remains subject to examination by the Internal Revenue Service from 2010 to present, our New Jersey tax returns remain open from 2008 to present, our Canada tax return remains open from 2009 to present, and other domestic and foreign tax returns remain open for all periods to which those filings relate. We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution.

We have not had any unrecognized tax benefits. We recognize interest and penalties accrued related to unrecognized tax benefits as components of our income tax provision. We have not had any interest and penalties accrued related to unrecognized tax benefits.

**Business Combinations**

We account for business combinations using the acquisition method of accounting. The acquisition method of accounting requires that the purchase price, including the fair value of contingent consideration, of the acquisition be allocated to the assets acquired and liabilities assumed using the fair values determined by management as of the acquisition date. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of assets acquired and the liabilities assumed. While the Company uses its best estimates and assumptions as part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the acquisition date, the Company's estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company records adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill to the extent the Company identifies adjustments to the preliminary purchase price allocation. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the consolidated statements of operations. We include the results of all acquisitions in our Consolidated Financial Statements from the date of acquisition.

Acquisition related transaction costs, such as banking, legal, accounting and other costs incurred in connection with an acquisition, are expensed as incurred in general and administrative expense.

Acquisition related integration costs include costs associated with exit or disposal activities, which do not meet the criteria of discontinued operations, including costs for employee, lease, and contract terminations, facility closing or other exit activities. Additionally, these costs include expenses directly related to integrating and reorganizing acquired businesses and include items such as employee retention costs, recruiting costs, certain moving costs, certain



duplicative costs during integration and asset impairments. These costs are expensed as incurred in general and administrative expense.

#### Foreign Currency

Generally, the functional currency of our non-United States subsidiaries is the local currency. The financial statements of these subsidiaries are translated to United States dollars using month-end rates of exchange for assets and liabilities, and average rates of exchange for revenues, costs, and expenses. Translation gains and losses are deferred and recorded in accumulated other comprehensive income as a component of stockholders' equity.

#### Share-Based Compensation

We account for share-based compensation in accordance with FASB ASC 718, "Compensation-Stock Compensation". Under the fair value recognition provisions of this pronouncement, share-based compensation cost is measured at the grant date based on the fair value of the award, reduced as appropriate based on estimated forfeitures, and is recognized as expense over the applicable vesting period of the stock award using the accelerated method. The excess tax benefit associated with stock compensation deductions have not been recorded in additional paid-in capital. When evaluating whether an excess tax benefit has been realized, share based compensation deductions are not considered realized until NOLs are no longer sufficient to offset taxable income. Such excess tax benefits will be recorded when realized.

#### Earnings per Share

Net income per share has been computed according to FASB ASC 260, "Earnings per Share", which requires a dual presentation of basic and diluted earnings per share ("EPS"). Basic EPS represents net income divided by the weighted average number of common shares outstanding during a reporting period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, including stock options and restricted stock units under our 2001 Stock Incentive Plan and 2006 Incentive Plan were exercised or converted into common stock. The dilutive effect of outstanding, stock options and restricted stock units is reflected in diluted earnings per share by application of the treasury stock method. In applying the treasury stock method for stock-based compensation arrangements, the assumed proceeds are computed as the sum of the amount the employee must pay upon exercise and the amounts of average unrecognized compensation cost attributed to future services.

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

The following table sets forth the computation for basic and diluted net income per share:

|   | For the years ended December 31, |           |          |
|---|----------------------------------|-----------|----------|
|   | 2015                             | 2014      | 2013     |
| Numerator   |                                  |           |          |
| Income from continuing operations   | \$25,035                         | \$29,707  | \$29,427 |
| Discontinued operations   | (2,439 )                         | (10,260 ) | (1,626 ) |
| Plus: Net loss from discontinued operations attributable to noncontrolling interest | 59                               | 819       | 488      |
| Loss from discontinued operations attributable to Vonage                            | (2,380 )                         | (9,441 )  | (1,138 ) |
| Net income attributable to Vonage   | \$22,655                         | \$20,266  | \$28,289 |
| Denominator   |                                  |           |          |
| Basic weighted average common shares outstanding                                    | 213,147                          | 209,822   | 211,563  |
| Dilutive effect of stock options and restricted stock units                         | 10,963                           | 9,597     | 8,957    |
| Diluted weighted average common shares outstanding                                  | 224,110                          | 219,419   | 220,520  |
| Basic net income per share  |                                  |           |          |
| Basic net income per share - from continuing operations                             | 0.12                             | 0.14      | 0.14     |
| Basic net loss per share - from discontinued operations attributable to Vonage      | (0.01 )                          | (0.04 )   | (0.01 )  |
| Basic net income per share - attributable to Vonage                                 | \$0.11                           | \$0.10    | \$0.13   |
| Diluted net income per share  |                                  |           |          |
| Diluted net income per share - from continuing operations                           | 0.11                             | 0.14      | 0.13     |
| Diluted net loss per share - from discontinued operations attributable to Vonage    | (0.01 )                          | (0.04 )   | (0.01 )  |
| Diluted net income per share - attributable to Vonage                               | \$0.10                           | \$0.09    | \$0.13   |

The following shares were excluded from the calculation of diluted income per share because of their anti-dilutive effects:

|                        | For the years ended December 31, |        |        |
|------------------------|----------------------------------|--------|--------|
|                        | 2015                             | 2014   | 2013   |
| Restricted stock units | 5,827                            | 5,454  | 3,625  |
| Employee stock options | 13,600                           | 18,428 | 25,437 |
|                        | 19,427                           | 23,882 | 29,062 |

## Comprehensive Income

Comprehensive income consists of net income (loss) and other comprehensive items. Other comprehensive items include foreign currency translation adjustments and unrealized gains (losses) on available for sale securities.

## Recent Accounting Pronouncements

In January 2016, Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities". This ASU provide guidance concerning certain matters involving the recognition, measurement, and disclosure of financial assets and financial liabilities. The guidance does not alter the basic framework for classifying debt instruments held as financial assets. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is not permitted, with some exceptions. The adoption of ASU 2016-01 will not have a material impact on our consolidated financial statements and related disclosures.

In November 2015, FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes". This ASU simplifies the presentation of deferred income taxes and requires deferred tax liabilities and assets be classified as non-current in a classified statement of financial position. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Earlier application is permitted for all entities as of

the beginning of an interim or annual reporting period. This ASU may be applied either prospectively or retrospectively to all periods presented. We are currently evaluating the impact of adopting ASU 2015-17 on our consolidated financial statements and related disclosures.

In September 2015, FASB issued ASU 2015-16, "Simplifying the Accounting for Measurement-Period Adjustments". This ASU simplifies the accounting for adjustments made to provisional amounts recognized in a business combination and eliminates the requirement to retrospectively account for those adjustments. This ASU is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. This ASU should be applied prospectively to adjustments to provisional amounts that occur after the effective date of this ASU with earlier application permitted for financial statements that have not been issued. We are currently evaluating the impact of adopting ASU 2015-16 on our consolidated financial statements and related disclosures.

In August 2015, FASB issued ASU 2015-15, "Interest-Imputation of Interest". This ASU provides guidance not addressed in ASU 2015-03 related to the presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. The SEC staff stated that they would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. We adopted this ASU along with the adoption of ASU 2015-03 in the third quarter of 2015 and

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

restated the prior periods presentation. The adoption of ASU 2015-15 did not have a material impact on our consolidated financial statements and related disclosures.

In July 2015, FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory". This ASU applies to inventory that is measured using first-in, first-out ("FIFO") or average cost. Under the updated guidance, an entity should measure inventory that is within scope at the lower of cost and net realizable value, which is the estimated selling prices in the ordinary course of business, less reasonably predicible costs of completion, disposal and transportation. Subsequent measurement is unchanged for inventory that is measured using last-in, first-out ("LIFO") or the retail inventory. This ASU is effective for annual and interim periods beginning after December 15, 2016, and should be applied prospectively with early adoption only permitted at the beginning of an interim and annual reporting period. We are currently evaluating the impact of adopting ASU 2015-11 on our consolidated financial statements and related disclosures.

In April 2015, FASB issued ASU 2015-05, "Customer's Accounting for Fees Paid in a Cloud Computing Arrangement". This ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new guidance does not change the accounting for a customer's accounting for service contracts. ASU 2015-05 is effective for interim and annual reporting periods beginning after December 15, 2015. We are currently evaluating the impact of adopting ASU 2015-05 on our consolidated financial statements and related disclosures. In April 2015, FASB issued ASU 2015-03, "Interest-Imputation of Interest". This ASU requires that debt issuance costs be reported in the balance sheet as a direct deduction from the face amount of the related liability, consistent with the presentation of debt discounts. Prior to the amendments, debt issuance costs were presented as a deferred charge (i.e., an asset) on the balance sheet. This ASU is effective for annual reporting periods beginning after December 15, 2015 and interim periods within fiscal years beginning after December 15, 2016. The amendments must be applied retrospectively. All entities have the option

of adopting the new requirements as of an earlier date for financial statements that have not been previously issued. Applicable disclosures for a change in an accounting principle are required in the year of adoption, including interim periods. We adopted this ASU in the third quarter of 2015 and conformed the prior period presentation. The adoption of ASU 2015-03 did not have a material impact on our consolidated financial statements and related disclosures. In May 2014, FASB issued ASU 2014-09, "Revenue from Contracts with Customers". This ASU is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. In August 2015, FASB issued ASU 2015-14 deferring the effective date to annual and interim periods beginning on or after December 15, 2017, and early adoption will be permitted, but not earlier than the original effective date of annual and interim periods beginning on or after December 15, 2016, for public entities. We will adopt this ASU when effective. Companies may use either a full retrospective or modified retrospective approach to adopt this ASU and our management is currently evaluating which transition approach to use. We are currently evaluating the impact of adopting ASU 2014-09 on our consolidated financial statements and related disclosures.

**Reclassifications**

As the Company's business evolves, positioning us as a Unified Communications as a Service ("UCaaS") provider, we have made certain changes to our income statement presentation. Sales expenses have been separated from selling, general, and administrative expenses and combined with marketing in a new sales and marketing caption. A new caption, engineering and development, has also been reclassified from selling, general and administrative expenses.

The remaining selling, general and administrative expenses, after the above reclassifications, have been renamed as general and administrative expenses. The reclassifications have been reflected in all periods presented and had no impact on net earnings previously reported.

Certain reclassifications have been made to prior year's balance sheet in order to conform to the current year's presentation due to the adoption of ASU 2015-03 and ASU 2015-15 in the third quarter of 2015. The reclassifications had no impact on net earnings previously reported.

Note 2. Supplemental Balance Sheet Account Information

Prepaid expenses and other current assets

|   | December 31,<br>2015 | December 31,<br>2014 |
|---|----------------------|----------------------|
| Nontrade receivables                      | \$ 2,113             | \$ 2,511             |
| Services                                  | 8,066                | 7,415                |
| Telecommunications                        | 3,138                | 459                  |
| Insurance                                 | 939                  | 803                  |
| Marketing                                 | 779                  | 519                  |
| Other prepaids                            | 624                  | 958                  |
| Prepaid expenses and other current assets | \$ 15,659            | \$ 12,665            |

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

|  |                      |                      |
|--|----------------------|----------------------|
| Property and equipment, net  | December 31,<br>2015 | December 31,<br>2014 |
| Building (under capital lease)   | \$ 25,709            | \$ 25,709            |
| Network equipment and computer hardware                                  | 89,025               | 73,599               |
| Leasehold improvements   | 48,872               | 48,574               |
| Customer premise equipment   | 7,292                | 3,220                |
| Furniture  | 2,508                | 1,914                |
| Vehicles   | 214                  | 195                  |
|  | 173,620              | 153,211              |
| Less: accumulated depreciation and amortization                          | (124,137 )           | (103,581 )           |
| Property and equipment, net  | \$ 49,483            | \$ 49,630            |
| Customer premise equipment, net  | December 31,<br>2015 | December 31,<br>2014 |
| Customer premise equipment   | \$ 7,292             | \$ 3,220             |
| Less: accumulated depreciation   | (2,068 )             | (74 )                |
| Customer premise equipment, net  | \$ 5,224             | \$ 3,146             |
| Software, net  | December 31,<br>2015 | December 31,<br>2014 |
| Purchased  | \$ 67,248            | \$ 55,636            |
| Licensed   | 909                  | 909                  |
| Internally developed   | 36,088               | 36,088               |
|  | 104,245              | 92,633               |
| Less: accumulated amortization   | (83,535 )            | (74,009 )            |
| Software, net  | \$ 20,710            | \$ 18,624            |
| The total expected future annual amortization of software is as follows: |                      |                      |
| 2016   |                      | \$9,552              |
| 2017   |                      | 6,773                |
| 2018   |                      | 3,629                |
| 2019   |                      | 756                  |
| Total  |                      | \$20,710             |
| Debt related costs, net  | December 31,<br>2015 | December 31,<br>2014 |
| Debt related costs related to Revolving Credit Facility                  | \$ 5,044             | \$ 3,640             |
| Less: accumulated amortization   | (2,991 )             | (2,457 )             |
| Debt related costs, net  | \$ 2,053             | \$ 1,183             |

|                                 | December 31,<br>2015 | December 31,<br>2014 |
|---------------------------------|----------------------|----------------------|
| Restricted cash                 |                      |                      |
| Letter of credit-lease deposits | \$ 2,498             | \$ 3,311             |
| Cash reserves                   | 89                   | 94                   |
| Restricted cash                 | \$ 2,587             | \$ 3,405             |

F-15 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

|  |                      |                      |
|--|----------------------|----------------------|
| Other assets                                       | December 31,<br>2015 | December 31,<br>2014 |
| Long term non-trade receivable                     | \$ 6,623             | \$ 6,623             |
| Others   | 2,980                | 1,125                |
| Other assets                                       | \$ 9,603             | \$ 7,748             |
| Accrued expenses                                   | December 31,<br>2015 | December 31,<br>2014 |
| Compensation and related taxes and temporary labor | \$ 33,196            | \$ 25,555            |
| Marketing  | 24,891               | 17,871               |
| Taxes and fees                                     | 11,808               | 17,300               |
| Litigation and settlements                         | 23                   | 23                   |
| Telecommunications                                 | 9,111                | 8,134                |
| Other accruals                                     | 11,523               | 9,771                |
| Customer credits                                   | 1,779                | 1,883                |
| Professional fees                                  | 2,080                | 2,178                |
| Accrued interest                                   | 22                   | 133                  |
| Inventory  | 1,514                | 1,267                |
| Credit card fees                                   | 180                  | 207                  |
| Accrued expenses                                   | \$ 96,127            | \$ 84,322            |
| Accumulated other comprehensive (loss) income      | December 31,<br>2015 | December 31,<br>2014 |
| Foreign currency translation adjustment            | \$ (1,656 )          | \$ (3,123 )          |
| Unrealized loss on available-for-sale securities   | (21 )                | (8 )                 |
| Accumulated other comprehensive (loss) income      | \$ (1,677 )          | \$ (3,131 )          |



Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

## Note 3. Goodwill and Intangible Assets

## Goodwill

The following table provides a summary of the changes in the carrying amounts of goodwill:

|   |           |   |
|---|-----------|---|
| Balance at January 1, 2014  | \$83,627  |   |
| Increase in goodwill related to acquisition of Telesphere                         | 62,310    |   |
| Decrease in goodwill related to tax adjustment of VBS                             | (3,393)   | ) |
| Balance at December 31, 2014  | 142,544   |   |
| Increase in goodwill related to acquisition of Simple Signal                      | 17,687    |   |
| Increase in goodwill related to acquisition of iCore                              | 63,294    |   |
| Increase in goodwill related to acquisition of gUnify                             | 660       |   |
| Decrease in goodwill related to working capital and tax adjustments of Telesphere | (2,079)   | ) |
| Balance at December 31, 2015  | \$222,106 |   |

## Intangible assets, net

The carrying values of intangible assets were as follows:

|                             | December 31,<br>2015 | December 31,<br>2014 |   |
|-----------------------------|----------------------|----------------------|---|
| Customer relationships      | \$92,609             | \$49,799             |   |
| Developed technology        | 75,694               | 72,900               |   |
| Patents and patent licenses | 20,164               | 12,764               |   |
| Trademark                   | 560                  | 560                  |   |
| Trade names                 | 760                  | 500                  |   |
| Non-compete agreements      | 2,933                | 2,726                |   |
| Gross Carrying Amount       | 192,720              | 139,249              |   |
| Customer relationships      | (21,777)             | (10,185)             | ) |
| Developed technology        | (18,880)             | (7,108)              | ) |
| Patents and patent licenses | (12,066)             | (10,426)             | ) |
| Trademark                   | (543)                | (472)                | ) |
| Trade names                 | (260)                | (113)                | ) |
| Non-compete agreements      | (995)                | (113)                | ) |
| Accumulated Amortization    | (54,521)             | (28,417)             | ) |
| Customer relationships      | 70,832               | 39,614               |   |
| Developed technology        | 56,814               | 65,792               |   |
| Patents and patent licenses | 8,098                | 2,338                |   |
| Trademark                   | 17                   | 88                   |   |
| Trade names                 | 500                  | 387                  |   |

|                        |           |           |
|------------------------|-----------|-----------|
| Non-compete agreements | 1,938     | 2,613     |
| Net Carrying Amount    | \$138,199 | \$110,832 |

Represents customer relationships, developed technology, trade names and non-compete agreements identified in the acquisition of businesses. In addition, includes patents and trademarks we have purchased and licensed, including in connection with the settlement of litigation.

F-17 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

The intangible assets are being amortized over periods which reflect the pattern in which economic benefits of the assets are expected to be realized. The customer relationships and developed technology are being amortized on an accelerated basis over an estimated useful life of ten years; patents and patent licenses are being amortized over their weighted average remaining lives; trademark is being amortized on a straight-line basis over eight years; trade names are being amortized on a straight-line basis over five years; and the non-compete agreements are being amortized on a straight-line basis over two years.

The total expected future annual amortization is as follows:

|            |           |
|------------|-----------|
| 2016       | \$30,465  |
| 2017       | 26,278    |
| 2018       | 21,400    |
| 2019       | 18,412    |
| 2020       | 14,804    |
| Thereafter | 26,840    |
| Total      | \$138,199 |

## Note 4. Supplemental Income Statement Account Information

## Amounts included in revenues

|   | For the years ended December 31, |          |          |
|---|----------------------------------|----------|----------|
|   | 2015                             | 2014     | 2013     |
| USF fees                                    | \$75,570                         | \$71,188 | \$70,009 |
| Disconnect fee, net of credits and bad debt | \$706                            | \$554    | \$955    |
| Initial activation fees                     | \$779                            | \$1,085  | \$1,278  |
| Customer equipment rental                   | \$3,677                          | \$—      | \$—      |
| Customer equipment fees                     | \$6,141                          | \$715    | \$418    |
| Equipment recovery fees                     | \$77                             | \$80     | \$103    |
| Shipping and handling fees                  | \$2,473                          | \$2,374  | \$1,178  |

## Amounts included in cost of services

|           | For the years ended December 31, |          |          |
|-----------|----------------------------------|----------|----------|
|           | 2015                             | 2014     | 2013     |
| USF costs | \$75,599                         | \$71,230 | \$70,009 |

## Amounts included in cost of goods sold

|                            | For the years ended December 31, |         |         |
|----------------------------|----------------------------------|---------|---------|
|                            | 2015                             | 2014    | 2013    |
| Shipping and handling cost | \$5,197                          | \$6,028 | \$5,188 |

## Amounts included in sales and marketing

|                   | For the years ended December 31, |           |           |
|-------------------|----------------------------------|-----------|-----------|
|                   | 2015                             | 2014      | 2013      |
| Advertising costs | \$103,320                        | \$141,138 | \$142,094 |

Amounts included in general and administrative expense

|                                       | For the years ended December 31, |         |         |
|---------------------------------------|----------------------------------|---------|---------|
|                                       | 2015                             | 2014    | 2013    |
| Acquisition related transaction costs | \$2,585                          | \$2,466 | \$2,681 |
| Acquisition related integration costs | \$25                             | \$100   | \$87    |

F-18 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

## Depreciation and amortization expense

|   | For the years ended December 31, |          |          |
|---|----------------------------------|----------|----------|
|   | 2015                             | 2014     | 2013     |
| Network equipment and computer hardware | \$12,571                         | \$13,449 | \$13,475 |
| Software                                | 12,627                           | 10,116   | 10,831   |
| Capital leases                          | 2,200                            | 2,200    | 2,200    |
| Other leasehold improvements            | 5,190                            | 4,434    | 4,167    |
| Customer premise equipment              | 2,147                            | 75       | —        |
| Furniture                               | 430                              | 194      | 120      |
| Vehicles                                | 71                               | 31       | 10       |
| Patents                                 | 1,740                            | 1,833    | 2,304    |
| Trademarks                              | 72                               | 72       | 70       |
| Customer relationships                  | 11,594                           | 8,539    | 1,644    |
| Acquired technology                     | 11,768                           | 6,296    | 813      |
| Trade names                             | 148                              | 100      | 13       |
| Non-compete agreements                  | 1,082                            | 101      | 13       |
|   | 61,640                           | 47,440   | 35,660   |
| Property and equipment impairments      | 193                              | 1,959    | 9        |
| Software impairments                    | —                                | 115      | 385      |
| Depreciation and amortization expense   | \$61,833                         | \$49,514 | \$36,054 |

## Amounts included in interest expense

|                                 | For the years ended December 31, |         |         |
|---------------------------------|----------------------------------|---------|---------|
|                                 | 2015                             | 2014    | 2013    |
| Debt related costs amortization | \$997                            | \$1,072 | \$1,515 |

## Amounts included in other income (expense), net

|   | For the years ended December 31, |      |          |
|---|----------------------------------|------|----------|
|   | 2015                             | 2014 | 2013     |
| Net (losses) gains resulting from foreign exchange transactions | \$(860 )                         | \$10 | \$(109 ) |

## Note 5. Income Taxes

The components of income from continuing operations before income tax expense are as follows:

|               | For the years ended December 31, |          |          |
|---------------|----------------------------------|----------|----------|
|               | 2015                             | 2014     | 2013     |
| United States | \$38,115                         | \$44,044 | \$39,650 |
| Foreign       | 5,338                            | 7,422    | 7,971    |
|               | \$43,453                         | \$51,466 | \$47,621 |



Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

The components of the income tax expense are as follows:

|                       | For the years ended December 31, |             |             |
|-----------------------|----------------------------------|-------------|-------------|
|                       | 2015                             | 2014        | 2013        |
| Current:              |                                  |             |             |
| Federal               | \$(1,846 )                       | \$(1,452 )  | \$(907 )    |
| Foreign               | (1,667 )                         | (376 )      | (155 )      |
| State and local taxes | (956 )                           | (803 )      | (337 )      |
|                       | \$(4,469 )                       | \$(2,631 )  | \$(1,399 )  |
| Deferred:             |                                  |             |             |
| Federal               | \$(11,289 )                      | \$(15,239 ) | \$(14,954 ) |
| Foreign               | (1,088 )                         | (2,985 )    | (1,603 )    |
| State and local taxes | (1,572 )                         | (904 )      | (238 )      |
|                       | \$(13,949 )                      | \$(19,128 ) | \$(16,795 ) |
|                       | \$(18,418 )                      | \$(21,759 ) | \$(18,194 ) |

The following table summarizes deferred taxes resulting from differences between financial accounting basis and tax basis of assets and liabilities.

|   | December 31,<br>2015 | December 31,<br>2014 |
|---|----------------------|----------------------|
| Current assets and liabilities:                             |                      |                      |
| Deferred revenue  | \$12,096             | \$13,265             |
| Accounts receivable and inventory allowances                | 640                  | 289                  |
| Accrued expenses  | 11,249               | 8,295                |
| Deferred tax assets, net, current                           | \$23,985             | \$21,849             |
| Non-current assets and liabilities:                         |                      |                      |
| Acquired intangible assets and property and equipment       | \$(33,129 )          | \$(13,799 )          |
| Accrued expenses  | (1,054 )             | (1,937 )             |
| Research and development and alternative minimum tax credit | 6,630                | 4,952                |
| Stock option compensation                                   | 20,545               | 17,802               |
| Capital leases  | (6,442 )             | (5,401 )             |
| Deferred revenue  | (634 )               | (524 )               |
| Net operating loss carryforwards                            | 237,127              | 241,525              |
|   | 223,043              | 242,618              |
| Valuation allowance   | (20,456 )            | (17,451 )            |
| Deferred tax assets, net, non-current                       | \$202,587            | \$225,167            |

We recognize deferred tax assets and liabilities at enacted income tax rates for the temporary differences between the financial reporting bases and the tax bases of our assets and liabilities. Any effects of changes in income tax rates or tax laws are included in the provision for income taxes in the period of enactment. Our net deferred tax assets primarily consist of net operating loss carry forwards (“NOLs”). We are required to record a valuation allowance against our net deferred tax assets if we conclude that it is more likely than not that taxable income generated in the future will be insufficient to utilize the future income tax benefit from our net deferred tax assets (namely, the NOLs), prior to expiration. We periodically review this conclusion, which requires significant management judgment. Until the fourth quarter of 2011, we recorded a valuation allowance fully against our net deferred tax assets. In 2011, we

completed our first full year of taxable income and completed our budgetary process for periods subsequent to 2011, which anticipates continued taxable income in the future. Based upon these factors and our sustained profitable operating performance over the past three years excluding certain losses associated with our prior convertible notes and our December 2010 debt refinancing, our evaluation determined that the benefit resulting from our net deferred tax assets (namely, the NOLs), are likely to be realized prior to their expiration. Accordingly, we released the related valuation allowance against our United States federal and Canada net deferred tax assets, and a portion of the allowance against

our state net deferred tax assets as certain NOLs may expire prior to utilization due to shorter utilization periods in certain states, resulting in a one-time non-cash income tax benefit of \$325,601 and a corresponding net deferred tax asset of \$325,601 in the fourth quarter of 2011. We still maintain a full valuation allowance against our United Kingdom net deferred tax assets as we are unable to conclude that it is more likely than not that some or all of the related United Kingdom net deferred tax assets will be realized.

In connection with the acquisition of iCore, we recorded a deferred tax liability of \$12,944 related to the \$38,064 of identified intangible assets that will be amortized for financial reporting purposes but not for tax purposes and a deferred tax asset of \$4,457 related to NOLs.

In connection with the acquisition of Simple Signal, we recorded a deferred tax liability of \$2,441 related to the \$6,407 of identified intangible assets that will be amortized for financial reporting purposes but not for tax purposes and a deferred tax asset of \$3,182 related to NOLs.

In connection with the acquisition of Telesphere, we recorded a deferred tax liability of \$17,050 related to the \$50,925 of identified intangible assets that will be amortized for financial reporting purposes



Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

but not for tax purposes and a deferred tax asset of \$17,101 related to NOLs.

In connection with the acquisition of Vocalocity, we recorded a deferred tax liability of \$30,000 related to the \$75,000 of identified intangible assets that will be amortized for financial reporting purposes but not for tax purposes and a deferred tax asset of \$6,000 related to NOLs, which consists of \$10,336 deferred tax asset and a valuation allowance of \$4,336 against Vocalocity's deferred tax assets based upon our preliminary assessment of the utilization of the NOLs as the NOLs are subject to Section 382 limitations. Subsequent to the

acquisition date, we increased the deferred tax assets by \$3,393 based upon updated information with respect to NOL utilization.

In the future, if available evidence changes our conclusion that it is more likely than not that we will utilize our net deferred tax assets prior to their expiration, we will make an adjustment to the related valuation allowance and income tax expense at that time. In subsequent periods, we would expect to recognize income tax expense equal to our pre-tax income multiplied by our effective income tax rate, an expense that was not recognized prior to the reduction of the valuation allowance.

The reconciliation between the United States statutory federal income tax rate and the effective rate is as follows:

|  | For the years ended December 31, |      |       |    |
|--|----------------------------------|------|-------|----|
|  | 2015                             | 2014 | 2013  |    |
| U.S. Federal statutory tax rate  | 35                               | % 35 | % 35  | %  |
| Permanent items  | 3                                | % 3  | % 4   | %  |
| State and local taxes, net of federal benefit                                    | 2                                | % 3  | % —   | %  |
| International tax (reflects effect of losses for which tax benefit not realized) | 1                                | % —  | % (2) | )% |
| Valuation reserve for income taxes and other                                     | 2                                | % 1  | % 1   | %  |
| Effective tax rate   | 43                               | % 42 | % 38  | %  |

As of December 31, 2015, we had NOLs for United States federal and state tax purposes of \$625,802 and \$186,776, respectively, expiring at various times from years ending 2016 through 2035 as follows:

|      | Federal | State    |
|------|---------|----------|
| 2016 | \$—     | \$41,530 |
| 2017 | —       | 21,823   |
| 2018 | —       | 17,032   |
| 2019 | —       | 9,880    |
| 2020 | —       | 8,028    |
| 2021 | —       | 6,075    |
| 2022 | —       | 2,073    |
| 2023 | —       | 8        |
| 2024 | —       | —        |
| 2025 | 3,140   | —        |
| 2026 | 192,209 | —        |
| 2027 | 235,966 | 1,072    |
| 2028 | 39,145  | 4,554    |
| 2029 | 17,482  | 3,024    |
| 2030 | 107,085 | 5,181    |

|       |           |           |
|-------|-----------|-----------|
| 2031  | 8,012     | 563       |
| 2032  | 2,808     | 625       |
| 2033  | 3,555     | 7,341     |
| 2034  | 3,814     | 14,080    |
| 2035  | 12,586    | 43,887    |
| Total | \$625,802 | \$186,776 |

United States federal and state NOLs of \$16,629 represent excess tax benefits from the exercise of share based awards which will

be recorded in additional paid-in capital when realized. We had NOLs for United Kingdom tax purposes of \$45,159 with no expiration date.

F-21 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

Under Section 382 of the Internal Revenue Code, if we undergo an “ownership change” (generally defined as a greater than 50% change (by value) in our equity ownership over a three-year period), our ability to use our pre-change of control NOLs and other pre-change tax attributes against our post-change income may be limited. The Section 382 limitation is applied annually so as to limit the use of our

pre-change NOLs to an amount that generally equals the value of our stock immediately before the ownership change multiplied by a designated federal long-term tax-exempt rate. At December 31, 2015, there were no limitations on the use of our NOLs except for certain of the NOLs of Vocalocity as of the date of acquisition.

## Note 6. Long-Term Debt and Revolving Credit Facility

A schedule of long-term debt at December 31, 2015 and 2014 is as follows:

|  | December 31,<br>2015 | December 31,<br>2014 |
|--|----------------------|----------------------|
| 2.875-3.375% Term note - due 2018, net of debt related costs (1) | \$ —                 | \$ 69,032            |
| 2.875-3.375% Revolving credit facility - due 2018                | \$ —                 | \$ 67,000            |
| 2.5-3.00% Term note - due 2019, net of debt related costs        | \$ 76,392            | \$ —                 |
| 2.5-3.0% Revolving credit facility - due 2019                    | \$ 119,000           | \$ —                 |
| Total Long-term note and revolving credit facility               | \$ 195,392           | \$ 136,032           |

(1) Restated due to the adoption of ASU 2015-03 and ASU 2015-15 in the third quarter of 2015.

At December 31, 2015, future payments under long-term debt obligations over each of the next five years and thereafter are as follows:

|                                      | 2015<br>Credit Facility |
|--------------------------------------|-------------------------|
| 2016                                 | 15,000                  |
| 2017                                 | 15,000                  |
| 2018                                 | 15,000                  |
| 2019                                 | 47,500                  |
| Minimum future payments of principal | 92,500                  |
| Less: unamortized debt related costs | 1,108                   |
| current portion                      | 15,000                  |
| Long-term portion                    | \$76,392                |

## 2015 Financing

On July 27, 2015, we entered into a credit agreement (the “2015 Credit Facility”) consisting of a \$100,000 term note and a \$250,000 revolving credit facility. The co-borrowers under the 2015 Credit Facility are the Company and Vonage America Inc., the Company’s wholly owned subsidiary. Obligations under the 2015 Credit Facility are guaranteed, fully and unconditionally, by the Company’s other United States material subsidiaries and are secured by substantially all of the assets of each borrower and each guarantor. The lenders under the 2015 Credit Facility are JPMorgan Chase Bank, N.A., Citizens Bank, N.A., Fifth Third Bank, MUFG Union Bank, N.A., Silicon Valley Bank, SunTrust Bank, Keybank National Association, Santander Bank, N.A., Capital One National Association, and First Niagara Bank, N.A. JPMorgan Chase Bank, N.A. is a party to the agreement as administrative agent, Citizens Bank, N.A. as syndication agent, and Fifth Third Bank, MUFG Union Bank, N.A., Silicon Valley Bank, SunTrust Bank as

documentation agents. J.P. Morgan Securities LLC and Citizens Bank, N.A. acted as joint lead bookrunners, and J.P. Morgan Securities LLC, Citizens Bank, N.A., Fifth Third Bank, MUFG Union Bank, N.A., Silicon Valley Bank, and SunTrust Robinson Humphrey Inc. acted as joint lead arrangers.

#### Use of Proceeds

We used \$167,000 of the net available proceeds of the 2015 Credit Facility to retire all of the debt under our 2014 Credit Facility. Remaining proceeds from the term note and the undrawn revolving credit facility under the 2015 Credit Facility will be used for general corporate purposes. We also incurred fees of \$2,007 in connection with the 2015 Credit Facility, of which \$602 was allocated to the term note and \$1,405 was allocated to the revolving credit facility. The unamortized

fees of \$1,628 in connection with the 2014 Credit Facility was allocated as follows: \$733 to the term note and \$895 revolving credit facility. In adopting ASU 2015-03, fees allocated to the term note were reported in the balance sheet as a direct deduction from the face amount of the liability and in adopting ASU 2015-15, fees allocated to the revolving credit facility were reported in the balance sheet as an asset. These fees are amortized to interest expenses over the life of the debt using the effective interest method for the term note and straight line method for the revolving credit facility. We used \$82,000 from our 2015 revolving credit facility in connection with the acquisition of iCore on August 31, 2015.

#### Repayments

In 2015, we made mandatory repayment of \$7,500 under the term note. In addition, we repaid the \$30,000 outstanding under the revolving credit facility.

#### 2015 Credit Facility Terms

The following description summarizes the material terms of the 2015 Credit Facility:

The loans under the 2015 Credit Facility mature in July 2019. Principal amounts under the 2015 Credit Facility are repayable in quarterly installments of \$3,750 for the term note. The unused portion of our revolving credit facility incurs a 0.40% commitment fee. Such commitment fee will be reduced to 0.375% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00 and to 0.35% if our consolidated leverage ratio is less than 0.75 to 1.00.

Outstanding amounts under the 2015 Credit Facility, at our option, will bear interest at:

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

LIBOR (applicable to one-, two-, three-, six-, or twelve-month periods) plus an applicable margin equal to 2.50% if our consolidated leverage ratio is less than 0.75 to 1.00, 2.75% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 3.00% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last day of each relevant interest period or, if the interest period is longer than three months, each day that is three months after the first day of the interest period, or the base rate determined by reference to the highest of (a) the prime rate of JPMorgan Chase Bank, N.A., (b) the federal funds effective rate from time to time plus 0.50%, and (c) the adjusted LIBO rate applicable to one month interest periods plus 1.00%, plus an applicable margin equal to 1.50% if our consolidated leverage ratio is less than 0.75 to 1.00, 1.75% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 2.00% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last business day of each March, June, September, and December and the maturity date of the 2015 Credit Facility. The 2015 Credit Facility provides greater flexibility to us in funding acquisitions and restricted payments, such as stock buybacks, than did the 2014 Credit Facility.

We may prepay the 2015 Credit Facility at our option at any time without premium or penalty. The 2015 Credit Facility is subject to mandatory prepayments in amounts equal to:

- > 100% of the net cash proceeds from any non-ordinary course sale or other disposition of our property and assets for consideration in excess of a certain amount subject to customary reinvestment provisions and certain other exceptions and

- > 100% of the net cash proceeds received in connection with other non-ordinary course transactions, including insurance proceeds not otherwise applied to the relevant insurance loss.

Subject to certain restrictions and exceptions, the 2015 Credit Facility permits us to obtain one or more incremental term loans and/or revolving credit facilities in an aggregate principal amount of up to \$90,000 plus an amount equal to repayments of the term note upon providing documentation reasonably satisfactory to the administrative agent. The 2015 Credit Facility includes customary representations and warranties and affirmative covenants of the borrowers. In addition, the 2015 Credit Facility contains customary negative covenants, including, among other things, restrictions on the ability of us and our subsidiaries to consolidate or merge, create liens, incur additional indebtedness, dispose of assets, consummate acquisitions, make investments, and pay dividends and other distributions. We must also comply with the following financial covenants:

- > a consolidated leverage ratio of no greater than 2.25 to 1.00, with a limited step-up to 2.75 to 1.00 for a period of four consecutive quarters, in connection with an acquisition made during the first two years of the 2015 Credit Facility;

- > a consolidated fixed coverage charge ratio of no less than 1.75 to 1.00 subject to adjustment to exclude up to \$80,000 million in specified restricted payments;

- > minimum cash of \$25,000 including the unused portion of the revolving credit facility; and

- > maximum capital expenditures not to exceed \$55,000 during any fiscal year, provided that the unused amount of any permitted capital expenditures in any fiscal year may be carried forward to the next following fiscal year.

In addition, annual excess cash flow increases permitted capital expenditures.

As of December 31, 2015, we were in compliance with all covenants, including financial covenants, for the 2015 Credit Facility.

The 2015 Credit Facility contains customary events of default that may permit acceleration of the debt. During the continuance of a payment default, interest will accrue on overdue amounts at a default interest rate of 2% above the interest rate which would otherwise be applicable, in the case of loans, and at a rate equal to the rate applicable to base rate loans plus 2%, in the case of all other amounts.

#### 2014 Financing

On August 13, 2014, we entered into a credit agreement (the “2014 Credit Facility”) consisting of a \$100,000 term note and a \$125,000 revolving credit facility. The co-borrowers under the 2014 Credit Facility were us and Vonage America Inc., our wholly owned subsidiary. Obligations under the 2014 Credit Facility are guaranteed, fully and unconditionally, by our other material United States subsidiaries and were secured by substantially all of the assets of each borrower and each guarantor. The lenders under the 2014 Credit Facility were JPMorgan Chase Bank, N.A., Citizens Bank, N.A., Silicon Valley Bank, SunTrust Bank, Fifth Third Bank, Keybank National Association, and MUFG Union Bank, N.A. JPMorgan Chase Bank, N.A. was a party to the agreement as administrative agent, Citizens Bank, N.A. as syndication agent, and Silicon Valley Bank and SunTrust Bank as documentation agents. J.P. Morgan Securities LLC and Citizens Bank, N.A. acted as joint lead bookrunners, and J.P. Morgan Securities LLC, Citizens Bank, N.A., Silicon Valley Bank, and SunTrust Robinson Humphrey Inc. acted as joint lead arrangers.

#### Use of Proceeds

We used \$90,000 of the net available proceeds of the 2014 Credit Facility to retire all of the debt under our 2013 Credit Facility. Remaining proceeds from the term note and the undrawn revolving credit facility under the 2014 Credit Facility were to be used for general corporate purposes. We also incurred \$1,910 of fees in connection with the 2014 Credit Facility, which were amortized, along with the unamortized fees of \$668 in connection with the 2013 Credit Facility, to interest expense over the life of the debt using the effective interest method. We used \$20,000 and \$67,000 from our 2014 revolving credit facility in connection with the acquisitions of Simple Signal on April 1, 2015 and Telesphere on December 15, 2014, respectively.

#### 2014 Credit Facility Terms

The following description summarizes the material terms of the 2014 Credit Facility:

The loans under the 2014 Credit Facility were to mature in August 2018. Principal amounts under the 2014 Credit Facility were repayable in quarterly installments of \$5,000 per quarter for the term note. The unused portion of our revolving credit facility incurred a 0.40% commitment fee.

Outstanding amounts under the 2014 Credit Facility, at our option, bore interest at:

LIBOR (applicable to one-, two-, three-, six-, or twelve-month periods) plus an applicable margin equal to 2.875% if our consolidated leverage ratio is less than 0.75 to 1.00, 3.125% if our consolidated leverage ratio is greater than or >equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 3.375% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last day of each relevant interest period or, if the interest period is longer than three months, each day that is three months after the first day of the interest period, or the base rate determined by reference to the highest of (a) the federal funds effective rate from time to time plus >0.50%, (b) the prime rate of JPMorgan Chase Bank, N.A., and (c) the

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

adjusted LIBO rate applicable to one month interest periods plus 1.00%, plus an applicable margin equal to 1.875% if our consolidated leverage ratio is less than 0.75 to 1.00, 2.125% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 2.375% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last business day of each March, June, September, and December and the maturity date of the 2014 Credit Facility.

The 2014 Credit Facility provided greater flexibility to us in funding acquisitions and restricted payments, such as stock buybacks, than the 2013 Credit Facility.

We were able to prepay the 2014 Credit Facility at our option at any time without premium or penalty. The 2014 Credit Facility was subject to mandatory prepayments in amounts equal to:

100% of the net cash proceeds from any non-ordinary course sale or other disposition of our property and assets for >consideration in excess of a certain amount subject to customary reinvestment provisions and certain other exceptions, and

> 100% of the net cash proceeds received in connection with other non-ordinary course transactions, including > insurance proceeds not otherwise applied to the relevant insurance loss.

Subject to certain restrictions and exceptions, the 2014 Credit Facility permitted us to obtain one or more incremental term notes and/or revolving credit facilities in an aggregate principal amount of up to \$60,000 plus an amount equal to repayments of the term note upon providing documentation reasonably satisfactory to the administrative agent. The 2014 Credit Facility included customary representations and warranties and affirmative covenants of the borrowers. In addition, the 2014 Credit Facility contained customary negative covenants, including, among other things, restrictions on the ability of us and our subsidiaries to consolidate or merge, create liens, incur additional indebtedness, dispose of assets, consummate acquisitions, make investments, and pay dividends and other distributions. We were also required to comply with the following financial covenants:

> a consolidated leverage ratio of no greater than 2.25 to 1.00;

> a consolidated fixed coverage charge ratio of no less than 1.75 to 1.00 subject to adjustment to exclude up to > \$80,000 in specified restricted payments;

> minimum cash of \$25,000 including the unused portion of the revolving credit facility; and

> maximum capital expenditures not to exceed \$55,000 during any fiscal year, provided that the unused amount of any > permitted capital expenditures in any fiscal year may be carried forward to the next following fiscal year.

In addition, annual excess cash flow up to \$8,000 increased permitted capital expenditures.

The 2014 Credit Facility contained customary events of default that may permit acceleration of the debt. During the continuance of a payment default, interest would accrue at a default interest rate of 2% above the interest rate which would otherwise be applicable, in the case of loans, and at a rate equal to the rate applicable to base rate loans plus 2%, in the case of all other amounts.

2013 Financing

On February 11, 2013 we entered into Amendment No. 1 to the 2011 Credit Agreement (as further amended by Amendment No. 2 to our 2011 Credit Facility, the "2013 Credit Facility"). The 2013 Credit Facility consisted of a \$70,000 term note and a \$75,000 revolving credit facility. The co-borrowers under the 2013 Credit Facility were us and Vonage America Inc., our wholly owned subsidiary. Obligations under the 2013 Credit Facility were guaranteed, fully and unconditionally, by

our other United States subsidiaries and were secured by substantially all of the assets of each borrower and each of the guarantors. On July 26, 2013 we entered into Amendment No. 2 to our 2011 Credit Agreement, which amended our financial covenant related to our consolidated fixed charge coverage ratio by increasing the amount of restricted payments excluded from such calculation from \$50,000 to \$80,000.

#### Use of Proceeds

We used \$42,500 of the net available proceeds of the 2013 Credit Facility to retire all of the debt under our 2011 Credit Facility. Remaining net proceeds of \$27,500 from the term note and the undrawn revolving credit facility under the 2013 Credit Facility were to be used for general corporate purposes. We also incurred \$2,009 of fees in connection with the 2013 Credit Facility, which was amortized, along with the pre-existing unamortized fees of \$670 in connection with the 2011 Credit Facility, to interest expense over the life of the debt using the effective interest method. We used \$75,000 from the 2013 revolving credit facility in connection with the acquisition of Vocalocity on November 15, 2013.

#### 2013 Credit Facility Terms

The following description summarizes the material terms of the 2013 Credit Facility:

The loans under the 2013 Credit Facility were to mature in February 2016. Principal amounts under the 2013 Credit Facility were repayable in quarterly installments of \$5,833 per quarter for the term note. The unused portion of our revolving credit facility incurred a 0.45% commitment fee.

Outstanding amounts under the 2013 Credit Facility, at our option, bore interest at:

LIBOR (applicable to one-, two-, three- or six-month periods) plus an applicable margin equal to 3.125% if our consolidated leverage ratio is less than 0.75 to 1.00, 3.375% if our consolidated leverage ratio is greater than or >equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 3.625% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last day of each relevant interest period or, if the interest period is longer than three months, each day that is three months after the first day of the interest period, or the base rate determined by reference to the highest of (a) the federal funds effective rate from time to time plus 0.50%, (b) the prime rate of JPMorgan Chase Bank, N.A., and (c) the LIBOR rate applicable to one month interest >periods plus 1.00%, plus an applicable margin equal to 2.125% if our consolidated leverage ratio is less than 0.75 to 1.00, 2.275% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 2.625% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last business day of each March, June, September, and December and the maturity date of the 2013 Credit Facility.

#### July 2011 Financing

On July 29, 2011, we entered into a credit agreement (the "2011 Credit Facility") consisting of an \$85,000 term note and a \$35,000 revolving credit facility. The co-borrowers under the 2011 Credit Facility were us and Vonage America Inc., our wholly owned subsidiary. Obligations under the 2011 Credit Facility were guaranteed, fully and unconditionally, by our other United States subsidiaries and are secured by substantially all of the assets of each borrower and each of the guarantors.

#### Use of Proceeds

We used \$100,000 of the net available proceeds of the 2011 Credit Facility, plus \$31,000 of cash on hand, to retire all of the debt



Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

under the credit facility that we entered into in December 2010 (the "2010 Credit Facility"), including a \$1,000 prepayment fee to holders of the 2010 Credit Facility. We also incurred \$2,697 of fees in connection with the 2011 Credit Facility, which is amortized to interest expense over the life of the debt using the effective interest method.

2011 Credit Facility Terms

The following description summarizes the material terms of the 2011 Credit Facility:

The loans under the 2011 Credit Facility mature in July 2014. Principal amounts under the 2011 Credit Facility are repayable in installments of \$7,083 per quarter for the term note. The unused portion of our revolving credit facility incurs a 0.50% commitment fee.

Outstanding amounts under each of the senior secured term loan and the revolving credit facility, at our option, will bear interest at:

> LIBOR (applicable to one-, two-, three- or six-month periods) plus an applicable margin equal to 3.25% if our consolidated leverage ratio is less than 0.75 to 1.00, 3.5% if our

consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 3.75% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last day of each relevant interest period or, if the interest period is longer than three months, each day that is three months after the first day of the interest period, or

> the base rate determined by reference to the highest of (a) the federal funds effective rate from time to time plus 0.50%, (b) the prime rate of JPMorgan Chase Bank, N.A., and (c) the LIBOR rate applicable to one month interest periods plus 1.00%, plus an applicable margin equal to 2.25% if our consolidated leverage ratio is less than 0.75 to 1.00, 2.5% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and 2.75% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00, payable on the last business day of each March, June, September, and December and the maturity date of the 2011 Credit Facility.

NOTE 7. Fair Value of Financial Instruments

Effective January 1, 2008, we adopted FASB ASC 820-10-25, "Fair Value Measurements and Disclosures". This standard establishes a framework for measuring fair value and expands disclosure about fair value measurements. We did not elect fair value accounting for any assets and liabilities allowed by FASB ASC 825, "Financial Instruments". FASB ASC 820-10 defines fair value as the amount that would be received for an asset or paid to transfer a liability (i.e., an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820-10 also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. FASB ASC 820-10 describes the following three levels of inputs that may be used:

> Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets and

liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

> Level 2: Observable prices that are based on inputs not quoted on active markets but corroborated by market data.

> Level 3: Unobservable inputs when there is little or no market data available, thereby requiring an entity to develop its own assumptions. The fair value hierarchy gives the lowest priority to Level 3 inputs.

Although management believed its valuation methods were appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could have resulted in a different fair value measurement at the reporting date.

The following table presents the assets that are measured and recognized at fair value on a recurring basis classified under the appropriate level of the fair value hierarchy as of December 31, 2015 and December 31, 2014:

|                                   | December 31,<br>2015 | December 31,<br>2014 |
|-----------------------------------|----------------------|----------------------|
| Level 1 Assets                    |                      |                      |
| Money market fund (1)             | \$57                 | \$2,786              |
| Level 2 Assets                    |                      |                      |
| Available-for-sale securities (2) | \$9,908              | \$7,162              |

(1) Included in cash and cash equivalents on our consolidated balance sheet.

(2) Included in marketable securities on our consolidated balance sheet.

#### Fair Value of Other Financial Instruments

The carrying amounts of our financial instruments, including cash and cash equivalents, accounts receivable, and accounts payable, approximate fair value because of their short maturities. The carrying amounts of our capital leases approximate fair value of these obligations based upon management's best estimates of interest rates that would

be available for similar debt obligations at December 31, 2015 and 2014. We believe the fair value of our debt at December 31, 2015 was approximately the same as its carrying amount as market conditions, including available interest rates, credit spread relative to our credit rating, and illiquidity, remain relatively unchanged from the issuance date of our debt on July 27, 2015 for a similar debt instrument.

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

## Note 8. Common Stock

## Net Operating Loss Rights Agreement

On June 7, 2012, we entered into a Tax Benefits Preservation Plan ("Preservation Plan") designed to preserve stockholder value and tax assets. Our ability to use our tax attributes to offset tax on U.S. taxable income would be substantially limited if there were an "ownership change" as defined under Section 382 of the U.S. Internal Revenue Code. In general, an ownership change would occur if one or more "5-percent shareholders," as defined under Section 382, collectively increase their ownership in us by more than 50 percent over a rolling three-year period.

In connection with the adoption of the Preservation Plan, our board of directors declared a dividend of one preferred share purchase right for each outstanding share of the Company's common stock. The preferred share purchase rights were distributed to stockholders of record as of June 18, 2012, as well as to holders of the Company's common stock issued after that date, but will only be activated if certain triggering events under the Preservation Plan occur.

Under the Preservation Plan, preferred share purchase rights will work to impose significant dilution upon any person or group which acquires beneficial ownership of 4.9% or more of the outstanding common stock, without the approval of our board of directors, from and after June 7, 2012. Stockholders that own 4.9% or more of the outstanding common stock as of the opening of business on June 7,

2012, will not trigger the preferred share purchase rights so long as they do not (i) acquire additional shares of common stock or (ii) fall under 4.9% ownership of common stock and then re-acquire shares that in the aggregate equal 4.9% or more of the common stock.

The Preservation Plan was set to expire no later than the close of business June 7, 2013, unless extended by our board of directors. On June 6, 2013, at the Vonage 2013 annual meeting of stockholders, stockholders ratified the extension of the Preservation Plan through June 7, 2015. On April 2, 2015, after consultation with our advisors, our board of directors determined to extend the Preservation Plan through June 30, 2017, subject to ratification of the extension by stockholders at our 2015 annual meeting of stockholders. On June 3, 2015, at the Vonage 2015 annual meeting of stockholders, stockholders ratified the extension of the Preservation Plan through June 30, 2018.

## Common Stock Repurchases

On July 25, 2012, our board of directors authorized a program to repurchase up to \$50,000 of Vonage common stock (the "\$50,000 repurchase program") through December 31, 2013. On February 7, 2013, our board of directors discontinued the remainder of our existing \$50,000 repurchase program effective at the close of business on February 12, 2013 with \$16,682 of availability remaining, and authorized a new program to repurchase up to \$100,000 of Vonage common stock (the "2012 \$100,000 repurchase program") by December 31, 2014.

We repurchased the following shares of common stock with cash resources under the 2012 \$100,000 repurchase program as of December 31, 2014:

|   |                   |
|---|-------------------|
|   | December 31, 2014 |
| Shares of common stock repurchased  | 13,475            |
| Value of common stock repurchased   | \$49,128          |
| (1) including 171 shares, or \$660, of common stock repurchases settled in January 2015; excluding commission of \$2. |                   |

As of December 31, 2014, approximately \$219 remained of our 2012 \$100,000 repurchase program. The repurchase program expired on December 31, 2014.

On December 9, 2014, Vonage's Board of Directors authorized a new program for the Company to repurchase up to \$100,000 of its outstanding common stock (the "2014 \$100,000 repurchase program"). Repurchases under the 2014 \$100,000 repurchase program are expected to be made over a four-year period ending on December 31, 2018.

Under the 2014 \$100,000 repurchase program, the timing and amount of repurchases will be determined by management based

on its evaluation of market conditions, the trading price of the stock and will vary based on available capital resources and other financial and operational performance, market conditions, securities law limitations, and other factors. Repurchases may be made in the open market or through private transactions from time to time. The repurchases will be made using available cash balances. In any period, under each repurchase program, cash used in financing activities related to common stock repurchases may differ from the comparable change in stockholders' equity, reflecting timing differences between the recognition of share repurchase transactions and their settlement for cash.

We repurchased the following shares of common stock with cash resources under the 2014 \$100,000 repurchase program as of December 31, 2015:

|                                    | December 31, 2015 |
|------------------------------------|-------------------|
| Shares of common stock repurchased | 3,320             |
| Value of common stock repurchased  | \$15,195          |

As of December 31, 2015, approximately \$84,805 remained of our 2014 \$100,000 repurchase program. The repurchase program

expires on December 31, 2018 but may be suspended or discontinued at any time without notice.

Table of Contents

In any period under the 2014 \$100,000 repurchase program, cash used in financing activities related to common stock repurchases may differ from the comparable change in stockholders' equity, reflecting timing differences between the recognition of share repurchase transactions and their settlement for cash.

**Stock Option Cancellation**

As part of our strategy to build shareholder value and to facilitate our goal of reducing the number of shares of common stock outstanding, on February 19, 2013, we entered into an agreement with our Chief Executive Officer to cancel a total of 4,500 of his vested stock options for \$5,463. The payment reflects a discount, in favor of the Company, from the closing price of the common stock on the New York Stock Exchange on February 19, 2013.

**Note 9. Employee Benefit Plans****Share-Based Compensation**

Our stock option program is a long-term retention program that is intended to attract, retain and provide incentives for talented employees, officers and directors, and to align stockholder and employee interests. Currently, we grant options from our 2006 Incentive Plan. Our 2001 Stock Incentive Plan was terminated by our board of directors in 2008. As such, share-based awards are no longer granted under the 2001 Stock Incentive Plan. Under the 2006 Incentive Plan,

share-based awards can be granted to all employees, including executive officers, outside consultants, and non-employee directors. Vesting periods for share-based awards are generally three or four years for both plans. Awards granted under each plan expire in five or ten years from the effective date of grant. As of April 2010, the Company began routinely granting awards with a ten year expiration period.

The fair value for these options was estimated at the date of grant using a Black-Scholes option-pricing model. The assumptions used to value options are as follows:

|                                 | 2015         | 2014         | 2013         |
|---------------------------------|--------------|--------------|--------------|
| Risk-free interest rate         | 1.38-1.80%   | 1.78-2.19%   | 1.13-2.02%   |
| Expected stock price volatility | 73.55-83.14% | 85.28-86.93% | 86.94-90.39% |
| Dividend yield                  | 0.00         | % 0.00       | % 0.00       |
| Expected life (in years)        | 6.25         | 6.25         | 6.25         |

Beginning January 1, 2006, we estimated the volatility of our stock using historical volatility of comparable public companies in accordance with guidance in FASB ASC 718, "Compensation-Stock Compensation". Beginning in the first quarter of 2008, we used the historical volatility of our common stock to measure expected volatility for future option grants.

The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of our employee stock

options. The expected term of employee stock options represents the weighted-average period that the stock options are expected to remain outstanding, which we derive based on our historical settlement experience.

Beginning in 2014, we issued restricted performance stock units with vesting that is contingent on both total shareholder return ("TSR") compared to members of our peer group and continued service.

For the market-based restricted performance stock units issued during the year ended December 31, 2015 and December 31, 2014, the payouts at vesting which are linearly interpolated between the percentiles specified below are as follows:

**Payout Schedule**

Percentile Ranking % of Target Earned

|     |      |
|-----|------|
| 80% | 200% |
| 50% | 100% |
| 30% | 50%  |
| 30% | —%   |

<

Notwithstanding the foregoing, if our TSR is negative for the performance period, then the vesting percentage shall not exceed 100%. In addition, we reduce the shares available for grant to cover the potential payout of 200%.

To value these market-based restricted performance stock units, we used a Monte Carlo simulation model on the date of grant.

Compensation expense for restricted stock units with performance and market conditions is recognized over the requisite service period using the straight-line method and includes the impact of estimated forfeitures.

The assumptions used to value these market based restricted performance stock units are as follows:

|                                 | 2015  | 2014    | 2013   |   |
|---------------------------------|-------|---------|--------|---|
| Risk-free interest rate         | 0.98  | % 0.69  | % —    | % |
| Expected stock price volatility | 40.21 | % 48.91 | % —    | % |
| Dividend yield                  | 0.00  | % 0.00  | % 0.00 | % |
| Expected life (in years)        | 2.79  | 2.79    | 0      |   |

F-27 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

Our stock incentive plans as of December 31, 2015 are summarized as follows (in thousands):

|                               | Shares<br>Authorized | Shares<br>Available<br>for Grant | Stock<br>Options<br>Outstanding | Restricted<br>Stock and<br>Restricted<br>Stock<br>Units |
|-------------------------------|----------------------|----------------------------------|---------------------------------|---|
| 2001 Incentive Plan           | —                    | —                                | 468                             | —   |
| 2006 Incentive Plan           | 71,669               | —                                | 19,463                          | 8,703   |
| 2015 Incentive Plan           | 21,731               | 21,548                           | 72                              | 1,684   |
| Total as of December 31, 2015 | 93,400               | 21,548                           | 20,003                          | 10,387  |

## 2001 Stock Incentive Plan

In February 2001, we adopted the 2001 Stock Incentive Plan, which is an amendment and restatement of the 2000 Stock Incentive Plan of MIN-X.COM, INC. There have not been any options available for future grant under the 2001 Stock Incentive Plan since our board of directors terminated the plan in 2008.

## 2006 Incentive Plan

In May 2006, we adopted the 2006 Incentive Plan. The 2006 Incentive Plan permits the grant of stock options, restricted stock, restricted stock units, stock appreciation rights, performance stock, performance units, annual awards, and other awards based on, or related to, shares of our common stock. Options awarded under our 2006 Incentive Plan may be non-qualified stock options or may qualify as incentive stock options under Section 422 of the Internal Revenue Code of 1986, as amended. Our 2006 Incentive Plan contains various limits with respect to the types of awards, as follows:

- a maximum of 20,000 shares may be issued under the plan pursuant to incentive stock options;
- a maximum of 10,000 shares may be issued pursuant to options and stock appreciation rights granted to any participant in a calendar year;
- a maximum of \$5,000 may be paid pursuant to annual awards granted to any participant in a calendar year; and a maximum of \$10,000 may be paid (in the case of awards denominated in cash) and a maximum of 10,000 shares may be issued (in the case of awards denominated in shares) pursuant to awards, other than options, stock appreciation rights or annual awards, granted to any participant in a calendar year.

The 2006 Incentive Plan was terminated upon the adoption of our 2015 Equity Incentive Plan. No additional awards may be made pursuant to the 2006 Incentive Plan.

## 2015 Equity Incentive Plan

On June 3, 2015, we adopted our 2015 Equity Incentive Plan. Shares issued under the plan may be authorized and unissued shares or may be issued shares that we have reacquired. Shares covered by awards that are forfeited, canceled or otherwise expire without having been exercised or settled, or that are settled by cash or other non-share consideration, will become available for issuance pursuant to a new award. Shares that are tendered or withheld to pay the exercise price of an award or to satisfy tax withholding obligations will not be available for issuance pursuant to new awards. At December 31, 2015, 21,548 shares were available for future grant under the 2015 Stock Incentive Plan.

The 2015 Equity Incentive Plan permits the grant of stock options, restricted stock, restricted stock units, stock appreciation rights, performance stock, performance units, annual awards, and other awards based on, or related to, shares of our common stock. Options awarded under our 2015 Equity Incentive Plan may be non-qualified stock options or may qualify as incentive stock options under Section 422 of the Internal Revenue Code of 1986, as amended. For purposes of complying with the requirements of Section 162(m) of the Internal Revenue Code of 1986,

as amended, the maximum number of shares of common stock that may be subject to stock options, stock appreciation rights, performance-based restricted stock awards, performance-based RSUs and performance-based stock awards granted to any participant other than a non-employee director during any calendar year will be limited to 10,000 shares of common stock for each such award type individually. The maximum number of shares of common stock that may be subject to stock options, stock appreciation rights, restricted stock awards, RSUs and stock awards granted to any non-employee director during any calendar year will be limited to 10,000 shares of common stock for all such award types in the aggregate. Further, the maximum amount that may become payable to any one Participant during any one calendar year under all Cash Performance Awards intended to qualify as “performance-based compensation” under Section 162(m) of the Code is limited to \$5,000. Our 2015 Equity Incentive Plan will terminate on June 3, 2025.



Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

The following table summarizes the activity for all awards under both of our stock incentive plans:

|   | Stock Options Outstanding |   | Restricted Stock and<br>Restricted Stock Units<br>Outstanding |  |
|---|---------------------------|---|---|--|
|   | Number of<br>Shares       | Weighted<br>Average<br>Exercise<br>Price Per<br>Share | Number of<br>Shares   | Weighted<br>Average<br>Grant<br>Date Fair<br>Market<br>Value<br>Per<br>Share |
|   | (in thousands)            |   | (in thousands)  |  |
| Balance at December 31, 2012  | 40,240                    | \$2.32  | 3,343   | \$2.59   |
| Stock options granted   | 9,315                     | 2.89  |   |  |
| Stock options exercised   | (7,842)                   | ) 1.47  |   |  |
| Stock options canceled  | (8,876)                   | ) 2.14  |   |  |
| Restricted stocks and restricted stock units granted                        |                           |   | 3,896   | 3.01   |
| Restricted stocks and restricted stock units exercised                      |                           |   | (1,549)   | ) 2.48   |
| Restricted stocks and restricted stock units canceled                       |                           |   | (508)   | ) 2.84   |
| Balance at December 31, 2013  | 32,837                    | 2.73  | 5,182   | 2.92   |
| Stock options granted   | 6,865                     | 3.47  |   |  |
| Stock options exercised   | (10,504)                  | ) 1.65  |   |  |
| Stock options canceled  | (3,547)                   | ) 3.19  |   |  |
| Restricted stocks and restricted stock units granted                        |                           |   | 5,240   | 4.71   |
| Restricted stocks and restricted stock units exercised                      |                           |   | (1,734)   | ) 2.83   |
| Restricted stocks and restricted stock units canceled                       |                           |   | (860)   | ) 3.32   |
| Balance at December 31, 2014  | 25,651                    | 3.31  | 7,828   | 4.09   |
| Stock options granted   | 505                       | 4.41  |   |  |
| Stock options exercised   | (3,495)                   | ) 2.82  |   |  |
| Stock options canceled  | (2,658)                   | ) (4.41)  | )   |  |
| Restricted stocks and restricted stock units granted                        |                           |   | 6,354   | 5.37   |
| Restricted stocks and restricted stock units exercised                      |                           |   | (2,436)   | ) 3.63   |
| Restricted stocks and restricted stock units canceled                       |                           |   | (1,359)   | ) 4.67   |
| Balance at December 31, 2015-stock options                                  | 20,003                    | \$3.28  |   |  |
| Balance at December 31, 2015-Restricted stock and<br>restricted stock units |                           |   | 10,387  | \$4.91   |
| Exercisable at December 31, 2015  | 11,072                    | \$3.32  |   |  |
| Unvested shares at December 31, 2014  | 14,943                    | \$3.10  |   |  |
| Unvested shares at December 31, 2015  | 8,931                     | \$3.23  |   |  |

The weighted average exercise price of options granted was \$4.41, \$3.47, and \$2.89 for the years ended December 31, 2015, 2014, and 2013, respectively. The weighted average grant date fair market value of restricted stock and restricted stock units granted was \$5.37, \$4.71, and \$3.01 during the year ended December 31, 2015, 2014, and 2013,

respectively.

The aggregate intrinsic value of exercised stock options for the years ended December 31, 2015, 2014, and 2013 was \$8,040, \$22,962, and \$9,891, respectively. The aggregate intrinsic value of exercised restricted stock and restricted stock units for the years ended December 31, 2015, 2014, and 2013 was \$8,844, \$4,909, and \$3,788, respectively. The weighted average grant date fair market value of stock options granted was \$3.09, \$2.55, and \$2.16 for the years ended December 31, 2015, 2014, and 2013.

Total share-based compensation expense recognized for the years ended December 31, 2015, 2014, and 2013 was \$27,541, \$21,070, and \$17,843, respectively, which were recorded to selling, general and administrative expense in the consolidated statement of income. As of December 31, 2015, total unamortized share-based compensation was \$25,800, net of estimated forfeitures, which is expected to be amortized over the remaining vesting period of each grant, up to the next 48 months. Compensation costs for all share-based awards are recognized using the ratable single-option approach on an accrual basis and are amortized using an accelerated amortization schedule. Our current policy is to issue new shares to settle the exercise of stock options and prospectively, the vesting of restricted stock units.

F-29 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

Information regarding the options outstanding as of December 31, 2015 is summarized below:

| Range of Exercise Prices | Stock Options Outstanding |   |                                 | Aggregate Intrinsic Value | Stock Options Exercisable            |   |                                 | Aggregate Intrinsic Value |
|--------------------------|---------------------------|---|---------------------------------|---------------------------|--------------------------------------|---|---------------------------------|---------------------------|
|                          | Stock Options Outstanding | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price |                           | Stock Options Vested and Exercisable | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price |                           |
|                          | (in thousands)            | (in years)                                  |                                 | (in thousands)            | (in thousands)                       | (in years)                                  |                                 | (in thousands)            |
| \$0.33 to \$1.43         | 2,506                     |   | 1.37                            |                           | 2,506                                |   | 1.37                            |                           |
| \$1.44 to \$1.99         | 94                        |   | 1.71                            |                           | 63                                   |   | 1.71                            |                           |
| \$2.00 to \$4.00         | 14,824                    |   | 3.03                            |                           | 6,300                                |   | 2.85                            |                           |
| \$4.01 to \$7.34         | 2,076                     |   | 4.78                            |                           | 1,701                                |   | 4.78                            |                           |
| \$7.35 to \$35.00        | 503                       |   | 14.21                           |                           | 502                                  |   | 14.21                           |                           |
|                          | 20,003                    | 6.5   | 3.28                            | \$ 53,609                 | 11,072                               | 5.3   | 3.32                            | \$ 31,176                 |

The aggregate intrinsic value of restricted stock units outstanding was \$59,619 as of December 31, 2015.

## Retirement Plan

In March 2001, we established a 401(k) Retirement Plan (the "Retirement Plan") available to employees who meet the plan's eligibility requirements. Participants may elect to contribute a percentage of their

compensation to the Retirement Plan up to a statutory limit. We may make a contribution to the Retirement Plan in the form of a matching contribution. The employer matching contribution is 50% of each employee's contributions not to exceed \$6 in 2013, 2014, and 2015. Our expense related to the Retirement Plan was \$3,676, \$2,959, and \$2,554 in 2015, 2014, and 2013, respectively.

## Note 10. Commitments and Contingencies

## Capital Leases

Assets financed under capital lease agreements are included in property and equipment in the consolidated balance sheet and related depreciation and amortization expense is included in the consolidated statements of operations. On March 24, 2005, we entered into a lease for our headquarters in Holmdel, New Jersey. We took possession of a portion of the office space at the inception of the lease, another portion on August 1, 2005 and took over the remainder of the office space in early 2006. The overall lease term is twelve years and five months. In connection with the lease, we issued a letter of credit which requires \$7,350 of cash as collateral, which is classified as restricted cash. Part of the cash was released, leaving a balance of \$2,315 at December 31, 2015. The gross amount of the building recorded under capital leases totaled \$25,709 as of December 31, 2015 and accumulated depreciation was approximately \$22,045 as of December 31, 2015.

In November 2015, we entered into the fourth amendment to our headquarters lease effective December 1, 2015. The amendment extend the term of the lease for a period of seventy-four months to commence September 1, 2017 and continue through October 31, 2023. Based on the terms of the lease, it is considered an operating lease when it becomes effective on September 1, 2017.

## Operating Leases

We have entered into various non-cancelable operating lease agreements for certain of our existing office and telecommunications co-location space in the United States and for international subsidiaries with original lease periods expiring between 2016 and 2023. We are committed to pay a portion of the buildings' operating expenses as determined under the agreements.

At December 31, 2015, future payments under capital leases and minimum payments under non-cancelable operating leases are as follows over each of the next five years and thereafter:

|                                      | December 31, 2015 |                     |
|--------------------------------------|-------------------|---------------------|
|                                      | Capital<br>Leases | Operating<br>Leases |
| 2016                                 | \$5,038           | \$6,817             |
| 2017                                 | 3,503             | 6,471               |
| 2018                                 | —                 | 8,936               |
| 2019                                 | —                 | 8,939               |
| 2020                                 | —                 | 8,288               |
| Thereafter                           | —                 | 17,798              |
| Total minimum payments required      | 8,541             | \$57,249            |
| Less amounts representing interest   | (780              | )                   |
| Minimum future payments of principal | 7,761             |                     |
| Current portion                      | 4,398             |                     |
| Long-term portion                    | \$3,363           |                     |

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

Rent expense was \$6,378 for 2015, \$7,007 for 2014, and \$6,071 for 2013.

Stand-by Letters of Credit

We have stand-by letters of credit totaling \$2,498 and \$3,311, as of December 31, 2015 and 2014, respectively.

End-User Commitments

We are obligated to provide telephone services to our registered end-users. The costs related to the potential utilization of minutes sold are expensed as incurred. Our obligation to provide this service is dependent on the proper functioning of systems controlled by third-party service providers. We do not have a contractual service relationship with some of these providers.

Vendor Commitments

We have several commitments primarily commitments to vendors who will provide local inbound services, customer care services, carrier operation, networks and telephone related services, license patents to us, provide marketing infrastructure and services, and partner with us in international operations, provide customer caller ID, and process LNP orders. In certain cases, we may terminate these arrangements early upon payment of specified fees. These commitments total \$251,888. Of this total amount, we expect to purchase \$101,042 in 2016, \$75,008 in 2017, \$69,880 in 2018, and \$5,958 in 2019, respectively. These amounts do not represent our entire anticipated purchases in the future, but represent only those items for which we are contractually committed. We also purchase products and services as needed with no firm commitment. For this reason, the amounts presented do not provide a reliable indicator of our expected future cash outflows or changes in our expected cash position.

Litigation

From time to time, in addition to those identified below, we are subject to legal proceedings, claims, investigations, and proceedings in the ordinary course of business, including claims of alleged infringement of third-party patents and other intellectual property rights, commercial, employment, and other matters. From time to time, we also receive letters or other communications from third parties inviting us to obtain patent licenses that might be relevant to our business or alleging that our services infringe upon third party patents or other intellectual property. In accordance with generally accepted accounting principles, we make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss or range of loss can be reasonably estimated. These provisions, if any, are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. We believe that we have valid defenses with respect to the legal matters pending against us and are vigorously defending these matters. Given the uncertainty surrounding litigation and our inability to assess the likelihood of a favorable or unfavorable outcome in the above noted matters and our inability to reasonably estimate the amount of loss or range of loss, it is possible that the resolution of one or more of these matters could have a material adverse effect on our consolidated financial position, cash flows or results of operations.

IP Matters

Bear Creek Technologies, Inc. On February 22, 2011, Bear Creek Technologies, Inc. (“Bear Creek”) filed a lawsuit against Vonage Holdings Corp., Vonage America Inc., Vonage Marketing LLC, and Aptela Inc. (the latter two entities being former subsidiaries of Vonage Holdings Corp. now merged into Vonage America Inc. and Vonage Business Inc., respectively) in the United States District Court for the Eastern District of Virginia alleging that Vonage’s and Aptela’s products and services are covered by United States Patent No. 7,889,722, entitled “System for Interconnecting Standard Telephony Communications Equipment to Internet Protocol Networks” (the “722 Patent”). The suit also named numerous other defendants. On August 17, 2011, the Court

dismissed Bear Creek’s case against the Vonage entities and Aptela, and all but one of the other defendants. Later, on August 17, 2011, Bear Creek re-filed its complaint in the United States District Court for the District of Delaware

against the same Vonage entities; and re-filed its complaint against Aptela in the United States District Court for the Eastern District of Virginia against Aptela. On May 2, 2012, the litigations against Vonage and Aptela were consolidated for pretrial proceedings with twelve other actions in the District of Delaware. Vonage filed an answer to Bear Creek's complaint, including counterclaims of non-infringement and invalidity of the '722 patent. Aptela, which filed a motion to dismiss Bear Creek's complaint on September 27, 2011, has not yet answered, as its motion remains pending. On November 5, 2012, Bear Creek filed an answer to Vonage's counterclaims. On July 17, 2013, the Court stayed the case pending resolution of the reexamination of the '722 patent requested by Cisco Systems, Inc. ("Cisco"), described below. On May 5, 2015, the Court closed the case, with leave to reopen if further attention by the Court is required.

A request for reexamination of the validity of the '722 Patent was filed on September 12, 2012 by Cisco. Cisco's request was granted on November 28, 2012. On March 24, 2014, the United States Patent and Trademark Office issued an Action Closing Prosecution, confirming its rejection of all claims of the '722 patent. On November 14, 2014, Bear Creek submitted its Appeal of the Action Closing Prosecution to the Patent Trial and Appeal Board. On December 29, 2015, Bear Creek's Appeal was denied and the Examiner's rejection of the '722 patent was affirmed. RPost Holdings, Inc. On August 24, 2012, RPost Holdings, Inc., RPost Communications Limited, and RMail Limited (collectively, "RPost") filed a lawsuit against StrongMail Systems, Inc. ("StrongMail") in the United States District Court for the Eastern District of Texas alleging that StrongMail's products and services, including its electronic mail marketing services, are covered by United States Patent Nos. 8,224,913, 8,209,389, 8,161,104, 7,966,372, and 6,182,219. On February 11, 2013, RPost filed an amended complaint, adding 27 new defendants, including Vonage America Inc. RPost's amended complaint alleges willful infringement of the RPost patents by Vonage and each of the other new defendants because they are customers of StrongMail. StrongMail has agreed to fully defend and indemnify Vonage in this lawsuit. Vonage answered the complaint on May 7, 2013. On January 30, 2014, RPost informed the Court that it is ready for a scheduling conference; the Court has not yet scheduled a conference. On September 17, 2015, the Court ordered the consolidation for pre-trial purposes of this case with other cases by RPost against third-parties Epsilon Data Management, LLC., Experian Marketing Solutions, LLC, and Vocus, Inc. The lead case has been administratively closed and stayed since January 30, 2014 due to multiple pending actions by third parties regarding ownership of the patents at issue. On December 1, 2015, the parties in the consolidated actions filed their most recent joint notice regarding status of the co-pending actions. Plaintiffs requested that the stay be lifted, while defendants maintain that the stay should remain in place.

AIP Acquisition LLC. On January 3, 2014, AIP Acquisition LLC ("AIP"), filed a lawsuit against Vonage Holdings Corp., Vonage America, Inc., and Vonage Marketing LLC in the U.S. District Court for the District of Delaware alleging that Vonage's products and services are covered by United States Patent No. 7,269,247. Vonage filed an answer and counterclaims on February 25, 2014. AIP filed an amended complaint on March 18, 2014, which Vonage answered on April 4, 2014. On April 8, 2014, the Court ordered a stay of the case pending final resolution of non-party Level 3's inter partes review request of United States Patent No. 7,724,879, which is a continuation of the '247 patent. On October 8, 2014, the Patent Office issued a Final Written Decision, finding all challenged claims of the '879 patent to be invalid. On November 10, 2015, the Federal Circuit rejected AIP's appeal and affirmed the Patent Office's rejection of the '879 patent.

A second request for inter partes review of the '879 patent was made by Cisco on December 12, 2013 and granted by the Patent

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

Office on May 27, 2014. On May 20, 2015, the Patent Office issued a Final Written Decision, finding all challenged claims of the '879 patent to be invalid. On July 17, 2015, AIP filed a Notice of Appeal to the Patent Office's rejection. AIP's request to voluntarily dismiss its appeal was granted on December 2, 2015.

Cisco petitioned for inter partes review of the '247 patent on November 25, 2014. On May 20, 2015, the Patent Office granted Cisco's request, setting oral argument for January 27, 2016.

Commercial Litigation

Merkin & Smith, et als. On September 27, 2013, Arthur Merkin and James Smith filed a putative class action lawsuit against Vonage America, Inc. in the Superior Court of the State of California, County of Los Angeles, alleging that Vonage violated California's Unfair Competition Law by charging its customers fictitious 911 taxes and fees. On October 30, 2013, Vonage filed a notice removing the case to the United States District Court for the Central District of California. On November 26, 2013, Vonage filed its Answer to the Complaint. On December 4, 2013, Vonage filed a Motion to Compel Arbitration, which the Court denied on February 4, 2014. On March 5, 2014, Vonage appealed that decision to the United States Court of Appeals for the Ninth Circuit. On March 26, 2014, the district court proceedings were stayed pending the appeal. Oral argument on the appeal took place on February 2, 2016.

Regulation

Telephony services are subject to a broad spectrum of state and federal regulations. Because of the uncertainty over whether Voice over Internet Protocol ("VoIP") should be treated as a telecommunications or information service, we have been involved in a substantial amount of state and federal regulatory activity. Implementation and interpretation of the existing laws and regulations is ongoing and is subject to litigation by various federal and state agencies and courts. Due to the uncertainty over the regulatory classification of VoIP service, there can be no assurance that we will not be subject to new regulations or existing regulations under new interpretations, and that such change would not introduce material additional costs to our business.

Federal - Net Neutrality

Clear and enforceable net neutrality rules make it more difficult for broadband Internet service providers to block or discriminate against Vonage service. In addition, explicitly applying net neutrality rules to wireless broadband Internet service providers could create greater opportunities for VoIP applications that run on wireless broadband Internet service. In December 2010, the FCC adopted net neutrality rules that applied strong net neutrality rules to wired broadband Internet service providers and limited rules to wireless broadband Internet service providers. On January 14, 2014, the D.C. Circuit Court of Appeals vacated a significant portion of the 2010 rules. On May 15, 2014, the FCC issued a Notice of Proposed Rulemaking (NPRM) proposing new net neutrality rules. After public response to the NPRM, the FCC adopted new neutrality rules on February 26, 2015. These rules prohibit broadband Internet service providers from: (1) blocking or throttling lawful content applications, or services; (2) imposing paid prioritization arrangements; and (3) unreasonably interfering or unreasonably disadvantaging consumers or edge providers. In addition, broadband Internet service providers are required to make certain disclosures regarding their network management practices, network performance, and commercial terms. These net neutrality rules apply the same requirements to wired and wireless broadband Internet service providers. Several parties have filed appeals which are pending at the D.C. Circuit Court of Appeals. Oral arguments at the D.C. Circuit Court of Appeals were held on December 4, 2015.

Federal - Universal Service Contribution Reform

On April 30, 2012, the FCC released a Further Notice of Proposed Rulemaking on reforming federal universal service fund

("USF") contributions. Currently USF contributions are assessed on the interstate and international revenue of traditional telephone carriers and interconnected VoIP providers like Vonage. The level of USF assessments on these

providers has been going up over time because of decreases in the revenue subject to assessment due to substitution of non-assessable services such as non-interconnected VoIP services. In addition, communications industry revenues, in general, have shifted away from USF assessable voice services to non-assessable broadband services. Both of these trends have reduced the USF contribution base and caused the assessment rate to increase to cover USF costs. In the order adopting the 2015 net neutrality rules, the FCC applied some universal service provisions to broadband internet service, but forbore from applying USF contribution obligations pending a recommendation from the Federal State Joint Board on Universal Service. If the FCC does reform USF contributions or add services to the contribution base, it is likely that Vonage's contribution burden will decline.

#### Federal - E-Rate Reform

On December 19, 2013, the FCC released a Second Report and Order and Order on Reconsideration modernizing the E-Rate program. The E-Rate program subsidizes voice and data services for schools and libraries and is one component of the federal universal service fund. The December 19 order increased the size of the E-Rate fund to \$3.9B in available annual funding. This represents an approximately \$1.5B annual (17%) increase in the overall size of the universal service fund. This increase in the size of the fund will likely lead to increased USF contribution levels for Vonage services subject to assessment for federal USF.

#### Federal - Rural Call Completion Issues

On February 7, 2013, the FCC released a Notice of Proposed Rulemaking (NPRM) on rural call completion issues. The NPRM proposed new detailed reporting requirements to gauge rural call completion performance. Rural carriers have argued that VoIP provider call completion performance to rural areas is generally poor. On October 28, 2013, the FCC adopted an order on rural call completion imposing new reporting obligations and restricting certain call signaling practices. The call signaling rules went into effect on January 31, 2014. We filed for extensions of the rules, which the FCC granted, and as of April 17, 2014, we were compliant with the FCC call signaling rules. The effective date for the reporting requirements was April 1, 2015 with the first report covering the 2nd quarter of 2015 due August 1, 2015. We could be subject to an FCC enforcement action in the future in the event the FCC took the position that our rural call completion performance is inadequate or we were not compliant with the FCC's order.

#### Federal - Numbering Rights

On April 18, 2013, the FCC issued a Notice of Proposed Rulemaking (NPRM) that proposed to modify FCC rules to allow VoIP providers to directly access telephone numbers. In addition, the FCC granted a waiver from its existing rules to allow Vonage to conduct a trial of direct access to telephone numbers. The trial would allow the FCC to obtain real-world data on direct access to telephone numbers by VoIP providers to inform consideration of the NPRM. Direct access to telephone numbers would facilitate IP to IP interconnection, which may allow VoIP providers to provide higher quality, lower cost services, promote the deployment of innovative new voice services, and experience reductions in the cost of telephony services. Vonage successfully completed the trial in certain markets and filed the required reports on the trial with the FCC. On January 31, 2014, the FCC Wireline Competition Bureau issued a positive report on the trial, concluding that Vonage's successful trial confirmed the technical feasibility of interconnected VoIP providers obtaining telephone numbers directly from the numbering administrators. On June 18, 2015, the FCC adopted an order that modifies its rules to allow interconnected VoIP providers to directly access telephone numbers. Part of the order requires approval from the Office of Management and Budget ("OMB") prior to the rule change becoming effective. On February 4, 2016, the FCC



Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

announced that OMB had approved the order and would begin accepting applications for authorization beginning on February 18, 2015. On December 23, 2015, the National Association of Regulatory Utility Commissioners filed an appeal of the June 18, 2015 FCC order at the D.C. Circuit Court of Appeals. This appeal is pending.

State Telecommunications Regulation

In general, the focus of interconnected VoIP telecommunications regulation is at the federal level. On November 12, 2004, the FCC issued a declaratory ruling providing that our service is subject to federal regulation and preempted the Minnesota Public Utilities Commission (“MPUC”) from imposing certain of its regulations on us. The FCC's decision was based on its conclusion that our service is interstate in nature and cannot be separated into interstate and intrastate components. On March 21, 2007, the United States Court of Appeals for the 8th Circuit affirmed the FCC's declaratory ruling preempting state regulation of our service.

While this ruling does not exempt us from all state oversight of our service, it effectively prevents state telecommunications regulators from imposing certain burdensome and inconsistent market entry requirements and certain other state utility rules and regulations on our service. State regulators continue to probe the limits of federal preemption in their attempts to apply state telecommunications regulation to interconnected VoIP service. On July 16, 2009, the Nebraska Public Service Commission and the Kansas Corporation Commission filed a petition with the FCC seeking a declaratory ruling or, alternatively, adoption of a rule declaring that state authorities may apply universal service funding requirements to nomadic VoIP providers. We participated in the FCC proceedings on the petition. On November 5, 2010, the FCC issued a declaratory ruling that allowed states to assess state USF on nomadic VoIP providers on a going forward basis provided that the states comply with certain conditions to ensure that imposing state USF does not conflict with federal law or policy. More recently on July 28, 2015, the MPUC found that it has authority to regulate Charter's fixed, interconnected VoIP service. Charter challenged the MPUC's order at the U.S. District Court for Minnesota. This challenge is currently pending. We expect that state public utility commissions and state legislators will continue their attempts to apply state telecommunications regulations to nomadic VoIP service.

State and Municipal Taxes

In accordance with generally accepted accounting principles, we make a provision for a liability for taxes when it is both probable that a liability has been incurred and the amount of the liability or range of liability can be reasonably estimated. These provisions are reviewed at

least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. For a period of time, we did not collect or remit state or municipal taxes (such as sales, excise, utility, use, and ad valorem taxes), fees or surcharges (“Taxes”) on the charges to our customers for our services, except that we historically complied with the New Jersey sales tax. We have received inquiries or demands from a number of state and municipal taxing and 911 agencies seeking payment of Taxes that are applied to or collected from customers of providers of traditional public switched telephone network services.

Although we have consistently maintained that these Taxes do not apply to our service for a variety of reasons depending on the statute or rule that establishes such obligations, we are now collecting and remitting sales taxes in certain of those states including a number of states that have changed their statutes to expressly include VoIP. In addition, many states address how VoIP providers should contribute to support public safety agencies, and in those states we remit fees to the appropriate state agencies. We could also be contacted by state or municipal taxing and 911 agencies regarding Taxes that do explicitly apply to VoIP and these agencies could seek retroactive payment of Taxes. As such, we have a reserve of \$3,903 as of December 31, 2015 as our best estimate of the potential tax exposure for any retroactive assessment. We believe the maximum estimated exposure for retroactive assessments is approximately \$12,000 as of December 31, 2015.

Employment Agreements

Our Chief Executive Officer is subject to an employment contract with a minimum salary commitment that is subject to annual review. He is also eligible for an annual performance bonus with a target based upon his then annual salary. The term of the employment contract with our Chief Executive Officer expires in 2017. In the event of the termination of our Chief Executive Officer's employment, depending upon the circumstances, he will be entitled to severance benefits equal to (i) twelve months base salary plus his target bonus amount for the year in which his employment terminates, payable over the twelve months period following termination of employment, (ii) a pro rata share (based on the portion of the year elapsed) of his bonus for the year in which his employment terminates, payable when, as and if under the Company's bonus program such bonus would otherwise be paid, but in no event later than March 15th of the year following the year to which such bonus relates, (iii) any prior year bonus amounts earned but unpaid as of the termination date, (iv) other accrued but unpaid compensation and benefits under the Company's benefits plans, (v) amounts to cover specified health care coverage premiums and (vi) vesting of certain equity awards pursuant to the terms of such awards.

#### Note 11. Acquisition of Business

##### Acquisition of iCore

Pursuant to the Agreement and Plan of Merger dated August 19, 2015 by and among the Company, Cirrus Acquisition Corp., a Delaware corporation and newly formed indirect, wholly owned subsidiary of Vonage ("Merger Sub"), iCore, and Stephen G. Canton, as representative of the security holders of iCore, on August 31, 2015, Merger Sub, on the terms and subject to the conditions thereof, merged with and into iCore, and iCore became a wholly owned indirect subsidiary of Vonage.

iCore provides cloud-based unified communications and collaboration services, delivering voice, video, and mobile communications solutions to business customers. iCore is a natural complement to our rapid growing UCaaS business and strengthens our national footprint.

We acquired iCore for \$92,689 in cash consideration, subject to adjustments pursuant to the merger agreement for closing cash and

working capital of iCore, reductions for indebtedness and transaction expenses of iCore that remained unpaid as of closing, and escrow fund deposits. We financed the transaction with \$10,689 of cash and \$82,000 from our 2015 revolving credit facility. The aggregate consideration will be allocated among iCore equity holders.

Pursuant to the merger agreement, \$9,200 of the cash consideration was placed in escrow for unknown liabilities that may have existed as of the acquisition date.

During 2015, we incurred \$1,353 in acquisition related transaction costs, which were recorded in general and administrative expense in the accompanying Consolidated Statements of Income.

The results of operations of the iCore business and the estimated fair values of the assets acquired and liabilities assumed have been included in our consolidated financial statements since the date of the acquisition.

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

The acquisition was accounted for using the acquisition method of accounting under which assets and liabilities of iCore were recorded at their respective fair values including an amount for goodwill representing the difference between the acquisition consideration and the fair value of the identifiable net assets. We do not expect any portion of this goodwill to be deductible for tax purposes. The goodwill attributable to the acquisition has been recorded as a non-current asset and is not amortized, but is subject to an annual review for impairment.

The acquisition price was allocated to the tangible and identified intangible assets acquired and liabilities assumed as of the closing date. The fair values assigned to tangible and identifiable

intangible assets acquired and liabilities assumed are based on management's estimates and assumptions. The estimated fair values of assets acquired and liabilities assumed are considered preliminary and are based on the most recent information available. We believe that the information provides a reasonable basis for assigning the fair values of assets acquired and liabilities assumed, but we are waiting for additional information, primarily related to income, sales, excise, and ad valorem taxes which are subject to change. Thus, the provisional measurements of fair value set forth below are subject to change. We expect to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

The table below summarizes the iCore assets acquired and liabilities assumed as of August 31, 2015:

|  | Estimated Fair Value |
|--|----------------------|
| Assets   |                      |
| Current assets:                                      |                      |
| Cash and cash equivalents                            | \$1,014              |
| Accounts receivable                                  | 1,492                |
| Inventory  | 191                  |
| Prepaid expenses and other current assets            | 1,017                |
| Total current assets                                 | 3,714                |
| Property and equipment                               | 4,437                |
| Software   | 281                  |
| Intangible assets                                    | 38,064               |
| Restricted cash                                      | 183                  |
| Other assets   | 195                  |
| Total assets acquired                                | 46,874               |
| Liabilities  |                      |
| Current liabilities:                                 |                      |
| Accounts payable                                     | 3,344                |
| Accrued expenses                                     | 3,963                |
| Deferred revenue, current portion                    | 576                  |
| Current maturities of capital lease obligations      | 557                  |
| Total current liabilities                            | 8,440                |
| Capital lease obligations, net of current maturities | 552                  |
| Deferred tax liabilities, net, non-current           | 8,487                |
| Total liabilities assumed                            | 17,479               |
| Net identifiable assets acquired                     | 29,395               |
| Goodwill   | 63,294               |

|   |          |
|---|----------|
| Total purchase price  | \$92,689 |
| The intangible assets as of the closing date of the Acquisition included: |          |
|   | Amount   |
| Customer relationships  | \$37,720 |
| Non-compete agreements  | 104      |
| Trade names   | 240      |
|   | \$38,064 |

Indications of fair value of the intangible assets acquired in connection with the acquisition were determined using either the income, market or replacement cost methodologies. The intangible assets are being amortized over periods which reflect the pattern in which economic benefits of the assets are expected to be realized. The customer

relationships are being amortized on an accelerated basis over an estimated useful life of ten years; developed technology is being amortized on an accelerated basis over an estimated useful life of eight years; and the non-compete agreements and trade names are being amortized on a straight-line basis over two years.

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

In addition, we recorded a deferred tax liability of \$12,944 related to the \$38,064 of identified intangible assets that will be amortized for financial reporting purposes but not for tax purposes and a deferred tax asset of \$4,457 related to NOLs.

The excess of purchase price over the fair value amounts assigned to the assets acquired and liabilities assumed represents the amount of goodwill resulting from the acquisition. We do not expect any portion of this goodwill to be deductible for tax purposes. The goodwill attributable to the acquisition has been recorded as a non-current asset and is not amortized, but is subject to an annual review for impairment. We believe the factors that contributed to goodwill include synergies that are specific to our consolidated business, the acquisition of a talented workforce that provides us with expertise in the small and medium business market, as well as other intangible assets that do not qualify for separate recognition.

Acquisition of Simple Signal

Pursuant to the Agreement and Plan of Merger dated March 15, 2015, by and among Vonage Holdings Corp., a Delaware corporation, Stratus Acquisition Corp., a California corporation and an indirect wholly owned subsidiary of Parent (“Merger Sub”), Simple Signal Inc., a California corporation (“Simple Signal”) and Simplerep, LLC, a Colorado limited liability company, as representative of the security holders of Simple Signal, on April 1, 2015, Merger Sub merged with and into Simple Signal, and Simple Signal became a wholly owned indirect subsidiary of Vonage. Simple Signal provides cloud-based unified communications and collaboration services, delivering voice, video, and mobile communications solutions to business customers. Simple Signal is a natural complement to our expanding UCaaS business.

We acquired Simple Signal for \$25,578, including 1,111 shares of Vonage common stock (which shares had an aggregate value of approximately \$5,578 based upon the closing stock price on April 1, 2015) and cash consideration of \$20,000, subject to adjustments pursuant to the merger agreement for closing cash and working capital of Simple Signal, reductions for indebtedness and transaction expenses of Simple Signal that remained unpaid as of closing, and escrow fund deposits. We financed the transaction with \$20,000 from our 2014 revolving credit facility. The aggregate consideration will be allocated among Simple Signal equityholders.

Pursuant to the merger agreement, \$2,356 of the cash consideration and \$1,144 of the stock consideration was placed in escrow for unknown liabilities that may have existed as of the acquisition date.

During 2015, we incurred \$470 in acquisition related transaction costs, which were recorded in general and administrative expense in the accompanying Consolidated Statements of Income.

The results of operations of the Simple Signal business and the estimated fair values of the assets acquired and liabilities assumed have been included in our consolidated financial statements since the date of the acquisition. The acquisition was accounted for using the acquisition method of accounting under which assets and liabilities of Simple Signal were recorded at their respective fair values including an amount for goodwill representing the difference between the acquisition consideration and the fair value of the identifiable net assets. We do not expect any portion of this goodwill to be deductible for tax purposes. The goodwill attributable to the acquisition has been recorded as a non-current asset and is not amortized, but is subject to an annual review for impairment.

The acquisition price was allocated to the tangible and identified intangible assets acquired and liabilities assumed as of the closing date. The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management’s estimates and assumptions. The estimated fair values of assets acquired and liabilities assumed are considered preliminary and are based on the most recent information available. We believe that the information provides a reasonable basis for assigning the fair values of assets acquired and liabilities assumed, but we are waiting for additional information, primarily related to income, sales, excise, and ad valorem taxes which are subject to change. Thus, the provisional measurements of fair value set forth below are subject to change. We expect

to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

F-35 VONAGE ANNUAL REPORT 2015

---

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

The table below summarizes the Simple Signal assets acquired and liabilities assumed as of April 1, 2015:

|   | Estimated Fair Value |
|---|----------------------|
| Assets  |                      |
| Current assets:   |                      |
| Cash and cash equivalents   | \$53                 |
| Accounts receivable   | 832                  |
| Inventory   | 67                   |
| Prepaid expenses and other current assets                                 | 159                  |
| Total current assets  | 1,111                |
| Property and equipment  | 979                  |
| Software  | 401                  |
| Intangible assets   | 6,407                |
| Deferred tax assets, net, non-current                                     | 741                  |
| Total assets acquired   | 9,639                |
| Liabilities   |                      |
| Current liabilities:  |                      |
| Accounts payable  | 785                  |
| Accrued expenses  | 593                  |
| Deferred revenue, current portion   | 370                  |
| Total current liabilities   | 1,748                |
| Total liabilities assumed   | 1,748                |
| Net identifiable assets acquired  | 7,891                |
| Goodwill  | 17,687               |
| Total purchase price  | \$25,578             |
| The intangible assets as of the closing date of the Acquisition included: |                      |
|   | Amount               |
| Customer relationships  | \$5,090              |
| Developed technologies  | 994                  |
| Non-compete agreements  | 303                  |
| Trade names   | 20                   |
|   | \$6,407              |

Indications of fair value of the intangible assets acquired in connection with the acquisition were determined using either the income, market or replacement cost methodologies. The intangible assets are being amortized over periods which reflect the pattern in which economic benefits of the assets are expected to be realized. The customer relationships are being amortized on an accelerated basis over an estimated useful life of ten years; developed technology is being amortized on an accelerated basis over an estimated useful life of eight years; and the non-compete agreements and trade names are being amortized on a straight-line basis over two years.

In addition, we recorded a deferred tax liability of \$2,441 related to the \$6,407 of identified intangible assets that will be amortized for financial reporting purposes but not for tax purposes and a deferred tax asset of \$3,182 related to NOLs.

The excess of purchase price over the fair value amounts assigned to the assets acquired and liabilities assumed represents the amount of goodwill resulting from the acquisition. We do not expect any portion of this goodwill to be

deductible for tax purposes. The goodwill attributable to the acquisition has been recorded as a non-current asset

and is not amortized, but is subject to an annual review for impairment. We believe the factors that contributed to goodwill include synergies that are specific to our consolidated business, the acquisition of a talented workforce that provides us with expertise in the small and medium business market, as well as other intangible assets that do not qualify for separate recognition.

#### Acquisition of Telesphere

Pursuant to the Agreement and Plan of Merger (the “Telesphere Merger Agreement”), dated November 4, 2014, by and among Vonage, Thunder Acquisition Corp., a Washington corporation and newly formed wholly owned subsidiary of Vonage (“Merger Sub”), Telesphere Networks Ltd. (“Telesphere”), and each of John Chapple and Gary O’Malley, as representative of the securityholders of Telesphere (collectively, the “Representative”). Pursuant to the Merger Agreement, on December 15, 2014, Merger Sub merged with and into Telesphere, and Telesphere became a wholly owned subsidiary of Vonage (the “Merger”).

Telesphere offers a comprehensive range of cloud voice and UCaaS services, including advanced call center solutions, collaboration,



Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

mobile office, and HD multi-point video conferencing. Facilitating its cloud services delivery, Telesphere also provides integrated MPLS services over its nationwide network enabling quality of service (QoS) management and security increasingly required by businesses utilizing extensive UCaaS features.

We acquired Telesphere for \$114,330, including 6,825 shares of Vonage common stock (which shares had an aggregate value of approximately \$22,727 based upon the closing stock price on December 15, 2014) and cash consideration of \$91,603 (of which \$3,610 was paid in January 2015) including payment of \$676 for excess cash as of closing date, a reduction for closing working capital of \$105, reductions for indebtedness and transaction expenses of Telesphere that remained unpaid as of closing, and deposits into the escrow funds. We financed the transaction with \$24,603 of cash and \$67,000 from our 2014 revolving credit facility. The aggregate consideration will be allocated among Telesphere equity holders.

Pursuant to the Acquisition Agreement, \$10,725 of the cash consideration and \$2,875 of the stock consideration was placed in escrow (the "Holdback") for unknown liabilities that may have existed as of the acquisition date. \$11,600 of the Holdback, which was included as part of the acquisition consideration, will be paid for such unknown liabilities or to the former Telesphere shareholders within 18 months from the closing date of the Acquisition. \$2,000 of the Holdback, which was included as part of the acquisition consideration, will be paid for such unknown tax specific liabilities or to the former Telesphere shareholders within 36 months from the closing date of the Acquisition.

During 2015 and 2014, we incurred \$102 and \$2,446, respectively, in acquisition related transaction costs, which were recorded in selling, general and administrative expense in the accompanying Consolidated Statements of Operations.

The results of operations of the Telesphere business and the estimated fair values of the assets acquired and liabilities assumed have been included in our consolidated financial statements since the date of the Acquisition.

The acquisition was accounted for using the acquisition method of accounting under which assets and liabilities of Telesphere were recorded at their respective fair values including an amount for goodwill representing the difference between the acquisition consideration and the fair value of the identifiable net assets.

During the first quarter of 2015, the Company completed the process of allocating the acquisition price to identified intangible assets acquired as of the closing date, which had been in process as of December 31, 2014. The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management's estimates and assumptions. The estimated fair values of assets acquired and liabilities assumed are considered preliminary and are based on the most recent information available. We believe that the information provides a reasonable basis for assigning the fair values of assets acquired and liabilities assumed, but we are waiting for additional information, primarily related to income, sales, excise, and ad valorem taxes which are subject to change. The December 31, 2014 balance sheet has been revised to reflect the allocation of the purchase price for Telesphere based upon completion of our valuation analysis of intangible assets. The key revision was to record identified intangible assets of \$50,925 with a corresponding reduction to goodwill.

The table below summarizes the Telesphere assets acquired and liabilities assumed as of December 15, 2014 as follows:

|   | Estimated Fair Value |
|---|----------------------|
| Assets                                    |                      |
| Current assets:                           |                      |
| Cash and cash equivalents                 | \$70                 |
| Accounts receivable                       | 2,925                |
| Inventory                                 | 386                  |
| Prepaid expenses and other current assets | 398                  |

|                                       |           |
|---------------------------------------|-----------|
| Total current assets                  | 3,779     |
| Property and equipment                | 5,731     |
| Software                              | 3         |
| Intangible assets                     | 50,925    |
| Deferred tax assets, net, non-current | 51        |
| Other assets                          | 76        |
| Total assets acquired                 | 60,565    |
| Liabilities                           |           |
| Current liabilities:                  |           |
| Accounts payable                      | 1,202     |
| Accrued expenses                      | 4,108     |
| Deferred revenue, current portion     | 1,156     |
| Total current liabilities             | 6,466     |
| Total liabilities assumed             | 6,466     |
| Net identifiable assets acquired      | 54,099    |
| Goodwill                              | 60,231    |
| Total purchase price                  | \$114,330 |

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

The intangible assets as of the closing date of the Acquisition included:

|                        | Amount    |
|------------------------|-----------|
| Customer relationships | \$ 10,699 |
| Developed technologies | 35,508    |
| Non-compete agreements | 2,526     |
| MPLS network           | 2,192     |
|                        | \$ 50,925 |

Indications of fair value of the intangible assets acquired in connection with the acquisition were determined using either the income, market or replacement cost methodologies. The intangible assets are being amortized over periods which reflect the pattern in which economic benefits of the assets are expected to be realized. The customer relationships and MPLS network are being amortized on an accelerated basis over an estimated useful life of seven years; developed technology is being amortized on an accelerated basis over an estimated useful life of ten years; and the non-compete agreements are being amortized on a straight-line basis over three years.

In addition, we recorded a deferred tax liability of \$17,050 related to the \$50,925 of identified intangible assets that will be amortized for financial reporting purposes but not for tax purposes and a deferred tax asset of \$17,101 related to NOLs.

The excess of purchase price over the fair value amounts assigned to the assets acquired and liabilities assumed represents the amount of goodwill resulting from the acquisition. We do not expect any portion of this goodwill to be deductible for tax purposes. The goodwill attributable to the acquisition has been recorded as a non-current asset and is not amortized, but is subject to an annual review for impairment. We believe the factors that contributed to goodwill include synergies that are specific to our consolidated business, the acquisition of a talented workforce that provides us with expertise in the small and medium business market, as well as other intangible assets that do not qualify for separate recognition.

Acquisition of Vocalocity

Vocalocity is an industry-leading provider of cloud-based communication services to small and medium businesses (SMB). The acquisition of Vocalocity positioned Vonage as a leader in the SMB hosted VoIP market. Subsequent to the acquisition, SMB and small office, home office (SOHO) services previously offered by Vonage were offered under the Vonage Business Solutions brand on the Vocalocity platform.

Pursuant to the Merger Agreement dated October 9, 2013, by and among Vocalocity and the Merger Sub, Vonage, and the

Shareholder Representative, on November 15, 2013, Merger Sub merged with and into Vocalocity, and Vocalocity became a wholly-owned subsidiary of Vonage. In addition, at the effective time of the Merger all previously unexercised vested Vocalocity stock options that were not out-of-the-money were cashed out at the spread between the applicable exercise price and the applicable merger consideration, subject to reductions for escrow deposits.

Unvested and/or out-of-the-money Vocalocity stock options were cancelled and terminated with no right to receive payment. Immediately prior to the consummation of the Merger, options to purchase common stock held by certain persons were accelerated, such that they are fully vested and exercisable as of the Effective Time.

We acquired Vocalocity for \$134,167, including 7,983 shares of Vonage common stock (which shares had an aggregate value of approximately \$26,186 based upon the closing stock price on November 15, 2013) and cash consideration of \$107,981 including payment of \$2,869 for excess cash as of closing date, subject to adjustments for closing cash and working capital of Vocalocity, reductions for indebtedness and transaction expenses of Vocalocity that remained unpaid as of closing, and deposits into the escrow funds, pursuant to the Merger Agreement. We

financed the transaction with \$32,981 of cash and \$75,000 from our 2013 revolving credit facility. The aggregate consideration will be allocated among holders of: (i) Vocalocity preferred stock, (ii) Vocalocity common stock, (iii) vested options to purchase Vocalocity common stock, and (iv) warrants to purchase Vocalocity preferred stock. During 2013, we incurred \$2,768 in acquisition related transaction and integration costs, which were recorded in selling, general and administrative expense in the accompanying Consolidated Statements of Operations. The Acquisition was accounted for using the acquisition method of accounting under which assets and liabilities of Vocalocity were recorded at their respective fair values including an amount for goodwill representing the difference between the acquisition consideration and the fair value of the identifiable net assets.

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

The table below summarizes the assets acquired and liabilities assumed as of November 15, 2013 as follows:

|   | Estimated Fair Value |
|---|----------------------|
| Assets  |                      |
| Current assets:   |                      |
| Cash and cash equivalents   | \$7,924              |
| Accounts receivable   | 275                  |
| Prepaid expenses and other current assets                                 | 787                  |
| Total current assets  | 8,986                |
| Property and equipment  | 1,777                |
| Intangible assets   | 75,000               |
| Other assets  | 53                   |
| Total assets acquired   | 85,816               |
| Liabilities   |                      |
| Current liabilities:  |                      |
| Accounts payable  | 2,226                |
| Accrued expenses  | 7,064                |
| Deferred revenue, current portion   | 1,986                |
| Total current liabilities   | 11,276               |
| Deferred tax liabilities, net, non-current                                | 24,000               |
| Total liabilities assumed   | 35,276               |
| Net identifiable assets acquired  | 50,540               |
| Goodwill  | 83,627               |
| Total purchase price  | \$134,167            |
| The intangible assets as of the closing date of the Acquisition included: |                      |
|   | Amount               |
| Customer relationships  | \$39,100             |
| Developed technologies  | 35,200               |
| Trade names   | 500                  |
| Non-compete agreements  | 200                  |
|   | \$75,000             |

Indications of fair value of the intangible assets acquired in connection with the Acquisition were determined using either the income, market or replacement cost methodologies. The intangible assets are being amortized over periods which reflect the pattern in which economic benefits of the assets are expected to be realized. The customer relationships and developed technology are being amortized on an accelerated basis over an estimated useful life of ten years; trade names are being amortized on a straight-line basis over five years; and the non-compete agreements are being amortized on a straight-line basis over two years.

In addition, we recorded a deferred tax liability of \$30,000 related to the \$75,000 of identified intangible assets that will be amortized for financial reporting purposes but not for tax purposes and a deferred tax asset of \$6,000 related to NOLs, which consists of \$10,336 deferred tax asset and a valuation allowance of \$4,336 against Vocalocity's deferred tax assets based upon our preliminary assessment of the utilization of the NOLs as the NOLs are subject to Section 382 limitations. Subsequent to the acquisition date, we increased the

deferred tax assets by \$3,393 based upon updated information with respect to NOL utilization.

The excess of purchase price over the fair value amounts assigned to the assets acquired and liabilities assumed represents the amount of goodwill resulting from the Acquisition. We do not expect any portion of this goodwill to be deductible for tax purposes. The goodwill attributable to the Acquisition has been recorded as a non-current asset and is not amortized, but is subject to an annual review for impairment. We believe the factors that contributed to goodwill include synergies that are specific to our consolidated business, the acquisition of a talented workforce that provides us expertise in small and medium business market as well as other intangible assets that do not qualify for separate recognition.

The results of operations of the Vocalocity business and the estimated fair values of the assets acquired and liabilities assumed have been included in our consolidated financial statements since the date of the Acquisition.

Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

## Pro forma financial information (unaudited)

The following unaudited supplemental pro forma information presents the combined historical results of operations of Vonage, Simple Signal, and iCore for the years 2015 and 2014, as if the Acquisitions had been completed at the beginning of 2014.

|   | For the years ended December 31, |           |
|---|----------------------------------|-----------|
|   | 2015                             | 2014      |
| Revenue   | \$943,554                        | \$942,882 |
| Net income attributable to Vonage                     | 20,653                           | 14,036    |
| Net income attributable to Vonage per share - basic   | 0.10                             | 0.07      |
| Net income attributable to Vonage per share - diluted | 0.09                             | 0.06      |

The pro forma financial information includes certain adjustments to reflect expenses in the appropriate pro forma periods as though the companies were combined as of the beginning of 2014. These adjustments include:

- > an increase in amortization expense of \$3,970 and \$7,666 for the year ended 2015 and 2014, respectively, related to the identified intangible assets of Simple Signal and iCore;
- > a decrease in income tax expense of \$1,511 and \$1,888 for the year ended 2015 and 2014, respectively, related to pro forma adjustments and Simple Signal and iCore's results prior to acquisition;

> the exclusion of our transaction-related expenses of \$2,610 for the year ended 2015;

- > an increase in interest expense of \$1,790 and \$3,060 for the years ended 2015 and 2014, respectively associated with borrowings under our revolving credit facility.

The Company recorded revenue of \$34,243 and net loss of \$2,385 attributable to iCore and Simple Signal for the year ended December 31, 2015.

## Note 12. Noncontrolling Interest and Redeemable Noncontrolling Interest

In the third quarter of 2013, we formed a consolidated foreign subsidiary in Brazil in connection with our previously announced joint venture in Brazil, which created a redeemable noncontrolling interest. The redeemable noncontrolling interest consists of the 30.0% interest in this subsidiary held by our joint venture partner.

In 2014, our joint venture partner did not make required capital calls and correspondingly its interest was diluted to 4% and was no longer contingently redeemable. As such, we reclassified the redeemable noncontrolling interest previously included in the mezzanine section of our Consolidated Balance Sheets to noncontrolling interest in the Stockholders' Equity section of our Consolidated Balance Sheets.

In December 2014 we announced plans to exit the Brazilian market for consumer telephony services and wind down our joint venture operations in the country. We completed the process at the end of the first quarter of 2015.

We expect to avoid material operating losses in Brazil in 2016 due to the significant planned incremental investment that would have been required to scale the business. In connection with the wind down, we incurred approximately \$111 and \$1,972 in cash and non-cash charges, respectively, in the fourth quarter of 2014 related to severance-related expenses and asset write downs. We incurred approximately \$500 in cash charges in 2015 related to contract terminations and severance-related expenses.

## Note 13. Discontinued Operations

On March 31, 2015, the Company completed its previously announced exit from the Brazilian market for consumer telephony services and the associated wind down of its joint venture operations in the country. The Company incurred a loss on disposal of \$824. The

loss on disposal is comprised of the write-off of noncontrolling interest of \$907, foreign currency loss on intercompany loan forgiveness of \$783, and residual cumulative translation of \$192, partially offset by a tax benefit of \$1,058.



Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

The results of operations of this discontinued operation are as follows:

| (In thousands, except per share amounts)  | For the years ended December 31, |            |            |
|---|----------------------------------|------------|------------|
|   | 2015                             | 2014       | 2013       |
| Revenues  | 33                               | 99         | —          |
| Operating expenses  | \$1,648                          | \$10,358   | \$1,626    |
| Loss from discontinued operations   | (1,615 )                         | (10,259 )  | (1,626 )   |
| Loss on disposal, net of taxes  | (824 )                           | (1 )       | —          |
| Net loss from discontinued operations   | (2,439 )                         | (10,260 )  | (1,626 )   |
| Plus: Net loss from discontinued operations attributable to noncontrolling interest | 59                               | 819        | 488        |
| Net loss from discontinued operations attributable to Vonage                        | \$(2,380 )                       | \$(9,441 ) | \$(1,138 ) |

## Note 14. Geographic Information

ASC 280 "Segment Reporting" establishes reporting standards for an enterprise's business segments and related disclosures about its products, services, geographic areas and major customers. Under ASC 280, the method for determining what information to report is based upon the way management organizes the operating segments within the Company for making operating decisions and assessing financial performance. Our chief operating decision-makers review financial information presented on a consolidated basis,

accompanied by disaggregated information about revenues and marketing expenses for consumer services and business services for purposes of allocating resources and evaluating financial performance. Based upon the information reviewed by our chief operating decision makers, we have determined that we have two operating segments; however, we have one reportable segment as our two operating segments meet the criteria for aggregation since the segments have similar operating and economic characteristics.

Information about our operations by geographic location is as follows:

|                    | For the years ended December 31, |              |              |
|--------------------|----------------------------------|--------------|--------------|
|                    | 2015                             | 2014         | 2013         |
| Revenue:           |                                  |              |              |
| United States      | \$854,706                        | \$823,857    | \$784,665    |
| Canada             | 25,935                           | 30,294       | 32,348       |
| United Kingdom     | 14,431                           | 14,703       | 12,054       |
|                    | \$895,072                        | \$868,854    | \$829,067    |
|                    |                                  | December 31, | December 31, |
|                    |                                  | 2015         | 2014         |
| Long-lived assets: |                                  |              |              |
| United States      |                                  | \$430,150    | \$320,811    |
| Brazil             |                                  | —            | 145          |
| United Kingdom     |                                  | 270          | 545          |
| Israel             |                                  | 78           | 129          |
|                    |                                  | \$430,498    | \$321,630    |



Table of Contents

## VONAGE HOLDINGS CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(In thousands, except per share amounts)

## Note 15. Quarterly Financial Information (Unaudited)

The following table sets forth the reviewed consolidated quarterly financial information for 2015 and 2014:

|  | For the Quarter Ended |          |               |              | Total   |
|--|-----------------------|----------|---------------|--------------|---------|
|  | March 31,             | June 30, | September 30, | December 31, |         |
| Year Ended 2015  |                       |          |               |              |         |
| Revenue  | 219,730               | 221,858  | 223,360       | 230,124      | 895,072 |
| Income from continuing operations  | 9,849                 | 8,347    | 3,433         | 3,406        | 25,035  |
| Loss from discontinued operations attributable to Vonage                         | (2,380)               | —        | —             | —            | (2,380) |
| Net income attributable to Vonage  | 7,469                 | 8,347    | 3,433         | 3,406        | 22,655  |
| Net income attributable to Vonage per common share:                              |                       |          |               |              |         |
| Basic net income per share   |                       |          |               |              |         |
| Basic net income per share-from continuing operations                            | 0.05                  | 0.04     | 0.02          | 0.02         |         |
| Basic net income per share-from discontinued operations attributable to Vonage   | (0.01)                | —        | —             | —            |         |
| Basic net income per share-net income attributable to Vonage                     | 0.04                  | 0.04     | 0.02          | 0.02         |         |
| Diluted net income per share   |                       |          |               |              |         |
| Diluted net income per share-from continuing operations                          | 0.04                  | 0.04     | 0.02          | 0.01         |         |
| Diluted net income per share-from discontinued operations attributable to Vonage | (0.01)                | —        | —             | —            |         |
| Diluted net income per share-net income attributable to Vonage                   | 0.03                  | 0.04     | 0.02          | 0.01         |         |
| Year Ended 2014  |                       |          |               |              |         |
| Revenue  | 220,733               | 218,878  | 214,710       | 214,533      | 868,854 |
| Income from continuing operations  | 5,484                 | 6,890    | 7,327         | 10,006       | 29,707  |
| Loss from discontinued operations attributable to Vonage                         | (896)                 | (1,372)  | (2,771)       | (4,402)      | (9,441) |
| Net income attributable to Vonage  | 4,588                 | 5,518    | 4,556         | 5,604        | 20,266  |
| Net income attributable to Vonage per common share:                              |                       |          |               |              |         |
| Basic net income per share   |                       |          |               |              |         |
| Basic net income per share-from continuing operations                            | 0.03                  | 0.03     | 0.04          | 0.05         |         |
| Basic net income per share-from discontinued operations attributable to Vonage   | —                     | (0.01)   | (0.01)        | (0.02)       |         |
|  | 0.02                  | 0.03     | 0.02          | 0.03         |         |

|  |      |       |         |         |
|--|------|-------|---------|---------|
| Basic net income per share-net income attributable to Vonage                     |      |       |         |         |
| Diluted net income per share   |      |       |         |         |
| Diluted net income per share-from continuing operations                          | 0.02 | 0.03  | 0.03    | 0.05    |
| Diluted net income per share-from discontinued operations attributable to Vonage | —    | (0.01 | ) (0.01 | ) (0.02 |
| Diluted net income per share-net income attributable to Vonage                   | 0.02 | 0.02  | 0.02    | 0.03    |