VONAGE HOLDINGS CORP
Form 10-Q
August 03, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2017
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period From __________ to __________
Commission File Number 001-32887
VONAGE HOLDINGS CORP.
(Exact name of registrant as specified in its charter)

Delaware	11-3547680
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
23 Main Street, Holmdel, NJ	07733
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: (732) 528-2600
(Former name, former address and former fiscal year, if changed since last report): Not Applicable

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 x No o
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 Regulation 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 x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a nonaccelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o	(Do not check if a smaller reporting company)	
Smaller reporting company	o	Emerging growth company	o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at July 31, 2017
Common Stock, par value $0.001	227,345,315 shares

VONAGE HOLDINGS CORP.
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Part 1 - Financial Information

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

PART 1 - FINANCIAL INFORMATION
ITEM 1 - CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND NOTES
VONAGE HOLDINGS CORP.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)

	June 30, 2017 (unaudited)	December 31, 2016 (revised) [1]
Assets		
Current assets:		
Cash and cash equivalents	$ 26,825	$ 29,078
Marketable securities	—	601
Accounts receivable, net of allowance of $3,112 and $2,093, respectively	36,185	36,688
Inventory, net of allowance of $137 and $117, respectively	3,503	4,116
Deferred customer acquisition costs, current	1,486	2,610
Prepaid expenses	25,833	26,041
Other current assets	2,278	3,147
Total current assets	96,110	102,281
Property and equipment, net of accumulated depreciation of $138,644 and $129,166, respectively	44,688	48,415
Goodwill	366,806	360,363
Software, net of accumulated amortization of $92,361 and $87,626, respectively	23,867	21,971
Restricted cash	1,802	1,851
Intangible assets, net of accumulated amortization of $107,914 and $88,419, respectively	188,076	199,256
Deferred tax assets	204,286	184,210
Other assets	15,761	17,319
Total assets	$ 941,396	$ 935,666
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 23,045	$ 30,751
Accrued expenses	84,170	109,195
Deferred revenue, current portion	31,157	32,442
Current maturities of capital lease obligations	1,021	3,288
Current portion of notes payable	18,750	18,750
Total current liabilities	158,143	194,426
Indebtedness under revolving credit facility	214,000	209,000
Notes payable, net of debt related costs and current portion	81,953	91,124
Capital lease obligations, net of current maturities	46	140
Other liabilities	5,084	4,435
Total liabilities	459,226	499,125
Commitments and Contingencies (Note 7)		
Stockholders' Equity		
Common stock, par value $0.001 per share; 596,950 shares authorized at June 30, 2017 and December 31, 2016; 294,386 and 282,319 shares issued at June 30, 2017 and December 31, 2016, respectively; 227,287 and 219,001 shares outstanding at June 30, 2017 and December 31, 2016, respectively	294	282
Additional paid-in capital	1,349,356	1,310,847

Accumulated deficit	(627,890)	(641,869)
Treasury stock, at cost, 67,099 shares at June 30, 2017 and 63,318 shares at December 31, 2016	(243,229)	(219,125)
Accumulated other comprehensive loss	3,639	(13,594)
Total stockholders' equity	482,170	436,541
Total liabilities and stockholders' equity	$ 941,396	$ 935,666

(1) see Note 3. Correction of Prior Period Financial Statements

See accompanying notes to condensed consolidated financial statements.

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VONAGE HOLDINGS CORP.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016 (revised) [1]	2017	2016 (revised) [1]
Total revenues	$251,836	$233,675	$495,183	$460,499
Operating Expenses:				
Cost of service (exclusive of depreciation and amortization)	97,674	76,078	185,270	145,228
Cost of goods sold	6,187	8,352	13,480	17,418
Sales and marketing	79,738	83,344	161,669	162,945
Engineering and development	6,670	7,243	15,040	14,077
General and administrative	36,514	35,053	71,600	61,723
Depreciation and amortization	18,394	18,218	36,341	35,197
Total operating expenses	245,177	228,288	483,400	436,588
Income from operations	6,659	5,387	11,783	23,911
Other Income (Expense):				
Interest income	4	25	9	46
Interest expense	(3,861)	(3,057)	(7,564)	(5,503)
Other income (expense), net	686	104	466	258
Total other income (expense), net	(3,171)	(2,928)	(7,089)	(5,199)
Income before income taxes	3,488	2,459	4,694	18,712
Income tax benefit (expense)	1,337	(2,241)	6,044	(10,563)
Net income	$4,825	$218	$10,738	$8,149
Earnings per common share:				
Basic	$0.02	$—	$0.05	$0.04
Diluted	$0.02	$—	$0.04	$0.04
Weighted-average common shares outstanding:				
Basic	223,492	213,558	221,930	213,800
Diluted	239,938	222,700	239,923	223,978

(1) see Note 3. Correction of Prior Period Financial Statements

See accompanying notes to condensed consolidated financial statements.

VONAGE HOLDINGS CORP.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016 (revised) [1]	2017	2016 (revised) [1]
Net income	$4,825	$ 218	$10,738	$ 8,149
Other comprehensive income (loss):				
Foreign currency translation adjustment	14,185	(1,691)	17,232	(1,713)
Unrealized gain on available-for-sale securities	(20)	4	1	26
Total other comprehensive income (loss)	14,165	(1,687)	17,233	(1,687)
Comprehensive income (loss)	$18,990	$ (1,469)	$27,971	$ 6,462

(1) see Note 3. Correction of Prior Period Financial Statements

See accompanying notes to condensed consolidated financial statements.

VONAGE HOLDINGS CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2017	2016 [1]
Cash flows from operating activities:		
Net income	$10,738	$8,149
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and impairment charges	17,381	18,579
Amortization of intangibles	18,826	16,618
Deferred income taxes	(8,111)	8,897
Allowance for doubtful accounts	452	597
Allowance for obsolete inventory	293	352
Amortization of debt issuance costs	204	517
Gain on sale of business	(928)	—
Loss on disposal of fixed assets	134	—
Share-based expense	20,891	16,670
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	1,280	(7,176)
Inventory	353	906
Prepaid expenses and other current assets	1,173	(2,587)
Deferred customer acquisition costs	1,129	913
Accounts payable	(8,124)	5,095
Accrued expenses	(23,787)	(23,311)
Deferred revenue	(1,506)	(1,534)
Other assets and liabilities	2,295	(158)
Net cash provided by operating activities	32,693	42,527
Cash flows from investing activities:		
Capital expenditures	(8,995)	(15,948)
Purchase of marketable securities	—	(5,664)
Maturities and sales of marketable securities	602	7,524
Acquisition and development of software assets	(6,884)	(5,655)
Acquisition of businesses, net of cash acquired	—	(163,042)
Proceeds from sale of business	1,000	—
Net cash used in investing activities	(14,277)	(182,785)
Cash flows from financing activities:		
Principal payments on capital lease obligations and other financing obligations	(4,861)	(6,329)
Principal payments on notes and revolving credit facility	(19,375)	(33,437)
Proceeds received from draw down of revolving credit facility and issuance of notes payable	15,000	181,250
Debt related costs	—	(1,316)
Common stock repurchases	(9,542)	(32,902)
Employee taxes paid on withholding shares	(14,562)	(3,966)
Proceeds from exercise of stock options	11,962	3,023
Net cash (used)/provided by financing activities	(21,378)	106,323
Effect of exchange rate changes on cash	660	(109)
Net decrease in cash, cash equivalents, and restricted cash	(2,302)	(34,044)
Cash, cash equivalents, and restricted cash, beginning of period	30,929	60,313

Cash, cash equivalents, and restricted cash, end of period	$28,627	$26,269
Supplemental disclosures of cash flow information:		
Cash paid during the periods for:		
Interest	$6,722	$4,833
Income taxes	$3,554	$3,163
Non-cash investing and financing activities:		
Capital expenditures included in accounts payable and accrued liabilities	$3,492	$4,918
Issuance of common stock in connection with acquisition of business	$—	$31,591
Contingent consideration in connection with acquisition of business	$—	$16,472
Assumption of options in connection with acquisition of business	$—	$4,779

(1) See Note 2. Summary of Significant Accounting Policies for reclassification due to the adoptions of new Accounting Standard Updates and Note 3. Correction of Prior Period Financial Statements

See accompanying notes to condensed consolidated financial statements.

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VONAGE HOLDINGS CORP.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(In thousands)
(Unaudited)

	Shares	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2016 (Revised) [1]	219,001	$ 282	$1,310,847	$(641,869)	$(219,125)	$ (13,594)	$436,541
Cumulative effect adjustment upon the adoption of ASU 2016-09			5,668	3,241			8,909
Stock option exercises	12,068	12	11,950				11,962
Share-based expense			20,891				20,891
Employee taxes paid on withholding shares	(2,183)				(14,562)		(14,562)
Common stock repurchases	(1,599)				(9,542)		(9,542)
Foreign currency translation adjustment						17,232	17,232
Unrealized loss on available-for-sale securities						1	1
Net income				10,738			10,738
Balance at June 30, 2017	227,287	$ 294	$1,349,356	$(627,890)	$(243,229)	$ 3,639	$482,170

(1) see Note 3. Correction of Prior Period Financial Statements

See accompanying notes to condensed consolidated financial statements.

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

Note 1. Basis of Presentation

Nature of Operations

Vonage Holdings Corp. (“Vonage”, “Company”, “we”, “our”, “us”) is incorporated as a Delaware corporation. We are a leadin provider of cloud communications services for business. We transform the way people work and businesses operate through a portfolio of cloud-based communications solutions that enable internal collaboration among employees, while also keeping companies closely connected with their customers, across any mode of communication, on any device.

Through our Nexmo subsidiary which was acquired on June 3, 2016, we are a global leader in the Communications-Platform-as-a-Service ("CPaaS") segment of the cloud communications market, providing innovative communication application program interfaces ("APIs") for text messaging and voice communications, allowing developers and enterprises to embed contextual communications into mobile apps, websites and business workflows via text, social media, chat apps and voice. With just few lines of code, developers can send and receive text messages and build programmable voice applications. Nexmo, the Vonage API Platform can scale from one API call to billions. The platform makes it easy for any of our developers to access communication services via software and APIs. Through Nexmo we have a global network of interconnected carriers delivering our API-based communications platform, enabling businesses to communicate with their customers reliably and with ease, no matter where in the world they are located. The addition of our Nexmo products to our business offering allows our customers to address their full communications needs, from employee to employee communications through business to customer communications.

We also provide a robust suite of feature-rich residential communication solutions.

Customers in the United States represented 85% and 93% of our consolidated revenues for the three months ended June 30, 2017 and 2016 and 86% and 94% for the six months ended June 30, 2017 and 2016, respectively, with the balance in Canada, the United Kingdom, and other countries. Nexmo Inc. ("Nexmo") has operations in the United States, United Kingdom, Hong Kong, and Singapore, and provides CPaaS solutions to our customers located in many countries around the world.

Unaudited Interim Financial Information

The accompanying unaudited interim condensed consolidated financial statements and information have been prepared in accordance with accounting principles generally accepted in the United States and in accordance with the SEC's regulations for interim financial information and with the instructions for Form 10-Q. Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, these financial statements contain all normal and recurring adjustments considered necessary to present fairly the financial position, results of operations, cash flows, and statement of stockholders’ equity for the periods presented. The results for the three and six months ended June 30, 2017 are not necessarily indicative of the results to be expected for the full year.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the Securities and Exchange Commission on February 28, 2017.

Use of Estimates

Our condensed 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 condensed consolidated financial statements and the accompanying notes. Actual results could differ materially from these estimates.

Reclassifications

Reclassifications have been made to our condensed consolidated financial statements for the prior year period to conform to classification used in the current year period. The reclassifications did not affect results from operations or net assets.

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

Note 2. Summary of Significant Accounting Policies

This footnote should be read in conjunction with the complete description of our significant accounting policies under Note 1, Basis of Presentation and Significant Accounting Policies to our Annual Report on Form 10-K for the year ended December 31, 2016.

Cost of Services

Cost of services excludes depreciation and amortization expense of $6,863 and $6,985 for the three months ended June 30, 2017 and 2016 and $13,645 and $13,818 for the six months ended June 30, 2017 and 2016, respectively.

Advertising Costs

We incurred advertising costs included in sales and marketing of $14,994 and $20,079 for the three months ended June 30, 2017 and 2016 and $32,337 and $36,958 for the six months ended June 30, 2017 and 2016, respectively.

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. Research and development costs related to new product development included in engineering and development were $5,349 and $5,402 for the three months ended June 30, 2017 and 2016 and $11,695 and $10,310 for the six months ended June 30, 2017 and 2016, respectively.

Restructuring Activities

During the three months ended June 30, 2017, we recognized $4 million of costs associated with restructuring activities included in general and administrative expense and is primarily comprised of costs associated with severance and other employee related costs. As of June 30, 2017, the accrued severance of $4 million is expected to be paid during the third quarter of 2017.

Fair Value of Financial Instruments

The Company records certain of its financial assets at fair value on a recurring basis. The Company's financial instruments, which includes cash and cash equivalents, accounts receivable and accounts payable, approximate fair value because of their short-term 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 June 30, 2017 and December 31, 2016. We believe the fair value of our debt at June 30, 2017 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 June 3, 2016 for a similar debt instrument.

As of June 30, 2017, we did not have any assets or liabilities that are measured and recognized at fair value on a recurring basis. The following table presents the assets and liabilities 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, 2016:

	December 31, 2016
Level 1 Assets	
Money market fund [(1)]	$ 300
Level 2 Assets	
Available-for-sale securities [(2)]	$ 601

(1) Included in cash and cash equivalents on our condensed consolidated balance sheet.
(2) Included in marketable securities on our condensed consolidated balance sheet.

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

Supplemental Balance Sheet Information

Cash, cash equivalents and restricted cash

	June 30, 2017	December 31, 2016
Cash and cash equivalents	$26,825	$ 29,078
Cash collateralized letter of credit-lease deposits	$1,580	$ 1,578
Cash reserves	222	273
Restricted cash	$1,802	$ 1,851
Cash, cash equivalents, and restricted cash	$28,627	$ 30,929

Intangible assets, net

	June 30, 2017	December 31, 2016
Customer relationships	129,635	133,774
Developed technology	51,882	57,245
Patents and patent licenses	4,789	5,547
Trade names	698	1,033
Non-compete agreements	1,072	1,657
Intangible assets, net	$188,076	$ 199,256

Accrued expenses

	June 30, 2017	December 31, 2016
Compensation and related taxes and temporary labor	$28,294	$ 35,308
Marketing	11,911	11,979
Taxes and fees	14,380	18,976
Acquisition related consideration accounted for as compensation	1,733	6,608
Telecommunications	16,019	14,724
Settlement	—	5,000
Other accruals	8,333	12,846
Customer credits	1,200	2,074
Professional fees	2,300	1,680
Accrued expenses	$84,170	$ 109,195

Recent Accounting Pronouncements
In January 2017, FASB issued ASU 2017-04, "Intangibles - Goodwill and Other". The ASU simplifies the subsequent measurement of goodwill and eliminates Step 2 from the goodwill impairment test. This ASU is effective for an annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019 on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We are currently evaluating the impact of adopting ASU 2017-04 on our condensed consolidated

financial statements and related disclosures.

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

In May 2014, FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" which was further amended through various updates issued by the FASB thereafter. The amendments of Topic 606 clarify the principles for recognizing revenue and provide a common revenue standard for U.S. GAAP and International Financial Reporting Standards, or IFRS, and to improve financial reporting. The core principle of these standards are that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Topic 606 also amends the current guidance for the recognition of costs to obtain and fulfill contracts with customers requiring that all incremental costs of obtaining and direct costs of fulfilling contracts with customers such as commissions be deferred and recognized over the expected customer life. In August 2015, an ASU was issued by the FASB which deferred the effective date to annual and interim periods beginning on or after December 15, 2017. We will adopt the requirements of the new standard in the first quarter of 2018 and anticipate using the modified retrospective transition method under which the standard will be applied only to the most current period presented and the cumulative effect of applying the standard will be recognized at the date of initial application.

We are in the process of evaluating the impact of the standard with respect to the terms of our revenue arrangements and expect our review to be substantially completed during the third quarter of 2017. We expect the timing of recognition of our sales commissions will also be impacted as a substantial portion of these costs which are currently expensed will be capitalized under the revised standard and amortized over the period of benefit.

In October 2016, FASB issued ASU 2016-16, "Income Taxes". This ASU improves the accounting for income tax consequences of intra-entity transfers of assets other than inventory. This ASU is effective for fiscal years beginning after December 15, 2017 on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Early adoption is permitted as of the beginning of an annual reporting period for which financial statements have not been issued or made available for issuance. We are currently evaluating the impact of adopting ASU 2016-16 on our condensed consolidated financial statements and related disclosures.

In August 2016, FASB issued ASU 2016-15, "Statement of Cash Flows". This ASU addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. This ASU is effective for fiscal years beginning after December 15, 2017 on a retrospective basis. Early adoption is permitted, including adoption in an interim period. The adoption of ASU 2016-15 will not have a material impact on our condensed consolidated financial statements and related disclosures.

In February 2016, FASB issued ASU 2016-02, "Leases". This ASU increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted for all entities. The adoption of this ASU will increase assets and liabilities for operating leases. We will adopt these ASUs when effective. We are currently evaluating the effect of adopting ASU 2016-02 on our condensed consolidated financial statements and related disclosures.

In January 2016, FASB issued 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 condensed consolidated financial statements and related disclosures.

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

The following standards were adopted by the Company during the current year:
In November 2016, FASB issued ASU 2016-18, "Statement of Cash Flows". This ASU requires that a statement of cash flows explains the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. As a result, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. We adopted this ASU in the first quarter of 2017 and applied the retrospective transition method for each period presented. For the six months ended June 30, 2016, $690 and $10 were reclassified from investing activity and effect of exchange rate changes on cash, respectively, and $51, $2,587 and $1,938 were adjusted to acquisition of business, net of cash acquired, cash, cash equivalents, and restricted cash, beginning of the period and end of the period balances, respectively.
In March 2016, FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting". This ASU is issued as part of its Simplification Initiative. The areas for simplification in this ASU involve several aspects of the accounting for share- based payment transactions, including the income tax consequences, recognition of share-based expense, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted for any entity in any interim or annual period. We adopted this ASU in the first quarter of 2017. We elected to account for forfeitures when they occur versus our prior practice of estimating the number of awards that are expected to vest. The election of this new ASU resulted in a one-time adjustment in 2017 to accumulated deficit and to additional paid-in-capital of $5,668 and the corresponding benefit to our accumulated deficit and deferred tax asset of $2,285 related to the reversal of forfeiture rate as of December 31, 2016. In addition, a benefit to our accumulated deficit and deferred tax asset of $6,624 was recorded for excess tax benefits on equity compensation as of December 31, 2016. We also classified cash paid by us when directly withholding shares for tax-withholding purposes as a financing activity. As a result, $3,966 was reclassified from operating activity to financing activity for the six months ended June 30, 2016.
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 predicable 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 on permitted at the beginning of an interim and annual reporting period. We adopted ASU 2015-11 in the first quarter of 2017 and the adoption of this ASU did not have a material impact on our condensed consolidated financial statements and related disclosures.

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

Note 3. Correction of Prior Period Financial Statements

In connection with the preparation of our condensed consolidated financial statements for the quarter ended March 31, 2017, and our remediation efforts related to the material weakness in our internal control over financial reporting related to our controls over the preparation of the annual tax provision, we identified an error as of December 31, 2016 in our recognition of a deferred tax asset related to contingent consideration with vesting requirements paid in connection with the acquisition of Nexmo. Based in part upon the vesting requirements of contingent consideration, we recorded the consideration as compensation expense in general and administrative expense in our consolidated statements of operations. However, for tax purposes the contingent consideration should have been recorded as merger consideration and not deductible compensation. The correction of this error requires the reversal of the deferred tax asset on the consolidated balance sheets and related tax benefits of $4,756 as of December 31, 2016. In accordance with Staff Accounting Bulletin (“SAB”) No. 99, Materiality, and SAB No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, we evaluated the error and determined that the related impact was not material to our results of operations or financial position for any prior annual or interim period, but that correcting the $4,756 cumulative impact of the error would be material to our results of operations for the three months ended March 31, 2017. Accordingly, we have corrected the consolidated balance sheets as of December 31, 2016 and will correct this error in all prior periods presented by revising the appropriate condensed consolidated financial statements. This error had no impact on the three months ended March 31, 2016.
The impact to the consolidated balance sheet as of December 31, 2016 and the consolidated statements of income for the three and six months ended June 30, 2016, the three and nine months ended September 30, 2016, and the three months and year ended December 31, 2016 is as follows:

Consolidated Balance Sheets

	As of December 31, 2016		
	As Reported	Adjustment	As Revised
Deferred tax assets, non-current	$188,966	$ 4,756	$184,210
Total assets	940,422	4,756	935,666
Accumulated deficit	(637,113)	4,756	(641,869)
Total stockholders' equity	441,297	4,756	436,541
Total liabilities and stockholders' equity	940,422	4,756	935,666

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Condensed Consolidated Statements of Income

	Three Months Ended June 30, 2016			Six Months Ended June 30, 2016		
	As Reported	Adjustment	As Revised	As Reported	Adjustment	As Revised
Income tax expense	$(1,562)	$ 679	$(2,241)	$(9,884)	$ 679	$(10,563)
Net income	897	679	218	8,828	679	8,149
Net income per common share:						
Basic	$—	$ —	$—	$0.04	$ —	$0.04
Diluted	$—	$ —	$—	$0.04	$ —	$0.04

	Three Months Ended September 30, 2016			Nine Months Ended September 30, 2016		
	As Reported	Adjustment	As Revised	As Reported	Adjustment	As Revised
Income tax expense	$(1,501)	$ 2,038	$(3,539)	$(11,385)	$ 2,717	$(14,102)
Net income	9,078	2,038	7,040	17,906	2,717	15,189
Net income per common share:						
Basic	$0.04	$ 0.01	$0.03	$0.08	$ 0.01	$0.07
Diluted	$0.04	$ 0.01	$0.03	$0.08	$ 0.01	$0.07

	Three Months Ended December 31, 2016			Year Ended December 31, 2016		
	As Reported	Adjustment	As Revised	As Reported	Adjustment	As Revised
Income tax expense	$(1,553)	$ 2,039	$(3,592)	$(12,938)	$ 4,756	$(17,694)
Net income	1	2,039	(2,038)	17,907	4,756	13,151
Net income per common share:						
Basic	$—	$ 0.01	$(0.01)	$0.08	$ 0.02	$0.06
Diluted	$—	$ 0.01	$(0.01)	$0.08	$ 0.02	$0.06

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Note 4. Earnings Per Share
The following table sets forth the computation for basic and diluted earnings per share for the three and six months ended June 30, 2017 and 2016:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016 (revised) (1)	2017	2016 (revised) (1)
Numerator				
Net income	$4,825	$ 218	$10,738	$ 8,149
Denominator				
Basic weighted average common shares outstanding	223,492	213,558	221,930	213,800
Dilutive effect of stock options and restricted stock units	16,446	9,142	17,993	10,178
Diluted weighted average common shares outstanding	239,938	222,700	239,923	223,978
Basic earnings per share				
Basic earnings per share	$0.02	$ —	$0.05	$ 0.04
Diluted earnings per share				
Diluted earnings per share	$0.02	$ —	$0.04	$ 0.04

(1) see Note 3. Correction of Prior Period Financial Statements

For the three and six months ended June 30, 2017 and 2016, the following were excluded from the calculation of diluted earnings per common share because of their anti-dilutive effects:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Restricted stock units	4,540	12,851	3,344	12,012
Stock options	4,605	14,597	4,254	14,400
	9,145	27,448	7,598	26,412

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Note 5. Long-Term Note and Revolving Credit Facility

This footnote should be read in conjunction with the complete description of our financing arrangements under Note 6, Long-Term Debt and Revolving Credit Facility to our Annual Report on Form 10-K for the year ended December 31, 2016.

A schedule of long-term note and revolving credit facility at June 30, 2017 and December 31, 2016 is as follows:

	June 30, 2017	December 31, 2016
2.50-3.25% Term note - due 2020, net of debt related costs	$81,953	$ 91,124
2.50-3.25% Revolving credit facility - due 2020	214,000	209,000
Total Long-term note and revolving credit facility	$295,953	$ 300,124

2016 Financing

On June 3, 2016, we entered into Amendment No. 1 to the Amended and Restated Credit Agreement (the “2016 Credit Facility”) consisting of a $125.0 million term note and a $325.0 million revolving credit facility. The co-borrowers under the 2016 Credit Facility are the Company and Vonage America Inc., the Company’s wholly owned subsidiary. Obligations under the 2016 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. We used $197.8 million of the net available proceeds of the 2016 Credit Facility to retire all of the debt under our 2015 Credit Facility. We used $179.0 million from our 2016 Credit Facility in connection with the acquisition of Nexmo on June 3, 2016. Remaining proceeds from the term note and the undrawn revolving credit facility under the 2016 Credit Facility will be used for general corporate purposes. During the six months ended June 30, 2017, we made mandatory repayments of $9.4 million under the term note and $10.0 million under the revolving credit facility, respectively, and borrowed $15.0 million under the revolving credit facility. In addition, the effective interest rate was 4.25% as of June 30, 2017.

Interest Rate Swap

On July 14, 2017, we executed on three interest rate swap agreements in order to hedge the variability of expected future cash interest payments related to the 2016 Credit Facility. The swaps have an aggregate notional amount of $150 million and are effective on July 31, 2017 through June 3, 2020 concurrent with the term of the 2016 Credit Facility. Under the swaps our interest rate is fixed at 4.7%. The interest rate swaps will be accounted for as cash flow hedges in accordance with ASC 815, Derivatives and Hedging.

Note 6. Common Stock

As of June 30, 2017 and December 31, 2016, the Company had 596,950 shares of common stock authorized and had 11,369 shares available for grants under our share-based compensation programs as of June 30, 2017. For a detailed description of our share-based compensation programs refer to Note 9, Employee Benefit Plans in our Annual Report on Form 10-K for the year ended December 31, 2016.

Common Stock Repurchases

On December 9, 2014, Vonage's Board of Directors authorized a program for the Company to repurchase up to $100.0 million of its outstanding common stock (the "2014 $100.0 million repurchase program"). Repurchases under the 2014 $100.0 million repurchase program are expected to be made over a four-year period ending on December 31, 2018.

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We repurchased the following shares of common stock with cash resources under the 2014 $100.0 million repurchase program during the three and six months ended June 30, 2017 and 2016:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Shares of common stock repurchased	—	5,747	1,599	7,400
Value of common stock repurchased	$—	$24,754	$9,510	$32,762

As of June 30, 2017, $42,533 remained of our 2014 $100.0 million repurchase program. The repurchase program expires on December 31, 2018 but may be suspended or discontinued at any time without notice.

In any period under the 2014 $100.0 million 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.

Note 7. Commitments and Contingencies

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 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 matters noted below 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 condensed consolidated financial position, cash flows or results of operations.

Litigation

IP Matters

Bear Creek Technologies, Inc. On June 26, 2017, the litigations brought by Bear Creek Technologies, Inc. against Vonage Holdings Corp. and certain of its subsidiaries were dismissed with prejudice pursuant to stipulation, with no settlement paid by the Company.

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 September 17, 2015, the Court ordered the consolidation for pre-trial purposes of this case with other cases by RPost. 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 June 1, 2017, the parties in the consolidated actions filed a 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.

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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 stayed 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.

Cisco petitioned for inter partes review of the ‘247 patent on November 25, 2014, which was granted on May 20, 2015. On May 18, 2016, the Patent Office issued a Final Written Decision, finding all challenged claims of the ‘247 patent to be invalid. AIP appealed to the Federal Circuit, filing its opening brief on December 15, 2016. On December 20, 2016, the Patent Office filed a notice of intervention in the appellate proceedings. Briefing on the appeal is complete, with oral argument to be scheduled.

Commercial Litigation

Merkin & Smith, et al. 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. On February 29, 2016, the Ninth Circuit reversed the district court’s ruling and remanded with instructions to grant the motion to compel arbitration. On March 22, 2016, Merkin and Smith filed a petition for rehearing. On May 4, 2016, the Ninth Circuit withdrew its February 29, 2016 decision and issued a new order reversing the district court’s order and remanded with instructions to compel arbitration. The Ninth Circuit also declared as moot the petition for rehearing. On June 27, 2016, the lower court stayed the case pending arbitration. A joint status report was filed with the District Court on December 23, 2016. A second joint status report was filed with the District Court on March 23, 2017. A third joint status report was filed with the District Court on June 27, 2017.

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 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. On June 14, 2016, the D.C. Circuit of Appeals denied the appeals. Several parties filed a petition for rehearing en banc on July 29, 2016, which was denied on May 1, 2017.

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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