

VONAGE HOLDINGS CORP
Form 10-Q
October 27, 2016
Table of Contents

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

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2016

or

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 (IRS Employer
incorporation or organization) Identification No.)

23 Main Street, 07733
Holmdel, NJ
(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 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 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 No

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

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

Edgar Filing: VONAGE HOLDINGS CORP - Form 10-Q

Class	Outstanding at	October 21, 2016
Common Stock, par value \$0.001		217,957,324 shares

Table of Contents

VONAGE HOLDINGS CORP.
INDEX

Part I. Financial Information

	Page
Item 1. <u>Financial Statements</u>	
<u>Consolidated Balance Sheets as of September 30, 2016 (Unaudited) and December 31, 2015</u>	3
<u>Unaudited Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2016 and 2015</u>	4
<u>Unaudited Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2016 and 2015</u>	5
<u>Unaudited Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2016 and 2015</u>	6
<u>Unaudited Consolidated Statement of Stockholders' Equity for the Nine Months Ended September 30, 2016</u>	7
<u>Notes to Unaudited Consolidated Financial Statements</u>	8
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	41
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	58
Item 4. <u>Controls and Procedures</u>	59

Part II. Other Information

Item 1. <u>Legal Proceedings</u>	60
Item 1A. <u>Risk Factors</u>	60
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	75
Item 3. <u>Defaults Upon Senior Securities</u>	75
Item 4. <u>Mine Safety Disclosures</u>	75
Item 5. <u>Other Information</u>	75
Item 6. <u>Exhibits</u>	77
<u>Signature</u>	78

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.

Table of Contents

Part I – Financial Information

Item 1. Financial Statements

VONAGE HOLDINGS CORP.

CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

	September 30, 2016	December 31, 2015
	(unaudited)	
Assets		
Assets		
Current assets:		
Cash and cash equivalents	\$ 33,236	\$ 57,726
Marketable securities	6,559	9,908
Accounts receivable, net of allowance of \$2,633 and \$1,091, respectively	33,259	19,913
Inventory, net of allowance of \$189 and \$686, respectively	4,440	5,542
Deferred customer acquisition costs, current	2,092	4,074
Deferred tax assets, current	23,985	23,985
Prepaid expenses and other current assets	21,192	15,659
Total current assets	124,763	136,807
Property and equipment, net	49,791	49,483
Goodwill	366,509	222,106
Software, net	22,082	20,710
Deferred customer acquisition costs, non-current	503	431
Debt related costs, net	2,504	2,053
Restricted cash	1,836	2,587
Intangible assets, net	214,578	138,199
Deferred tax assets, non-current	169,943	202,587
Other assets	2,779	9,603
Total assets	\$ 955,288	\$ 784,566
Liabilities and Stockholders' Equity		
Liabilities		
Current liabilities:		
Accounts payable	\$ 27,345	\$ 42,798
Accrued expenses	103,990	96,127
Deferred revenue, current portion	31,862	32,605
Current maturities of capital lease obligations	4,332	4,398
Current portion of notes payable	18,750	15,000
Total current liabilities	186,279	190,928
Indebtedness under revolving credit facility	229,000	119,000
Notes payable, net of debt related costs and current portion	95,702	76,392
Deferred revenue, net of current portion	531	851
Capital lease obligations, net of current maturities	226	3,363
Other liabilities, net of current portion in accrued expenses	2,816	5,291
Total liabilities	514,554	395,825
Commitments and Contingencies		
Stockholders' Equity		
Common stock, par value \$0.001 per share; 596,950 shares authorized at September 30, 2016 and December 31, 2015; 280,624 and 268,947 shares issued at September 30,	283	270

Edgar Filing: VONAGE HOLDINGS CORP - Form 10-Q

2016 and December 31, 2015, respectively; 217,640 and 214,280 shares outstanding at September 30, 2016 and December 31, 2015, respectively

Additional paid-in capital	1,294,600	1,224,947
Accumulated deficit	(637,114	) (655,020)
Treasury stock, at cost, 62,984 shares at September 30, 2016 and 54,667 shares at December 31, 2015	(217,040	) (179,779)
Accumulated other comprehensive income (loss)	5	(1,677)
Total stockholders' equity	440,734	388,741
Total liabilities and stockholders' equity	\$ 955,288	\$ 784,566

The accompanying notes are an integral part of the consolidated financial statements.

3

Table of Contents

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Total revenues	\$248,359	\$223,360	\$708,858	\$664,948
Operating Expenses:				
Cost of service (excluding depreciation and amortization of \$7,460, \$6,415, \$21,278, and \$18,144 respectively)	87,377	67,193	232,605	193,255
Cost of goods sold	8,591	8,206	26,009	25,613
Sales and marketing	83,731	88,028	246,676	257,977
Engineering and development	8,075	6,830	22,152	20,299
General and administrative	27,538	28,860	89,261	79,256
Depreciation and amortization	18,018	15,446	53,215	43,854
	233,330	214,563	669,918	620,254
Income from operations	15,029	8,797	38,940	44,694
Other Income (Expense):				
Interest income	19	24	65	65
Interest expense	(3,974)	(2,222)	(9,477)	(6,245)
Other income (expense), net	(495)	(50)	(237)	(595)
	(4,450)	(2,248)	(9,649)	(6,775)
Income from continuing operations before income tax expense	10,579	6,549	29,291	37,919
Income tax expense	(1,501)	(3,116)	(11,385)	(16,290)
Income from continuing operations	9,078	3,433	17,906	21,629
Loss from discontinued operations	—	—	—	(1,615)
Loss on disposal, net of taxes	—	—	—	(824)
Discontinued operations	—	—	—	(2,439)
Net income	9,078	3,433	17,906	19,190
Plus: Net loss from discontinued operations attributable to noncontrolling interest	—	—	—	59
Net income attributable to Vonage	\$9,078	\$3,433	\$17,906	\$19,249
Net income per common share - continuing operations:				
Basic	\$0.04	\$0.02	\$0.08	\$0.10
Diluted	\$0.04	\$0.02	\$0.08	\$0.10
Net loss per common share - discontinued operations attributable to Vonage:				
Basic	\$—	\$—	\$—	\$(0.01)
Diluted	\$—	\$—	\$—	\$(0.01)
Net income attributable to Vonage per common share:				
Basic	\$0.04	\$0.02	\$0.08	\$0.09
Diluted	\$0.04	\$0.02	\$0.08	\$0.09
Weighted-average common shares outstanding:				
Basic	217,000	213,291	214,872	212,907
Diluted	234,868	225,182	227,499	222,820

The accompanying notes are an integral part of the consolidated financial statements.

4

Table of Contents

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

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Net income	\$9,078	\$3,433	\$17,906	\$19,190
Other comprehensive income:				
Foreign currency translation adjustment	3,372	56	1,659	369
Discontinued operations cumulative translation adjustment	—	—	—	974
Unrealized gain (loss) on available-for-sale securities	(3	) 1	23	(5
Total other comprehensive income	3,369	57	1,682	1,338
Comprehensive income	12,447	3,490	19,588	20,528
Comprehensive income attributable to noncontrolling interest:				
Comprehensive income	—	—	—	59
Total comprehensive income attributable to non-controlling interest	—	—	—	59
Comprehensive income attributable to Vonage	\$12,447	\$3,490	\$19,588	\$20,587

The accompanying notes are an integral part of the consolidated financial statements.

Table of ContentsVONAGE HOLDINGS CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended			
	September 30,			
	2016		2015	
Cash flows from operating activities:				
Net income	\$	17,906	\$	19,190
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization and impairment charges	27,841		26,222	
Amortization of intangibles	25,374		17,823	
Deferred tax expense	8,930		13,478	
Change in contingent consideration	(7,362))	—	
Loss on foreign currency	—		1,358	
Allowance for doubtful accounts	720		(8)
Allowance for obsolete inventory	514		1,362	
Amortization of debt related costs	800		743	
Share-based expense	27,128		20,081	
Non-controlling interest	—		907	
Changes in operating assets and liabilities, net of acquisitions:				
Accounts receivable	(5,244)	)	(1,991)
Inventory	582		1,076	
Prepaid expenses and other current assets	(2,161)	)	(4,567)
Deferred customer acquisition costs	1,906		677	
Other assets	201		(1,357)
Accounts payable	(17,252)	)	(8,700)
Accrued expenses	(11,868)	)	(1,492)
Deferred revenue	(2,785)	)	(2,066)
Other liabilities	25		890	
Net cash provided by operating activities	65,255		83,626	
Cash flows from investing activities:				

Edgar Filing: VONAGE HOLDINGS CORP - Form 10-Q

Capital expenditures	(19,980	)	(9,578)
Purchase of intangible assets	—		(2,500)
Purchase of marketable securities	(5,664	)	(7,255)
Maturities and sales of marketable securities	9,036		4,875	
Acquisition and development of software assets	(8,987	)	(7,932)
Acquisition of businesses, net of cash acquired	(163,093	)	(116,890)
Decrease in restricted cash	791		997	
Net cash used in investing activities	(187,897	)	(138,283)
Cash flows from financing activities:				
Principal payments on capital lease obligations	(7,453	)	(2,515)
Principal payments on notes and revolving credit facility	(48,125	)	(13,750)
Proceeds received from draw down of revolving credit facility and issuance of notes payable	181,250		102,000	
Debt related costs	(1,316	)	(2,007)
Common stock repurchases	(32,902	)	(15,911)
Proceeds from exercise of stock options	6,169		6,010	
Net cash provided by financing activities	97,623		73,827	
Effect of exchange rate changes on cash	529		(190)
Net change in cash and cash equivalents	(24,490	)	18,980	
Cash and cash equivalents, beginning of period	57,726		40,797	
Cash and cash equivalents, end of period	\$ 33,236		\$ 59,777	
Supplemental disclosures of cash flow information:				
Cash paid during the periods for:				
Interest	\$ 8,216		\$ 5,426	
Income taxes	\$ 5,165		\$ 2,104	

Non-cash transactions
during the periods for:

Common stock repurchases	\$	—	\$	—
Issuance of common stock in connection with acquisition of business	\$	31,591	\$	5,578
Purchase of intangible assets	\$	—	\$	5,000
Contingent consideration in connection with acquisition of business	\$	16,472	\$	—
Assumption of options in connection with acquisition of business	\$	4,779	\$	—

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

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

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2015	\$ 270	\$1,224,947	\$ (655,020)	\$(179,779)	\$ (1,677)	\$388,741
Stock option exercises	6	6,163				6,169
Share-based expense		27,128				27,128
Share-based award activity				(4,359)		(4,359)
Common stock repurchases				(32,902)		(32,902)
Acquisition of business	7	36,362				36,369
Foreign currency translation adjustment					1,659	1,659
Unrealized loss on available-for-sale securities					23	23
Net income			17,906			17,906
Balance at September 30, 2016	\$ 283	\$1,294,600	\$ (637,114)	\$(217,040)	\$ 5	\$440,734

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

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 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, we are a global leader in the Communications-Platform-as-a-Service (“CPaaS”) segment of the cloud communications market. We provide 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. Nexmo has a global network of interconnected carriers delivering its API-based communications platform, enabling businesses to communicate with their customers reliably and with ease, no matter where in the world they are located. We also provide a robust suite of feature-rich residential communication solutions.

Customers in the United States represented 93% of our combined subscriber lines and seats at September 30, 2016, with the balance in Canada and the United Kingdom. In addition, 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 consolidated financial statements and information have been prepared in accordance with accounting principles generally accepted in the United States and in accordance 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 nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the full year.

These unaudited interim 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, 2015 filed with the Securities and Exchange Commission on February 12, 2016.

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;

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

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;

assumptions used in determining the need for, and amount of, a valuation allowance on net deferred tax assets; and assumptions used in determining the contingent consideration in connection with the Nexmo acquisition.

We base our estimates on historical experience, available market information, appropriate valuation methodologies, and on various other assumptions that we believe 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 revenue and customer equipment (which enables our services) and shipping revenue. 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 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.

Our recently acquired subsidiary, Nexmo, provides CPaaS solutions to our customers. Through Nexmo, we provide innovative communication 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. Nexmo has a global network of interconnected carriers delivering its API-based communications

platform, enabling businesses to communicate with their customers reliably and with ease, no matter where in the world they are located.

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Nexmo has two types of revenue activities:

Revenue is primarily derived from supplying messaging (SMS and Voice) services to customers. Revenue is recognized in the period when messages are sent by the customer. Revenue is recognized based on the price on the website pricing page or as otherwise agreed with the customer.

Our trading customers operate within the communications industry as service providers or bulk SMS aggregators. With our trading business, we sell to trading specialists who are delivering voice or SMS messages on behalf of their customers. Typically, trade is based on single supply route and margins, which are effectively fixed at a deal level, represent the value of the transaction to us. As such, for the trading business we record revenue 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.

Cost of Service

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 \$6,234 and \$4,706 for the three months ended September 30, 2016 and 2015 and \$16,544 and \$13,405 for the nine months ended September 30, 2016 and 2015,

respectively.

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

10

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

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 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

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

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 three and nine months ended September 30, 2016.

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 three and nine months ended September 30, 2016.

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.

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

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 Sheets 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.

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 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 percent 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. 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. The 2016 estimated annual effective tax rate is expected to approximate 39%, but may fluctuate due to the timing of other discrete period transactions including changes in the contingent consideration in connection with the Nexmo acquisition.

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 2012 to present, our New Jersey tax returns remain open from 2011 to present, our Canada tax return remains open from 2011 to present, and other

domestic and foreign tax returns remain open for all periods to which those filings relate. Our consolidated corporate income tax return for 2013 has been selected for examination by the Internal Revenue Service. Our Canadian corporate income tax returns for 2012 and 2013 have been selected for examination by the Canada Revenue Agency. 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 percent likelihood of being realized upon ultimate resolution.

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

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.

Acquisition related consideration accounted for as compensation expense, such as restricted cash, restricted stock and option related costs incurred in connection with an acquisition are included in general and administrative expense.

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 believes 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.

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

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 September 30, 2016 and December 31, 2015:

	September 30, 2016	December 31, 2015
Level 1 Assets		
Money market fund (1)	\$ 2	\$ 57
Level 2 Assets		
Available-for-sale securities (2)	\$ 6,559	\$ 9,908
Level 3 Liabilities		
Contingent consideration (3)	\$ 9,110	\$ —

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

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

(3) Included in accrued expenses on our consolidated balance sheet.

The following summarizes the changes in liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	Nine Months Ended September 30, 2016
Beginning balance	\$ —
Initial contingent consideration at fair value	16,472
Change in fair value included in net income attributable to Vonage	(7,362)
Ending balance	\$ 9,110

Our contingent consideration liability is valued using a discounted cash flow valuation method encompassing significant unobservable inputs. The inputs include estimated revenue scenarios for the applicable performance periods, probability weightings assigned to revenue scenarios and the discount rate applied. Nexmo shareholders may earn a contingent consideration of up to \$20,000, subject to the achievement of certain performance targets during the 12 month period following the closing of the transaction. The contingent consideration payable to the holders of Nexmo stock is determined based on (i) the achievement of certain revenue targets for the calendar year 2016, and (ii) Nexmo's revenues received from its top customers following the closing. The contingent consideration may be in the form of cash, a number of shares of Vonage common stock or a combination thereof, at our sole discretion. We estimated using probability weighting that the value of the contingent consideration was \$17,840 at the acquisition date and included that amount in acquisition cost at the net present value amount of \$16,472. As of September 30, 2016, we have adjusted our probability weighting based upon updated information and have reduced the value of the contingent consideration to \$9,866 with a net present value of \$9,110. This reduction in the contingent consideration of \$7,362 was recorded in general and administrative expenses.

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 September 30, 2016 and December 31, 2015. We believe the fair value of our debt at September 30, 2016 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.

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Foreign Currency

Generally, the functional currency of our non-United States subsidiaries is the local currency. However, the functional currency of Nexmo's United States's subsidiary is the euro. 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

(In thousands, except per share amounts)

(Unaudited)

The following table sets forth the computation for basic and diluted net income per share for the three and nine months ended September 30, 2016:

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Numerator				
Income from continuing operations	\$9,078	\$ 3,433	\$17,906	\$21,629
Discontinued operations	—	—	\$—	\$(2,439)
Plus: Net loss from discontinued operations attributable to noncontrolling interest	\$—	\$—	\$—	\$59
Loss from discontinued operations attributable to Vonage	\$—	\$—	\$—	\$(2,380)
Net income attributable to Vonage	\$9,078	\$ 3,433	\$17,906	\$19,249
Denominator				
Basic weighted average common shares outstanding	217,000	213,291	214,872	212,907
Dilutive effect of stock options and restricted stock units	17,868	11,891	12,627	9,913
Diluted weighted average common shares outstanding	234,868	225,182	227,499	222,820
Basic net income per share				
Basic net income per share-from continuing operations	\$0.04	\$ 0.02	\$0.08	\$0.10
Basic net loss per share-from discontinued operations attributable to Vonage	\$—	\$—	\$—	\$(0.01)
Basic net income per share-net income attributable to Vonage	\$0.04	\$ 0.02	\$0.08	\$0.09
Diluted net income per share				
Diluted net income per share-from continuing operations	\$0.04	\$ 0.02	\$0.08	\$0.10
Diluted net loss per share-from discontinued operations attributable to Vonage	\$—	\$—	\$—	\$(0.01)
Diluted net income per share-net income attributable to Vonage	\$0.04	\$ 0.02	\$0.08	\$0.09

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

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Restricted stock units	8,130	6,616	11,120	7,171
Stock options	9,766	13,362	12,017	14,785
	17,896	19,978	23,137	21,956

Comprehensive Income (Loss)

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 May 2016, Financial Accounting Standards Board ("FASB") issued ASU 2016-12, "Revenue from Contract with Customers - Narrow-Scope Improvements and Practical Expedients". In April 2016, FASB issued ASU 2016-10,

"Revenue from

17

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Contracts with Customers - Identifying Performance Obligations and Licensing". In March 2016, FASB issued ASU 2016-08, "Revenue from Contract with Customers - Principal versus Agent Considerations (Reporting Revenue Gross versus Net)". In August 2015, FASB issued ASU 2015-14 deferring the effective date to annual and interim periods. In May 2014, FASB issued ASU 2014-09, "Revenue from Contracts with Customers". The core principle of these ASUs 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. The amendments in ASU 2016-12 affect only the narrow aspects of the guidance, such as assessing the collectibility criterion and accounting for contracts that do not meet the criterion, presentation of sales and other similar taxes collected from customers, non-cash consideration, and contract modifications at transition. ASU 2016-10 clarifies two aspects of the guidance: identifying performance obligations and the licensing implementation. The intention of the ASU 2016-08 is to improve the operability and understandability of the implementation guidance on principal versus agent considerations. ASU 2015-14 defers 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. ASU 2014-09 is a comprehensive new revenue recognition model for revenue from contract with customers. We will adopt these ASUs when effective. We are currently evaluating the impacts of adopting ASU 2016-12, ASU 2016-10, ASU 2016-08, ASU 2015-14, and ASU 2014-09 on our consolidated financial statements and related disclosures.

In March 2016, FASB issued Accounting Standards Update ("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, 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 are currently evaluating the impact of adopting ASU 2016-09 on our 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. We are currently evaluating the impact of adopting ASU 2016-02 on our 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 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. The adoption of ASU 2015-17 will 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 on permitted at the beginning of an interim and annual reporting period. The adoption of ASU 2015-11 will not have a material impact on our consolidated financial statements and related disclosures.

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Note 2. Supplemental Balance Sheet Account Information

Prepaid expenses and other current assets

	September 30, 2016	December 31, 2015
Nontrade receivables	\$ 4,040	\$ 2,113
Services	3,041	8,066
Telecommunications	9,339	3,138
Insurance	1,444	939
Marketing	2,456	779
Other prepaids	872	624
Prepaid expenses and other current assets	\$ 21,192	\$ 15,659

Property and equipment, net

	September 30, 2016	December 31, 2015
Building (under capital lease)	\$ 25,709	\$ 25,709
Network equipment and computer hardware	97,946	89,025
Leasehold improvements	50,641	48,872
Customer premise equipment	8,508	7,292
Furniture	3,949	2,508
Vehicles	203	214
	186,956	173,620
Less: accumulated depreciation and amortization	(137,165)	(124,137)
Property and equipment, net	\$ 49,791	\$ 49,483

Customer premise equipment, net

	September 30, 2016	December 31, 2015
Customer premise equipment	\$ 8,508	\$ 7,292
Less: accumulated depreciation	(3,555)	(2,068)
Customer premise equipment, net	\$ 4,953	\$ 5,224

Software, net

	September 30, 2016	December 31, 2015
Purchased	\$ 71,797	\$ 67,248
Licensed	—	909
Internally developed	36,222	36,088
	108,019	104,245
Less: accumulated amortization	(85,937)	(83,535)

Software, net	\$ 22,082	\$ 20,710
---------------	-----------	-----------

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Debt related costs, net

	September 30, December 31,	
	2016	2015
Debt related costs related to Revolving Credit Facility	\$ 5,965	\$ 5,044
Less: accumulated amortization	(3,461)	(2,991)
Debt related costs, net	\$ 2,504	\$ 2,053

Restricted cash

	September 30, December 31,	
	2016	2015
Letter of credit-lease deposits	\$ 1,577	\$ 2,498
Cash reserves	259	89
Restricted cash	\$ 1,836	\$ 2,587

Intangible assets, net

	September 30, December 31,	
	2016	2015
Customer relationships	\$ 178,509	\$ 92,609
Developed technology	89,462	75,694
Patents and patent licenses	20,164	20,164
Trademarks	560	560
Trade names	1,890	760
Non-compete agreements	3,905	2,933
Intangible assets, gross	294,490	192,720
Customer relationships	(34,693)	(21,777)
Developed technology	(28,068)	(18,880)
Patents and patent licenses	(14,113)	(12,066)
Trademarks	(560)	(543)
Trade names	(613)	(260)
Non-compete agreements	(1,865)	(995)
Less: accumulated amortization	(79,912)	(54,521)
Customer relationships	143,816	70,832
Developed technology	61,394	56,814
Patents and patent licenses	6,051	8,098
Trademarks	—	17
Trade names	1,277	500
Non-compete agreements	2,040	1,938
Intangible assets, net	\$ 214,578	\$ 138,199

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Other assets

	September 30, 2016	December 31, 2015
Long term non-trade receivable	—	6,623
Others	2,779	2,980
Other assets	\$ 2,779	\$ 9,603

Accrued expenses

	September 30, 2016	December 31, 2015
Compensation and related taxes and temporary labor	\$ 28,579	\$ 33,196
Marketing	17,593	24,891
Taxes and fees	14,391	11,808
Contingent consideration	13,069	—
Telecommunications	14,814	9,111
Other accruals	9,299	11,546
Customer credits	2,177	1,779
Professional fees	2,900	2,080
Accrued interest	125	22
Inventory	733	1,514
Credit card fees	310	180
Accrued expenses	\$ 103,990	\$ 96,127

Accumulated other comprehensive income (loss)

	September 30, 2016	December 31, 2015
Foreign currency translation adjustment	3	(1,656)
Unrealized gain (loss) on available-for sale securities	2	(21)
Accumulated other comprehensive income (loss)	\$ 5	\$ (1,677)

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Note 3. Supplemental Income Statement Account Information

Amounts included in revenues

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
USF fees	\$19,705	\$19,278	\$58,934	\$56,821
Disconnect fees, net of credits and bad debt	\$323	\$88	\$1,333	\$450
Initial activation fees	\$137	\$184	\$447	\$592
Customer equipment rental	\$1,291	\$945	\$3,572	\$2,627
Customer equipment fees	\$2,249	\$1,635	\$6,035	\$4,159
Equipment recovery fees	\$15	\$24	\$59	\$56
Shipping and handling fees	\$710	\$638	\$1,889	\$1,862

Amount included in cost of services

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
USF costs	\$19,705	\$19,288	\$58,934	\$56,831

Amount included in cost of goods sold

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Shipping and handling cost	\$1,443	\$1,382	\$4,212	\$3,941

Amount included in sales and marketing

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Advertising costs	\$18,765	\$24,999	\$55,723	\$79,827

Table of Contents

VONAGE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Amounts included in general and administrative expense

Three Months Ended		Nine Months Ended
September 30, 2016	2015	September 30, 2016