VONAGE HOLDINGS CORP
Form 10-Q
October 27, 2016
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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 September 30, 2016
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 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	x	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

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	October 21, 2016
Common Stock, par value $0.001		217,957,324 shares

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Part I. 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.

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Part I – Financial Information

Item 1. Financial Statements
VONAGE HOLDINGS CORP.
CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)

Assets	September 30, 2016 (unaudited)	December 31, 2015
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

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.

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

	Three Months Ended September 30,		Nine Months Ended 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.

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

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

VONAGE 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:		

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.

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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.

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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 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, 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;

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.

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.

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 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.

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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.

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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.

(In thousands, except per share amounts)

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.

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.

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

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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 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. The adoption of ASU 2015-11 will not have a material impact on our consolidated financial statements and related disclosures.

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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

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Debt related costs, net

	September 30, 2016	December 31, 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, 2016	December 31, 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, 2016	December 31, 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

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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)

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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

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Amounts included in general and administrative expense

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Acquisition related transaction costs	$(68)	$1,854	$5,082	$2,514
Change in contingent consideration	$(7,362)	$—	$(7,362)	$—
Organizational transformation	$2,435	$—	$2,435	$—
Acquisition related integration costs	$—	$—	$—	$25
Acquisition related consideration accounted for as compensation	$6,655	$—	$9,967	$—

Depreciation and amortization expense

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Network equipment and computer hardware	$3,798	$3,144	$11,538	$9,092
Software	2,530	3,227	7,850	9,559
Capital leases	550	550	1,650	1,650
Other leasehold improvements	1,367	1,345	4,073	3,836
Customer premise equipment	678	578	1,956	1,543
Furniture	277	107	652	299
Vehicles	18	18	54	51
Patents	682	436	2,046	1,058
Trademarks	—	18	18	54
Customer relationships	4,126	2,626	12,903	7,083
Acquired technology	3,431	3,044	9,186	8,761
Trade names	175	30	351	80
Non-compete agreements	342	323	870	787
	17,974	15,446	53,147	43,853
Property and equipment impairments	44	—	68	1
Software impairments	—	—	—	—
Depreciation and amortization expense	$18,018	$15,446	$53,215	$43,854

Amount included in interest expense

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

Debt related costs amortization	$283	$279	$800	$743

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Amount included in other income (expense), net

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net loss resulting from foreign exchange transactions	$(497)	$(59)	$(246)	$(613)

Note 4. Long-Term Note and Revolving Credit Facility

A schedule of long-term note and revolving credit facility at September 30, 2016 and December 31, 2015 is as follows:

	September 30, 2016	December 31, 2015
2.50-3.00% Term note - due 2019, net of debt related costs	—	76,392
2.50-3.00% Revolving credit facility - due 2019	—	119,000
2.50-3.25% Term note - due 2020, net of debt related costs	95,702	—
2.50-3.25% Revolving credit facility - due 2020	229,000	—
Total Long-term note and revolving credit facility	$ 324,702	$ 195,392

At September 30, 2016, future payments under term note obligations over each of the next five years and thereafter were as follows:

	Term Note
2016	$4,687
2017	18,750
2018	18,750
2019	18,750
2020	54,688
Minimum future payments of principal	115,625
Less: unamortized debt related costs	1,173
current portion	18,750
Long-term portion	$95,702

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 $125,000 term note and a $325,000 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. The lenders under the 2016 Credit Facility are JPMorgan Chase Bank, N.A., Citizens Bank, N.A., Fifth Third Bank, MUFG Union Bank, N.A., Silicon Valley Bank, SunTrust Bank, Keybank National Association, Santander Bank, N.A., Capital One National Association, and First Niagara Bank, N.A. J.P. Morgan Securities LLC and Citizens Bank, N.A. acted as joint lead bookrunners, and J.P. Morgan Securities LLC, Citizens Bank, N.A., Fifth Third Bank, MUFG Union Bank, N.A., Silicon Valley Bank, and SunTrust Robinson Humphrey Inc. acted as joint lead arrangers.

Use of Proceeds

We used $197,750 of the net available proceeds of the 2016 Credit Facility to retire all of the debt under our 2015 Credit Facility. We used $179,000 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

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corporate purposes. We also incurred fees of $1,316 in connection with the 2016 Credit Facility, of which $395 was allocated to the term note and $921 was allocated to the revolving credit facility. The unamortized fees of $2,740 in connection with the 2015 Credit Facility were allocated as follows: $930 to the term note and $1,810 to the revolving credit facility. In adopting ASU 2015-03, fees allocated to the term note were reported in the balance sheet as a direct deduction from the face amount of the liability and in adopting ASU 2015-15, fees allocated to the revolving credit facility were reported in the balance sheet as an asset. These fees are amortized to interest expenses over the life of the debt using the effective interest method for the term note and straight line method for the revolving credit facility.

Repayments

We made mandatory repayments of $9,375 under the term note for the nine months ended September 30, 2016. In addition, we repaid the $25,000 outstanding under the revolving credit facility for the nine months ended September 30, 2016.

2016 Credit Facility Terms

The following description summarizes the material terms of the 2016 Credit Facility:

The loans under the 2016 Credit Facility mature in June 2020. Principal amounts under the 2016 Credit Facility are repayable in quarterly installments of approximately $4,688 for the term note. The unused portion of our revolving credit facility incurs a 0.45% commitment fee. Such commitment fee will be reduced to 0.40% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00 and less than 2.50 to 1.00, 0.375% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and to 0.35% if our consolidated leverage ratio is less than 0.75 to 1.00.

Outstanding amounts under the 2016 Credit Facility, at our option, will bear interest at:

- LIBOR (applicable to one-, two-, three-, six-, or twelve-month periods) plus an applicable margin equal to 2.50% if our consolidated leverage ratio is less than 0.75 to 1.00, 2.75% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, 3.00% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00 and less than 2.5 to 1.00, and 3.25% if our consolidated leverage ratio is greater than or equal to 2.50 to 1.00, payable on the last day of each relevant interest period or, if the interest period is longer than three months, each day that is three months after the first day of the interest period, or
- the base rate determined by reference to the highest of (a) the prime rate of JPMorgan Chase Bank, N.A., (b) the federal funds effective rate from time to time plus 0.50%, and (c) the adjusted LIBO rate applicable to one month interest periods plus 1.00%, plus an applicable margin equal to 1.50% if our consolidated leverage ratio is less than 0.75 to 1.00, 1.75% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, 2.00% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00 and less than 2.50 to 1.00, and 2.25% if our consolidated leverage ratio is greater than or equal to 2.5 to 1.00, payable on the last business day of each March, June, September, and December and the maturity date of the 2016 Credit Facility.

The 2016 Credit Facility provides greater flexibility to us in funding acquisitions and restricted payments, such as stock buybacks, than did the 2015 Credit Facility.

We may prepay the 2016 Credit Facility at our option at any time without premium or penalty. The 2016 Credit Facility is subject to mandatory prepayments in amounts equal to:

- 100% of the net cash proceeds from any non-ordinary course sale or other disposition of our property and assets for consideration in excess of a certain amount subject to customary reinvestment provisions and certain other exceptions and
- 100% of the net cash proceeds received in connection with other non-ordinary course transactions, including insurance proceeds not otherwise applied to the relevant insurance loss.

Subject to certain restrictions and exceptions, the 2016 Credit Facility permits us to obtain one or more incremental term notes and/or revolving credit facilities in an aggregate principal amount of up to $100,000 plus an amount equal to repayments of the term note upon providing documentation reasonably satisfactory to the administrative agent. The 2016 Credit Facility includes customary representations and warranties and affirmative covenants of the borrowers. In addition, the 2016 Credit Facility contains customary negative covenants, including, among other things, restrictions on the ability of us and our subsidiaries to consolidate or merge, create liens, incur additional indebtedness, dispose of assets, consummate acquisitions, make investments, and pay dividends and other distributions. We must also comply with the following financial covenants:

- a consolidated leverage ratio of no greater than 3.25 to 1.00 as of the end of the fiscal quarter of Holdings ending June 30, 2016 and for each of the three consecutive fiscal quarters ending immediately thereafter; and a consolidated

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leverage ratio of no less than 2.75 to 1.00 as of the end of any fiscal quarter of Holdings, commencing with the fiscal quarter ending June 30, 2017, with a limited step-up to 3.25 to 1.00 for a period of four consecutive quarters, in connection with an acquisition;

- a consolidated fixed coverage charge ratio of no less than 1.75 to 1.00 subject to adjustment to exclude up to $80,000 million in specified restricted payments;
- minimum cash of $25,000 including the unused portion of the revolving credit facility; and
- maximum capital expenditures not to exceed $55,000 during any fiscal year, provided that the unused amount of any permitted capital expenditures in any fiscal year may be carried forward to the next following fiscal year.

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

As of September 30, 2016, we were in compliance with all covenants, including financial covenants, for the 2016 Credit Facility.

The 2016 Credit Facility contains customary events of default that may permit acceleration of the debt. During the continuance of a payment default, interest will accrue on overdue amounts at a default interest rate of 2% above the interest rate which would otherwise be applicable, in the case of loans, and at a rate equal to the rate applicable to base rate loans plus 2%, in the case of all other amounts.

2015 Financing

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

Use of Proceeds

We used $167,000 of the net available proceeds of the 2015 Credit Facility to retire all of the debt under our 2014 Credit Facility. Remaining proceeds from the term note and the undrawn revolving credit facility under the 2015 Credit Facility were used for general corporate purposes. We also incurred fees of $2,007 in connection with the 2015 Credit Facility, of which $602 was allocated to the term note and $1,405 was allocated to the revolving credit facility. The unamortized fees of $1,628 in connection with the 2014 Credit Facility were allocated as follows: $733 to the term note and $895 to the revolving credit facility. In adopting ASU 2015-03, fees allocated to the term note were reported in the balance sheet as a direct deduction from the face amount of the liability and in adopting ASU ASU 2015-15, fees allocated to the revolving credit facility were reported in the balance sheet as as asset. These fees are amortized to interest expenses over the life of the debt using the effective interest method for the term note and straight line method for the revolving credit facility. We used $82,000 from our 2015 revolving credit facility in connection with the acquisition of iCore on August 31, 2015.

Repayments

We made mandatory repayment of $3,750 under the term note for the nine months ended September 30, 2016 and $7,500 under the term note for the year ended December 31, 2015. In addition, we repaid the $10,000 outstanding

under the revolving credit facility for the nine months ended September 30, 2016 and $30,000 outstanding under the revolving credit facility for the year ended December 31, 2015.
2015 Credit Facility Terms
The following description summarizes the material terms of the 2015 Credit Facility:
The loans under the 2015 Credit Facility were to mature in July 2019. Principal amounts under the 2015 Credit Facility were repayable in quarterly installments of $3,750 for the term note. The unused portion of our revolving credit facility incurred a

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0.40% commitment fee. Such commitment fee reduced to 0.375% if our consolidated leverage ratio was greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00 and to 0.35% if our consolidated leverage ratio was less than 0.75 to 1.00.

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

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

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

We were able to prepay the 2015 Credit Facility at our option at any time without premium or penalty, and did so in connection with the 2016 Credit Facility. The 2015 Credit Facility was subject to mandatory prepayments in amounts equal to:

- 100% of the net cash proceeds from any non-ordinary course sale or other disposition of our property and assets for consideration in excess of a certain amount subject to customary reinvestment provisions and certain other exceptions and
- 100% of the net cash proceeds received in connection with other non-ordinary course transactions, including insurance proceeds not otherwise applied to the relevant insurance loss.

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

- a consolidated leverage ratio of no greater than 2.25 to 1.00, with a limited step-up to 2.75 to 1.00 for a period of four consecutive quarters, in connection with an acquisition made during the first two years of the 2015 Credit Facility;
- a consolidated fixed coverage charge ratio of no less than 1.75 to 1.00 subject to adjustment to exclude up to $80,000 million in specified restricted payments;
- minimum cash of $25,000 including the unused portion of the revolving credit facility; and
- maximum capital expenditures not to exceed $55,000 during any fiscal year, provided that the unused amount of any permitted capital expenditures in any fiscal year may be carried forward to the next following fiscal year.

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

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

2014 Financing

On August 13, 2014, we entered into a credit agreement (the “2014 Credit Facility”) consisting of a $100,000 term note and a $125,000 revolving credit facility. The co-borrowers under the 2014 Credit Facility were us and Vonage America Inc., our wholly owned subsidiary. Obligations under the 2014 Credit Facility were guaranteed, fully and unconditionally, by our other material United States subsidiaries and were secured by substantially all of the assets of each borrower and each guarantor. The lenders under the 2014 Credit Facility were JPMorgan Chase Bank, N.A., Citizens Bank, N.A., Silicon Valley Bank, SunTrust Bank, Fifth

Third Bank, Keybank National Association, and MUFG Union Bank, N.A. JPMorgan Chase Bank, N.A. was a party to the agreement as administrative agent, Citizens Bank, N.A. as syndication agent, and Silicon Valley Bank and SunTrust Bank as documentation agents. J.P. Morgan Securities LLC and Citizens Bank, N.A. acted as joint lead bookrunners, and J.P. Morgan Securities LLC, Citizens Bank, N.A., Silicon Valley Bank, and SunTrust Robinson Humphrey Inc. acted as joint lead arrangers. We used $20,000 and $67,000 from our 2014 revolving credit facility in connection with the acquisitions of Simple Signal on April 1, 2015 and Telesphere on December 15, 2014, respectively.

Use of Proceeds

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

Note 5. Common Stock

Net Operating Loss Rights Agreement

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

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

Under the Preservation Plan, preferred share purchase rights will work to impose significant dilution upon any person or group which acquires beneficial ownership of 4.9% or more of the outstanding common stock, without the approval of our board of directors, from and after June 7, 2012. Stockholders that own 4.9% or more of the outstanding common stock as of the opening of business on June 7, 2012, will not trigger the preferred share purchase rights so long as they do not (i) acquire additional shares of common stock or (ii) fall under 4.9% ownership of common stock and then re-acquire shares that in the aggregate equal 4.9% or more of the common stock.

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

Common Stock Repurchases

On July 25, 2012, our board of directors authorized a program to repurchase up to $50,000 of Vonage common stock (the "$50,000 repurchase program") through December 31, 2013. On February 7, 2013, our board of directors discontinued the remainder of the $50,000 repurchase program effective at the close of business on February 12, 2013 with $16,682 of availability remaining, and authorized a new program to repurchase up to $100,000 of Vonage common stock (the "2012 $100,000 repurchase program") by December 31, 2014. As of December 31, 2014, approximately $219 remained of our 2012 $100,000 repurchase program. The repurchase program expired on December 31, 2014.

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

Under the 2014 $100,000 repurchase program, the timing and amount of repurchases will be determined by management based on its evaluation of market conditions, the trading price of the stock and will vary based on available capital resources and other financial and operational performance, market conditions, securities law limitations, and other factors. Repurchases may be made in the open market or through private transactions from time to time. The repurchases will be made using available cash

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

We repurchased the following shares of common stock with cash resources under the 2014 $100,000 repurchase program during the three and three months ended September 30, 2016 and 2015:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Shares of common stock repurchased	—	372	7,400	3,320
Value of common stock repurchased	$ —	$ 1,821	$ 32,762	$ 15,195

As of September 30, 2016, $52,043 remained of our 2014 $100,000 repurchase program. The repurchase program expires on December 31, 2018 but may be suspended or discontinued at any time without notice.

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

Note 6. Commitments and Contingencies

Litigation

IP Matters

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

A request for reexamination of the validity of the ‘722 Patent was filed on September 12, 2012 by Cisco. Cisco’s request was granted on November 28, 2012. On March 24, 2014, the United States Patent and Trademark Office issued an Action Closing Prosecution, confirming its rejection of all claims of the ‘722 patent. Bear Creek’s November 14, 2014 appeal of that decision to the Patent Trial and Appeal Board was denied on December 29, 2015. Bear Creek appealed the Board’s decision to the United States Court of Appeals for the Federal Circuit. Briefing on the appeal is complete.

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 September 1, 2016, 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.

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 filed a Notice of Appeal to the Federal Circuit on July 18, 2016. AIP's opening brief is due December 15, 2016.

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 is due to the District Court by December 23, 2016.

From time to time, in addition to those identified above, 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 above noted matters and our inability to reasonably estimate the amount of loss or range of loss, it is possible that the resolution of one or more of these matters could have a material adverse effect on our consolidated financial position, cash flows or results of operations.

Regulation

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

Federal - Net Neutrality

Clear and enforceable net neutrality rules make it more difficult for broadband Internet service providers to block or discriminate against Vonage service. In addition, explicitly applying net neutrality rules to wireless broadband Internet service providers could create greater opportunities for VoIP applications that run on wireless broadband Internet service. In December

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

Federal - Lifeline Reform

On March 31, 2016, the FCC adopted an order modernizing the Lifeline program. The Lifeline program previously subsidized voice service for low-income customers and is one component of the federal universal service fund. The order refocuses the program to subsidize broadband. Increased adoption of broadband services expands the market for Vonage services. The order will also likely increase the overall size of the federal universal fund and lead to increased USF contribution levels for Vonage services subject to assessment for federal USF.

Federal - Rural Call Completion Issues

On February 7, 2013, the FCC released a Notice of Proposed Rulemaking (NPRM) on rural call completion issues. The NPRM proposed new detailed reporting requirements to gauge rural call completion performance. Rural carriers have argued that VoIP provider call completion performance to rural areas is generally poor. On October 28, 2013, the FCC adopted an order on rural call completion imposing new reporting obligations and restricting certain call signaling practices. The call signaling rules went into effect on January 31, 2014. We filed for extensions of the rules, which the FCC granted, and as of April 17, 2014, we were compliant with the FCC call signaling rules. The effective date for the reporting requirements was April 1, 2015. We could be subject to an FCC enforcement action in the future in the event the FCC took the position that our rural call completion performance is inadequate or we were not compliant with the FCC’s order.

Federal - Numbering Rights

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

Federal - Privacy Rules

On April 1, 2016, the FCC issued a Notice of Proposed Rulemaking (NPRM) that proposed the adoption of privacy rules for providers of broadband Internet access service and updating its rules for voice services to make them consistent with the proposed privacy rules for broadband Internet access services. In addition to regulating customer proprietary network information (CPNI), a category of information that the FCC has traditionally regulated for voice services, the FCC proposed to regulate use of customer personal information (PI), a broader set of information than CPNI, by broadband and voice service providers. Further, the NPRM would regulate voice and broadband provider privacy policies and data security practices, including imposing vicarious liability for vendors who handle PI and CPNI on behalf of a broadband or voice provider. Finally, the NPRM would impose another data breach reporting notification obligation on voice and broadband providers on top of existing state data breach notification requirements. The FCC is scheduled to vote on its proposed new privacy rules at its October 27, 2016 open meeting.

State Telecommunications Regulation

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

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

Stand-by Letters of Credit

We had stand-by letters of credit totaling $1,577 and $2,498, as of September 30, 2016 and December 31, 2015, respectively.

End-User Commitments

We are obligated to provide telephone services to our registered end-users. The costs related to the potential utilization of minutes sold are expensed as incurred. Our obligation to provide this service is dependent on the proper functioning of systems controlled by third-party service providers. We do not have a contractual service relationship with some of these providers.

Vendor Commitments

We have committed to purchase software license from a vendor. We have committed to pay this vendor approximately $100 in 2016 and $400 in 2017 and 2018, and $250 in 2019, respectively.

We have committed to purchase carrier operation services from a vendor. We have committed to pay this vendor approximately $1,900 in 2017, 2018, and 2019, respectively.

We have committed to lease a co-location facility from a vendor. We have committed to pay this vendor approximately $300 in 2016 and $1,300 in 2017 and 2018, and $500 in 2019, respectively.

We have committed to purchase efax service from a vendor. We have committed to pay this vendor approximately $300 in 2016 and $1,200 in 2017, and $800 in 2018, respectively.

State and Municipal Taxes

In accordance with generally accepted accounting principles, we make a provision for a liability for taxes when it is both probable that a liability has been incurred and the amount of the liability or range of liability can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. For a period of time, we did not collect or remit state or municipal taxes (such as sales, excise, utility, use, and ad valorem taxes), fees or surcharges ("Taxes") on the charges to our customers for our services, except that we historically complied with the New Jersey sales tax. We have received inquiries or demands from a number of state and municipal taxing and 911 agencies seeking payment of Taxes that are applied to or collected from customers of providers of traditional public switched telephone network services. Although we have consistently maintained that these Taxes do not apply to our service for a variety of reasons depending on the statute or rule that establishes such obligations, we are now collecting and remitting sales taxes in certain of those states including a number of states that have changed their statutes to expressly include VoIP. In addition, many states address how VoIP providers should contribute to support public safety agencies, and in those states we remit fees to the appropriate state agencies. We could also be contacted by state or municipal taxing and 911 agencies regarding Taxes that do explicitly apply to VoIP and these agencies could seek retroactive payment of Taxes. As such, we have a reserve of $1,763 as of September 30, 2016 as our best estimate of the potential tax exposure for any retroactive assessment. We believe the maximum estimated exposure for retroactive assessments is approximately $2,600 as of September 30, 2016.

(In thousands, except per share amounts)

Note 7. Noncontrolling Interest and Redeemable Noncontrolling Interest

In the third quarter of 2013, we formed a consolidated foreign subsidiary in Brazil in connection with our previously announced joint venture in Brazil, which created a redeemable noncontrolling interest. The redeemable noncontrolling interest consisted of the 30.0% interest in this subsidiary initially held by our joint venture partner.

In 2014, our joint venture partner did not make required capital calls and correspondingly its interest was diluted to 4% and was no longer contingently redeemable. As such, we reclassified the redeemable noncontrolling interest previously included in the mezzanine section of our Consolidated Balance Sheets to noncontrolling interest in the Stockholders' Equity section of our Consolidated Balance Sheets.

In December 2014, we announced plans to exit the Brazilian market for consumer telephony services and wind down our joint venture operations in the country. We completed the process at the end of the first quarter of 2015.

We expect to avoid material operating losses in Brazil in 2016 due to the significant planned incremental investment that would have been required to scale the business. In connection with the wind down, we incurred approximately $500 in cash charges in 2015 related to contract terminations and severance-related expenses.

Note 8. Discontinued Operations

On March 31, 2015, the Company completed its previously announced exit from the Brazilian market for consumer telephony services and the associated wind down of its joint venture operations in the country. In 2015, the Company incurred a loss on disposal of $824. The loss on disposal is comprised of the write-off of noncontrolling interest of $907, foreign currency loss on intercompany loan forgiveness of $783, and residual cumulative translation of $192, partially offset by a tax benefit of $1,058.

The results of operations of this discontinued operation are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues	$ —	$ —	$ —	$ 33
Operating expenses	—	—	—	1,648
Loss from discontinued operations	—	—	—	(1,615)
Loss on disposal, net of taxes	—	—	—	(824)
Net loss from discontinued operations	—	—	—	(2,439)
Plus: Net loss from discontinued operations attributable to noncontrolling interest	$ —	$ —	$ —	$ 59
Net loss from discontinued operations attributable to Vonage	$ —	$ —	$ —	$ (2,380)

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VONAGE HOLDINGS CORP.
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Note 9. Acquisition of Business
Acquisition of Nexmo
Nexmo is a global leader in the Communications-Platform-as-a-Service (“CPaaS”) segment of the cloud communications market. Nexmo provides 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.
Pursuant to the Agreement and Plan of Merger dated May 5, 2016, by and among the Company, Neptune Acquisition Corp., a Delaware corporation and newly formed indirect, wholly owned subsidiary of Vonage (“Merger Sub”), Nexmo, a Delaware corporation, and Shareholder Representative Services LLC, a Colorado limited liability company, as representative of the security holders of Nexmo, on June 3, 2016, Merger Sub, on the terms and subject to the conditions thereof, merged with and into Nexmo, and Nexmo became a wholly owned indirect subsidiary of Vonage. On June 2, 2016, Vonage, Merger Sub, Nexmo and the Representative entered into Amendment No. 1 to the Merger Agreement (the “ Amendment”). The Amendment amends the Merger Agreement to, among other things, (1) increase the purchase price payable to the Nexmo securityholders by the amount of unrestricted cash and cash equivalents of Nexmo in lieu of the declaration of a dividend or other distribution of such unrestricted cash and cash equivalents to the Nexmo securityholders, (2) clarify the treatment of enterprise management incentive options issued by Nexmo to certain of its employees located in the United Kingdom, and (3) add certain technical provisions with respect to deposits made to the escrow agent and the exchange agent in connection with the closing of the transactions contemplated by the Merger Agreement.
Under the agreement, Nexmo shareholders will receive consideration of $231,122, with an additional earn-out opportunity (the "contingent consideration") of up to $20,000 contingent upon Nexmo achieving certain performance targets. Of the consideration, $194,684 (net of cash acquired of $16,094) was paid at close, consisting of $163,093 of cash (net of $16,094 of cash acquired) and 6,823 in shares of Vonage common stock valued at $31,591. The remaining $36,438 of the $231,122 purchase price is in the form of restricted cash, restricted stock and options held by Nexmo management and employees (the "Employee Payout Amount"), subject to vesting requirements over time and to be amortized to compensation expense quarterly until vested. We financed the transaction with $179,000 from our 2016 Credit Facility. The purchase price is subject to adjustments pursuant to the merger agreement for closing cash and working capital of Nexmo, reductions for indebtedness and transaction expenses of Nexmo that remained unpaid as of closing, and escrow fund deposits. The aggregate consideration will be allocated among Nexmo equityholders.
The consideration was allocated to acquisition cost as follows:

Cash paid at closing (inclusive of cash acquired of $16,094)	$179,186
Stock paid at closing	31,591
Contingent consideration (described below)	16,472
Employee Payout Amount (described below)	4,779
Acquisition Cost	$232,028

In addition, 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 is $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.
In addition, Nexmo management and employees may earn an Employee Payout Amount of $36,438 attributable to restricted cash, restricted stock and assumed options, of which $4,779 is included in acquisition cost as service had been provided pre-acquisition and $31,659 will be recorded as post-acquisition expense assuming all amounts vest, of which $31,087 will be recorded as compensation expense and $572 will be recorded as interest expense as continued employment is a condition of receiving consideration.

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The post-acquisition expense will be recorded as follows:

	Restricted Stock	Restricted Cash	Assumed Options	Interest Expense	Total
2016	$ 7,380	$ 6,353	$ 2,700	$ 255	$ 16,688
2017	6,197	5,383	1,293	271	13,144
2018	661	620	424	46	1,751
2019	—	—	76	—	76
Total	$ 14,238	$ 12,356	$ 4,493	$ 572	$ 31,659

Pursuant to the merger agreement, $20,372 of the cash consideration and $5,081 of the stock consideration were placed in escrow for unknown liabilities that may have existed as of the acquisition date.
During 2016, we incurred approximately $5,000 in acquisition related transaction costs, which were recorded in general and administrative expense in the accompanying Consolidated Statements of Income.
The acquisition was accounted for using the acquisition method of accounting under which assets and liabilities of Nexmo were recorded at their respective fair values including an amount for goodwill representing the difference between the acquisition consideration and the fair value of the identifiable net assets. We do not expect any portion of this goodwill to be deductible for tax purposes. The goodwill attributable to the acquisition has been recorded as a non-current asset and is not amortized, but is subject to an annual review for impairment.
The acquisition price was allocated to the tangible and identified intangible assets acquired and liabilities assumed as of the closing date. The fair values assigned to identifiable intangible assets assumed were based on management's current estimates and assumptions and is considered preliminary. The estimated fair values of the identified current assets, property and equipment, software and other assets acquired and current liabilities assumed are also considered preliminary and are based on the most recent information available. We believe that the most recent information available provides a reasonable basis for assigning fair value, but we anticipate receiving additional information, and, as such, the provisional measurements of fair value set forth below are subject to change. We expect to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.
The table below summarizes the Nexmo assets acquired and liabilities assumed as of June 3, 2016:

	Estimated Fair Value
Assets	
Current assets:	
Cash and cash equivalents	$ 16,094
Accounts receivable	8,764
Prepaid expenses and other current assets	3,427
Total current assets	28,285
Property and equipment	757
Software, net	242
Intangible assets	101,770
Restricted cash	51
Total assets acquired	131,105
Liabilities	
Current liabilities:	
Accounts payable	1,841

Accrued expenses	8,080
Deferred revenue, current portion	1,735
Total current liabilities	11,656
Deferred tax liabilities, net, non-current	30,129
Total liabilities assumed	41,785
Net identifiable assets acquired	89,320
Goodwill	142,708
Total purchase price	$232,028

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The intangible assets as of the closing date of the acquisition included:

	Amount
Customer relationships	$85,900
Developed technologies	13,768
Non-compete agreements	972
Trade names	1,130
	$101,770

Indications of fair value of the intangible assets acquired in connection with the acquisition were determined using either the income, market or replacement cost methodologies. The intangible assets are being amortized over periods which reflect the pattern in which economic benefits of the assets are expected to be realized. The customer relationships are being amortized on an accelerated basis over an estimated useful life of twelve years, the developed technologies are being amortized on an accelerated basis over an estimated useful life of eight years, the non-compete agreements are being amortized on a straight-line basis over three years, and trade names are being amortized on a straight-line basis over two years.

In addition, we recorded a deferred tax liability of $36,408 related to the $101,770 of identified intangible assets that will be amortized for financial reporting purposes but not for tax purposes and a deferred tax asset of $6,279 related to NOLs.

The excess of purchase price over the fair value amounts assigned to the assets acquired and liabilities assumed represents the amount of goodwill resulting from the acquisition. We do not expect any portion of this goodwill to be deductible for tax purposes. The goodwill attributable to the acquisition has been recorded as a non-current asset and is not amortized, but is subject to an annual review for impairment. We believe the factors that contributed to goodwill include synergies that are specific to our consolidated business, the acquisition of a talented workforce that provides us with expertise in the small and medium business market, as well as other intangible assets that do not qualify for separate recognition.

Acquisition of iCore

Pursuant to the Agreement and Plan of Merger dated August 19, 2015 by and among the Company, Cirrus Acquisition Corp., a Delaware corporation and newly formed indirect, wholly owned subsidiary of Vonage (“Merger Sub”), iCore, and Stephen G. Canton, as representative of the security holders of iCore, on August 31, 2015, Merger Sub, on the terms and subject to the conditions thereof, merged with and into iCore, and iCore became a wholly owned indirect subsidiary of Vonage.

iCore provides cloud-based unified communications and collaboration services, delivering voice, video, and mobile communications solutions to business customers. iCore is a natural complement to our rapid growing UCaaS business and strengthens our national footprint.

We acquired iCore for $92,689 in cash consideration, subject to adjustments pursuant to the merger agreement for closing cash and working capital of iCore, reductions for indebtedness and transaction expenses of iCore that remained unpaid as of closing, and escrow fund deposits. We financed the transaction with $10,689 of cash and $82,000 from our 2015 revolving credit facility. The aggregate consideration was allocated among iCore equity holders.

Pursuant to the merger agreement, $9,200 of the cash consideration was placed in escrow for unknown liabilities that may have existed as of the acquisition date.

During 2015, we incurred $1,353 in acquisition related transaction costs, which were recorded in general and administrative expense in the accompanying Consolidated Statements of Income.

The results of operations of the iCore business and the estimated fair values of the assets acquired and liabilities assumed have been included in our consolidated financial statements since the date of the acquisition.

The acquisition was accounted for using the acquisition method of accounting under which assets and liabilities of iCore were recorded at their respective fair values including an amount for goodwill representing the difference between the acquisition consideration and the fair value of the identifiable net assets. We do not expect any portion of this goodwill to be deductible for tax purposes. The goodwill attributable to the acquisition has been recorded as a non-current asset and is not amortized, but is subject to an annual review for impairment.

The acquisition price was allocated to the tangible and identified intangible assets acquired and liabilities assumed as of the closing date. The fair values assigned to identifiable intangible assets assumed was based on management's estimates and assumptions. The estimated fair values of the identified current assets, property and equipment, software and other assets acquired and current liabilities assumed are finalized as of September 30, 2016.

(In thousands, except per share amounts)

The table below summarizes the iCore assets acquired and liabilities assumed as of August 31, 2015:

	Estimated Fair Value
Assets	
Current assets:	
Cash and cash equivalents	$ 1,014
Accounts receivable	1,492
Inventory	191
Prepaid expenses and other current assets	1,017
Total current assets	3,714
Property and equipment	4,437
Software	281
Intangible assets	38,064
Restricted cash	183
Other assets	195
Total assets acquired	46,874
Liabilities	
Current liabilities:	
Accounts payable	3,344
Accrued expenses	3,979
Deferred revenue, current portion	576
Current maturities of capital lease obligations	557
Total current liabilities	8,456
Capital lease obligations, net of current maturities	552
Deferred tax liabilities, net, non-current	8,487
Total liabilities assumed	17,495
Net identifiable assets acquired	29,379
Goodwill	63,310
Total purchase price	$ 92,689

The intangible assets as of the closing date of the acquisition included:

	Amount
Customer relationships	$37,720
Non-compete agreements	104
Trade names	240
	$38,064

Indications of fair value of the intangible assets acquired in connection with the acquisition were determined using either the income, market or replacement cost methodologies. The intangible assets are being amortized over periods which reflect the pattern in which economic benefits of the assets are expected to be realized. The customer relationships are being amortized on an accelerated basis over an estimated useful life of ten years; and the

non-compete agreements and trade names are being amortized on a straight-line basis over two years.
In addition, we recorded a deferred tax liability of $12,944 related to the $38,064 of identified intangible assets that will be amortized for financial reporting purposes but not for tax purposes and a deferred tax asset of $4,457 related to NOLs.
The excess of purchase price over the fair value amounts assigned to the assets acquired and liabilities assumed represents the amount of goodwill resulting from the acquisition. We do not expect any portion of this goodwill to be deductible for tax purposes. The goodwill attributable to the acquisition has been recorded as a non-current asset and is not amortized, but is subject to an annual review for impairment. We believe the factors that contributed to goodwill include synergies that are specific to our

consolidated business, the acquisition of a talented workforce that provides us with expertise in the small and medium business market, as well as other intangible assets that do not qualify for separate recognition.

Acquisition of Simple Signal

Pursuant to the Agreement and Plan of Merger dated March 15, 2015 by and among Vonage Holdings Corp., a Delaware corporation, Stratus Acquisition Corp., a California corporation and an indirect wholly owned subsidiary of Parent (“Merger Sub”), Simple Signal Inc., a California corporation (“Simple Signal”) and Simplerep, LLC, a Colorado limited liability company, as representative of the security holders of Simple Signal, on April 1, 2015, Merger Sub merged with and into Simple Signal, and Simple Signal became a wholly owned indirect subsidiary of Vonage. Simple Signal provides cloud-based unified communications and collaboration services, delivering voice, video, and mobile communications solutions to business customers. Simple Signal is a natural complement to our expanding UCaaS business.

We acquired Simple Signal for $25,578, including 1,111 shares of Vonage common stock (which shares had an aggregate value of approximately $5,578 based upon the closing stock price on April 1, 2015) and cash consideration of $20,000, subject to adjustments pursuant to the merger agreement for closing cash and working capital of Simple Signal, reductions for indebtedness and transaction expenses of Simple Signal that remained unpaid as of closing, and escrow fund deposits. We financed the transaction with $20,000 from our 2014 revolving credit facility. The aggregate consideration was allocated among Simple Signal equityholders.

Pursuant to the merger agreement, $2,356 of the cash consideration and $1,144 of the stock consideration was placed in escrow for unknown liabilities that may have existed as of the acquisition date.

During 2015, we incurred $470 in acquisition related transaction costs, which were recorded in general and administrative expense in the accompanying Consolidated Statements of Income.

The results of operations of the Simple Signal business and the estimated fair values of the assets acquired and liabilities assumed have been included in our consolidated financial statements since the date of the acquisition.

The acquisition was accounted for using the acquisition method of accounting under which assets and liabilities of Simple Signal were recorded at their respective fair values including an amount for goodwill representing the difference between the acquisition consideration and the fair value of the identifiable net assets. We do not expect any portion of this goodwill to be deductible for tax purposes. The goodwill attributable to the acquisition has been recorded as a non-current asset and is not amortized, but is subject to an annual review for impairment.

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The table below summarizes the Simple Signal assets acquired and liabilities assumed as of April 1, 2015:

	Estimated Fair Value
Assets	
Current assets:	
Cash and cash equivalents	$ 53
Accounts receivable	832
Inventory	67
Prepaid expenses and other current assets	143
Total current assets	1,095
Property and equipment	979
Software	401
Intangible assets	6,407
Deferred tax assets, non-current	741
Total assets acquired	9,623
Liabilities	
Current liabilities:	
Accounts payable	785
Accrued expenses	593
Deferred revenue, current portion	370
Total current liabilities	1,748
Total liabilities assumed	1,748
Net identifiable assets acquired	7,875
Goodwill	17,703
Total purchase price	$ 25,578

The intangible assets as of the closing date of the acquisition included:

	Amount
Customer relationships	$ 5,090
Developed technologies	994
Non-compete agreements	303
Trade names	20
	$ 6,407

Indications of fair value of the intangible assets acquired in connection with the acquisition were determined using either the income, market or replacement cost methodologies. The intangible assets are being amortized over periods which reflect the pattern in which economic benefits of the assets are expected to be realized. The customer relationships are being amortized on an accelerated basis over an estimated useful life of ten years; developed technology is being amortized on an accelerated basis over an estimated useful life of eight years; and the non-compete agreements and trade names are being amortized on a straight-line basis over two years.
In addition, we recorded a net deferred tax liability of $2,441 related to the $6,407 of identified intangible assets that will be amortized for financial reporting purposes but not for tax purposes and a deferred tax asset of $3,182 related to NOLs.

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(In thousands, except per share amounts)

Pro forma financial information

The following unaudited supplemental pro forma information presents the combined historical results of operations of Vonage and Nexmo for the nine months ended September 30, 2016 and September 30, 2015, as if the Acquisitions had been completed at January 1, 2015.

	Nine Months Ended September 30,	
	2016	2015
Revenue	$743,083	$709,744
Net income attributable to Vonage	$12,718	$6,998
Net income attributable to Vonage per share - basic	$0.06	$0.03
Net income attributable to Vonage per share - diluted	$0.05	$0.03

The pro forma financial information includes certain adjustments to reflect expenses in the appropriate pro forma periods as though the companies were combined as of the beginning of 2015. These adjustments include:

- a decrease in income tax expense of $3,317 and $9,242 for the nine months ended September 30, 2016 and September 30, 2015, respectively, related to pro forma adjustments and Nexmo's results prior to acquisition;
- the exclusion of our acquisition-related expenses of $5,869 for the nine months ended September 30, 2016;
- a decrease in general and administrative expense attributable to acquisition related consideration accounted for as compensation of $7,414, offset by a change in the contingent consideration of $7,362, for the nine months ended September 30, 2016 and an increase in general and administrative expense attributable to acquisition related consideration accounted for as compensation of $2,310 for the nine months ended September 30, 2015;
- an increase in interest expense of $2,591 and $5,255 for the nine months ended September 30, 2016 and September 30, 2015, respectively, associated with borrowings under our revolving line of credit; and
- an increase in amortization expense of $6,620 and $6,200 for the nine months ended September 30, 2016 and September 30, 2015, respectively, related to the identified intangible assets of Nexmo.

The Company recorded revenue of $31,607 and net loss of $5,398 attributable to Nexmo for the nine months ended September 30, 2016.

Goodwill

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

Balance at December 31, 2015	$222,106
Increase in goodwill related to acquisition of iCore	16
Increase in goodwill related to acquisition of Simple Signal	16
Increase in goodwill related acquisition of Nexmo	142,708
Currency translation adjustments	1,663
Balance at September 30, 2016	$366,509

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion together with our consolidated financial statements and the related notes included elsewhere in this Form 10-Q and our audited financial statements included in our Annual Report on Form 10-K. This discussion contains forward-looking statements. These forward-looking statements are based on information available at the time the statements are made and/or management's belief as of that time with respect to future events and involve risks and uncertainties that could cause actual results and outcomes to be materially different. Important factors that could cause such differences include but are not limited to: the competition we face; the expansion of competition in the unified communications market; our ability to adapt to rapid changes in the market for voice and messaging services; risks associated with the market for CPaaS products and services; our ability to retain customers and attract new customers, including in a cost effective manner; the risk associated with developing and maintaining effective internal sales teams; the risk associated with developing and maintaining effective distribution channels; risks related to the acquisition or integration of future businesses; security breaches and other compromises of information security; risks associated with sales of our UCaaS services to medium-sized and enterprise customers; our dependence on third party facilities, equipment, systems and services; system disruptions or flaws in our technology and systems; our ability to scale our business and grow efficiently; risks associated with our third-party vendor cloud infrastructure; our reliance on third party hardware and software; our dependence on third party vendors; the impact of fluctuations in economic conditions, particularly on our small and medium business customers; our ability to obtain or maintain relevant intellectual property licenses; intellectual property and other litigation that have been and may be brought against us; failure to protect our trademarks and internally developed software; obligations and restrictions associated with data privacy; uncertainties relating to regulation of VoIP and CPaaS services; results of regulatory inquiries into our business practices; customer misuse of our CPaaS products; the impact of export controls and economic sanctions regulations; fraudulent use of our name or services; our ability to establish and expand strategic alliances; risks associated with operating abroad; liability under anti-corruption laws; governmental regulation and taxes in our international operations; the impact of domestic and international tax regulations on our CPaaS products and services; our dependence upon key personnel; our dependence on our customers' existing broadband connections; restrictions in our debt agreements that may limit our operating flexibility; foreign currency fluctuations; our ability to obtain additional financing if required; any reinstatement of holdbacks by our vendors; our history of net losses and ability to achieve consistent profitability in the future; and other factors that are set forth in the "Risk Factors" in our Annual Report on Form 10-K, in our Quarterly Reports on Form 10-Q and in our Current Reports on Form 8-K. While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, and therefore, you should not rely on these forward-looking statements as representing our views as of any date subsequent to the date this Form 10-Q is filed with the Securities and Exchange Commission.

Financial Information Presentation

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

Overview

We are a leading provider of cloud communications services for businesses and consumers. We transform the way people work and businesses operate through a portfolio of 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. We also provide a robust suite of feature-rich residential communication solutions.

Business Services

For our business services customers, we provide innovative, cloud-based Unified Communications as a Service, or UCaaS, solutions, comprised of integrated voice, text, video, data, collaboration, and mobile applications over our flexible, scalable Session Initiation Protocol (SIP) based Voice over Internet Protocol, or VoIP, network. Our products and services permit these customers to communicate with their customers and employees through any cloud-connected device, in any place, at any time without the often costly investment required with on-site equipment.

We have a robust set of product families tailored to serve the full range of the business market, including the small and medium business, or SMB, mid-market, and enterprise segments. We provide customers with multiple deployment options, designed to provide the reliability and quality of service they demand. Through our cloud-based middleware solution, gUnify, we provide customers the ability to integrate our cloud communications platform with many SaaS business applications, including Google for Work, Zendesk, Salesforce's Sales Cloud, Clio, and other CRM solutions.

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

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

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

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

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

Through our Nexmo subsidiary, 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.

Consumer Services

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

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

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

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

For both our North American and international customers we provide mobile capability through our patented Vonage Extensions mobile app. Our mobile applications enable consumer services customers to make and receive phone calls on their

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mobile devices from anywhere they have a Wi-Fi or cellular data connection. Our customers have found value in our ability to deliver high-quality voice solutions coupled with useful features and services.

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

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

Services outside of the United States. We currently have UCaaS and consumer operations in the United States, United Kingdom, and Canada and believe that our low-cost Internet based communications platform enables us to cost effectively deliver voice and messaging services to other locations throughout the world.

Through Nexmo, we have operations in the United States, United Kingdom, Hong Kong, and Singapore, and provide CPaaS solutions to our customers located in many countries around the world.

We had approximately 2.4 million combined consumer subscriber lines and business seats as of September 30, 2016, of which 93% were in the United States. We also have customers in Canada and the United Kingdom.

Trends

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

Competitive landscape. We face intense competition from traditional telephone companies, wireless companies, cable companies, and alternative communication providers. Most traditional wireline and wireless telephone service providers and cable companies are substantially larger and better capitalized than we are and have the advantage of a large existing customer base. In addition, because our competitors provide other services, they often choose to offer VoIP services or other voice services as part of a bundle that includes other products, such as video, high speed Internet access, and wireless telephone service, which we do not offer. In addition, such competitors may in the future require new customers or existing customers making changes to their service to purchase voice services when purchasing high speed Internet access. Further, as wireless providers offer more minutes at lower prices, better coverage, and companion landline alternative services, their services have become more attractive to households as a replacement for wireline service. We also compete against alternative communication providers, such as magicJack, Skype, and Google Voice. Some of these service providers have chosen to sacrifice telephony revenue in order to gain market share and have offered their services at low prices or for free. As we continue to introduce applications that integrate different forms of voice and messaging services over multiple devices, we are facing competition from emerging competitors focused on similar integration, as well as from alternative voice communication providers. In addition, our competitors have partnered and may in the future partner with other competitors to offer products and services, leveraging their collective competitive positions. We also are subject to the risk of future disruptive technologies. In connection with our emphasis on the international long distance market in the United States, we face competition from low-cost international calling cards and VoIP providers in addition to traditional telephone companies, cable companies, and wireless companies, each of which may implement promotional pricing targeting international long distance callers.

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

Regulation. Our business has developed in a relatively lightly regulated environment. The United States and other countries, however, are examining how VoIP services should be regulated. A November 2010 order by the FCC that permits states to impose state universal service fund obligations on VoIP service, discussed in Note 6 to our financial statements, is an example of efforts

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by regulators to determine how VoIP service fits into the telecommunications regulatory landscape. In addition to regulatory matters that directly address VoIP, a number of other regulatory initiatives could impact our business. One such regulatory initiative is net neutrality. In December 2010, the FCC adopted a revised set of net neutrality rules for broadband Internet service providers. These rules made it more difficult for broadband Internet service providers to block or discriminate against Vonage service. On January 14, 2014, the D.C. Circuit Court of Appeals vacated a significant portion of the 2010 rules. On May 15, 2014, the FCC issued a Notice of Proposed Rulemaking (NPRM) proposing new net neutrality rules. After public response to the NPRM, the FCC adopted new neutrality rules on February 26, 2015. Several parties have filed appeals which are pending at the D.C. Circuit Court of Appeals. Oral arguments at the D.C. Circuit Court of Appeals were held on December 4, 2015. 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. The petition is pending. See also the discussion under "Regulation" in Note 6 to our financial statements for a discussion of regulatory issues that impact us.

Key Operating Data

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

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

Consumer	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues	$142,050	$166,285	$443,017	$516,871
Average monthly revenues per subscriber line	$26.36	$27.38	$26.55	$27.72
Subscriber lines (at period end)	1,767,212	1,998,982	1,767,612	1,998,982
Customer churn	2.2 %	2.3 %	2.2 %	2.3 %

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

Average monthly revenues per subscriber line. Average monthly revenues per subscriber line for a particular period is calculated by dividing our revenues for that period by the simple average number of subscriber lines for the period, and dividing the result by the number of months in the period. The simple average number of subscriber lines for the period is the number of subscriber lines on the first day of the period, plus the number of subscriber lines on the last day of the period, divided by two. Our average monthly revenues per subscriber line decreased from $27.38 for the three months ended September 30, 2015 to $26.36 for the three months ended September 30, 2016 due primarily to new, lower, pricing structures implemented in 2015 and lower ILD pay-per-use revenue.

Subscriber lines. Our subscriber lines include, as of a particular date, all paid subscriber lines from which a customer can make an outbound telephone call on that date. Our subscriber lines include fax lines, including fax lines bundled with subscriber lines in our small office home office calling plans and soft phones, but do not include our virtual phone numbers and toll free numbers, which only allow inbound telephone calls to customers. Subscriber lines decreased from 1,998,982 as of September 30, 2015 to 1,767,212 as of September 30, 2016, reflecting planned actions to enhance the profitability of the assisted sales channel by eliminating lower performing locations and restructuring the pricing offers, and to shift investment to our business market.

Customer churn. Customer churn is calculated by dividing the number of customers that have terminated during a period by the simple average of number of customers in a given period. The simple average number of customers during the period is the number of customers on the first day of the period, plus the number of customers on the last day of the period, divided by two. Terminations, as used in the calculation of churn statistics, do not include customers terminated during the period if termination occurred within the first month after activation. Other companies may calculate customer churn differently, and their customer

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churn data may not be directly comparable to ours. Customer churn was 2.2% for the three months ended September 30, 2016, compared to 2.1% for the three months ended June 30, 2016 and 2.3% for the three months ended September 30, 2015. Customer churn decreased to 2.2% for the nine months ended September 30, 2016 from 2.3% for the nine months ended September 30, 2015. The decrease was due primarily to our decision to maximize customer value by focusing marketing spend on higher return channels and away from assisted selling channels which had higher early life churn. We monitor customer churn on a daily basis and use it as an indicator of the level of customer satisfaction. Customers who have been with us for a year or more tend to have a lower churn rate than customers who have not. In addition, our customers who are international callers generally churn at a lower rate than customers who are domestic callers. Our customer churn will fluctuate over time due to economic conditions, competitive pressures including promotional pricing targeting international long distance callers, marketplace perception of our services, and our ability to provide high quality customer care and network quality and add future innovative products and services. Customer churn differs from our previously reported average monthly customer churn in that our business customers are no longer included in this metric. See the discussion below for detail regarding churn impacting our business customers.

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

Business	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues (1)	$106,309	$57,075	$265,841	$148,077
Average monthly revenues per seat (2)	$45.50	$41.56	$44.96	$39.87
Seats (at period end) (2)	615,728	(3) 514,184	615,728	(3) 514,184
Revenue churn (2)	1.4 %	1.3 %	1.4 %	1.2 %

(1) Includes $23,909 and $31,607 of revenue from Nexmo, which was acquired on June 3, 2016, for the three and nine months ended September 30, 2016, respectively.

(2) Excludes impact of Nexmo, which was acquired on June 3, 2016.

(3) Seats (at period end) include an adjustment of 13,352 seats that were excluded from previously reported seats in the second quarter due to certain customers not being reflected in metrics report.

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

Average monthly revenues per seat. Average monthly revenues per seat for a particular period is calculated by dividing our revenues for that period by the simple average number of seats for the period, and dividing the result by the number of months in the period. The simple average number of seats for the period is the number of seats on the first day of the period, plus the number of seats on the last day of the period, divided by two. Our average monthly revenues per seat increased from $41.56 for the three months ended September 30, 2015 to $45.50 for the three months ended September 30, 2016 due to our successful acquisitions and subsequent organic growth in the mid-market and enterprise space starting last December.

Seats. Seats include, as of a particular date, all paid seats from which a customer can make an outbound telephone call on that date and virtual seats. Seats exclude electronic fax lines and toll free numbers, which do not allow outbound telephone calls by customers. Seats increased from 514,184 as of September 30, 2015 to 615,728 as of September 30, 2016. This increase is due to continued growth in our business customers as we have increased marketing investment to attract these more profitable customers. It also includes 35,256 seats existing at Simple Signal at the time of acquisition, and 86,309 seats existing at iCore at the time of acquisition, respectively.

Revenue churn. Revenue churn is calculated by dividing the monthly recurring revenue from customers that have terminated during a period by the simple average of the total monthly recurring revenue from all customers in a given period. The simple average of total monthly recurring revenue from all customers during the period is the total monthly recurring revenue on the first day of the period, plus the total monthly recurring revenue on the last day of the period, divided by two. Terminations, as used in the calculation of churn statistics, do not include customers terminated during the period if termination occurred within the first month after activation. Other companies may calculate revenue churn differently, and their revenue churn data may not be directly comparable to ours. Revenue churn was 1.4% for the three months ended September 30, 2016 and the three months ended June 30, 2016, respectively, and 1.3% for the three months ended September 30, 2015. Revenue churn was 1.4% for the nine months ended September 30, 2016 and 1.2% for the nine months ended September 30, 2015. Our revenue churn will fluctuate over time due to economic conditions, loss of customers who are acquired, and competitive pressures including promotional pricing. We are continuing to invest in our overall quality of service which includes customer care headcount and systems, billing systems, on-boarding processes and self-service options to ensure we scale our processes to our growth and continue to improve the overall customer experience.

Revenues

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

We derive most of our services revenue from monthly subscription fees that we charge our customers under our service plans. We also offer residential fax service, virtual phone numbers, toll free numbers and other services, and charge an additional monthly fee for each service. We automatically charge these fees to our customers' credit cards, debit cards, or electronic check payments ("ECP"), monthly in advance. We also automatically charge the per minute fees not included in our monthly subscription fees to our customers' credit cards, debit cards or ECP monthly in arrears unless they exceed a certain dollar threshold, in which case they are charged immediately.

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

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

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

Services revenue is offset by the cost of certain customer acquisition activities, such as rebates and promotions.

Customer equipment and shipping revenue consists of revenue from sales of customer equipment to our wholesalers or directly to customers and retailers. In addition, customer equipment and shipping revenues include revenues from the sale of VoIP telephones in order to access our small and medium business services. Customer equipment and shipping revenue also includes the fees, when collected, that we charge our customers for shipping any equipment to them.

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Operating Expenses

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

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

- Access charges that we pay to other companies to terminate domestic and international calls on the public switched telephone network, with a portion of these payments ultimately being made to incumbent telephone companies. When a Vonage subscriber calls another Vonage subscriber, we do not pay an access charge.
- The cost of leasing Internet transit services from multiple Internet service providers. This Internet connectivity is used to carry VoIP session initiation signaling and packetized audio media between our subscribers and our regional data centers.
- The cost of leasing from other companies the telephone numbers that we provide to our customers. We lease these telephone numbers on a monthly basis.
- The cost of co-locating our regional data connection point equipment in third-party facilities owned by other companies, Internet service providers or collocation facility providers.
- The cost of providing local number portability, which allows customers to move their existing telephone numbers from another provider to our service. Only regulated telecommunications providers have access to the centralized number databases that facilitate this process. Because we are not a regulated telecommunications provider, we must pay other telecommunications providers to process our local number portability requests.
- The cost of complying with FCC regulations regarding VoIP emergency services, which require us to provide enhanced emergency dialing capabilities to transmit 911 calls for our customers.
- Taxes that we pay on our purchase of telecommunications services from our suppliers or imposed by government agencies such as Federal USF and related fees.
- License fees for use of third party intellectual property.
- The personnel and related expenses of certain network operations and technical support employees and contractors.

Cost of goods sold. Cost of goods sold primarily consists of costs that we incur when a customer first subscribes to our service. These costs include:

- The cost of the equipment that we provide to residential customers who subscribe to our service through our direct sales channel in excess of activation fees when an activation fee is collected. Business customers' purchased equipment is recorded on a net basis. The remaining cost of customer equipment is deferred up to the activation fee collected and amortized over the estimated average customer life.
- The cost of the equipment that we sell directly to retailers.
- The cost of shipping and handling for customer equipment, together with the installation manual, that we ship to customers.
- The cost of certain products or services that we give customers as promotions.

Sales and marketing expense. Sales and marketing expense includes:

- Advertising costs, which comprise a majority of our sales and marketing expense and include online, television, direct mail, alternative media, promotions, sponsorships, and inbound and outbound telemarketing.
- Creative and production costs.
- The costs to serve and track our online advertising.
- Certain amounts we pay to retailers for activation commissions.
- The cost associated with our customer referral program.
- The personnel and related expenses of sales and marketing employees and contractors.
- Transaction fees paid to credit card, debit card, and ECP companies and other third party billers such as iTunes, which may include a per transaction charge in addition to a percent of billings charge.
- The cost of customer support and collections.

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- Systems and information technology support.

Engineering and development expense. Engineering and development expense includes:

- The personnel and related expenses of developers responsible for new products and software engineers maintaining and enhancing existing products.

General and administrative expense. General and administrative expense includes:

- Personnel and related costs for executive, legal, finance, and human resources employees and contractors.
- Share-based expense related to share-based awards to employees, directors, and consultants.
- Rent and related expenses.
- Professional fees for legal, accounting, tax, public relations, lobbying, and development activities.
- Acquisition related transaction and integration costs.
- Litigation settlements.

Depreciation and amortization expenses. Depreciation and amortization expenses include:

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

Other Income (Expense)

Other Income (Expense) includes:

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

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Results of Operations

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

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Revenues	100 %	100 %	100 %	100 %
Operating Expenses:				
Cost of service (excluding depreciation and amortization)	35	30	33	29
Cost of goods sold	4	4	4	4
Sales and marketing	34	39	35	39
Engineering and development	3	3	3	3
General and administrative	11	13	13	12
Depreciation and amortization	7	7	7	6
	94	96	95	93
Income from operations	6	4	5	7
Other Income (Expense):				
Interest income	—	—	—	—
Interest expense	(2)	(1)	(1)	(1)
Other income (expense), net	—	—	—	—
	(2)	(1)	(1)	(1)
Income from continuing operations before income tax expense	4	3	4	6
Income tax expense	—	(1)	(1)	(3)
Income from continuing operations	4	2	3	3
Loss from discontinued operations	—	—	—	—
Loss on disposal, net of taxes	—	—	—	—
Discontinued operations	—	—	—	—
Net income	4	2	3	3
Plus: Net loss from discontinued operations attributable to noncontrolling interest	—	—	—	—
Net income attributable to Vonage	4 %	2 %	3 %	3 %

Summary of Results for the Three Months Ended September 30, 2016 and September 30, 2015

Revenues, Cost of Service and Cost of Goods Sold

(in thousands, except percentages)	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Dollar Change	Percent Change	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015	Dollar Change	Percent Change
Revenues	$248,359	$223,360	$24,999	11 %	$708,858	$664,948	$43,910	7 %
Cost of service (1)	87,377	67,193	20,184	30 %	232,605	193,255	39,350	20 %
Cost of goods sold	8,591	8,206	385	5 %	26,009	25,613	396	2 %
	152,391	147,961	4,430	3 %	450,244	446,080	4,164	1 %

(1) Excludes depreciation and amortization of $7,460, $6,415, $21,278, and $18,144, respectively.

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Three Months Ended September 30, 2016 compared to Three Months Ended September 30, 2015

Revenues. Revenues increased $24,999, or 11%, as a result of growth in Business revenue of $49,234 due to an increase in the number of Business seats as we have shifted marketing investment to attract these more profitable customers and the impact of iCore, which was acquired on August 31, 2015, and the impact of Nexmo, which was acquired on June 3, 2016. This growth in Business revenue was offset by a decrease of $24,235 in Consumer revenue due to fewer subscriber lines reflecting planned actions to enhance profitability by modulating marketing spend, restructuring pricing offers, and targeting consumers with lower subscriber acquisition cost and churn profiles.

Cost of service. The increase in cost of service of $20,184, or 30%, was primarily driven by higher technical care costs and network operations cost in support of growth in Business customers including the addition of iCore and Nexmo, offset by a decrease in international usage costs.

Cost of goods sold. The increase in cost of goods sold of $385, or 5%, was primarily due to an increase in business customers' equipment costs of $1,446 due to higher new customer additions, offset by a decrease in consumer customers' equipment costs of $1,393 due to lower new customer additions.

Nine Months Ended September 30, 2016 compared to Nine Months Ended September 30, 2015

Revenues. Revenues increased $43,910, or 7%, as a result of growth in Business revenue of $117,764 due to an increase in the number of Business seats as we have shifted marketing investment to attract these more profitable customers and the impact of Simple Signal, which was acquired on April 1, 2015, the impact of iCore, which was acquired on August 31, 2015, and the impact of Nexmo, which was acquired on June 3, 2016. This growth in Business revenue was offset by a decrease of $73,854 in Consumer revenue due to fewer subscriber lines reflecting planned actions to enhance profitability by modulating marketing spend, restructuring pricing offers, and targeting consumers with lower subscriber acquisition cost and churn profiles.

Cost of service. The increase in cost of service of $39,350, or 20%, was primarily driven by higher technical care costs and network operations cost in support of growth in Business customers including the addition of Simple Signal, iCore and Nexmo, and higher USF and related fees imposed by government agencies, offset by a decrease in international usage costs.

Cost of goods sold. The increase in cost of goods sold of $396, or 2%, was primarily due to an increase in business customers' equipment costs of $4,476 due to higher new customer additions and higher installation costs of $657, offset by a decrease in consumer customers' equipment costs of $4,096 due to lower new customer additions and a decrease in reserve related to inventory of $765.

Sales and Marketing

(in thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
Sales and marketing	$83,731	$88,028	$(4,297)	(5)%	$246,676	$257,977	$(11,301)	(4)%

Three Months Ended September 30, 2016 compared to Three Months Ended September 30, 2015

Sales and marketing. Sales and marketing expense decreased by $4,297, or 5%, due to a reduction in Consumer marketing reflecting planned actions to enhance profitability by targeting consumers with lower subscriber acquisition cost and churn profiles, offset by an increase in Business marketing as we have shifted marketing investment to attract these more profitable customers and an increase from Nexmo which was acquired in June 2016.

Nine Months Ended September 30, 2016 compared to Nine Months Ended September 30, 2015

Sales and marketing. Sales and marketing expense decreased by $11,301, or 4%, due to a reduction in Consumer marketing reflecting planned actions to enhance profitability by targeting consumers with lower subscriber acquisition cost and churn profiles, offset by an increase in Business marketing as we have shifted marketing investment to attract these more profitable customers and an increase from iCore which was acquired in August 2015 and Nexmo which was acquired in June 2016.

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Engineering and Development

(in thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
Engineering and development	$8,075	$6,830	$1,245	18 %	$22,152	$20,299	$1,853	9 %

Three Months Ended September 30, 2016 compared to Three Months Ended September 30, 2015

Engineering and development. Engineering and development expense increased by $1,245, or 18%, due to incremental investment in new business products and services, and the acquisition of Nexmo in June, 2016.

Nine Months Ended September 30, 2016 compared to Nine Months Ended September 30, 2015

Engineering and development. Engineering and development expense increased by $1,853, or 9%, due to incremental investment in new business products and services, and the acquisition of Nexmo in June, 2016.

General and Administrative

(in thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
General and administrative	$27,538	$28,860	$(1,322)	(5)%	$89,261	$79,256	$10,005	13 %

Three Months Ended September 30, 2016 compared to Three Months Ended September 30, 2015

General and administrative. General and administrative expense decreased by $1,322, or 5%, primarily due to the reduction of Nexmo contingent consideration of $7,362, offset by the increase in merger consideration accounted for as compensation of $6,655.

Nine Months Ended September 30, 2016 compared to Nine Months Ended September 30, 2015

General and administrative. General and administrative expense increased by $10,005, or 13%, primarily due to the addition of Simple Signal, iCore and Nexmo, offset by the reduction of Nexmo contingent consideration of $7,362.

Depreciation and Amortization

(in thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
Depreciation and amortization	$18,018	$15,446	$2,572	17 %	$53,215	$43,854	$9,361	21 %

Three Months Ended September 30, 2016 compared to Three Months Ended September 30, 2015

Depreciation and amortization. The increase in depreciation and amortization of $2,572, or 17%, was primarily due to the amortization of acquisition-related intangibles from the acquisition of iCore in August 2015 and Nexmo in June 2016.

Nine Months Ended September 30, 2016 compared to Nine Months Ended September 30, 2015

Depreciation and amortization. The increase in depreciation and amortization of $9,361, or 21%, was primarily due to the amortization of acquisition-related intangibles from the acquisition of Simple Signal in April 2015, iCore in

August 2015, and Nexmo in June 2016.

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Other Income (Expense)

(in thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
Interest income	$19	$24	$(5)	(21)%	$65	$65	$—	— %
Interest expense	(3,974)	(2,222)	(1,752)	(79)%	(9,477)	(6,245)	(3,232)	(52)%
Other income (expense), net	(495)	(50)	(445)	(890)%	(237)	(595)	358	60 %
	$(4,450)	$(2,248)	$(2,202)		$(9,649)	$(6,775)	$(2,874)	

Three Months Ended September 30, 2016 compared to Three Months Ended September 30, 2015

Interest expense. The increase in interest expense of $1,752, or 79%, was due mainly to the funds we borrowed from the 2015 Credit Facility in August 2015 in connection with the acquisition of iCore and the funds we borrowed from the 2016 Credit Facility in June 2016 in connection with the acquisition of Nexmo.

Other income (expense), net. The decrease in other income (expense), net of $445, or (890)%, was due mainly to higher unrealized loss on foreign currency in 2016.

Nine Months Ended September 30, 2016 compared to Nine Months Ended September 30, 2015

Interest expense. The increase in interest expense of $3,232, or 52%, was due mainly to the funds we borrowed from the 2014 Credit Facility in April 2015 in connection with the acquisition of Simple Signal, the funds we borrowed from the 2015 Credit Facility in August 2015 in connection with the acquisition of iCore, and the funds we borrowed from the 2016 Credit Facility in June 2016 in connection with the acquisition of Nexmo.

Other income (expense), net. The increase in other income (expense), net of $358, or 60%, was due mainly to higher unrealized loss on foreign currency in 2015.

Provision for Income Taxes

(in thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
Income tax expense	$(1,501)	$(3,116)	$1,615	52 %	$(11,385)	$(16,290)	$4,905	30 %
Effective tax rate	14.2 %	47.6 %			38.9 %	43.0 %		

We recognize income tax expense equal to pre-tax income multiplied by our effective income tax rate. In addition, adjustments are recorded for discrete period items and changes to our state effective tax rate which can cause the rate to fluctuate from quarter to quarter. In the first quarter of 2016 a discrete period tax expense of $1,220 was recorded related to expired stock options which was partially offset by $389 which was recorded in the second quarter of 2016 and partially offset by $661 which was recorded in the third quarter of 2016. In addition, certain acquisition related expenses incurred in the second quarter of 2016 are treated as a permanent difference as the expenses are not deductible for tax purposes but are a reduction of pre-tax income. In the third quarter of 2016, the reduction in the value of our contingent consideration in connection with the acquisition of Nexmo was treated as a permanent difference resulting in a decrease in the effective tax rate for the three months ended September 30, 2016. In the first quarter of 2015 a discrete period tax benefit of $1,058 was recorded in discontinued operations related to the write-off of intercompany loans associated with the wind down of our joint venture in Brazil.

The provision also includes the federal alternative minimum tax and state and local income taxes.

The effective tax rate is calculated by dividing income tax expense by income before income tax expense. The 2016 estimated annual effective tax rate is expected to approximate 39%, but may fluctuate each quarter due to our foreign operations and certain discrete period transactions.

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Discontinued Operations Attributable to Vonage

(in thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
Loss from discontinued operations	$—	$—	$—	—%	$—	$(1,615)	$1,615	100 %
Loss on disposal, net of taxes	$—	$—	$—	—%	$—	$(824)	$824	100 %
Discontinued operations	$—	$—	$—	—	$—	$(2,439)	$2,439	
Loss from discontinued operations attributable to noncontrolling interest	$—	$—	$—	—%	$—	$59	$(59)	(100)%
Loss from discontinued operations attributable to Vonage	$—	$—	$—	—%	$—	$(2,380)	$2,380	100 %

Nine Months Ended September 30, 2016 compared to Nine Months Ended September 30, 2015

Discontinued operations attributable to Vonage. The 2015 loss from discontinued operations attributable to Vonage was for the operation loss from our discontinued Brazilian market.

Liquidity and Capital Resources

Overview

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

	Nine Months Ended September 30,	
	2016	2015
	(in thousands)	
Net cash provided by operating activities	$65,255	$83,626
Net cash used in investing activities	(187,897)	(138,283)
Net cash provided by financing activities	97,623	73,827

For the nine months ended September 30, 2016, we generated income from operations. We expect to continue to balance efforts to grow our revenue while consistently achieving operating profitability. To grow our revenue, we continue to make investments in growth initiatives, marketing, application development, network quality and expansion, and customer care. Although we believe we will achieve consistent profitability in the future, we ultimately may not be successful and we may not achieve consistent profitability. We believe that cash flow from operations and cash on hand will fund our operations for at least the next twelve months.

Acquisition of Nexmo

Nexmo was acquired on June 3, 2016. Nexmo shareholders are receiving consideration of $231,122, with an additional earn-out opportunity of up to $20,000 contingent upon Nexmo achieving certain performance targets. Of the consideration, $194,684 (net of cash acquired of $16,094) was paid at close, consisting of $163,093 of cash (net of $16,094 of cash acquired) and 6,823 in shares of Vonage common stock valued at $31,591. The remaining $36,438 of the $231,122 purchase price is in the form of restricted cash, restricted stock and options held by Nexmo management and employees, subject to vesting requirements over time. We financed the transaction with $179,000 from our 2016 Credit Facility.

Acquisition of iCore

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

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Acquisition of Simple Signal

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

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 $125,000 term note and a $325,000 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. The lenders under the 2016 Credit Facility are JPMorgan Chase Bank, N.A., Citizens Bank, N.A., Fifth Third Bank, MUFG Union Bank, N.A., Silicon Valley Bank, SunTrust Bank, Keybank National Association, Santander Bank, N.A., Capital One National Association, and First Niagara Bank, N.A. J.P. Morgan Securities LLC and Citizens Bank, N.A. acted as joint lead bookrunners, and J.P. Morgan Securities LLC, Citizens Bank, N.A., Fifth Third Bank, MUFG Union Bank, N.A., Silicon Valley Bank, and SunTrust Robinson Humphrey Inc. acted as joint lead arrangers.

Use of Proceeds

We used $197,750 of the net available proceeds of the 2016 Credit Facility to retire all of the debt under our 2015 Credit Facility. We used $179,000 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. We also incurred fees of $1,316 in connection with the 2016 Credit Facility, of which $395 was allocated to the term note and $921 was allocated to the revolving credit facility. The unamortized fees of $2,740 in connection with the 2015 Credit Facility were allocated as follows: $930 to the term note and $1,810 to the revolving credit facility. In adopting ASU 2015-03, fees allocated to the term note were reported in the balance sheet as a direct deduction from the face amount of the liability and in adopting ASU 2015-15, fees allocated to the revolving credit facility were reported in the balance sheet as as asset. These fees are amortized to interest expenses over the life of the debt using the effective interest method for the term note and straight line method for the revolving credit facility.

Repayments

We made mandatory repayment of $9,375 under the term note for the nine months ended September 30, 2016. In addition, we repaid the $25,000 outstanding under the revolving credit facility for the nine months ended September 30, 2016.

2016 Credit Facility Terms

The following description summarizes the material terms of the 2016 Credit Facility:

The loans under the 2016 Credit Facility mature in June 2020. Principal amounts under the 2016 Credit Facility are repayable in quarterly installments of approximately $4,688 for the term note. The unused portion of our revolving credit facility incurs a 0.45% commitment fee. Such commitment fee will be reduced to 0.40% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00 and less than 2.50 to 1.00, 0.375% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, and to 0.35% if our consolidated leverage ratio is less than 0.75 to 1.00.

Outstanding amounts under the 2016 Credit Facility, at our option, will bear interest at:

- LIBOR (applicable to one-, two-, three-, six-, or twelve-month periods) plus an applicable margin equal to 2.50% if our consolidated leverage ratio is less than 0.75 to 1.00, 2.75% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, 3.00% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00 and less than 2.5 to 1.00, and 3.25% if our consolidated leverage ratio is greater than or equal to 2.50 to 1.00, payable on the last day of each relevant interest period or, if the interest period is longer than three months, each day that is three months after the first day of the interest period, or
- the base rate determined by reference to the highest of (a) the prime rate of JPMorgan Chase Bank, N.A., (b) the federal funds effective rate from time to time plus 0.50%, and (c) the adjusted LIBO rate applicable to one month

interest periods plus 1.00%, plus an applicable margin equal to 1.50% if our consolidated leverage ratio is less than 0.75 to 1.00, 1.75% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, 2.00% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00 and less than 2.50 to 1.00, and 2.25% if our consolidated leverage ratio is greater than or equal to 2.5 to 1.00, payable on the last business day of each March, June, September, and December and the maturity date of the 2016 Credit Facility.

The 2016 Credit Facility provides greater flexibility to us in funding acquisitions and restricted payments, such as stock buybacks, than did the 2015 Credit Facility.

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We may prepay the 2016 Credit Facility at our option at any time without premium or penalty. The 2016 Credit Facility is subject to mandatory prepayments in amounts equal to:

- 100% of the net cash proceeds from any non-ordinary course sale or other disposition of our property and assets for consideration in excess of a certain amount subject to customary reinvestment provisions and certain other exceptions and
- 100% of the net cash proceeds received in connection with other non-ordinary course transactions, including insurance proceeds not otherwise applied to the relevant insurance loss.

Subject to certain restrictions and exceptions, the 2016 Credit Facility permits us to obtain one or more incremental term notes and/or revolving credit facilities in an aggregate principal amount of up to $100,000 plus an amount equal to repayments of the term note upon providing documentation reasonably satisfactory to the administrative agent. The 2016 Credit Facility includes customary representations and warranties and affirmative covenants of the borrowers. In addition, the 2016 Credit Facility contains customary negative covenants, including, among other things, restrictions on the ability of us and our subsidiaries to consolidate or merge, create liens, incur additional indebtedness, dispose of assets, consummate acquisitions, make investments, and pay dividends and other distributions. We must also comply with the following financial covenants:

- a consolidated leverage ratio of no greater than 3.25 to 1.00 as of the end of the fiscal quarter of Holdings ending June 30, 2016 and for each of the three consecutive fiscal quarters ending immediately thereafter; and a consolidated leverage ratio of no less than 2.75 to 1.00 as of the end of any fiscal quarter of Holdings, commencing with the fiscal quarter ending June 30, 2017, with a limited step-up to 3.25 to 1.00 for a period of four consecutive quarters, in connection with an acquisition;
- a consolidated fixed coverage charge ratio of no less than 1.75 to 1.00 subject to adjustment to exclude up to $80,000 million in specified restricted payments;
- minimum cash of $25,000 including the unused portion of the revolving credit facility; and
- maximum capital expenditures not to exceed $55,000 during any fiscal year, provided that the unused amount of any permitted capital expenditures in any fiscal year may be carried forward to the next following fiscal year.

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

As of September 30, 2016, we were in compliance with all covenants, including financial covenants, for the 2016 Credit Facility.

The 2016 Credit Facility contains customary events of default that may permit acceleration of the debt. During the continuance of a payment default, interest will accrue on overdue amounts at a default interest rate of 2% above the interest rate which would otherwise be applicable, in the case of loans, and at a rate equal to the rate applicable to base rate loans plus 2%, in the case of all other amounts.

2015 Financing

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

Use of Proceeds

We used $167,000 of the net available proceeds of the 2015 Credit Facility to retire all of the debt under our 2014 Credit Facility. Remaining proceeds from the term note and the undrawn revolving credit facility under the 2015

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

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and straight line method for the revolving credit facility. We used $82,000 from our 2015 revolving credit facility in connection with the acquisition of iCore on August 31, 2015.

Repayments

We made mandatory repayment of $3,750 under the term note for the nine months ended September 30, 2016 and $7,500 under the term note for the year ended December 31, 2015. In addition, we repaid the $10,000 outstanding under the revolving credit facility for the nine months ended September 30, 2016 and $30,000 outstanding under the revolving credit facility for the year ended December 31, 2015.

2015 Credit Facility Terms

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

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

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

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

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

We were able to prepay the 2015 Credit Facility at our option at any time without premium or penalty, and did so in connection with the 2016 Credit Facility. The 2015 Credit Facility was subject to mandatory prepayments in amounts equal to:

- 100% of the net cash proceeds from any non-ordinary course sale or other disposition of our property and assets for consideration in excess of a certain amount subject to customary reinvestment provisions and certain other exceptions and
- 100% of the net cash proceeds received in connection with other non-ordinary course transactions, including insurance proceeds not otherwise applied to the relevant insurance loss.

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

- a consolidated leverage ratio of no greater than 2.25 to 1.00, with a limited step-up to 2.75 to 1.00 for a period of four consecutive quarters, in connection with an acquisition made during the first two years of the 2015 Credit Facility;
- a consolidated fixed coverage charge ratio of no less than 1.75 to 1.00 subject to adjustment to exclude up to $80,000 million in specified restricted payments;
- minimum cash of $25,000 including the unused portion of the revolving credit facility; and

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

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

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

2014 Financing

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

Use of Proceeds

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

State and Local Sales Taxes

We also have contingent liabilities for state and local sales taxes. As of September 30, 2016, we had a reserve of $1,763. If our ultimate liability exceeds this amount, it could affect our liquidity unfavorably. However, we do not believe it will significantly impair our liquidity.

Capital Expenditures

For the nine months ended September 30, 2016, capital expenditures were primarily for the implementation of software solutions and purchase of network equipment as we continue to expand our network. Our capital expenditures for the nine months ended September 30, 2016 were $28,967, of which $8,987 was for software acquisition and development. The majority of these expenditures are comprised of investments in information technology and systems infrastructure, including an electronic data warehouse, online customer service, and customer management platforms. For 2016, we believe our capital and software expenditures will be approximately $38,000. This amount is net of Tenant Improvement capital dollars we are investing in our Holmdel, New Jersey headquarters which are being refunded by the building owner in connection with the long-term lease renewal we executed in the fourth quarter of 2015.

Operating Activities

Cash provided by operating activities decreased to $65,255 for the nine months ended September 30, 2016 compared to $83,626 for the nine months ended September 30, 2015, primarily due to changes in working capital.

Changes in working capital requirements include changes in accounts receivable, inventory, prepaid and other assets, accounts payable, accrued and other liabilities, and deferred revenue and costs. Cash used for working capital requirements increased by $19,066 during the nine months ended September 30, 2016 compared to the prior year period.

Investing Activities

Cash used in investing activities for the nine months ended September 30, 2016 of $187,897 was mainly attributable to the acquisition of business of $163,093, the purchase of capital expenditures of $19,980 and development of software assets of $8,987, offset by a decrease in restricted cash of $791 and the sales of marketable securities, net of purchase of $3,372.

Cash used in investing activities for the nine months ended September 30, 2015 of $138,283 was mainly attributable to the acquisition of businesses of $116,890, purchases of marketable securities, net of sales of $2,380, capital expenditures of $9,578, intangible assets of $2,500, and development of software assets of $7,932, offset by a decrease in restricted cash of $997 due to the return of part of the security deposit on our leased office property in Holmdel, New Jersey.

Financing Activities

Cash provided by financing activities for the nine months ended September 30, 2016 of $97,623 was primarily attributable to $181,250 in net proceeds received from our 2016 Credit Facility and $6,169 in proceeds received from the exercise of stock options, offset by $9,375 in 2016 term note principal payments, $25,000 in 2016 revolving credit facility principal payments, $3,750 in 2015 term note principal payments, $10,000 in 2015 revolving credit facility principal payments, $4,250 in patent license payments, $3,203 in capital lease payments, $32,902 in common stock repurchases, and $1,316 in debt related costs payments.

Cash provided by financing activities for the nine months ended September 30, 2015 of $73,827 was primarily attributable to $82,000 in net proceeds received from our 2015 Credit Facility, $20,000 in net proceeds received from our 2014 Credit Facility, and $6,010 in proceeds received from the exercise of stock options, partially offset by $3,750 in 2015 Credit Facility principal payments, $10,000 in 2014 Credit Facility principal payments, $2,515 in capital lease payments, and $15,911 in common stock repurchases.

Common Stock Repurchases

On July 25, 2012, our board of directors authorized a program to repurchase up to $50,000 of Vonage common stock through December 31, 2013. On February 7, 2013, our board of directors discontinued the remainder of the $50,000 repurchase program effective at the close of business on February 12, 2013 with $16,682 of availability remaining, and authorized a new program to repurchase up to $100,000 of Vonage common stock by December 31, 2014 (the "2012 $100,000 repurchase program"). As of December 31, 2014, approximately $219 remained of our 2012 $100,000 repurchase program. The repurchase program expired on December 31, 2014.

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

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

As of September 30, 2016, approximately $52,043 remained of our 2014 $100,000 repurchase program. The repurchase program expires on December 31, 2018 but may be suspended or discontinued at any time without notice.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Foreign Exchange Risk

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

Interest Rate and Debt Risk

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

Our 2016 Credit Facility consisting consisting of a $125,000 term note and a $325,000 revolving credit facility. We are exposed to interest rate risk since amounts payable under the 2016 Credit Facility, at our option, bore interest at:

- LIBOR (applicable to one-, two-, three-, six-, or twelve-month periods) plus an applicable margin equal to 2.50% if our consolidated leverage ratio is less than 0.75 to 1.00, 2.75% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, 3.00% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00 and less than 2.5 to 1.00, and 3.25% if our consolidated leverage ratio is greater than or equal to 2.50 to 1.00, payable on the last day of each relevant interest period or, if the interest period is longer than three months, each day that is three months after the first day of the interest period, or

- the base rate determined by reference to the highest of (a) the prime rate of JPMorgan Chase Bank, N.A., (b) the federal funds effective rate from time to time plus 0.50%, and (c) the adjusted LIBO rate applicable to one month

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interest periods plus 1.00%, plus an applicable margin equal to 1.50% if our consolidated leverage ratio is less than 0.75 to 1.00, 1.75% if our consolidated leverage ratio is greater than or equal to 0.75 to 1.00 and less than 1.50 to 1.00, 2.00% if our consolidated leverage ratio is greater than or equal to 1.50 to 1.00 and less than 2.50 to 1.00, and 2.25% if our consolidated leverage ratio is greater than or equal to 2.5 to 1.00, payable on the last business day of each March, June, September, and December and the maturity date of the 2016 Credit Facility.

As of September 30, 2016, if the interest rate on our variable rate debt changed by 1% on our 2016 term note, our annual debt service payment would change by approximately $1,200. As of September 30, 2016, if the interest rate on our variable rate debt changed by 1% on our 2016 revolving credit facility, our annual debt service payment would change by approximately $2,300.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. Based on the evaluation of our disclosure controls and procedures (as defined in Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) required by Securities Exchange Act Rules 13a-15(b) or 15d-15(b), our Chief Executive Officer and our Chief Financial Officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective.

Changes in Internal Controls. There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II—Other Information

Item 1. Legal Proceedings

We are subject to a number of lawsuits, government investigations and claims arising out of the conduct of our business. See a discussion of our litigation matters in Note 6 of Notes to our Consolidated Financial Statements, which is incorporated herein by reference.

Item 1A. Risk Factors

You should carefully consider the risks below, as well as the risk factors previously disclosed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015, and all of the other information contained in this Quarterly Report on Form 10-Q and our financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q, in evaluating our company and our business. Any of these risks could materially adversely affect our business, financial condition and results of operations and the trading price of our common stock.

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

The Unified Communications as a service, or UCaaS, and Communications Platform as a service, or CPaaS, industries, which we refer to as “cloud communications services,” are highly competitive. We face intense competition from a broad set of companies, including:

- traditional telephone service providers such as AT&T, Verizon Communications, CenturyLink, Sprint, T-Mobile, and Verizon Wireless;
- cable companies such as Cablevision, Charter Communications, Comcast Corporation, Cox Communications, and Time Warner Cable; and
- software as a service (SaaS) companies and other alternative communication providers, such as Twilio, EvolveIP, Jive, Mitel, RingCentral, ShoretelSky, Thinking Phone, West UC, 8x8 and other providers of cloud communications services.

To the extent that these or other companies strengthen their offerings to small and medium businesses, we may have to reduce our prices, increase promotions, or offer additional features, which may adversely impact our revenues and profitability. Many of these providers are substantially larger and better capitalized than we are and have the advantage of greater name and brand name recognition and a large existing customer base. These service providers may have the ability to devote greater resources to their communications services and may be able to respond more quickly and effectively than we can to new or changing opportunities. Because most of our target consumer services customers are already purchasing communications services from one or more of these providers, our success is dependent upon our ability to attract target customers away from their existing providers. Our competitors' financial resources may allow them to offer services at prices below cost or even for free in order to maintain and gain market share or otherwise improve their competitive positions. Some of our competitors also could use their greater financial resources to develop and market telephony and messaging services with more attractive features and more robust customer service. In addition, because of the other services our competitors provide, some of these service providers choose to offer cloud communications services as part of a bundle that includes other products, such as high speed Internet access and wireless telephone service. These bundled offers may enable our competitors to offer cloud communications services at prices with which we may not be able to compete or to offer functionality that integrates cloud communications services with their other offerings, both of which may be more desirable. Some of these service providers, including Internet product and software companies, have chosen to sacrifice telephony revenue in order to gain market share or attract customers to their platform or have lower cost structures and have offered their services at low prices or for free or are using different payment structures such as one-time or low annual fees. As we continue the introduction of applications that integrate different forms of voice and messaging services over multiple devices, we face competition from emerging competitors focused on similar integration, as well as from established alternative communication providers. Any of these competitive factors could make it more difficult for us to attract and retain customers, reduce our market share and revenues, or cause us to lower our prices or offer additional features that may result in additional costs without commensurate price increases. In order to compete with such service providers, we may have to reduce our prices, which would impair our profitability, or offer additional features that may cause us to incur additional costs without commensurate price increases.

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

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

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

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

As the cloud communications services market evolves, combining voice, video, messaging and data networks, and information technology and communication applications, opportunity is created for new competitors to enter the cloud communications services market and offer competing products. This new competition may take many forms, and may offer products and applications similar to ours. If these new competitors emerge, the cloud communications services market will become increasingly competitive and we may not be able to maintain or improve our market position. Our failure to do so could materially and adversely affect our business and results of operations.

If we fail to adapt to rapid changes in the market for cloud communications services, then our products and services could become obsolete.

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

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

Cloud communications services are complex, and new products and plans and enhancements to existing products and plans can require long development and testing periods. Any delays in developing and releasing new or enhanced products and plans could cause us to lose revenue opportunities and customers. Any technical flaws in products we release could diminish the innovative impact of the products and have a negative effect on customer adoption and our reputation.

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

The market for our CPaaS products and platform is relatively nascent and may not experience the growth that we anticipate.

The utilization of application program interfaces (“APIs”) for text messaging and voice communications, allowing developers and businesses to embed contextual, programmable communications into mobile apps, websites and business systems, remains a relatively new market, and developers and organizations may not yet recognize the need for, or benefits of, our products and platform. It is important that we are able to educate developers, organizational leaders, and other potential customers regarding our products and platform in order to help grow our market share, The market for our products and platform or our share of that market could fail to grow significantly. If the CPaaS

market, or our share of that market, does not experience significant growth, then our business, results of operations and financial condition could be adversely affected.
If we are unsuccessful at retaining customers or attracting new consumer or business customers we may experience a reduction in revenue or may be required to spend more money or alter our marketing approaches to grow our customer base.
Our rate of customer terminations for our UCaaS services could increase in the future if customers are not satisfied with the quality and reliability of our network, the value proposition of our products, and the ability of our customer service to meet the needs and expectations of our customers. We measure customer terminations for our consumer customers by average monthly customer churn and for our UCaaS business customers by average monthly revenue churn. Competition from traditional telephone companies, cable companies, wireless companies, alternative communications providers, low-cost international calling cards,

disruptive technologies, general economic conditions, and our ability to activate and register new customers on our networks, also influence our churn rate. For our CPaaS customers, our ability to grow revenue depends, in part, on our ability to maintain and grow usage of our platform by new and existing customers. If we are not able to increase customer usage of our products, our revenue may decline which would adversely impact our business, results of operations and financial condition. Our CPaaS customers are charged based on their usage of our products and generally our customers do not have long-term contractual financial commitments to us, therefore, usage rates may fluctuate at any time. A material decline in the usage of our products could cause us to spend significantly more on sales and marketing than we currently budget in order to maintain or increase revenue from customers, which could adversely affect our business, results of operations and financial condition. In addition, our agreements with customers typically provide for service level commitments. If we are unable to meet these commitments or if we suffer extended periods of downtime for our products or platform, our business, results of operations and financial condition could be adversely affected.

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

Our success in the CPaaS market depends in part on attracting new customers in a cost-effective manner. The failure to do so could materially and adversely affect our business.

The success of our business relies in part on the manner in which we use, and the cost effectiveness of, a variety of marketing channels used to promote our products and platform and attract new customers. We use developer events and developer evangelism, search engine marketing and optimization, and other marketing efforts such as regional customer events, email campaigns, advertising and public relations events. These methods are prioritized depending on effectiveness and efficiency, and may be altered if costs increase dramatically. Alternative, less expensive channels, may not be as effective as our preferred channels. Our continued success requires that we continue to attract new customers in a cost-effective manner. If we fail to do so, our revenues may decrease and our operating results would suffer.

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

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

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

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

We may face difficulties related to the acquisition or integration of businesses, which could harm our growth or operating results.

Beginning with our acquisition of Vocalocity in 2013, we have made five acquisitions related to the UCaaS market, including Telesphere Networks, Ltd. in 2014, Simple Signal, Inc. and iCore Networks, Inc. in 2015 and Nexmo Inc., in 2016. However, acquisition and integration activities require substantial management time and resources. Acquisitions of existing businesses, including Nexmo, involve substantial risks, including the risk that we may not be able to integrate the operations, personnel, services, or technologies, the potential disruption of our ongoing businesses, the diversion of management attention, the maximization of financial and strategic opportunities, the difficulty in developing or maintaining controls and procedures, and the dilution to our existing stockholders from the issuance of additional shares of common stock. We may elect to acquire additional businesses or assets in the future. However, we cannot predict or guarantee that we will be able to identify suitable acquisition candidates or consummate any acquisition. As a result of these and other risks, we may not produce anticipated revenue, profitability, or synergies.

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

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

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

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

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

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

We have taken steps designed to improve the security of our networks and computer systems and our physical space. Despite these defensive measures, there can be no assurance that we are adequately protecting our information or that we will not experience future incidents. The expenses associated with protecting our information could reduce our

operating margins. We maintain insurance intended to cover some of these risks, however, this insurance may not be sufficient to cover all of our losses from any future breaches of our systems. In addition, third parties with which we do business may also be sources of cybersecurity or other technological risks. We outsource certain functions, which results in the storage and processing of customer information by third parties. While we engage in certain actions to reduce the exposure resulting from outsourcing, unauthorized access, loss or destruction of data or other cyber incidents could occur, resulting in similar costs and consequences as those discussed above.
We make available on our website our privacy policy, which describes how we collect, use, and disclose our customers' personal information. To the extent we expand our operations into new geographies, we may become subject to local data security, privacy, data retention, and disclosure laws and regulations. It may be difficult for us to comply with these laws and regulations

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if they were deemed to be applicable to us. In addition, risks related to cybercrime and fraud increase when establishing a global presence.

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

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

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

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

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

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

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

In order to access our consumer services, a customer needs to connect a standard telephone to a broadband Internet connection through a Vonage-enabled device that we provide. Although we closely monitor inventory levels, if we are unable to procure a sufficient number of devices from our suppliers in a timely manner, including as a result of a failure by a component supplier, we would be delayed in activating new customers and may lose these customers. While we believe that relations with our current third party providers are good, and we have contracts in place with these vendors, there can be no guarantee that these third party providers will be able or willing to supply services to us in the future on commercially reasonable terms, or that we will be able to engage alternative or additional providers. We believe that we could replace our current third party providers, however, our ability to provide our cloud communications services may be impacted during any transition, which could have an adverse effect on our business, financial condition or results of operations.

For our CPaaS customers, we rely upon Softlayer to operate our platform. Any disruption of or interference with our use of Softlayer could have an adverse effect on our business, financial condition or results of operations.

We rely upon Softlayer to provide substantially all of the cloud infrastructure that hosts our CPaaS products and platform. Our CPaaS customers require uninterrupted performance of this platform and we are therefore vulnerable to service interruptions at Softlayer. We may experience interruptions, delays and outages in Softlayer's service and availability due to a variety of factors, including infrastructure changes, human or software errors, website hosting disruptions and capacity constraints caused by technical failures, natural disasters, fraud or security attacks. To the extent that we do not effectively address interruptions, delays and outages in Softlayer's service and availability or capacity constraints, our business, results of operations and financial condition may be adversely affected.

We rely on third-party hardware and software that may be difficult to replace or may not perform adequately.

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

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

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

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

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

As our cloud communications services business expands, we will need to continue to improve our application architecture, integrate our products and applications across our technology platforms, integrate with third-party systems, and maintain infrastructure performance. We expect the number of users, the amount of data transferred and processed, the number of locations where our service is being used, and the volume of communications over our networks to continue to expand. To address this growth, we will need to scale our systems and customer services organization. Our ability to execute on these initiatives may impact system and network performance, customer satisfaction, and ultimately, sales and revenue. These efforts may also divert management resources. These factors may materially and adversely harm our business and results of operations.

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

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

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

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

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

Federal, state, local and foreign laws and regulations, commercial obligations and industry standards, each provide for obligations and restrictions with respect to data privacy and security, as well as the collection, storage, retention, protection, use, processing, transmission, sharing, disclosure and protection of personal information and other customer data. The evolving nature of these obligations and restrictions dictates that differing interpretations, inconsistency or conflicts among countries or rules, and general uncertainty impact the application to our business. These obligations and restrictions may limit our ability to collect, store, process, use, transmit and share data with our customers, employees, and third party providers and to allow our customers to collect, store, retain, protect, use, process, transmit, share and disclose data with others through our products and services. Compliance with, and other burdens imposed by, such obligations and restrictions could increase the cost of our operations and impact our ability to market our products and services through effective segmentation.

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

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

Our ability to compete effectively is dependent in large part upon the maintenance and protection of systems and software that we have developed internally based on open standards. While we own more than 120 issued U.S. patents (and a number of foreign patents) and more than 200 pending U.S. patent applications (and a number of foreign patent applications), we cannot patent much of the technology that is important to our business. Our pending patent applications may not be granted. Any issued patent that we own may be challenged, narrowed, invalidated, or circumvented. To date, we have relied on patent, copyright and trade secret laws, as well as confidentiality procedures and licensing arrangements, to establish and protect our rights to this technology. We typically enter into confidentiality agreements with our employees, consultants, customers, and vendors in an effort to control access to and distribution of technology, software, documentation, and other information. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use this technology without authorization. Policing unauthorized use of this technology is difficult. The steps we take may not prevent misappropriation of the technology we rely on. In addition, effective protection may be unavailable or limited in some jurisdictions outside the United States, Canada, and the United Kingdom. Litigation may be necessary in the future to enforce or protect our rights or to determine the validity and scope of the rights of others. That litigation could cause us to incur substantial costs and divert resources away from our daily business, which in turn could materially adversely affect our business.

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

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

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

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

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

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

We may be subject to damaging and disruptive intellectual property litigation that could materially and adversely affect our business, results of operations, and financial condition, as well as the continued viability of our company.

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

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

>result in the loss of a substantial number of existing customers or prohibit the acquisition of new customers;

>cause us to accelerate expenditures to preserve existing revenues;

>cause existing or new vendors to require prepayments or letters of credit;

>cause our credit card processors to demand reserves or letters of credit or make holdbacks;

>result in substantial employee layoffs;

>materially and adversely affect our brand in the marketplace and cause a substantial loss of goodwill;

>cause our stock price to decline significantly;

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- materially and adversely affect our liquidity, including our ability to pay debts and other obligations as they become due;
- cause us to change our business methods or services;
- require us to cease certain business operations or offering certain products and services; and
- lead to our bankruptcy or liquidation.

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

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

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

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

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

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

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

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

In general, the focus of interconnected VoIP telecommunications regulation is at the federal level. On November 12, 2004, the FCC issued a declaratory ruling providing that our service is subject to federal regulation and preempted the

Minnesota Public Utilities Commission from imposing certain of its regulations on us. While this ruling does not exempt us from all state oversight of our service, it effectively prevents state telecommunications regulators from imposing certain burdensome and inconsistent market entry requirements and certain other state utility rules and regulations on our service. As such, Vonage is subject to relatively few state regulatory requirements including:

> Payment of state and local E911 fees; and

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>State Universal Service support obligations.
In Canada, the Canadian Radio-television and Telecommunications Commission ("CRTC") regulates VoIP service. CRTC VoIP regulations include:
>Requirement to provide 911 service; and
>Local Number Portability requirements.
In the UK, we are subject to regulation in the UK by the Office of Communications ("OFCOM"). OFCOM VoIP regulations include:
>Requirement to provide 999/112 service; and
>Number Portability requirements.
Vonage seeks to comply with all applicable regulatory requirements. We could, however, be subject to regulatory enforcement action if a regulator does not believe that we are complying with applicable regulations.
In addition, the regulatory framework for VoIP service is still evolving and it is possible that Vonage could be subject to additional regulatory obligations and/or existing regulatory obligations could be modified or expanded. The effects of future regulatory developments are uncertain. Future legislative, judicial or other regulatory actions could have a negative effect on our business. If we become subject to the rules and regulations applicable to telecommunications providers in individual states, we may incur significant litigation and compliance costs, and we may have to restructure our service offerings, exit certain markets, or raise the price of our services, any of which could cause our services to be less attractive to customers. In addition, future regulatory developments could increase our cost of doing business and limit our growth.
The regulatory framework for CPaaS services is not developed; future legislative, regulatory or judicial actions on CPaaS could adversely affect our business and expose us to liability.
In most countries where we offer CPaaS products, it is not clear how CPaaS fits into the communications regulatory framework. Regulators could claim that our CPaaS products are subject to licensing and substantive communications regulatory requirements or could modify their regulatory requirements to make it clear that CPaaS products are covered. Future legislative, judicial or other regulatory actions could have a negative effect on our business. If our CPaaS products become subject to the rules and regulations applicable to communications providers, we may incur significant litigation and compliance costs, and we may have to restructure our service offerings, exit certain markets, or raise the price of our services, any of which could cause our services to be less attractive to customers. In addition, future regulatory developments could increase our cost of doing business and limit our growth.
Customer misuse of our CPaaS products in violation of the Telephone Consumer Protection Act may cause us to face litigation risk.
The Telephone Consumer Protection Act of 1991 restricts telemarketing and the use of automatic SMS text messages without proper consent. The scope and interpretation of the laws that are or may be applicable to the delivery of text messages are continuously evolving and developing. If we do not comply with these laws or regulations or if we become liable under these laws or regulations due to the failure of our customers to comply with these laws by obtaining proper consent, we could face liability.
Our CPaaS products may be subject to governmental export controls and economic sanctions regulations that could impair our ability to compete in international markets due to licensing requirements and subject us to liability if we are not in compliance with applicable laws.
Our products and services may be subject to export control and economic sanctions regulations, including the U.S. Export Administration Regulations, U.S. Customs regulations and various economic and trade sanctions regulations administered by the U.S. Treasury Department's Office of Foreign Assets Controls. Our products and services must be offered and sold in compliance with these laws and regulations. If we do not comply with these laws or regulations or if we become liable under these laws or regulations due to the failure of our customers to comply with these laws by obtaining proper consent, we could face liability. In addition, changes in our products or services, changes in applicable regulations, or change in the target of such regulations, could also result in decreased use of our products and services, or in our decreased ability to sell our products or provide our services to existing or prospective customers with international operations. Any decreased use of our products and services or limitation on our ability to export our products and provide our services could adversely affect our business, results of operations and financial

condition.
We may incur significant costs and harm to our reputation from lawsuits and regulatory inquiries related to our business practices, which may also divert the attention of our management from other aspects of our business.
We have been subject to periodic regulatory inquiries regarding our business practices, including an investigation settled in 2009 with a group of 32 states' attorneys general into certain of our business practices. There was no finding of any violation

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or wrongdoing by us, and the 32 states participating in the settlement released us and our affiliates from the matters investigated. On July 18, 2011, we entered into an amended settlement agreement initiated at our request to reflect revised business practices associated with our new “consumable” product offerings. Any similar claims or regulatory inquiries, whether successful or not, could require us to devote significant amounts of monetary or human resources to defend ourselves and could harm our reputation. We may need to spend significant amounts on our legal defense, senior management may be required to divert their attention from other portions of our business, new product launches may be deferred or canceled as a result of any proceedings, and we may be required to make changes to our present and planned products or services. If, as a result of any proceedings, a judgment is rendered or a decree is entered against us, it may materially and adversely affect our business, financial condition, and results of operations and harm our reputation.

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

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

Our international long distance business is subject to country-specific governmental regulation and related actions and taxes that may increase our costs or impact our product offerings.

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

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

As a United States-based company, any foreign subsidiary or joint venture that we use for international operations may be subject to a variety of governmental regulations in the countries where we market our products, including tariffs and taxes. For example, distributions of earnings and other payments, including interest, received from our foreign subsidiaries may be subject to withholding taxes imposed by the jurisdiction in which such entities are formed or operating, which will reduce the amount of after-tax cash we can receive. In general, as a United States corporation, we may claim a foreign tax credit against our federal income tax expense for such foreign withholding taxes and for foreign income taxes paid directly by foreign corporate entities in which we own 10% or more of the voting stock. The ability to claim such foreign tax credits and to utilize net foreign losses is, however, subject to numerous limitations, and we may incur incremental tax costs as a result of these limitations or because we are not currently in a tax-paying position in the United States. We may also be required to include in our income for United States federal income tax purposes our proportionate share of certain earnings of those foreign subsidiaries that are classified as “controlled foreign corporations” without regard to whether distributions have been actually received from such subsidiaries.

Our CPaaS offerings may be subject to liability for historic and future sales, use and similar taxes, that may increase our costs or impact our product offerings.

In some United States tax jurisdictions in which we conduct operations, sales and use and telecommunications taxes could apply to our CPaaS products. Historically, we have not billed or collected these taxes from our CPaaS customers. It is possible that some tax jurisdictions may assert that such taxes are applicable to our CPaaS products, which could result in tax assessments, penalties and interest, and we may be required to collect such taxes on our CPaaS customers in the future. Such tax assessments, penalties and interest or future requirements may adversely affect our business, results of operations and financial condition. To the extent that we decide to collect such taxes from our CPaaS customers in the future, we may have some customers that question the incremental tax charges and some may seek to negotiate lower pricing from us, which could adversely affect our business, results of operations and financial condition.

The global scope of our operations may subject us to potentially adverse tax consequences.

We generally report our taxable income in various jurisdictions worldwide based upon our business operations in those jurisdictions. Intercompany relationships are subject to complex transfer pricing regulations in various jurisdictions. If revenue and taxing authorities disagree with positions we have taken we could be required to pay additional taxes, interest and penalties, which could result in one-time tax charges, higher effective tax rates, reduced cash flows and lower overall profitability of our operations. In addition, changes in tax laws of countries in which we do business could change on a prospective or retroactive basis, and any such changes could increase our liabilities for taxes, interest and penalties, and therefore could harm our business, cash flows, results of operations and financial position.

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

Many of the key responsibilities of our business have been assigned to a relatively small number of individuals. Our future success depends to a considerable degree on the vision, skills, experience, and effort of our senior management. The loss of the services of these officers could have a material adverse effect on our business. In addition, our continued growth depends on our ability to attract and retain experienced key employees.

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

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

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

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

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

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

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

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If customers do not accept the differences between our service and traditional telephone service, they may choose to remain with their current telephone service provider or may choose to return to service provided by traditional telephone companies.
For certain users, aspects of our service are not the same as traditional telephone service. Our continued growth is dependent on the adoption of our services by mainstream customers, so these differences are important. For example:

- Both our E-911 and emergency calling services are different, in significant respects, from the 911 service associated with traditional wireline and wireless telephone providers and, in certain cases, with other VoIP providers.
- In the event of a power loss or Internet access interruption experienced by a customer, our service is interrupted. Unlike some of our competitors, we have not installed batteries at customer premises to provide emergency power for our customers' equipment if they lose power, although we do have backup power systems for our network equipment and service platform.
- Our customers may experience lower call quality than they are used to from traditional wireline telephone companies, including static, echoes, and delays in transmissions.
- Our customers may experience higher dropped-call rates than they are used to from traditional wireline telephone companies.
- Customers who obtain new phone numbers from us do not appear in the phone book and their phone numbers are not available through directory assistance services offered by traditional telephone companies.
- Our customers cannot accept collect calls.
- Our customers cannot call premium-rate telephone numbers such as 1-900 numbers and 976 numbers.

If customers do not accept the differences between our service and traditional telephone service, they may choose to remain with their current telephone service provider or may choose to return to service provided by traditional telephone companies.
The debt agreements governing our financing contain restrictions that may limit our flexibility in operating our business or executing on our acquisition strategy.
On June 3, 2016, we entered into Amendment No. 1 to the Amended and Restated Credit Agreement (the "2016 Credit Facility") consisting of a $125,000 senior secured term loan and a $325,000 revolving credit facility. The 2016 Credit Facility contains customary representations and warranties and affirmative covenants that limit our ability and/or the ability of certain of our subsidiaries to engage in specified types of transactions. These covenants and other restrictions may under certain circumstances limit, but not necessarily preclude, our and certain of our subsidiaries' ability to, among other things:

- consolidate or merge;
- create liens;
- incur additional indebtedness;
- dispose of assets;
- consummate acquisitions;
- make investments; or
- pay dividends and other distributions.

Under the 2016 Credit Facility, we are required to comply with the following financial covenants: specified maximum consolidated leverage ratio, specified minimum consolidated fixed coverage charge ratio, minimum cash position and maximum capital expenditures. Our ability to comply with such financial and other covenants may be affected by events beyond our control, so we may not be able to comply with these covenants. A breach of any such covenant could result in a default under the 2016 Credit Facility. In that case, the lenders could elect to declare due and payable immediately all amounts due under the 2016 Credit Facility, including principal and accrued interest.
Significant foreign currency exchange rate fluctuations could adversely affect our financial results.
Because our consolidated financial statements are presented in U.S. dollars, increases or decreases in the value of the U.S. dollar relative to other currencies in which we transact business could materially adversely affect our financial results. For example, Nexmo collects revenues in Euros, the strengthening of the U.S. dollar relative to the Euro

adversely affects our revenue and operating results presented in U.S. dollars. In addition, on June 23, 2016, the United Kingdom (U.K.) held a referendum in which a majority of voters approved an exit from the European Union (E.U.), commonly referred to as "Brexit." As a result of the referendum, it is expected that the British government will begin negotiating the terms of the U.K.'s withdrawal from the E.U. Brexit caused significant volatility in global stock markets and currency exchange rate fluctuations that resulted in the strengthening of the U.S. dollar against foreign currencies in which we conduct business, such as the British Pound, Euro and other currencies. Such strengthening of the U.S. dollar relative to other currencies may adversely affect our revenue and operating results. In addition, changes to U.K. border and immigration policy could likewise occur as a result of Brexit, affecting our U.K. operation's ability to recruit and retain employees from outside the U.K.

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

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

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

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

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

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

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

Under our credit card processing agreements with our Visa, MasterCard, American Express, and Discover credit card processors, the credit card processor has the right, in certain circumstances, including adverse events affecting our business, to impose a holdback of our advanced payments purchased using a Visa, MasterCard, American Express, or Discover credit card, as applicable, or demand additional reserves or other security. If circumstances were to occur that would allow any of these processors to reinstate a holdback, the negative impact on our liquidity likely would be significant. In addition, our Visa and MasterCard credit card processing agreement may be terminated by the credit card processor at its discretion if we are deemed to be financially insecure. As a significant portion of payments to us are made through Visa and MasterCard credit cards, if the credit card processor does not assist in transitioning our business to another credit card processor, the negative impact on our liquidity likely would be significant. There were no cash reserves and cash-collateralized letters of credit with any credit card processors as of December 31, 2015.

We have incurred cumulative losses since our inception and may not achieve consistent profitability in the future.

While we achieved net income attributable to Vonage of $17,906 for the nine months ended September 30, 2016, our accumulated deficit is $637,114 from our inception through September 30, 2016, which included the release of $325,601 of the valuation allowance recorded against our net deferred tax assets that we recorded as a one-time non-cash income tax benefit for the year ended December 31, 2011. Although we believe we will achieve consistent profitability in the future, we ultimately may not be successful. We believe that our ability to achieve consistent profitability will depend, among other factors, on our ability to continue to achieve and maintain substantive operational improvements and structural cost reductions while maintaining and growing our net revenues. In addition, certain of the costs of our business are not within our control and may increase. For example, we and other telecommunications providers are subject to regulatory termination charges imposed by regulatory authorities in countries to which customers make calls, such as India where regulatory authorities have been petitioned by local providers to

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consider termination rate increases. As we attract additional international long distance callers, we will be more affected by these increases to the extent that we are unable to offset such costs by passing through price increases to customers.

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

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

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

As of December 31, 2015, Mr. Citron beneficially owned approximately 9.8% of our outstanding common stock, including outstanding securities exercisable for common stock within 60 days of such date. As a result, Mr. Citron is able to exert significant influence over all matters presented to our stockholders for approval, including election and removal of our directors and change of control transactions. In addition, as our non-executive Chairman, Mr. Citron has and will continue to have influence over our strategy and other matters as a board member. Mr. Citron’s interests may not always coincide with the interests of other holders of our common stock.

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

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

> permit our board of directors to issue additional shares of common stock and preferred stock and to establish the number of shares, series designation, voting powers (if any), preferences, other special rights, qualifications, limitations or restrictions of any series of preferred stock;

> limit the ability of stockholders to amend our restated certificate of incorporation and second amended and restated bylaws, including supermajority requirements;

> allow only our board of directors, Chairman of the board of directors or Chief Executive Officer to call special meetings of our stockholders;

> eliminate the ability of stockholders to act by written consent;

> require advance notice for stockholder proposals and director nominations;

> limit the removal of directors and the filling of director vacancies; and

> establish a classified board of directors with staggered three-year terms.

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

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

Such provisions could have the effect of depriving stockholders of an opportunity to sell their shares at a premium over prevailing market prices. Any delay or prevention of, or significant payments required to be made upon, a change of control

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transaction or changes in our board of directors or management could deter potential acquirors or prevent the completion of a transaction in which our stockholders could receive a substantial premium over the then-current market price for their shares.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Item 2(a) and (b) are not applicable.

(c) Common stock repurchases (in thousands, except per share value):

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet be Purchased under the Plans or Program
July 1, 2016 - July 31, 2016	—	$ —	—	$ 52,043
August 1, 2016 - August 31, 2016	—	$ —	—	$ 52,043
September 1, 2016 - September 30, 2016	—	$ —	—	$ 52,043
	—		—	

On February 7, 2013, our board of directors discontinued the remainder of the $50,000 repurchase program effective at the close of business on February 12, 2013 with $16,682 of availability remaining, and authorized a new program to repurchase up to $100,000 of Vonage common stock by December 31, 2014. As of December 31, 2014, approximately $219 remained of our 2012 $100,000 repurchase program. This repurchase program expired on December 31, 2014.

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

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

During the three months ended September 30, 2016, we repurchased 0 shares of Vonage Holdings Corp. common stock for $0 using cash resources pursuant to the 2014 $100,000 repurchase program. When executed, repurchases occur in the open market and pursuant to a trading plan under Rule 10b5-1 of the Securities Exchange Act of 1934. As of September 30, 2016, approximately $52,043 remained of our 2014 $100,000 repurchase program.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

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Item 5. Other Information

Kurt M. Rogers, the Company's Chief Legal Officer and Corporate Secretary since July 2009, will step down from these positions on November 30, 2016. The Board thanks Mr. Rogers for his many important contributions to the Company's success throughout his tenure. Mr. Rogers will serve as a special advisor to his successor through April 30, 2017 (the "Transition Period") to facilitate a smooth and orderly transition.

Pursuant to a Separation Agreement, dated October 26, 2016, Mr. Rogers will be entitled to receive (i) his current base salary, or payments at the same rate, for an aggregate of twelve months commencing December 1, 2016; (ii) an annual bonus for 2016 based on his current target bonus opportunity without proration based on the Company's achievement of the applicable performance metrics, when determined and paid in 2017; and (iii) continued vesting of a prorated amount of previously-granted equity awards through the Transition Period. Mr. Rogers' entitlement to substantially all of these benefits is subject to his execution of a release in favor of the Company.

Randy K. Rutherford, currently the Company's Vice President, Law and Deputy General Counsel, will become Chief Legal Officer and Corporate Secretary on an interim basis commencing December 1, 2016.

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Item 6. Exhibits

31.1	Certification of the Company’s Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002(1)
31.2	Certification of the Company’s Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002(1)
32.1	Certification of the Company’s Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(1)
101	The following financial statements from Vonage Holdings Corp.’s Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2016, filed with the Securities and Exchange Commission on October 26, 2016, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations; (iii) the Consolidated Statements of Comprehensive Income; (iv) the Consolidated Statements of Cash Flows; (v) the Consolidated Statements of Stockholders’ Deficit; and (vi) the Notes to Consolidated Financial Statements.

(1) Filed herewith.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

			VONAGE HOLDINGS CORP.
Dated:	October 26, 2016	By:	/s/ David T. Pearson
			David T. Pearson
			Chief Financial Officer and Treasurer
			(Principal Financial and Accounting Officer and Duly Authorized Officer)

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EXHIBIT INDEX

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(1) Filed herewith.