VONAGE HOLDINGS CORP
Form 10-Q
August 04, 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 June 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 (State or other jurisdiction of incorporation or organization)	11-3547680 (IRS Employer Identification No.)
23 Main Street, Holmdel, NJ (Address of principal executive offices)	07733 (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	July 31, 2016
Common Stock, par value $0.001	216,428,636	shares

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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)

	June 30, 2016 (unaudited)	December 31, 2015
Assets		
Assets		
Current assets:		
Cash and cash equivalents	$ 24,331	$ 57,726
Marketable securities	8,074	9,908
Accounts receivable, net of allowance of $3,620 and $1,091, respectively	35,272	19,913
Inventory, net of allowance of $406 and $686, respectively	4,288	5,542
Deferred customer acquisition costs, current	3,102	4,074
Deferred tax assets, current	23,985	23,985
Prepaid expenses and other current assets	21,557	15,659
Total current assets	120,609	136,807
Property and equipment, net	52,563	49,483
Goodwill	362,269	222,106
Software, net	21,288	20,710
Deferred customer acquisition costs, non-current	487	431
Debt related costs, net	2,674	2,053
Restricted cash	1,938	2,587
Intangible assets, net	225,997	138,199
Deferred tax assets, non-current	169,582	202,587
Other assets	3,311	9,603
Total assets	$ 960,718	$ 784,566
Liabilities and Stockholders' Equity		
Liabilities		
Current liabilities:		
Accounts payable	$ 49,700	$ 42,798
Accrued expenses	79,135	96,127
Deferred revenue, current portion	33,070	32,605
Current maturities of capital lease obligations	4,615	4,398
Current portion of notes payables	18,750	15,000
Total current liabilities	185,270	190,928
Indebtedness under revolving credit facility	239,000	119,000
Notes payable, net of debt related costs and current portion	100,277	76,392
Deferred revenue, net of current portion	592	851
Capital lease obligations, net of current maturities	1,067	3,363
Other liabilities, net of current portion in accrued expenses	19,436	5,291
Total liabilities	545,642	395,825
Commitments and Contingencies	—	—
Stockholders' Equity		
Common stock, par value $0.001 per share; 596,950 shares authorized at June 30, 2016 and December 31, 2015; 279,227 and 268,947 shares issued at June 30, 2016 and	281	270

December 31, 2015, respectively; 216,311 and 214,280 shares outstanding at June 30, 2016 and December 31, 2015, respectively		
Additional paid-in capital	1,280,998	1,224,947
Accumulated deficit	(646,192)	(655,020)
Treasury stock, at cost, 62,916 shares at June 30, 2016 and 54,667 shares at December 31, 2015	(216,647)	(179,779)
Accumulated other comprehensive loss	(3,364)	(1,677)
Total stockholders' equity	415,076	388,741
Total liabilities and stockholders' equity	$ 960,718	$ 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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Total revenues	$233,675	$221,858	$460,499	$441,588
Operating Expenses:				
Cost of service (excluding depreciation and amortization of $6,985, $6,005, $13,818, and $11,729 respectively)	76,078	64,209	145,228	126,062
Cost of goods sold	8,352	8,217	17,418	17,407
Sales and marketing	83,344	84,385	162,945	169,949
Engineering and development	7,243	6,864	14,077	13,469
General and administrative	35,053	27,162	61,723	50,396
Depreciation and amortization	18,218	14,463	35,197	28,408
	228,288	205,300	436,588	405,691
Income from operations	5,387	16,558	23,911	35,897
Other Income (Expense):				
Interest income	25	21	46	41
Interest expense	(3,057)	(2,088)	(5,503)	(4,023)
Other income (expense), net	104	32	258	(545)
	(2,928)	(2,035)	(5,199)	(4,527)
Income from continuing operations before income tax expense	2,459	14,523	18,712	31,370
Income tax expense	(1,562)	(6,176)	(9,884)	(13,174)
Income from continuing operations	897	8,347	8,828	18,196
Loss from discontinued operations	—	—	—	(1,615)
Loss on disposal, net of taxes	—	—	—	(824)
Discontinued operations	—	—	—	(2,439)
Net income	897	8,347	8,828	15,757
Plus: Net loss from discontinued operations attributable to noncontrolling interest	—	—	—	59
Net income attributable to Vonage	$897	$8,347	$8,828	$15,816
Net income per common share - continuing operations:				
Basic	$—	$0.04	$0.04	$0.09
Diluted	$—	$0.04	$0.04	$0.08
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	$0.04	$0.07
Diluted	$—	$0.04	$0.04	$0.07
Weighted-average common shares outstanding:				
Basic	213,558	213,582	213,800	212,711
Diluted	222,700	222,188	223,978	221,557

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		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Net income	$897	$8,347	$8,828	$15,757
Other comprehensive income (loss):				
Foreign currency translation adjustment	(1,691)	1	(1,713)	313
Discontinued operations cumulative translation adjustment	—	—	—	974
Unrealized loss on available-for-sale securities	4	(2)	26	(6)
Total other comprehensive income (loss)	(1,687)	(1)	(1,687)	1,281
Comprehensive income	(790)	8,346	7,141	17,038
Comprehensive loss attributable to noncontrolling interest:				
Comprehensive loss	—	—	—	59
Total comprehensive loss attributable to non-controlling interest	—	—	—	59
Comprehensive income attributable to Vonage	$(790)	$8,346	$7,141	$17,097

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

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

	Six Months Ended June 30, 2016	2015
Cash flows from operating activities:		
Net income	$ 8,828	$ 15,757
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization and impairment charges	18,579	17,253
Amortization of intangibles	16,618	11,346
Deferred tax expense	8,218	11,046
Loss on foreign currency	—	1,358
Allowance for doubtful accounts	597	(9)
Allowance for obsolete inventory	352	1,234
Amortization of debt related costs	517	464
Share-based expense	16,670	12,192
Non-controlling interest	—	907
Changes in operating assets and liabilities:		
Accounts receivable	(7,176)	(6,129)
Inventory	906	994
Prepaid expenses and other current assets	(2,587)	(3,527)
Deferred customer acquisition costs	913	811
Other assets	(331)	(946)
Accounts payable	5,095	(6,594)
Accrued expenses	(27,277)	(9,684)
Deferred revenue	(1,534)	(1,333)
Other liabilities	173	821
Net cash provided by operating activities	38,561	45,961
Cash flows from investing activities:		
Capital expenditures	(15,948)	(4,960)
	(5,664)	(4,509)

Purchase of marketable securities						
Maturities and sales of marketable securities	7,524			2,130		
Acquisition and development of software assets	(5,655		)	(5,542		)
Acquisition of businesses, net of cash acquired	(163,093		)	(25,252		)
Decrease in restricted cash	690			998		
Net cash used in investing activities	(182,146		)	(37,135		)
Cash flows from financing activities:						
Principal payments on capital lease obligations	(6,329		)	(1,616		)
Principal payments on notes and revolving credit facility	(33,437		)	(10,000		)
Proceeds received from draw down of revolving credit facility and issuance of notes payable	181,250			20,000		
Debt related costs	(1,316		)	—		
Common stock repurchases	(32,902		)	(13,760		)
Proceeds from exercise of stock options	3,023			4,277		
Net cash provided by (used in) financing activities	110,289			(1,099		)
Effect of exchange rate changes on cash	(99		)	(38		)
Net change in cash and cash equivalents	(33,395		)	7,689		
Cash and cash equivalents, beginning of period	57,726			40,797		
Cash and cash equivalents, end of period	$	24,331		$	48,486	
Supplemental disclosures of cash flow information:						
Cash paid during the periods for:						
Interest	$	4,833		$	3,531	
Income taxes	$	3,163		$	1,481	
Non-cash transactions during the periods for:						
	$	—		$	322	

Common stock repurchases				
Issuance of common stock in connection with acquisition of business	$	31,591	$	5,578
Variable payout amount 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	4	3,019				3,023
Share-based expense		16,670				16,670
Share-based award activity				(3,966)		(3,966)
Common stock repurchases				(32,902)		(32,902)
Acquisition of business	7	36,362				36,369
Foreign currency translation adjustment					(1,713)	(1,713)
Unrealized loss on available-for-sale securities					26	26
Net income			8,828			8,828
Balance at June 30, 2016	$ 281	$1,280,998	$(646,192)	$(216,647)	$ (3,364)	$415,076

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 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. Customers in the United States represented 93% of our combined subscriber lines and seats at June 30, 2016, with the balance in Canada and the United Kingdom.
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 six months ended June 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; and
- assumptions used in determining the need for, and amount of, a valuation allowance on net deferred tax assets.

We base our estimates on historical experience, available market information, appropriate valuation methodologies, and on various other assumptions that we believe to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

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(In thousands, except per share amounts)
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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.

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 $5,402 and $4,644 for the three months ended June 30, 2016 and 2015 and $10,310 and $8,699 for the six months ended June 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 six months ended June 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 six months ended June 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.

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. In the fourth quarter of 2011, we released $325,601 of valuation allowance. 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 44%, but may fluctuate due to the timing of other discrete period transactions.

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.

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.

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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.

The following table presents the assets that are measured and recognized at fair value on a recurring basis classified under the appropriate level of the fair value hierarchy as of June 30, 2016 and December 31, 2015:

	June 30, 2016	December 31, 2015
Level 1 Assets		
Money market fund (1)	$1,969	$ 57
Level 2 Assets		
Available-for-sale securities (2)	$8,074	$ 9,908

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

Fair Value of Other Financial Instruments

The carrying amounts of our financial instruments, including cash and cash equivalents, accounts receivable, and accounts payable, approximate fair value because of their short maturities. The carrying amounts of our capital leases approximate fair value of these obligations based upon management’s best estimates of interest rates that would be available for similar debt obligations at June 30, 2016 and December 31, 2015. We believe the fair value of our debt at June 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. 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

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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.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Numerator				
Income from continuing operations	$897	$8,347	$8,828	$18,196
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	$897	$8,347	$8,828	$15,816
Denominator				
Basic weighted average common shares outstanding	213,558	213,582	213,800	212,711
Dilutive effect of stock options and restricted stock units	9,142	8,606	10,178	8,846
Diluted weighted average common shares outstanding	222,700	222,188	223,978	221,557
Basic net income per share				
Basic net income per share-from continuing operations	$—	$0.04	$0.04	$0.09
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	$0.04	$0.07
Diluted net income per share				
Diluted net income per share-from continuing operations	$—	$0.04	$0.04	$0.08
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	$0.04	$0.07

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

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Restricted stock units	12,851	7,596	12,012	7,196
Stock options	14,597	16,169	14,400	16,329
	27,448	23,765	26,412	23,525

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 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. We are currently evaluating the impact of adopting ASU 2015-17 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. We are currently evaluating the impact of adopting ASU 2015-11 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

	June 30, 2016	December 31, 2015
Nontrade receivables	$2,755	$ 2,113
Services	7,903	8,066
Telecommunications	7,394	3,138
Insurance	45	939
Marketing	2,294	779
Other prepaids	1,166	624
Prepaid expenses and other current assets	$21,557	$ 15,659

Property and equipment, net

	June 30, 2016	December 31, 2015
Building (under capital lease)	$25,709	$ 25,709
Network equipment and computer hardware	99,266	89,025
Leasehold improvements	49,350	48,872
Customer premise equipment	7,811	7,292
Furniture	3,775	2,508
Vehicles	203	214
	186,114	173,620
Less: accumulated depreciation and amortization	(133,551)	(124,137)
Property and equipment, net	$52,563	$ 49,483

Customer premise equipment, net

	June 30, 2016	December 31, 2015
Customer premise equipment	$7,811	$ 7,292
Less: accumulated depreciation	(3,041)	(2,068)
Customer premise equipment, net	$4,770	$ 5,224

Software, net

	June 30, 2016	December 31, 2015
Purchased	$70,338	$ 67,248
Licensed	909	909
Internally developed	36,219	36,088
	107,466	104,245
Less: accumulated amortization	(86,178)	(83,535)

Software, net	$21,288	$ 20,710

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Debt related costs, net

	June 30, 2016	December 31, 2015
Debt related costs related to Revolving Credit Facility	$5,965	$ 5,044
Less: accumulated amortization	(3,291)	(2,991)
Debt related costs, net	$2,674	$ 2,053

Restricted cash

	June 30, 2016	December 31, 2015
Letter of credit-lease deposits	$ 1,576	$ 2,498
Cash reserves	362	89
Restricted cash	$ 1,938	$ 2,587

Intangible assets, net

	June 30, 2016	December 31, 2015
Customer relationships	$182,007	$ 92,609
Developed technology	87,614	75,694
Patents and patent licenses	20,164	20,164
Trademarks	560	560
Trade names	3,144	760
Non-compete agreements	3,628	2,933
Intangible assets, gross	297,117	192,720
Customer relationships	(30,539)	(21,777)
Developed technology	(24,633)	(18,880)
Patents and patent licenses	(13,431)	(12,066)
Trademarks	(560)	(543)
Trade names	(435)	(260)
Non-compete agreements	(1,522)	(995)
Less: accumulated amortization	(71,120)	(54,521)
Customer relationships	151,468	70,832
Developed technology	62,981	56,814
Patents and patent licenses	6,733	8,098
Trademarks	—	17
Trade names	2,709	500
Non-compete agreements	2,106	1,938
Intangible assets, net	$225,997	$ 138,199

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Other assets

	June 30, 2016	December 31, 2015
Long term non-trade receivable	—	6,623
Others	3,311	2,980
Other assets	$ 3,311	$ 9,603

Accrued expenses

	June 30, 2016	December 31, 2015
Compensation and related taxes and temporary labor	$25,499	$ 33,196
Marketing	14,444	24,891
Taxes and fees	6,711	11,808
Litigation and settlements	23	23
Telecommunications	14,102	9,111
Other accruals	11,196	11,523
Customer credits	1,570	1,779
Professional fees	4,572	2,080
Accrued interest	37	22
Inventory	715	1,514
Credit card fees	266	180
Accrued expenses	$79,135	$ 96,127

Accumulated other comprehensive loss

	June 30, 2016	December 31, 2015
Foreign currency translation adjustment	(3,369)	(1,656)
Unrealized loss on available-for sale securities	5	(21)
Accumulated other comprehensive loss	$(3,364)	$ (1,677)

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Note 3. Supplemental Income Statement Account Information

Amounts included in revenues

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
USF fees	$19,709	$19,028	$39,229	$37,543
Disconnect fees, net of credits and bad debt	$796	$160	$1,010	$362
Initial activation fees	$(58)	$188	$310	$408
Customer equipment rental	$1,179	$912	$2,281	$1,682
Customer equipment fees	$1,705	$1,351	$3,786	$2,524
Equipment recovery fees	$26	$17	$44	$32
Shipping and handling fees	$571	$621	$1,179	$1,224

Amount included in cost of services

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
USF costs	$19,709	$19,028	$39,229	$37,543

Amount included in cost of goods sold

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Shipping and handling cost	$1,307	$1,274	$2,769	$2,559

Amount included in sales and marketing

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Advertising costs	$20,079	$26,579	$36,958	$54,828

Amounts included in general and administrative expense

	Three Months Ended	Six Months Ended

	June 30,		June 30,	
	2016	2015	2016	2015
Acquisition related transaction costs	$5,057	$222	$5,150	$660
Acquisition related integration costs	$—	$8	$—	$25
Acquisition related consideration accounted for as compensation	$3,312	$—	$3,312	$—

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Depreciation and amortization expense

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Network equipment and computer hardware	$3,907	$3,058	$7,740	$5,948
Software	2,591	3,259	5,320	6,332
Capital leases	550	550	1,100	1,100
Other leasehold improvements	1,351	1,266	2,706	2,491
Customer premise equipment	649	505	1,278	965
Furniture	213	97	375	192
Vehicles	18	17	36	33
Patents	682	311	1,364	622
Trademarks	—	18	18	36
Customer relationships	4,928	2,228	8,777	4,457
Acquired technology	2,950	2,897	5,755	5,717
Trade names	122	25	176	50
Non-compete agreements	274	232	528	464
	18,235	14,463	35,173	28,407
Property and equipment impairments	(17)	—	24	1
Software impairments	—	—	—	—
Depreciation and amortization expense	$18,218	$14,463	$35,197	$28,408

Amount included in interest expense

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Debt related costs amortization	$266	$226	$517	$464

Amount included in other income (expense), net

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net loss resulting from foreign exchange transactions	$95	$ 13	$251	$(554)

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Note 4. Long-Term Note and Revolving Credit Facility
A schedule of long-term note and revolving credit facility at June 30, 2016 and December 31, 2015 is as follows:

	June 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	100,277	—
2.50-3.25% Revolving credit facility - due 2020	239,000	—
Total Long-term note and revolving credit facility	$339,277	$ 195,392

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

	Term Note
2016	$9,375
2017	18,750
2018	18,750
2019	18,750
2020	54,688
Minimum future payments of principal	120,313
Less: unamortized debt related costs	1,286
current portion	18,750
Long-term portion	$100,277

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 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 repayment of $4,687 under the term note for the six months ended June 30, 2016. In addition, we repaid the $15,000 outstanding under the revolving credit facility for the six months ended June 30, 2016.

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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 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.

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As of June 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 six months ended June 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 six months ended June 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

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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.

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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 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 June 30, 2016 and 2015:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015 (1)	2016	2015 (1)
Shares of common stock repurchased	5,747	1,169	7,400	2,948
Value of common stock repurchased	$24,754	$5,605	$32,762	$13,374

(1) including 65 shares, or $321, of common stock repurchases settled in July 2015; excluding commission of $1.

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As of June 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. On July 25, 2016, Bear Creek filed its opening brief with the United States Court of Appeals for the Federal Circuit, appealing the Patent Trial and Appeal Board’s decision. The brief was rejected for failure to comply with the Federal Circuit’s rules, and the corrected brief is due August 9, 2016.

RPost Holdings, Inc. On August 24, 2012, RPost Holdings, Inc., RPost Communications Limited, and RMail Limited (collectively, “RPost”) filed a lawsuit against StrongMail Systems, Inc. (“StrongMail”) in the United States District Court for the Eastern District of Texas alleging that StrongMail’s products and services, including its electronic mail marketing services, are covered by United States Patent Nos. 8,224,913, 8,209,389, 8,161,104, 7,966,372, and 6,182,219. On February 11, 2013, RPost filed an amended complaint, adding 27 new defendants, including Vonage America Inc. RPost’s amended complaint alleges willful infringement of the RPost patents by Vonage and each of the other new defendants because they are customers of StrongMail. StrongMail has agreed to fully defend and indemnify Vonage in this lawsuit. Vonage answered the complaint on May 7, 2013. On September 17, 2015, the Court ordered the consolidation for pre-trial purposes of this case with other cases by RPost. The lead case has been administratively closed and stayed since January 30, 2014 due to multiple pending actions by third parties regarding ownership of the patents at issue. On June 1, 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.

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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.

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.

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.

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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.

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 $1,576 and $2,498, as of June 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 lease a co-location facility from a vendor. We have committed to pay this vendor approximately $500 in 2016 and $1,000 in 2017 and 2018, and $500 in 2019, respectively.

We have committed to purchase local inbound services from a vendor. We have committed to pay this vendor approximately $900 in 2016, $1,400 in 2017, and $500 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 June 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 June 30, 2016.

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.

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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 June 30, 2016	2015	Six Months Ended June 30, 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)

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 are receiving consideration of $231,122, with an additional earn-out opportunity (the "Variable Payout Amount") 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

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(In thousands, except per share amounts)

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
Variable Payout Amount (described below)	16,472
Employee Payout Amount (described below)	4,779
Acquisition Cost	$232,028

In addition, Nexmo shareholders may earn a Variable Payout Amount 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 Variable Payout Amount payable to the holders of Nexmo stock is determined based on (i) Nexmo's revenues received from its top customers following the closing, and (ii) the achievement of certain revenue targets during the 12 month period following the Closing. The Variable Payout Amount 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 Variable Payout Amount is $17,840 at the acquisition date and is included in acquisition cost at the net present value amount of $16,472.

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 compensation expense as continued employment is a condition of receiving consideration.

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 results of operations of the Nexmo 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 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.

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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	3,364
Total current assets	28,222
Property and equipment	757
Software, net	242
Intangible assets	105,100
Restricted cash	51
Total assets acquired	134,372
Liabilities	
Current liabilities:	
Accounts payable	1,841
Accrued expenses	8,095
Deferred revenue, current portion	1,735
Total current liabilities	11,671
Deferred tax liabilities, net, non-current	31,546
Total liabilities assumed	43,217
Net identifiable assets acquired	91,155
Goodwill	140,873
Total purchase price	$232,028

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

	Amount
Customer relationships	$90,000
Developed technologies	12,000
Non-compete agreements	700
Trade names	2,400
	$105,100

Indications of fair value of the intangible assets acquired in connection with the acquisition were determined using either the income, market or replacement cost methodologies. The intangible assets are being amortized over periods which reflect the pattern in which economic benefits of the assets are expected to be realized. The customer relationships and developed technologies 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 three years.
In addition, we recorded a deferred tax liability of $37,825 related to the $105,100 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.

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Canton, as representative of the security holders of iCore, on August 31, 2015, Merger Sub, on the terms and subject to the conditions thereof, merged with and into iCore, and iCore became a wholly owned indirect subsidiary of Vonage.

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

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

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

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

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

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 will be 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 considered preliminary and are based on the most recent information available. We believe that the information provides a reasonable basis for assigning fair value, but we are waiting for additional information, primarily related to income, sales, excise, and ad valorem taxes which are subject to change. Thus, the provisional measurements of fair value set forth below are subject to change. We expect to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

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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	3,985
Deferred revenue, current portion	576
Current maturities of capital lease obligations	557
Total current liabilities	8,462
Capital lease obligations, net of current maturities	552
Deferred tax liabilities, net, non-current	8,487
Total liabilities assumed	17,501
Net identifiable assets acquired	29,373
Goodwill	63,316
Total purchase price	$ 92,689

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

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

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

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.

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Acquisition of Simple Signal

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

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

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

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

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

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

The acquisition price was allocated to the tangible and identified intangible assets acquired and liabilities assumed as of the closing date. The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management's estimates and assumptions. The estimated fair values of assets acquired and liabilities assumed are considered preliminary and are based on the most recent information available. We believe that the information provides a reasonable basis for assigning the fair values of assets acquired and liabilities assumed, but we are waiting for additional information, primarily related to income, sales, excise, and ad valorem taxes which are subject to change. Thus, the provisional measurements of fair value set forth below are subject to change. We expect to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

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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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Pro forma financial information

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

	Six Months Ended June 30,	
	2016	2015
Revenue	$494,094	$468,647
Net income attributable to Vonage	$5,887	$6,522
Net income attributable to Vonage per share - basic	$0.03	$0.03
Net income attributable to Vonage per share - diluted	$0.03	$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 $2,219 and $7,011 for the six months ended June 30, 2016 and June 30, 2015, respectively, related to pro forma adjustments and Nexmo's results prior to acquisition;
- the exclusion of our acquisition-related expenses of $7,910 for the six months ended June 30, 2016;
- an increase in interest expense of $2,643 and $3,172 for the six months ended June 30, 2016 and June 30, 2015, respectively, associated with borrowings under our revolving line of credit; and
- an increase in amortization expense of $6,502 and $7,802 for the six months ended June 30, 2016 and June 30, 2015, respectively, related to the identified intangible assets of Nexmo.

The Company recorded revenue of $7,698 and net loss of $1,356 attributable to Nexmo for the six months ended June 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	22
Increase in goodwill related to acquisition of Simple Signal	16
Increase in goodwill related acquisition of Nexmo	140,873
Currency translation adjustments	(748)
Balance at June 30, 2016	$362,269

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,

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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.

Our recently acquired subsidiary, Nexmo, is a global leader in the Communications-Platform-as-a-Service ("CPaaS") segment of the cloud communications market. Through Nexmo, 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 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

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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. In December 2014 we announced plans to exit the Brazilian market for residential telephony services and wind down our joint venture operations in the country. The Company completed this process at the end of the first quarter of 2015. This decision underscores the Company's focus on providing UCaaS solutions to domestic consumer services and SMB, medium and large enterprise customers, which offer higher investment return opportunities.

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

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

We had approximately 2.4 million combined consumer subscriber lines and business seats as of June 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 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

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14, 2014, the D.C. Circuit Court of Appeals vacated a significant portion of the 2010 rules. On May 15, 2014, the FCC issued a Notice of Proposed Rulemaking (NPRM) proposing new net neutrality rules. After public response to the NPRM, the FCC adopted new neutrality rules on February 26, 2015. Several parties have filed appeals which are pending at the D.C. Circuit Court of Appeals. Oral arguments at the D.C. Circuit Court of Appeals were held on December 4, 2015. See also the discussion under "Regulation" in Note 10 to our financial statements for a discussion of regulatory issues that impact us.

Key Operating Data

Through our acquisitions 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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues	$147,963	$172,756	$300,967	$350,586
Average monthly revenues per subscriber line	$26.61	$27.79	$26.64	$27.86
Subscriber lines (at period end)	1,824,668	2,049,424	1,824,668	2,049,424
Customer churn	2.1 %	2.2 %	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 $27.79 for the three months ended June 30, 2015 to $26.61 for the three months ended June 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 2,049,424 as of June 30, 2015 to 1,824,668 as of June 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 churn data may not be directly comparable to ours. Customer churn was 2.1% for the three months ended June 30, 2016, compared to 2.2% for the three months ended March 31, 2016 and June 30, 2015. Customer churn decreased to 2.2% for the six months ended June 30, 2016 from 2.3% for the six months ended June 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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues (1)	$85,712	$49,102	$159,532	$91,002
Average monthly revenues per seat (2)	$45.52	$42.28	$45.18	$42.58
Seats (at period end) (2)	578,355	401,256	578,355	401,256
Revenue churn (2)	1.4 %	1.3 %	1.4 %	1.4 %

(1) Includes $7,698 of revenue from Nexmo, which was acquired on June 3, 2016.

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

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 $42.28 for the three months ended June 30, 2015 to $45.52 for the three months ended June 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 401,256 as of June 30, 2015 to 578,355 as of June 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 June 30, 2016, and 1.3% for the three months ended March 31, 2016 and for the three months ended June 30, 2015. Revenue churn was flat at 1.4% for the six months ended June 30, 2016 and for the six months ended June 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.

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

We derive most of our services revenue from monthly subscription fees that we charge our customers under our service plans. We also offer 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.

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.

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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.
- Systems and information technology support.

Engineering and development expense. Engineering and development expense includes:

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- 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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues	100 %	100 %	100 %	100 %
Operating Expenses:				
Cost of service (excluding depreciation and amortization)	33	29	32	29
Cost of goods sold	3	4	4	4
Sales and marketing	36	38	35	38
Engineering and development	3	3	3	3
General and administrative	15	12	13	