

VONAGE HOLDINGS CORP  
Form 10-K  
February 13, 2014  
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION • WASHINGTON, D.C. 20549

FORM 10-K

<input checked="" type="checkbox"/> Annual Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934 For the fiscal year ended December 31, 2013	or	<input type="checkbox"/> Transition Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934 For the transition period from            to
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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 (I.R.S. Employer Identification No.)
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23 Main Street, Holmdel, New Jersey (Address of principal executive offices)	07733 (Zip Code)
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Registrant's telephone number, including area code: (732) 528-2600

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

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

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

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

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

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

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

Large accelerated filer  Accelerated filer

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

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

Yes  No  x

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant at June 30, 2013 was \$475,667,272 based on the closing price of \$2.83 per share.

The number of shares outstanding of the registrant's common stock as of January 31, 2014 was 211,519,604.

Documents Incorporated By Reference

Selected portions of the Vonage Holdings Corp. definitive Proxy Statement, which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2013, are incorporated by reference in Part III of this Form 10-K.

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FORWARD-LOOKING STATEMENTS

VONAGE ANNUAL REPORT 2012

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FORWARD-LOOKING STATEMENTS

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

The words “plan,” “anticipate,” “believe,” “estimate,” “expect,” “intend,” “will,” “should” and similar expressions, as they relate to us, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events, are subject to certain risks, uncertainties, and assumptions, and are not a guarantee of future performance. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in such forward-looking statements or information. In light of the significant uncertainties in these forward-looking statements, you should not place undue reliance on these forward-looking statements. The forward-looking statements and information contained in this Annual Report on Form 10-K relate to events and state our beliefs and the assumptions made by us only as to the date of this Annual Report on Form 10-K. We do not intend to update these forward-looking statements, except as required by law. In accordance with the provisions of the Litigation Reform Act, we are making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors that could cause actual results to differ materially from those contemplated by the forward-looking statements contained in this Annual Report on Form 10-K, any exhibits to this Form 10-K and other public statements we make. Such factors include, but are not limited to: the competition we face; our ability to adapt to rapid changes

in the market for voice and messaging services; our ability to retain customers and attract new customers; our ability to establish and expand strategic alliances; governmental regulation and related actions and taxes in our international operations; increased market and competitive risks, including currency restrictions, in our international operations; risks related to the acquisition or integration of future businesses or joint ventures, including the risks related to the acquisition of Vocalocity, and the economic and performance risks associated with our joint venture in Brazil; 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; security breaches and other compromises of information security; obligations and restrictions associated with data privacy; our dependence on third party facilities, equipment, systems and services; system disruptions or flaws in our technology and systems; uncertainties relating to regulation of VoIP services; liability under anti-corruption laws; results of regulatory inquiries into our business practices; fraudulent use of our name or services; our ability to maintain data security; our dependence upon key personnel; our dependence on our customers' existing broadband connections; differences between our service and traditional phone services; restrictions in our debt agreements that may limit our operating flexibility; our ability to obtain additional financing if required; any reinstatement of holdbacks by our vendors; our history of net losses and ability to achieve consistent profitability in the future; and other factors that are set forth in the “Risk Factors” section and other sections of this Annual Report on Form 10-K, as well as in our Quarterly Reports on Form 10-Q and Current Reports on Form 8-K.

FINANCIAL INFORMATION PRESENTATION

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

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PART I

ITEM 1. Business

OVERVIEW AND STRATEGY

OVERVIEW

We are a leading provider of communications services connecting people through cloud-connected devices worldwide. We rely heavily on our network, which is a flexible, scalable Session Initiation Protocol (SIP) based Voice over Internet Protocol, or VoIP, network. This platform enables a user via a single “identity,” either a number or user name, to access and utilize services and features regardless of how they are connected to the Internet, including over 3G, 4G, Cable, or DSL broadband networks. This technology enables us to offer our customers attractively priced voice and messaging services and other features around the world on a variety of devices.

Over the past five years, we have fundamentally transformed our company - strategically, operationally and financially. Strategically, we shifted our primary focus to serving rapidly growing but under-served ethnic segments in the United States with international calling needs. We improved our value proposition by being the first to deliver flat-rate, unlimited calling primarily from the United States to over 60 countries with the launch of our Vonage World service, and we were the first to provide easy-to-use, enhanced features, like voice-to-text translation and mobile Extension services, at no extra cost. These strategic shifts have resulted in new customers with a higher average lifetime value and a better churn profile than those in the past.

Our focus on operations during this period has resulted in a significantly improved cost structure. We have implemented operational efficiencies throughout our business and have reduced domestic and international termination costs per minute, and customer care costs. Importantly, we have enabled structural cost reductions while significantly improving network call quality and customer service performance. Improvements in the overall customer experience have contributed to lower churn, which has remained in the mid 2% range for six consecutive quarters. Through debt refinancings in December 2010, July 2011, and February 2013, we have fundamentally improved our balance sheet, reducing annual interest expense from \$49 million in 2010 to \$6 million in 2012 and reducing interest rates from as high as 20% in 2009 to less than 4%.

In part as a result of our operational and financial stability, and our disciplined approach to cash management, we established our share repurchase program which was first instituted in August of 2012. The Company currently has a \$100 million repurchase authorization in place to be completed by December 31, 2014. We believe our repurchase program reflects our balanced approach to capital allocation as we invest for growth through our growth priorities and deliver value to shareholders without compromising our ongoing operational needs.

Having achieved operational and financial stability, we are focused on driving revenue through three major growth priorities. The first of these is 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, where we have entered the low-end domestic market with our flanker brand, BasicTalk, a low-priced home phone service offering unlimited calling throughout the United States, and where we have expanded our offering to small and medium business (SMB) and small office, home office (SOHO) customers through the acquisition of Vocalocity, Inc. Our second growth priority is international expansion outside of North America through strategic partnerships. Finally, our third growth priority is mobile services, which we view as a strategic enabler of the Company's entire product offering.

> Core North American Markets

International long distance. As a part of our strategic plan, we shifted our primary focus in our domestic markets to serving the rapidly growing but under-served ethnic segments in the United States with international calling needs.

The markets for international long distance are large and growing, and they allow us to leverage our VoIP network by providing customers a low-cost and convenient alternative to services offered by telecom and cable providers and international calling cards. According to industry data, the total outbound international long distance calling market is estimated to be \$80 billion, and approximately 10 to 15 percent of all US households make international long distance calls, using a mix of home and mobile phones. With our Vonage World product, we have successfully grown our international calling customer base in multiple ethnic markets.

To increase the visibility of our international 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 direct 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 and localized street teams. Our retail distribution outlets include Walmart, Best Buy, Kmart, Sears, Brandsmart, Fry's, and Microcenter.

Sales from our assisted selling initiative, where we place Vonage sales representatives in mass merchant stores to proactively engage customers, have increased as a portion of total sales. We have increased the number of stores with assisted selling to more than 500 at the end of 2013 and we expect to expand that number in 2014. In addition, we have increased the number of part-time sales agents, organized in community teams, selling Vonage services directly to consumers in targeted ethnic segments. We have a presence in nearly every major ethnic market in the United States and we are expanding in Canada.

**Low-end domestic.** We believe the low-end domestic market represents a large incremental market opportunity for light users and security-conscious households, often with poor in-home wireless coverage. To address this market, in the second quarter of 2013 we launched nationwide BasicTalk, our low-end domestic calling product. BasicTalk is sold in all Walmart stores nationwide and through our direct telesales and online channels. We believe the low-end domestic segment remains a sizeable opportunity, with over 40 million broadband households, and we expect to continue to gain share as we expand distribution and improve our direct channel performance.

**Small and Medium Business.** Pursuant to an Agreement and Plan of Merger (the "Merger Agreement") dated October 9, 2013, by and among Vocalocity Inc. ("Vocalocity"), Vista Merger Corp., a Delaware corporation and newly formed wholly-owned subsidiary of Vonage ("Merger Sub"), Vonage and Shareholder Representative Services, LLC (acting solely in its capacity as the Representative, the "Representative"), on November 15, 2013, Merger Sub merged with and into Vocalocity, and Vocalocity became a wholly-owned subsidiary of Vonage (the "Merger").

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

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Vonage as a leader in the SMB hosted VoIP market. SMB and SOHO services will be offered under the Vonage Business Solutions brand.

### >International Expansion

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

The global consumer communications market is estimated to be \$200 billion and growing at approximately 7% per year. We are expanding our geographic footprint through partnerships and are pursuing a range of business concepts which include jointly providing low rates and expanded footprints with international partners to providing a full suite of communications services sold and marketed jointly with or by other companies.

In 2012, we signed our first partnership with Globe in the Philippines, offering a Philippines calling plan for the more than three million Filipinos living in the United States. In February 2013, we signed our second international partnership, a joint venture to deliver communications services in Brazil. We are in discussions with other prospective international partners in countries we have targeted for expansion. These partnerships underscore our strategy to expand our services beyond North America and the United Kingdom.

### >Mobile Services

Mobile and other connected device services. Mobility has become central to our development priorities, including enhancements to our core services through our patented Extensions product and our digital calling card, international expansion opportunities, and as a standalone product through Vonage Mobile, our all-in-one mobile application that provides free, high quality voice and video calling and messaging between users who have the application, as well as low-cost international calling to more than 200 countries to any other phone. In 2013 we continued to improve Vonage Mobile with quality and feature enhancements including video calling and video voicemail. In addition, we recently conducted a technical trial of our new ReachMe roaming feature in Western Europe.

Customer interest in our Extensions product, which allows consumers to extend their Vonage home phone service to another phone, including mobiles, continues to grow, and we now have 28% of our customer base signed up to use Vonage on their mobile phone through this service. 25% of all international calls on our network now originate from a mobile phone. Our recently launched Digital Calling Card for mobile phones makes use of the same platform, directly competing with traditional calling card services.

We had approximately 2.5 million subscriber lines for broadband telephone replacement services as of December 31, 2013. We bill customers in the United States, Canada, and the United Kingdom. Customers in the United States represented 94% of our subscriber lines at December 31, 2013.

## SERVICE OFFERINGS

Our home telephone replacement services are offered to residential customers through several service plans with different pricing structures. The service plans include basic features such as voicemail, call waiting call forwarding as well as unique features Simulring, visual voicemail and Extensions. We also charge for local and international calling outside of plan limits. Information on our revenues, operating income, and identifiable assets appears in Note 1 to our consolidated financial statements included in Item 8 hereof.

As of December 31, 2013, approximately 89% of our United States subscriber lines were for residential service. Our primary residential offering is Vonage World with approximately 1.0 million subscriber lines as of December 31, 2013. For a flat monthly fee, this plan includes unlimited domestic calling (U.S., Canada, and Puerto

Rico) and unlimited calling to landline phones in more than 60 countries, including India, Mexico, and China, and unlimited calling to mobile phones in certain of those countries. In addition, the Vonage World offer includes unlimited Vonage Visual Voicemail, which is “readable voicemail” delivered via email or SMS text message, Vonage Extensions, which extends the plan to additional phone numbers and devices including smartphones and feature

phones, and directory assistance. We also market other residential plans that include limited domestic or international minutes, such as our 800 plan that includes 800 minutes to the U.S., Canada and Puerto Rico. We offer similar plans in Canada and the United Kingdom.

Each of our residential calling plans provides a number of basic features including call waiting, caller ID with name, call forwarding, and voicemail. We also offer, in some cases for additional fees, features that we believe help differentiate our service from our competitors, such as:

> Area Code Selection. Customers can select from approximately 287 United States area codes for their telephone number for use with our service, regardless of physical location.

Virtual Phone Number. A customer can have additional inbound telephone numbers that ring on a primary subscriber line, each for an additional fee. Each of these inbound telephone numbers can have a different area code. In addition to United States virtual phone numbers, we offer virtual phone numbers for 19 other countries. For >example, a customer living in New York City with a New York City phone number can purchase a Toronto virtual phone number that rings on the customer's primary subscriber line. In this instance, a caller from Toronto could call the customer's virtual phone number and be billed as if the customer were in Toronto. Virtual phone numbers are not included in our subscriber line count.

Web-Enabled Voicemail. Our service allows customers to receive e-mail notification of a voicemail with the voice >message attached to the e-mail message as an audio file. Our customers can also check and retrieve voicemails online or from any phone.

Through our recent acquisition of Vocalocity, Vonage Business Solutions offers SMB and SOHO customers several service plans with different pricing structures. The service plans include an array of features applicable to the needs of SMB and SOHO customers. Customers also have the opportunity to purchase premium features for additional fees. Our mobile services include enhancements to our residential calling plans as well as mobile applications that can be initially downloaded for iPhone®, iPad®, iPod touch®, and Android® OS devices for free. In August 2011, we launched Extensions, an enhancement to our flat rate, unlimited international calling plan that extends the plan to additional phone numbers and devices including smartphones and feature phones. A customer may sign-up for up to two extensions with the first extension provided free of charge and the second extension incurring an additional fee. 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 low-cost international calling to more than 200 countries to any other phone. In addition, calls by users of the mobile application to Vonage home or business lines are also free. This mobile application works over WiFi, 3G and 4G and in more than 90 countries worldwide.

#### Devices

In order to access our residential and SOHO services, a customer need only connect a standard telephone to a broadband Internet connection through a small Vonage-enabled device. In order



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to access our SMB services, a customer need only connect through a VoIP-enabled telephone. After connecting the device, our customers can use their telephone to make and receive calls. Vonage-enabled devices allow customers to use the Internet connection for their computer and telephones at the same time while ensuring a high quality calling experience. We also offer a cordless multi-phone system solution. Our plug-and-play Vonage-enabled devices permit portability as customers can take their Vonage device to different locations where broadband service is available. Since May 2009, we generally have not charged new customers for the adapters permitting use of our service.

WORK OPERATIONS

NETWORK OPERATIONS

Our network operations are conducted by a wholly-owned subsidiary that holds our networking equipment and employs the personnel who develop and operate our technology.

The Vonage network uses our customer's existing high-speed broadband Internet service to allow calls over the Internet either from a standard telephone through a Vonage-enabled device or through soft phone software or mobile client applications. Our service is not dependent on any specific type or provider of Internet service, and our customers are free to change their Internet service provider in response to a competitive alternative, or because they have moved to a different location. Our Vonage-enabled devices, soft phone software, and mobile client applications allow our customers to be authenticated and authorized to access our network in a secure manner.

Our network is scalable and geographically distributed for robustness, high availability, and reliability across multiple call processing sites, using regional data interconnection points, where calls to non-Vonage customers are interconnected with the public switched telephone network. We periodically assess the locations of our regional data connection points in connection with efforts to improve the quality of and efficiency in delivering our service. In 2013, we consolidated certain interconnection points, increasing efficiencies and creating a platform for growth. Our interconnections with the public switched telephone network are made pursuant to agreements we have with several telecommunications providers. Under these agreements, we transfer calls originated by our customers to other carriers who connect the call to the called party or connect peer to peer. We have a varying degree of settlement arrangements with our carrier partners for indirect third party or direct termination of our calls. The calls are routed from our network to other carriers' interconnected circuits at co-location facilities in which we lease space. This method of connecting to the public switched telephone network allows us to expand capacity quickly, as necessary to meet call volume, and to provide redundancy within our network. In 2013, we continued to enhance our call routing platform, increasing our control over call routing which lowered costs and improved call quality. Our business is not substantially dependent upon our agreements with any single carrier or our interconnection agreements because we can easily substitute other telecommunications providers in order to obtain the same or similar service.

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

The following are also important in supporting our network operations:

Network Operations Center. We currently maintain a network operations center at our headquarters with monitoring redundancies at several points within our network. The network operations center monitors and manages the status and health of our network elements, allowing us to manage our network in real time, respond to alert notifications, and re-route network traffic as needed. We pursue a multi-faceted approach to managing our network to ensure high call quality and reliable communications services to our customers.

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

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

Web Portal. We provide a fully functional customer Web portal that allows our customers to configure and manage almost all aspects of their service on the Internet without requiring intervention of a customer-care representative.

> The portal permits customers to add and change features and phone numbers, update billing information, and access call usage and billing details.

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

Local Number Portability. Our system allows our telephone replacement customers to port telephone numbers, which allows new customers to retain their existing telephone numbers when subscribing to our services. We rely on >an agreement with a provider to facilitate the transfer of customer telephone numbers. In addition, we have engaged a provider that performs the third party verification of pertinent local number portability information from our subscribers prior to porting a customer from one local telephone company to us.

Security. We have developed a service architecture and platform that uses industry-standard security techniques and allows us to remotely manage customer devices. Any Vonage-enabled device used by our customers can be securely >managed by us, and these devices use authentication mechanisms to identify themselves to our service in order to place and receive calls. We regularly update our protocols and systems to protect against unauthorized access.

> Internet Protocol (IP) Addresses. Every machine on the Internet has a unique identifying number called an Internet Protocol address or IP address. Though there has been

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recent publicity surrounding the exhaustion of IP addresses under the current Internet Protocol version, we have procured a supply of addresses that we believe will cover our needs for the foreseeable future.

### MARKETING

Our marketing objective is to grow subscriber lines and revenue by cost-effectively acquiring and retaining customers. We employ an integrated multi-channel approach to marketing, whereby we evaluate and focus our efforts on efficient marketing vehicles to accomplish our goals. To do this, we make use of both broad-reaching and highly-targeted media channels in the general market and for specific international long distance markets, including television, direct mail, online, alternative media, telemarketing, partner marketing, and customer referral programs. We regularly evaluate the cost per acquisition by media vehicle and reallocate budgets to identify more effective media mixes. We make use of marketing research to gain consumer insights into brand, product, and service performance, and utilize those learnings to improve our messaging and media plans. Market research is also leveraged in the areas of testing, retention marketing, and product marketing to ensure we bring compelling products and services to market for our customers.

### SALES AND DISTRIBUTION

#### Direct Sales

Our primary sales channels for our home telephone replacement services have been in-bound telemarketing and online direct sales. Customers can subscribe to our services at our websites, <http://www.vonage.com>, <http://www.vonage.ca> and <http://www.vonage.co.uk>, or through multiple toll free numbers including 1-877-4VONAGE. We are also increasing efforts to focus on promising international long distance markets. In 2013, we continued to enhance our complete Spanish language experience for our customers, including inbound telesales, full customer service, a Spanish language online environment and purchasing experience, television advertising, as well as direct mail. For business customers our primary sales channels include telesales and resellers. Customers can subscribe to our services at our websites, <http://www.vonagebusiness.com>, <http://www.vocalocity.com> and <http://www.vonagebusinesssolutions.com>, or through toll free numbers including 1-877-862-2562.

#### Retail Sales

In addition to our direct sales channel, we also offer sales through our retail channel. In 2013, we continued to increase our retail presence at leading regional and national retailers, including Walmart, Best Buy, Kmart, Sears, Brandsmart, Fry's, and Microcenter. We believe that the availability of our services through premier retailers enhances and reinforces the Vonage brand, and that the retail channel increases our ability to acquire mainstream consumers by reaching them in a familiar and interactive shopping environment. National and regional retailers provide Vonage with a wide footprint to distribute our service.

#### Community Sales Channels

We have continued to expand our presence in key markets with high ethnic concentration with the introduction of community sales teams. Our community sales teams provide culturally relevant ways to connect with customers at a grass roots level. We expanded our community sales team presence in 2013 and now operate in over 35 markets across 18 states and Canada. In addition, we continue to operate Vonage kiosks in certain markets throughout the United States.

#### Customer Service

We offer our customers support 24 hours a day, seven days a week through both our comprehensive online account management website and our toll free number. Many customers use our self-service website when they have a question or problem with their service and

are able to resolve their concerns online without needing to speak to a customer care representative. Our customers can manage almost all aspects of their accounts online. This capability empowers our customers through self-service and reduces our customer care expenses.

Customers who cannot or do not wish to resolve their questions through our website may contact a customer care representative through our toll free number. We staff our customer care organization through a combination of our own employees and outsourced customer care representatives. All new customer care representatives are trained

through an established program developed by Vonage. We also have a separate team that provides advanced technical support for resolving customers' complex issues. We use extensive monitoring of call quality and customer satisfaction scores to determine additional training or coaching requirements for individual associates and to drive continuous improvement in our processes, policies, and technology. We offer support in English, Spanish, Tagalog and French Canadian.

#### Billing

All customer billing for our broadband telephone replacement services is automated through our website. We automatically collect all fees from our customers' credit card, debit card or electronic check payment ("ECP"). 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 exposure, which is recorded as a reduction to revenue. If a customer's credit card, debit card or ECP is declined, we generally suspend international calling. 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 cannot be successfully processed during three billing cycles (i.e. the current and two subsequent monthly billing cycles), we terminate the account.

#### INTELLECTUAL PROPERTY

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

In addition to developing technology and intellectual property, we evaluate for potential licensing and acquisition technology and intellectual property of third parties to identify opportunities that may provide us with a strategic or commercial advantage in exchange for royalties or other consideration. From time to time we receive letters from third parties inviting us to obtain patent licenses that might be relevant to our business. As a result of these efforts, we have acquired multiple U.S. and foreign patents, and obtained licenses to numerous other patents. From time to time, we also have become involved in litigation alleging that our products or services infringe on third party patents or other intellectual property rights. See "Item 3. - Legal Proceedings-IP Matters."

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

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

## COMPETITION

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

### Traditional telephone and cable companies

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

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

Cable companies and, in many cases traditional phone companies, are also aggressively using their existing customer relationships to bundle services. For example, they bundle Internet access, cable television, and home phone service with an implied price for the phone service that may be significantly below ours. In addition, such competitors may in the future require new customers or existing customers making changes to their service to purchase voice services when purchasing high speed Internet access. Certain traditional phone companies are also able to bundle wireless telephone service. Many of these competitors are able to advertise on their local access channels with no significant out-of-pocket cost and through mailings in bills with little marginal cost. They also receive advertising time as part of their relationships with television networks and are able to use this time to promote their telephone service offerings. Traditional phone and cable companies’ ownership of Internet connections to our customers could enable them to detect and interfere with the completion of our customers’ calls. While we are not aware of any such occurrence, it is unclear whether current regulations would permit these companies to degrade the quality of, give low priority to or block entirely the information packets and other data we transmit over their lines. In addition, these companies may attempt to charge their customers more for using our services.

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

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

In many cases, we charge prices that are lower than prices charged by the traditional phone and cable companies. In addition, some of our competitors offer low introductory pricing followed by an increase in price after a certain period of time. We believe that these step-up promotions enable us to gain market share by attracting customers who leave our competitors following these price increases. We believe that we also currently compete successfully with the traditional phone and cable companies on the basis of the features we offer that they may not (such as area code selection, portable service, virtual phone numbers, and readable voice mail). We offer many of these features at no extra charge.

#### Wireless telephone companies

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

#### Alternative communication providers

We also compete against alternative communication providers such as magicJack, Skype, and Google Voice, some of which are larger than us and have the ability to devote greater resources to their communications services. Some of these service providers, including Internet product and software companies, have chosen to sacrifice telephony revenue in