

VONAGE HOLDINGS CORP
Form 10-K
February 26, 2010
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FORM 10-K

Annual Report Pursuant to Section 13
or 15(d) of The Securities Exchange Act
of 1934

For the fiscal year ended December 31, 2009

or

Transition Report Pursuant to Section 13
or 15(d) of The Securities Exchange Act
of 1934

For the transition period from _____ to _____

Commission file number 001-32887

VONAGE HOLDINGS CORP.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of

incorporation or organization)

23 Main Street, Holmdel, New Jersey
(Address of principal executive offices)
(732) 528-2600

Registrant's telephone number, including area code

11-3547680
(IRS Employer Identification No.)

07733
(Zip Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common Stock, Par Value \$0.001 Per Share
Securities registered pursuant to Section 12(g) of the Act:

Name of each exchange on which registered
The New York Stock Exchange

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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 shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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.

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

The aggregate market value of the common equity held by non-affiliates of the registrant at June 30, 2009 was \$24,105,982.

The number of shares outstanding of the registrant's common stock as of January 31, 2010 was 199,995,701.

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, 2009, are incorporated by reference in Part III of this Form 10-K.

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From time to time, we may provide information, whether orally or in writing, including certain statements in this Annual Report on Form 10-K, 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 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 and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected or intended or using other similar expressions. 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 control customer churn and attract new customers; worsening economic conditions; restrictions in our debt agreements that may limit our operating flexibility; system disruptions or flaws in our technology; results of pending litigation and intellectual property and other litigation that may be brought against us; results of regulatory inquiries into our business practices; our dependence on third party facilities, equipment and services; our dependence upon key personnel; any failure to meet New York Stock Exchange listing requirements; our history of net operating losses; our ability to obtain additional financing if needed; differences between our service and traditional phone services, including our 911 service; our dependence on our customers' existing broadband connections; uncertainties relating to regulation of VoIP services; 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.

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.

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PART I

ITEM 1. Business

We are a leading provider of high quality voice and messaging services over broadband networks. Our technology serviced approximately 2.4 million subscriber lines as of December 31, 2009. While customers in the United States represented 94% of our subscriber lines at December 31, 2009, we also serve customers in Canada and in the United Kingdom.

Our residential, small and home office services are portable and we enable our customers to make and receive phone calls with a telephone almost anywhere a broadband Internet connection is available. We transmit these calls using Voice over Internet Protocol, or VoIP, technology, which converts voice signals into digital data packets for transmission over the Internet. At a cost effective rate, each of our calling plans provides a number of basic features typically offered by traditional telephone service providers, plus a wide range of enhanced features that we believe differentiate our service and offer an attractive value proposition to our customers. We also offer a number of premium services for additional fees.

We rely heavily on our network, which is a flexible, scalable Session Initiation Protocol (SIP) based VoIP network that rides on top of the Internet. This platform enables a user via a single identity to access and utilize services and features regardless of how they are connected to the Internet. As a result, with one identity, either a number or user name, customers have access to Vonage voice, messaging, features and personal profile information regardless of location, device or how they access the Internet, including over 3G, 4G, Cable or DSL broadband networks.

In August 2009, we launched Vonage World, a residential plan that includes unlimited calling to more than 60 countries, including India, Mexico and China for the current flat monthly rate of \$24.99. In addition, the Vonage World offer includes unlimited Vonage Visual Voicemail, which provides readable voicemail delivered via email or short message service (SMS) text message.

In October 2009, we launched Vonage Mobile, our first mobile calling application for smart phones. Vonage Mobile is a free downloadable application that provides seamless, low-cost pay-per-use international calling while on Wi-Fi or cellular networks, depending on the device. In December 2009, we began offering Vonage World Mobile using this mobile calling application. Bundle discounts are provided for customers who subscribe to both our residential and mobile Vonage World plans.

Vonage has developed both a direct sales channel, as represented by web-sites and toll free numbers, and a retail distribution channel through regional and national retailers, including Wal-Mart. The direct and retail distribution channels are supported through integrated advertising campaigns across multiple media such as online, television, direct mail, alternative media, telemarketing, partner marketing and customer referral programs.

Our primary source of revenue is subscription fees that we charge customers for our service plans, primarily on a monthly basis. We also generate revenue from international calls customers make that are not included in their service plan and for additional features that customers add to their service plans. Information on our revenues, operating income, and identifiable assets appears in Note 1 to our consolidated financial statements included in Item 8 hereof.

Vonage is rapidly evolving into a company that provides high quality voice and integrated messaging services on multiple devices, over fixed and mobile broadband networks, connecting customers around the world. In this evolution, we continue to leverage the following factors that have been instrumental in building our customer base:

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- > *Attractive Value Proposition.* We offer our customers an attractive value proposition through our Vonage World and Vonage World Mobile plans, which provide unlimited calling around the world to more than 60 countries, for a low, flat rate. These portable land-line phone replacement and mobile calling applications offer unique and compelling features that differentiate our service from the competition at prices for domestic and international calling and messaging considerably lower than those of traditional telephone services and wireless providers.

- > *Strong Brand Identity.* We believe our strong brand recognition has enhanced our ability to sell our services through direct and retail distribution channels, allowing us to capitalize on growing market demand for broadband, VoIP and mobile applications.

- > *Innovative, Low-Cost Technology Platform.* Vonage maintains and operates a robust, high quality VoIP network that supports over six billion communications per year. We believe our innovative software and network technology platform not only provides us with a competitive advantage over many other VoIP service providers but also allows us to maintain a low cost structure relative to traditional telephone and cable companies that need to build or lease costly last-mile networks. Our network is unique in its scale, versus many other VoIP networks, and permits our customers to communicate virtually everywhere. Our network and services

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also provide the foundation for some unique opportunities to partner with applications developers, device manufacturers, and network providers, to enable voice, video, and varied forms of messaging over new mediums, including social networks and Internet-connected gaming.

We have also made progress with six strategic imperatives that we believe positively impacted our business in 2009 and will continue to drive efficiencies and improve our business performance in 2010 and beyond:

- > *Onboarding and Early Life Satisfaction.* Delivery of a frictionless experience from the time of sale through the customer's active use of service. In 2009, we implemented an onboarding queue, which provides specialized assistance to new customers. As of December 31, 2009, these agents supported nearly all of new customer call volume resulting in improved early life satisfaction.
- > *Distribution and Marketing Effectiveness.* Increasing our gross line additions without increasing our year-over-year investment in marketing. With our continued focus on delivering value to international callers as part of our Vonage World plan, we are developing and delivering targeted marketing and in-language advertising to ethnic calling segments, while lowering mass marketing spending.
- > *Network, Product and Platform Reliability and Quality.* Ensuring our services deliver a consistent, high quality experience. We have developed call quality metrics that enable us to collect more robust data on the frequency and breadth of customer issues at a geographic and subscriber level. This information has helped us to make improvements in call quality and reliability.
- > *New and Enhanced Products and Services.* Developing differentiated products that meet the needs of specific customer segments and promote frequent usage and brand loyalty. In the second half of 2009, we launched several new service offerings including Vonage World and Vonage Mobile.
- > *Cost Optimization.* Achieving a reduction in per line operating costs that more than offsets inflationary pricing and potential compression in average revenue per line. We continue to reduce our cost of telephony services per line as we leverage higher international calling volume to negotiate lower rates with carriers to mitigate increased costs associated with our Vonage World offer. We reduced our total operating expenses by 8% in 2009 from the prior year, including significant reductions in selling, general and administrative expense and marketing expense. In addition, we continue to focus on reducing hardware costs and costs for devices that enable our service.
- > *Organizational Capacity and Skills Enhancement.* Increasing the organization's productivity through talent management, employee development and improved management tools. New members of our senior leadership team in 2009 included heads of customer care, product development and information technology, product management, network operations and legal.

For 2010, we have added an additional strategic imperative that we believe will positively impact our business:

- > *Focus on Technology Transformation.* Transforming our technology infrastructure to deliver flexibility, improved time-to-market for new products and a superior online experience.

We offer our broadband telephone services to customers through several service plans with different pricing structures. The service plans include an array of both basic and enhanced features, and customers have the opportunity to purchase a number of premium features at an additional fee. In order to access our residential, small and home office services, a customer need only connect a standard telephone to a broadband Internet connection through a small Vonage-enabled device. After connecting the device, our customers can use their telephone to make and receive calls. Our mobile calling application is available for download on the iPhone®, BlackBerry® and iPod touch® and permits calling while on wireless (Wi-Fi) or cellular networks, depending on the device.

Plans

In the United States, we market three residential calling plans, two mobile plans and two small office and home office plans:

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- > *Vonage World*. For a monthly fee, this plan includes unlimited calling to landline phones in all cities and locations in more than 60 countries, including India, Mexico and China, and unlimited calling to cellular phones in certain of those countries. In addition, the Vonage World offer includes unlimited Vonage Visual Voicemail, which provides readable voicemail delivered via email or short message service (SMS) text message.
- > *Vonage World Mobile*. This mobile calling plan provides unlimited outbound calling to landline phones in all cities and locations in more than 60 countries, including India, Mexico and China, and unlimited calling to cellular phones in certain of those countries, for a flat monthly rate.
- > *Residential Premium Unlimited*. Subject to certain restrictions, this plan, which we no longer market to new customers, includes unlimited local and long distance calling anywhere in the U.S., Canada and Puerto Rico. It also includes free calls to five select European countries.
- > *Residential Basic 500*. This plan includes 500 minutes per month of local and long distance calling anywhere in the U.S., Canada, and Puerto Rico. Customers are charged 3.9¢ per minute after the first 500 monthly minutes used.
- > *Vonage Pro Plan*. This plan combines the Residential Premium Unlimited Plan with certain premium services described below like Vonage Companion and Vonage Visual Voicemail.
- > *World Plans*. For a monthly fee, Residential Premium Unlimited Plan customers can choose to add an international calling plan where they can make unlimited calls to a region of their choice.
- > *Small Business Premium Unlimited*. Subject to certain restrictions, this plan includes unlimited local and long distance calling anywhere in the U.S., Canada and Puerto Rico for business customers. It also includes free calls to five select European countries and a free dedicated fax line.
- > *Small Business Basic 1500 Minutes*. This plan includes 1,500 minutes per month of local and long distance calling any -

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where in the U.S., Canada, and Puerto Rico for business customers. Customers are charged 3.9¢ per minute after the first 1,500 monthly minutes used. This plan also includes a free dedicated fax line.

> *Vonage Mobile Pay Per Use.* This mobile calling plan provides low per-minute international outbound calling rates on certain mobile devices. As of December 31, 2009, approximately 93% of our U.S. subscriber lines were for residential service. Approximately 49% of those residential subscriber lines were under the Residential Premium Unlimited Plan and 25% were under the Vonage World Plan. We offer similar plans in Canada and the United Kingdom. Please see Note 12 to our consolidated financial statements for financial information about our geographic areas.

Basic and Enhanced Features

Each of our residential, small office and home office calling plans provides a number of basic features including call waiting, caller ID with name, call forwarding and voicemail. All of these calling plans include a wide range of enhanced features at no additional charge to our customers, such as:

- > *Area Code Selection.* Customers can select from approximately 267 U.S. area codes for their telephone number for use with our service, regardless of physical location.
- > *Service and Number Portability.* Our service is portable. Our customers can use their Vonage phone numbers to make and receive calls almost anywhere in the world that a broadband Internet connection is available by taking their Vonage-enabled device with them.
- > *Online Account Management.* Customers can view and manage their accounts online. Our service provides capabilities such as real-time feature management, call forwarding options and a lifetime call activity log.
- > *Personalized 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.

Premium Services

We also offer a number of premium services, in some cases for additional fees. These services include:

- > *Vonage Visual Voicemail.* This feature, which is included free as part of the Vonage World plan and Vonage Pro plan, allows a customer to have their voicemail messages transcribed to text and sent to their e-mail address or mobile phone.
- > *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. For example, a customer living in New York City with a New York City phone number can purchase a Los Angeles virtual phone number that rings on the customer's primary subscriber line. In this instance, a caller from Los Angeles could call the customer's virtual phone number and be billed as if the customer were in Los Angeles. In addition to U.S. virtual phone numbers, we offer international virtual phone numbers as well. Virtual phone numbers are not included in our subscriber line count.
- > *Toll Free Plus.* A customer can have toll free numbers that ring on an existing subscriber line. Toll free numbers are not included in our subscriber line count.
- > *Vonage SoftPhone.* A SoftPhone is a software application that can be downloaded and installed on computers, laptops and Wi-Fi-enabled personal digital assistant devices. It enables a user to use a computer as a full-functioning telephone, with its own phone number, through a screen-based interface that works just like a telephone keypad.

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- > *Residential Fax Service.* For a monthly fee, we offer 250 minutes of outgoing fax service within the United States, Puerto Rico and Canada on a dedicated fax line plus unlimited incoming faxes, with customers charged a per minute fee of 3.9 cents thereafter.
- > *Business Fax Service.* We offer 500 minutes of outgoing fax service within the United States, Puerto Rico and Canada on a dedicated fax line plus unlimited incoming faxes, with customers charged a per minute fee of 3.9 cents thereafter. One business fax line is included in each of our business calling plans.

Devices

We believe that our ability to offer a variety of devices with enhanced features and capabilities differentiates our service offering from that of many of our competitors. Our plug-and-play Vonage-enabled devices permit portability because customers can take their Vonage device to different locations where broadband service is available, including switching between different Internet service providers while continuing to make and receive calls on their Vonage phone number. We offer our customers a range of equipment alternatives for their Vonage-enabled devices based upon our continued relationships with technology companies.

- > *Vonage V-Portal.* The Vonage V-Portal can connect up to two Vonage lines through a high-speed Internet connection and includes a networking router. It has a user-friendly LCD display with caller ID and call timer, call logs, language selection, and built-in upstream bandwidth tester. Utilizing Vonage's advanced quality of service software, the Vonage V-Portal allows customers to use the Internet connection for their computer and telephones at the same time while ensuring a high quality calling experience.
- > *Analog Telephone Adapter.* Our analog telephone adapters, which convert analog audio signals into digital data packets for transmission over the Internet, are plugged in between the customer's telephone and existing broadband Internet connection.
- > *Integrated Adapter and Wireless Router.* Our integrated adapters and wireless routers simplify installation by combining a standard analog telephone adapter, a broadband router and a Wi-Fi access point in one device.
- > *Vonage Bundled Cordless Phone and V-Portal.* Our cordless multi-phone system offers customers further simplification of equipment by combining Digital Enhanced Cordless telecommunications, or DECT, cordless phone system, our V-Portal and a router into one easy to install package. These

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cordless multi-phone systems are designed to appeal to the needs of mainstream consumers who are looking for a whole house solution.

- > *V-Phone.* The Vonage V-Phone is a USB compatible device designed for use with our service. Vonage software comes pre-loaded on the V-Phone and updates itself on the device's 256 megabyte flash drive without requiring the customer to install any software on the host laptop or PC. The V-Phone comes with a standard 2.5 millimeter stereo earpiece microphone and customers can make and receive calls by plugging the device into virtually any Windows-based laptop or PC with a high speed broadband Internet connection.

- > *Vonage Companion.* Vonage Companion is a downloadable softphone that extends the boundaries of a Vonage home or office phone line, providing more freedom over how to communicate. Vonage Companion has the same phone number as a customer's main Vonage phone line.

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.

How Vonage Calls Work

The Vonage system uses our customer's existing high-speed broadband Internet service to connect a Vonage-enabled device to our call processing complex over the Internet. Our service is not dependent on any specific type or provider of Internet service, and our customers are free to change the provider of their Internet service as they wish, either because of a competitive alternative, or because they have moved to a different location.

The Vonage-enabled adapter adapts our customer's existing telephones to Vonage's VoIP-based system. When a customer places a call on our system, their Vonage-enabled adapter signals to our call processing system to deliver the call either to the traditional telephone network, or to another Vonage customer. Our call processing system is scalable and geographically distributed in four distinct Call Processing Centers for robustness and reliability.

For our residential, small office and home office services, a Vonage-enabled adapter converts the traditional analog voice signal from our customer's telephone into a series of IP packets that are sent over his high-speed broadband connection, across the Internet, to a VoIP media gateway at one of our Regional Data Connection Points, where the packets are converted back into traditional public switched telephone network telephone signals. Vonage's architecture has VoIP media gateways and connections to our public switched telephone network termination partners at multiple, distributed geographical locations for capacity, scalability and reliability.

The voice functionality of the Vonage-enabled adapters are remotely configured and managed by Vonage. We can remotely perform software upgrades to enable new features or address operational issues without requiring an in-home service technician or our customer's involvement.

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.

Our web-based customer portal allows our customers to manage most aspects of their Vonage service without requiring the intervention of a customer-care representative. Customers can add and change features, phone numbers, update billing information and review their historical calling and billing records using this self-service portal. Since we remotely manage the Vonage-enabled adapters, customers see a common and consistent interface, regardless of what generation equipment they may have.

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Core Network Elements

- > *Call Processing Centers.* Our call processing centers communicate with the equipment at the Vonage customer's location to authenticate and authorize access to our network. The call processing centers are also responsible for all call signaling in our network, such as initiating phone calls, delivering inbound calls to a customer's phone, and other calling features such as call forwarding. The call processing centers are built from our internally-developed software and industry-standard servers and make use of techniques in distributed computing.

- > *Regional Data Connection Points.* Calls into or out of our network, where one of the parties is not a Vonage customer, are interconnected with the public switched telephone network at 13 regional data connection points in the United States, Canada, Chile, Mexico and the United Kingdom. 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. We pay a per-minute charge for this. The calls are transferred from our equipment to other carriers at connection points that are typically housed in small co-location facilities in which we lease space from other telecommunications providers. We generally pay monthly for this co-location, based on the amount of space we use. 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. These connection points are also used as interconnection with Internet Service Providers to provide the optimal networking path for all calls. Our business is not substantially dependent upon our agreements with other carriers or our interconnection agreements, because we can easily substitute other telecommunications providers in order to obtain the same or similar service at similar cost.

- > *Network Operations Center.* We currently maintain a network operations center at our headquarters and 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 offering more efficiently and effectively. Key aspects of these systems include:
 - > *Customer Device Management System.* We have developed a suite of software solutions that enable us to remotely provision, monitor and configure customer devices and services. When we develop new service offerings or software solutions, we can securely update a customer's equipment and software features without the need for costly field visits.

 - > *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. In addition, we have developed our own scaleable Web-based billing system that allows our customers to access all of their call usage and billing details.

 - > *Reporting Tools.* To enhance our network operations efforts, we utilize an industry standard monitoring tool and also have a series of internally developed monitoring and reporting tools that enable us to quantify the quality of all calls within our network and quickly and efficiently recognize and respond to potential issues.

- > *Emergency Calling Service and Enhanced 911 Service.* We have deployed E-911 service to approximately 98.9% of our U.S. customer base that is comparable to the emergency calling services provided to customers of traditional wire line telephone companies in the same area. For customers in areas where our E-911 service is available, emergency calls are routed, subject to the limitations discussed below, directly to an emergency services dispatcher at the public safety answering point, or PSAP, in the area of the customer's registered location. The dispatcher will have automatic access to the customer's telephone number and registered location information. However, if a customer places an emergency call using the customer's Vonage-enabled device in a location different from the one registered with us, the emergency call will be routed to a PSAP in the customer's registered location, not the customer's actual location at the time of the call. Every time a customer moves his or her Vonage-enabled device to a new location, the customer's registered location information must be updated and verified. Until this occurs, the customer will have to verbally advise the emergency dispatcher of his or her actual location at the time of the call and wait for the call to be transferred, if possible, to the appropriate local emergency response center before emergency assistance can be dispatched.

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In some cases, even under our 911 service, emergency calls may be routed to a PSAP in the area of the customer's registered location, but such PSAP may not be capable of receiving our transmission of the caller's registered location information and, in some cases, the caller's phone number. Where the emergency call center is unable to process the information, the caller is provided a service that is similar to the basic 911 services offered to some wire line telephone customers and some wireless customers. In these instances, the emergency caller may be required to verbally advise the operator of their location at the time of the call and, in some cases, provide a call back number so that the call can be handled or forwarded to an appropriate emergency dispatcher.

The emergency calls of customers located in areas where we currently do not provide either E-911 or the basic 911 described above are either routed directly to the PSAP in the area of the customer's location or supported by a national call center that is run by a third party provider and operates 24 hours a day, seven days a week. In these cases, a caller must provide the operator with his or her physical location and call back number. If a customer reaches the call center, the operator will coordinate connecting the caller to the appropriate PSAP or emergency services provider. Our E-911 service does not support the calls of our V-Phone, Wi-Fi phone, Vonage Companion and Vonage SoftPhone users. The emergency calls of our V-Phone, Wi-Fi phone, Vonage

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Companion and Vonage SoftPhone users are supported by the national call center.

- > *Agreements with E-911 Service Providers.* 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 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. We also maintain agreements with several companies that maintain 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.

- > *Other Agreements.* We have entered into agreements with several service providers to assist us with operations. In particular, we contract with third parties to support local number portability for our customers, which allow 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.

 - > Third Party Verification, Inc. performs the third party verification of pertinent local number portability information from our subscribers. This verification is an integral process step prior to porting a customer from one local telephone company to us. Our agreement with Third Party Verification, Inc. will continue through April 2011.

- > *Security.* We have developed a service architecture and platform that use industry-standard security techniques and allow 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.

Our marketing objective is to grow subscriber lines by cost-effectively acquiring and retaining customers.

We employ an integrated multi-channel approach to marketing. We make use of broad-reach and highly-targeted media channels including television, online, direct mail, alternative media, telemarketing, partner marketing and customer referral programs. As a national provider, we believe we are able to buy online and traditional media in a highly efficient manner. Our customers have a variety of vehicles to purchase our services and products, through the internet, by phone, in a retail store or at a kiosk. In addition, we accept multiple forms of payment such as credit cards, debit cards, and electronic check payments (ECP).

We monitor the results of our marketing efforts closely in a number of ways, including the cost of acquiring new subscriber lines, to evaluate which approaches produce the best results and deploy our marketing resources accordingly. All of our testing follows disciplined direct marketing tactics, which help us isolate the variables that are driving performance. Because we track performance beyond the gross sale, we are able to prioritize those programs that bring in high value, long-term customers.

We make use of marketing research to gain consumer insights into brand, product and service performance. We also monitor brand strength among VoIP, broadband and dial-up customers. Market research is also leveraged in the areas of testing, retention marketing and product marketing. We believe gaining insights into customer needs, wants and preferences is a key marketing asset.

We augment these marketing efforts with Refer-a-Friend, our online customer referral program. Under this program, existing customers can use the Vonage website to send e-mails to their friends that describe our service offerings and track their responses. Referrers may also use their Vonage telephone number as a type of coupon code. We also introduced a referral feature that allows an existing customer to place a promotional banner on the customer's social networking page. In return for referring a new customer, both the new and the existing customer receive a service credit.

Direct Sales

The primary sales channels for our service historically have been through 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 complement these sales channels with marketing vehicles including television, direct mail, alternative media, outbound telemarketing, partner marketing, social marketing and media efforts along with customer referral programs. We are increasing targeting efforts to focus on ethnic calling segments.

Retail Sales

In addition to our direct sales channel, we also offer sales through our retail channel. Our service currently is available at the outlets of leading regional and national retailers, including Wal-Mart, Brandsmart and Fry's Electronics. We believe that the availability of our devices through premier retailers enhances and reinforces the Vonage brand with consumers 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. In looking at ways to increase control in the sales channel, we opened Vonage kiosks throughout the United States in 2006 and 2007 and continue to look at ways to optimize sales performance at each kiosk location while looking at growth opportunities in favorable geographic markets. We had 16 kiosks in operation at the end of 2009 compared to 31 at the end of 2008.

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. We believe that many customers use our self-service website when they have a question or problem with their service and that many of them 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 both

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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 can contact a live 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 called Advanced Technical Support for resolving customers' complex issues that could not be handled by our other representatives and an onboarding queue, which provides specialized assistance to new customers. We use extensive monitoring of call quality and customer satisfaction scores to determine additional training or coaching requirements for individual associates.

Billing

All customer billing is automated through our website. We automatically collect all fees from our customers' credit card, debit card or 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.

In December 2009, we entered into a contract with Amdocs, Inc. pursuant to which Amdocs, Inc. will (i) license to us billing and ordering software, (ii) provide professional services relating to the implementation, operation, support and maintenance of the licensed systems and (iii) transition support services in connection with migration to the licensed systems. We expect this software to provide us with enhanced ordering and billing capabilities to better suit the current and future needs of the business. The initial term of the agreement with Amdocs, Inc. extends for five years following the earlier to occur of (i) the date on which a specified number of subscribers are successfully migrated from our current billing and order systems to the licensed system or (ii) the first new subscriber is added to the licensed system.

We believe that our technological position depends primarily on the experience, technical competence and the creative ability of our engineering and technology staff. We review our technological developments with our technology staff and business units to identify the features of our core technology that provide us with a technological or commercial advantage and file patent applications as necessary to protect these features in the United States and internationally. Our company policies require our employees to assign their intellectual property rights to us and to treat all technology as our confidential information. We have been issued three patents and have filed several other patent applications to protect our technology, which are currently pending.

In addition to developing technology, we evaluate the licensing and acquisition of intellectual property of others in order to identify technology that provides us with a technological or commercial advantage. In 2006, we acquired three patents from Digital Packet Licensing Inc. that enable VoIP technology. The patents are related to the compression of packetized digital signals commonly used in VoIP technology. Two of the patents have expired, and the other patent expires in 2013.

We were named as a defendant in several suits that relate to patent infringement and entered into settlement agreements in 2007 and 2008 to settle certain of the suits, which in certain cases include payments, patent licenses and covenants not to sue.

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

We endeavor to protect our internally developed systems and maintain our trademarks and service marks. Typically, we enter into confidentiality or license 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.

We face strong competition from incumbent telephone companies, cable companies, alternative voice communication providers and wireless companies. 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.

Incumbent telephone companies

The incumbent telephone companies are our primary competitors and have historically dominated their regional markets. These competitors include AT&T, Qwest Communications and Verizon Communications as well as rural incumbents, such as Frontier Communications. These competitors are substantially larger and better capitalized than we are and have the advantage of a large existing customer base.

In many cases, we charge prices that are significantly lower than prices charged by the incumbent phone companies. We believe that we currently compete successfully with the incumbent phone companies on the basis of the features we offer that they do not (such as area code selection and virtual phone numbers) and features we offer at no extra charge.

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

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mile connections enable these competitors to bundle phone service with Internet access and television at prices we may find difficult to compete with.

The incumbent phone companies, as well as the 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.

Cable companies

These competitors include companies such as Cablevision, Charter Communications, Comcast Corporation, Cox Communications and Time Warner Cable. Cable companies have significant financial resources and have made and are continuing to make substantial investments in delivering broadband Internet access and phone service to their customers. Providing Internet access and cable television to many of our existing and potential customers allows them to engage in highly targeted, low-cost direct marketing and may enhance their image as trusted providers of services.

Similar to incumbent phone companies, cable companies are also aggressively using their existing customer relationships to bundle services. For example, they bundle Internet access, cable television and phone service with an implied price for the phone service that may be significantly below ours. They 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 they are able to use this time to promote their telephone service offerings.

Many 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.

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 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. This could also apply to phone companies that connect our customers to the Internet.

We believe our ability to successfully compete with cable companies is enhanced by the value and features we offer that cable companies do not offer (such as unlimited international calling, portable service and wide choice of area codes).

Wireless telephone companies

We also compete with wireless phone companies, such as AT&T, Sprint, T-Mobile and Verizon Wireless. Some consumers use wireless phones, instead of VoIP phones, as a replacement for a wire line 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 competing replacement for wire line service. For example, many wireless phone companies now offer dual mode phones, which permit voice communications over a Wi-Fi network when available and which do not count against mobile plan minutes. Certain wireless phone companies have also made available products incorporating femtocells that utilize broadband connections to act as a miniature cellular tower, listening for and enhancing signals from a subscriber's cell phone, improving call quality at a subscriber's residence or other location. Wireless telephone companies have a strong retail presence and have significant financial resources. We believe our ability to successfully compete with wireless telephone companies is enhanced by our delivery of voice and messaging services over the Internet, enabling us to deliver value to customers.

Alternative voice communication providers

We also compete against established alternative voice communication providers, such as Skype, Google Voice, magicJack and independent VoIP service providers. 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. While not all of these competitors currently offer the ability to call or be called by anyone not using their service, line portability and customer service, in the future they may integrate such capabilities into their service offerings. As we continue the introduction of applications that integrate different forms of voice and messaging services over multiple devices, we are likely to face competition from emerging competitors focused on similar integration, as well as from established alternative voice communication providers.

In addition, a continuing trend toward consolidation of telecommunications companies and the formation of strategic alliances within the telecommunications industry, as well as the development of new technologies, could give rise to significant new competition.

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As of December 31, 2009, we had 1,225 employees. None of our employees are subject to a collective bargaining agreement.

We were incorporated in Delaware in May 2000 and changed our name to Vonage Holdings Corp in February 2001. We maintain a website with the address www.vonage.com. The information contained on our website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor's own Internet access charges, we make available free of charge through our website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we have electronically filed such material with, or furnished such material to, the Securities and Exchange Commission.