

VONAGE HOLDINGS CORP  
Form S-1/A  
November 14, 2006

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As filed with the Securities and Exchange Commission on November 14, 2006

Registration No. 333-136773

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

AMENDMENT NO. 1

TO

**FORM S-1**

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

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**VONAGE HOLDINGS CORP.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State of Incorporation)

**4813**  
(Primary Standard Industrial  
Classification Code Number)  
**23 Main Street**  
**Holmdel, New Jersey 07733**  
**(732) 528-2600**

**11-3547680**  
(I.R.S. Employer  
Identification No.)

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

**John S. Rego**  
**Executive Vice President,**  
**Chief Financial Officer and Treasurer**  
**Vonage Holdings Corp.**  
**23 Main Street**  
**Holmdel, New Jersey 07733**  
**(732) 528-2600**

(Name, address, including zip code, and telephone number, including area code, of agent for service)

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*With copies to:*

**James S. Scott, Sr., Esq.**  
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**Approximate date of commencement of proposed sale to the public:**  
**As soon as practicable after this Registration Statement is declared effective.**

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If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, check the following box.

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

**The registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

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**The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION, DATED NOVEMBER 14, 2006**

**PROSPECTUS**

**17,834,898 Shares**

## **Vonage Holdings Corp.**

### **Common Stock**

We previously issued 5% senior unsecured convertible notes due December 1, 2010 in the aggregate principal amount of \$253.6 million which we refer to as the "convertible notes." This prospectus will be used by the selling stockholders named herein from time to time to resell any shares of our common stock issuable upon conversion of the notes. We will not receive any proceeds from the sale of any shares of our common stock issuable upon conversion of the notes offered by this prospectus.

Our common stock is listed on the New York Stock Exchange under the symbol "VG." On November 13, 2006, the closing sale price of our common stock as reported on the New York Stock Exchange was \$6.53.

**Investing in our common stock involves a high degree of risk. See "Risk Factors" beginning on page 8 to read about risk factors you should consider before buying shares of our common stock.**

In connection with our sale of the convertible notes, we entered into a registration rights agreement with the holders of the convertible notes pursuant to which we are required to file a registration statement of which this prospectus forms a part, to cover the resale of shares of common stock issuable upon conversion of the convertible notes.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

Prospectus dated November 14, 2006

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## TABLE OF CONTENTS

	<b>Page</b>
Prospectus Summary	1
Risk Factors	8
Special Note Regarding Forward-Looking Statements	22
Use of Proceeds	23
Dividend Policy	23
Common Stock Price Range	23
Selected Historical Financial Data	24
Management's Discussion and Analysis of Financial Condition and Results of Operations	26
Industry Overview	61
Business	64
Regulation	86
Management	95
Information Concerning Our Founder, Chairman and Chief Strategist	114
Principal and Selling Stockholders	116
Certain Relationships and Related Party Transactions	124
Description of Convertible Notes	126
Description of Capital Stock	128
Material United States Federal Income Tax Consequences for Non-U.S. Holders	132
Plan of Distribution	135
Legal Matters	137
Experts	137
Where You Can Find Additional Information	137
Index to Financial Statements	F-1

## IMPORTANT NOTICE TO READERS

This prospectus is part of a registration statement we filed with the Securities and Exchange Commission, or SEC, using a "shelf" registration process. Under this shelf registration process, the selling stockholders may, from time to time, offer shares of our common stock issued upon conversion of the convertible notes owned by them. Each time the selling stockholders offer shares of common stock under this prospectus, they are required to provide to potential purchasers a copy of this prospectus and, if applicable, a copy of a prospectus supplement. You should read both this prospectus and, if applicable, any prospectus supplement. See "Where You Can Find Additional Information" for more information.

**You should rely only on information contained in this prospectus or in any related free writing prospectus filed with the Securities and Exchange Commission and used or referred to in an offering to you of these securities. We have not authorized anyone to provide you with different information. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front of this prospectus.**

## PROSPECTUS SUMMARY

*The following summary is qualified in its entirety by the more detailed information and financial statements and notes appearing elsewhere in this prospectus. Before making an investment, prospective investors should read this entire prospectus carefully, especially the information set forth under the heading "Risk Factors."*

### **Our Company**

We are a leading provider of broadband telephone services with over 2.0 million subscriber lines as of September 30, 2006. Utilizing our innovative Voice over Internet Protocol, or VoIP, technology platform, we offer feature-rich, low-cost communications services that offer users an experience similar to traditional telephone services. While customers in the United States currently represent over 95% of our subscriber lines, we continue to expand internationally, having launched our service in Canada in November 2004 and in the United Kingdom in May 2005. Since our U.S. launch in October 2002, we have experienced rapid subscriber line growth. For example, we more than tripled our subscriber lines during 2005.

We offer our customers a variety of service plans, each of which has a fixed monthly fee. Each of our service plans includes a full suite of features typically offered by traditional telephone service providers, such as call waiting, caller ID and call forwarding. In addition, we offer several enhanced features at no additional charge that are not typically offered by traditional circuit-switched telephone service providers, such as area code selection, web- and e-mail-based voicemail and an account management website that allows customers to add or change their features online. We also offer a number of premium services for an additional fee, such as toll free numbers, fax numbers and virtual phone numbers. We offer low international per minute calling rates for calls to locations outside the United States, Puerto Rico and Canada. We believe the combination of these factors allows us to offer an attractive value proposition to our customers.

Our customers can make and receive calls using a standard telephone plugged into a portable Vonage-enabled device that can be used almost anywhere a broadband Internet connection is available. We transmit these calls using VoIP technology, which converts voice signals into digital data packets for transmission over the Internet. We provide our service by using our customers' existing broadband Internet connections, eliminating the need for us to build or lease costly "last-mile" connections. In addition, our network is based on internally developed software and industry-standard servers, rather than the more expensive switches used by traditional telephone service providers. This network design enables us to monitor, maintain and expand our network quickly and efficiently while realizing capital and operating cost savings.

We have invested heavily to build a strong brand that helps drive our subscriber growth. During 2005 and the first nine months of 2006, we spent an aggregate of \$513.2 million on marketing. We employ an integrated marketing strategy that includes extensive television, online, print and radio advertising, a customer referral program and a range of other promotions, all designed to build our brand, attract new customers and retain existing customers. For example, according to Nielsen//NetRatings, an independent Internet media and market research firm, we were the top advertiser on the Internet from January 2005 through the first quarter of 2006 based on estimated spending and impressions. We employ a broad distribution strategy and acquire customers through our websites, our toll free numbers and our presence in leading retail outlets, including Best Buy, Circuit City, CompUSA and RadioShack stores.

We have experienced rapid revenue growth since our inception. Our revenues were \$18.7 million in 2003, \$79.7 million in 2004, \$269.2 million in 2005 and \$423.0 million for the nine months ended September 30, 2006. While our revenues have grown rapidly, we have experienced increasing net losses, primarily driven by our increase in marketing expenses. For the period from inception through

September 30, 2006, our accumulated deficit was \$603.8 million. For 2005 and the nine months ended September 30, 2006, our net loss was \$261.3 million and \$221.5 million, respectively, and our marketing expenses were \$243.4 million and \$269.8 million, respectively. To grow our revenue and customer base and enhance awareness of our brand, we have chosen to spend significant amounts on our marketing activities, and we intend to continue to do so. While this strategy will have the effect of delaying or preventing us from generating net income in the near term, we believe that our focus on growth will better position us as a strong competitor in the long term. As of September 30, 2006, our debt consisted of \$253.4 million of convertible notes (principal amount of \$253.6 less unamortized discount of \$0.2 million) and \$24.5 million of capital leases.

### **Our Market Opportunity**

VoIP communications are carried as data packets and require a broadband Internet connection that has sufficient bandwidth to deliver the data uninterrupted. As a result, broadband penetration has been a key driver of VoIP's expansion to date. We believe that as broadband adoption becomes even more prevalent worldwide, consumers will increasingly look to use their high-speed Internet connections for more of their voice, video and data communications. Many independent market research analysts believe that the growth rate in new VoIP subscribers over the next few years will exceed the growth rate for new broadband subscribers. For example, several such analysts have estimated that the approximately 0.9 to 1.5 million U.S. or North American consumer VoIP users in 2004 will grow to between 8.2 and 15.3 million by the end of 2007. As a leading provider of broadband telephone services using VoIP, we believe we are well positioned to benefit from the growth expected in this marketplace. However, the VoIP market may not grow as expected, and our business might not benefit from any actual growth that does occur.

### **Our Strengths**

We believe we have the following strengths:

Leading VoIP Market Position and VoIP Brand in the United States

Attractive Customer Value Proposition

Innovative, Low-Cost Technology Platform

Strong Direct and Retail Distribution Channels

Loyal Customer Base

### **Our Strategy**

We believe that our strong brand identity and reputation for quality communications services are instrumental to building our customer base. Our core business strategy is to enhance our brand image and the quality of our services in order to attract new customers. As we build on our leading brand and above-mentioned strengths, our additional business strategies are to:

Develop Attractive, Innovative Features and Products

Expand our Direct and Retail Distribution Capabilities

Continue to Improve the Customer Experience

Expand into New Geographic Markets

### **E-911 Initiative**

The U.S. Federal Communications Commission, or FCC, required us to provide enhanced emergency dialing capabilities, or E-911, to all of our U.S. customers by November 28, 2005. We are not currently in compliance with the FCC's order, although approximately 91% of our U.S. subscriber lines were E-911 compliant as of November 1, 2006. Additional progress is being made on a daily basis and we expect to provide E-911 capabilities to nearly all of our remaining subscriber lines within the year. We have requested a waiver from the FCC to provide us with the additional time needed to complete the roll-out. It is possible the FCC will deny our request and subject us to fines or penalties or order us to stop accepting new customers in certain areas until we have rolled out E-911 capability in those areas.

### **Risk Factors**

An investment in our common stock involves a high degree of risk. The following risks, as well as the other risks discussed in "Risk Factors," should be carefully considered before participating in this offering:

our history of net operating losses and our need for cash to finance our growth;

the competition we face, including from companies with greater financial resources;

our dependence on our customers' existing broadband connections, which gives us less control over call quality than traditional telephone networks;

differences between our service and traditional telephone services, including our 911 service;

uncertainties relating to regulation of VoIP services;

system disruptions or flaws in our technology;

our ability to manage our rapid growth; and

the risk that VoIP does not gain broader acceptance.

### **Corporate Information**

We were incorporated in Delaware in May 2000 and changed our name to Vonage Holdings Corp. in February 2001. Our principal executive offices are located at 23 Main Street, Holmdel, NJ 07733. Our telephone number is (732) 528-2600. Our websites are <http://www.vonage.com>, <http://www.vonage.ca> and <http://www.vonage.co.uk>. We also maintain a website at <http://ir.vonage.com> on which we post all reports we file with the Securities and Exchange Commission under Section 13(a) of the Securities Exchange Act of 1934. We also post on this site our key corporate governance documents, including our board committee charters and our ethics policy. **Information contained on our websites or that can be accessed through our websites is not part of this prospectus, and investors should not rely on any such information in making the decision whether to purchase our common stock.**

**The Offering**

Common stock offered by the selling stockholders	17,834,898 shares(1)
Common stock outstanding after the offering	172,757,531 shares(2)
Use of proceeds	We will not receive any proceeds from the sale of shares in this offering.
Dividend policy	We do not intend to pay any cash dividends on our common stock.
Risk factors	Investing in our common stock involves a high degree of risk. See "Risk Factors" beginning on page 8 to read about risk factors you should consider before buying shares of our common stock.
New York Stock Exchange trading symbol	VG

- (1) Represents the aggregate number of shares of our common stock that are currently issuable upon conversion of the convertible notes based on a conversion price of \$14.22 per share. Additional shares will be issuable upon conversion if we elect to pay interest on these notes in kind by increasing the principal outstanding under the notes. See "Description of Convertible Notes."
- (2) Assumes the conversion of all of the convertible notes into shares of common stock.

The number of shares of common stock outstanding after this offering excludes:

16,568,504 shares of common stock issuable upon exercise of currently outstanding options as of September 30, 2006 with exercise prices ranging from \$0.70 to \$35.00 and having a weighted average exercise price of \$8.09 per share and 983,169 of restricted stock units at September 30, 2006;

3,085,715 shares of common stock issuable upon exercise of currently outstanding warrants with exercise prices ranging from \$0.70 to \$1.40 per share and having a weighted average exercise price of \$1.28 per share; and

shares of common stock reserved for future grants under our 2001 Incentive Plan as of September 30, 2006 were 11,719,634 shares. Of this amount, our board of directors limited the amount of shares to 2,000,000 shares of which 1,573,857 shares are currently available.

shares of common stock reserved for future grants under our 2006 Incentive Plan is determined using a formula and will equal approximately 17.65% of the number of shares that are issued and outstanding from time to time. As of September 30, 2006, there were approximately 15,619,237 shares reserved for grant.



### Summary Consolidated Financial Data

The following table sets forth our summary consolidated financial data. The statement of operations data for the years ended December 31, 2003, 2004 and 2005 and the balance sheet data as of December 31, 2004 and 2005 are derived from our audited consolidated financial statements and related notes included in the back of this prospectus. The balance sheet data as of December 31, 2003 is derived from our audited consolidated financial statements and related notes not included in this prospectus. The statement of operations data for the nine months ended September 30, 2005 and 2006 and the balance sheet data as of September 30, 2006 are derived from our unaudited consolidated financial statements included in the back of this prospectus. In the opinion of management, the unaudited consolidated financial statements have been prepared on the same basis as our audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the information set forth therein. The results for any interim period are not necessarily indicative of the results that may be expected for a full year.

The results included below and elsewhere in this prospectus are not necessarily indicative of our future performance. You should read this information together with "Capitalization," "Selected Historical Financial Data," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes included elsewhere in this prospectus.

	For the Years Ended December 31,			For the Nine Months Ended September 30,	
	2003	2004	2005	2005	2006
(dollars in thousands)					
<b>Statement of Operations Data:</b>					
Operating Revenues:					
Telephony services	\$ 16,905	\$ 75,864	\$ 258,165	\$ 167,280	\$ 402,781
Customer equipment and shipping	1,817	3,844	11,031	6,736	20,202
	<u>18,722</u>	<u>79,708</u>	<u>269,196</u>	<u>174,016</u>	<u>422,983</u>
Operating Expenses:					
Direct cost of telephony services (excluding depreciation and amortization of \$1,388, \$2,519, \$6,671, \$4,405 and \$8,707)	8,556	23,209	84,050	54,341	116,802
Direct cost of goods sold	4,867	18,878	40,441	30,451	50,561
Selling, general and administrative	19,174	49,186	154,716	98,808	191,036
Marketing(1)	11,819	56,075	243,404	176,279	269,768
Depreciation and amortization	2,367	3,907	11,122	7,026	16,645
	<u>46,783</u>	<u>151,255</u>	<u>533,733</u>	<u>366,905</u>	<u>644,812</u>
Loss from operations	(28,061)	(71,547)	(264,537)	(192,889)	(221,829)
Net loss	\$ (29,974)	\$ (69,921)	\$ (261,334)	\$ (189,620)	\$ (221,480)
<b>Statement of Cash Flow Data:</b>					
Net cash used in operating activities	\$ (16,583)	\$ (38,600)	\$ (189,765)	\$ (131,155)	\$ (160,692)
Net cash used in investing activities	(4,933)	(73,707)	(154,638)	(64,914)	(297,200)
Net cash provided by financing activities	34,226	141,094	434,006	195,994	479,349

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	December 31,			September 30,	
	2003	2004	2005	2006	
(dollars in thousands)					
<b>Balance Sheet Data (at period end):</b>					
Cash, cash equivalents and marketable securities	\$ 14,245	\$ 105,768	\$ 266,379	\$ 544,330	
Property and equipment, net	9,325	16,290	103,638	123,523	
Total assets	28,311	136,493	446,882	788,911	
Convertible notes(2)			247,958	253,420	
Capital lease obligations	5		22,431	24,489	
Total liabilities	14,038	51,045	426,940	495,927	
Total redeemable preferred stock	51,409	192,521	388,427		
Total stockholders' equity (deficit)	(37,136)	(107,073)	(368,485)	292,984	
	For the Years Ended December 31,			For the Nine Months Ended September 30,	
	2003	2004	2005	2005	2006
<b>Operating and Other Data (unaudited):</b>					
Gross subscriber line additions(3)	91,522	364,214	1,099,641	824,609	1,158,044
Net subscriber line additions(4)	77,936	304,849	878,472	671,220	788,806
Subscriber lines(5)(6)	85,717	390,566	1,269,038	1,061,786	2,057,844
Average monthly customer churn(7)	2.5%	1.8%	2.1%	2.1%	2.4%
Average monthly revenue per line(8)	\$ 33.37	\$ 27.89	\$ 27.03	\$ 26.63	\$ 28.25
Average monthly telephony services revenue per line(9)	\$ 30.13	\$ 26.55	\$ 25.93	\$ 25.60	\$ 26.90
Average monthly direct cost of telephony services per line(10)	\$ 15.25	\$ 8.12	\$ 8.44	\$ 8.31	\$ 7.80
Marketing cost per gross subscriber line addition(11)	\$ 129.14	\$ 153.96	\$ 221.35	\$ 213.77	\$ 232.95
Employees(5)(12)	189	648	1,355	1,393	1,675

- (1) Marketing expense consists of costs of advertising, which include online, television, print and radio advertising and direct mail, promotions, sponsorships and inbound and outbound telemarketing; creative and production costs; the costs to serve and track our online advertising; certain amounts we pay to retailers for newspaper insert advertising, product placement and activation commissions; and the cost associated with our customer referral program. Marketing expense does not include the cost of certain customer acquisition activities, such as rebates and promotions, which are accounted for as an offset to revenues, or customer equipment subsidies, which are accounted for as direct cost of goods sold.
- (2) As of September 30, 2006, we had convertible notes with a principal amount of \$253.6 million before unamortized discount of \$0.2 million.
- (3) Gross subscriber line additions for a particular period are calculated by taking the net subscriber line additions during that period and adding to that the number of subscriber lines that terminated during that period. This number does not include subscriber lines both added and terminated during the period, where termination occurred within the first 30 days after activation. The number does include, however, subscriber lines added during the period that are terminated within 30 days of activation but after the end of the period.
- (4) Net subscriber line additions for a particular period reflect the number of subscriber lines at the end of the period less the number of subscriber lines at the beginning of the period.
- (5) At end of period.



- (6) Subscriber lines include, as of a particular date, all subscriber lines from which a customer can make an outbound telephone call on that date. Our subscriber lines include fax lines, the Vonage V-Phone, SoftPhones and WiFi phones but do not include our virtual phone numbers or toll free numbers, which only allow inbound telephone calls to customers.
- (7) Average monthly customer churn for a particular period is calculated by dividing the number of customers that terminated during that period by the simple average number of customers during the period and dividing the result by the number of months in the period. The simple average number of customers during the period is the number of customers on the first day of the period, plus the number of customers on the last day of the period, divided by two. Terminations, as used in the calculation of churn statistics, do not include customers terminated during the period if termination occurred within the first 30 days after activation. We monitor churn on a daily basis and use it as an indicator of the level of customer satisfaction. Other companies may calculate churn differently, and their churn data may not be directly comparable to ours. Average monthly customer churn is calculated using the number of customers, not subscriber lines. The number of customers is lower than the number of subscriber lines because some customers have more than one subscriber line.
- (8) Average monthly revenue per line for a particular period is calculated by dividing our total revenue for that period by the simple average number of subscriber lines for the period and dividing the result by the number of months in the period. The simple average number of subscriber lines for the period is the number of subscriber lines on the first day of the period, plus the number of subscriber lines on the last day of the period, divided by two.
- (9) Average monthly telephony services revenue per line for a particular period is calculated by dividing our total telephony services revenue for that period by the simple average number of subscriber lines for the period and dividing the result by the number of months in the period.
- (10) Average monthly direct cost of telephony services per line for a particular period is calculated by dividing our direct cost of telephony services for that period by the simple average number of subscriber lines for the period and dividing the result by the number of months in the period.
- (11) Marketing cost per gross subscriber line addition is calculated by dividing our marketing expense for a particular period by the number of gross subscriber line additions during the period.
- (12) Represents the number of personnel that are on our payroll and excludes temporary or outsourced labor.

## RISK FACTORS

*Investing in our common stock involves a high degree of risk. Before you invest in our common stock, you should understand and carefully consider the risks below, as well as all of the other information contained in this prospectus and our financial statements and the related notes included elsewhere in this prospectus. Any of these risks could materially adversely affect our business, financial condition and results of operations and the trading price of our common stock, and you may lose all or part of your investment.*

### **Risks Related to Our Business**

*We have incurred increasing quarterly losses since our inception, and we expect to continue to incur losses in the future.*

We have incurred losses since our inception, and we expect to continue to incur losses in the future. For the period from our inception through September 30, 2006, our accumulated deficit was \$603.8 million. Until recently, our quarterly net losses generally have increased each quarter from our inception through the quarter ended September 30, 2006, for which our net loss was \$62.2 million. Initially, our net losses were driven principally by start-up costs and the costs of developing our technology. More recently, our net losses have been driven principally by marketing expense, which was \$91.3 million for the three months ended September 30, 2006. In order to grow our revenue and customer base, we have chosen to increase our marketing expenditures significantly. In addition, we plan to continue to invest in research and development and customer care. We are pursuing growth, rather than profitability, in the near term to capitalize on the current expansion of the broadband and VoIP markets and enhance the future value of our company. Although we believe we will achieve profitability in the future, we ultimately may not be successful and we may never achieve profitability. In the past, we projected that we would generate net income during future periods, but then generated a net loss. We intend to continue to increase our marketing expense, and we may continue to generate net losses for the foreseeable future. In addition, we will always be required to incur some marketing expense in order to replace customers who terminate our service, or "churn." Further, marketing expense is not the only factor that may contribute to our net losses. For example, interest expense on our convertible notes of at least \$12.7 million annually will contribute to our net losses. As a result, even if we significantly reduce our marketing expense, we may continue to incur net losses.

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

The telecommunications industry is highly competitive. We face intense competition from traditional telephone companies, wireless companies, cable companies and alternative voice communication providers. Our principal competitors are the traditional telephone service providers, namely AT&T, Inc. (formerly SBC Communications Inc.), BellSouth Corp., Citizens Communications Corp., Qwest Communications International Inc. and Verizon Communications, Inc., which provide telephone service based on the public switched telephone network. Some of these traditional providers also have added or are planning to add VoIP services to their existing telephone and broadband offerings. We also face, or expect to face, competition from cable companies, such as Cablevision Systems Corp., Charter Communications, Inc., Comcast Corporation, Cox Communications, Inc. and Time Warner Cable (a division of Time Warner Inc.), which have added or are planning to add VoIP services to their existing cable television, voice and broadband offerings. Further, wireless providers, including Cingular Wireless LLC, Sprint Nextel Corporation, T-Mobile USA Inc. and Verizon Wireless, offer services that some customers may prefer over wireline service. In the future, as wireless companies offer more minutes at lower prices, their services may become more attractive to customers as a replacement for wireline service. Some of these providers may be developing a dual mode phone that will be able to use VoIP where broadband access is available and cellular phone service elsewhere, which will pose additional competition to our offerings.

Most traditional wireline and wireless telephone service providers and cable companies are substantially larger and better capitalized than we are and have the advantage of a large existing customer base. 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 target customers away from their existing providers. Until recently, our target market has been composed largely of early adopters, or people who tend to seek out new technologies and services. Attracting customers away from their existing providers will become more difficult as the early adopter market becomes saturated and mainstream customers make up more of our target market. In addition, these competitors could focus their substantial financial resources to develop competing technology that may be more attractive to potential customers than what we offer. Our competitors' financial resources may allow them to offer services at prices below cost or even for free in order to maintain and gain market share or otherwise improve their competitive positions. Our competitors also could use their greater financial resources to offer VoIP services with more attractive service packages that include on-site installation and more robust customer service. In addition, because of the other services our competitors provide, they may choose to offer VoIP services as part of a bundle that includes other products, such as video, high speed Internet access and wireless telephone service, which we do not offer. This bundle may enable our competitors to offer VoIP service at prices with which we may not be able to compete or to offer functionality that integrates VoIP service with their other offerings, both of which may be more desirable to consumers. Any of these competitive factors could make it more difficult for us to attract and retain customers, cause us to lower our prices in order to compete and reduce our market share and revenues.

We also compete against established alternative voice communication providers, such as Skype (a service of eBay Inc.), and face competition from other large, well-capitalized Internet companies, such as America Online, Inc., Google Inc., Microsoft Corporation and Yahoo! Inc., which have recently launched or plan to launch VoIP-enabled instant messaging services. In addition, we compete with independent VoIP service providers. Some of these service providers may choose to sacrifice revenue in order to gain market share and have offered their services at lower prices or for free. In order to compete with such service providers, we may have to significantly reduce our prices, which would delay or prevent our profitability.

***Decreasing telecommunications prices may cause us to lower our prices to remain competitive, which could delay or prevent our future profitability.***

Currently, our prices are lower than those of many of our competitors for comparable services. However, domestic and international telecommunications prices have decreased significantly over the last few years, and we anticipate that prices will continue to decrease. Users who select our service offerings to take advantage of our prices may switch to another service provider as the difference between prices diminishes or disappears, and we may be unable to use our price as a distinguishing feature to attract new customers in the future. Such competition or continued price decreases may require us to lower our prices to remain competitive, may result in reduced revenue, a loss of customers or a decrease in our subscriber line growth and may delay or prevent our future profitability.

***If VoIP technology fails to gain acceptance among mainstream consumers, our ability to grow our business will be limited.***

The market for VoIP services is rapidly evolving. We currently generate most of our revenue from the sale of VoIP services and related products to residential customers. Revenue generated from sales to residential customers will continue to account for most of our revenue for the foreseeable future. We believe that a significant portion of our residential customers are early adopters of VoIP technology. However, in order for our business to continue to grow and to become profitable, VoIP technology must gain acceptance among mainstream consumers, who tend to be less technically

knowledgeable and more resistant to new technology services. Because potential VoIP customers need to connect additional hardware not required for the use of traditional telephone service, mainstream consumers may be reluctant to use our service. We have increased our focus on more mainstream customers and have added advertising in media with a broader reach, such as television, to enhance our brand awareness. However, if mainstream consumers choose not to adopt our technology, our ability to grow our business will be limited.

***Certain aspects of our service are not the same as traditional telephone service, which may limit the acceptance of our services by mainstream consumers and our potential for growth.***

Certain aspects of our service are not the same as traditional telephone service. Our continued growth is dependent on the adoption of our services by mainstream customers, so these differences are becoming increasingly important. For example:

Both our new E-911 and emergency calling services are different, in significant respects, from the 911 service associated with traditional wireline and wireless telephone providers and, in certain cases, with other VoIP providers.

Our customers may experience lower call quality than they are used to from traditional wireline telephone companies, including static, echoes and delays in transmissions.

Our customers may experience higher dropped-call rates than they are used to from traditional wireline telephone companies.

Customers who obtain new phone numbers from us do not appear in the phone book and their phone numbers are not available through directory assistance services offered by traditional telephone companies.

Our customers cannot accept collect calls.

In the event of a power loss or Internet access interruption experienced by a customer, our service is interrupted. Unlike some of our competitors, we have not installed batteries at customer premises to provide emergency power for our customers' equipment if they lose power, although we do have backup power systems for our network equipment and service platform.

If customers do not accept the differences between our service and traditional telephone service, they may choose to remain with their current telephone service provider or may choose to return to service provided by traditional telephone companies.

***Our emergency and new E-911 calling services are different from those offered by traditional wireline telephone companies and may expose us to significant liability.***

Both our emergency calling service and our new E-911 calling service are different, in significant respects, from the emergency calling services offered by traditional wireline telephone companies. In each case, those differences may cause significant delays, or even failures, in callers' receipt of the emergency assistance they need.

Traditional wireline telephone companies route emergency calls over a dedicated infrastructure directly to an emergency services dispatcher at the public safety answering point, or PSAP, in the caller's area. Generally, the dispatcher automatically receives the caller's phone number and actual location information. While our new E-911 service being deployed in the United States is designed to route calls in a fashion similar to traditional wireline services, our new E-911 capabilities are not yet available in all locations. In addition, the only location information that our E-911 service can transmit to a dispatcher at a PSAP is the information that our customers have registered with us. A customer's registered location may be different from the customer's actual location at the time of the call because

customers can use their Vonage-enabled devices to make calls almost anywhere a broadband connection is available.

We are currently deploying E-911 service that is comparable to the emergency calling services provided to customers of traditional wireline telephone companies in the same area. For those customers located in an E-911 area, emergency calls are routed, subject to the limitations discussed below, directly to an emergency services dispatcher at the 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 that takes place, 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.

In some cases, even under our new 911 service, emergency calls may be routed to a PSAP in the area of the customer's registered location, but such PSAP will 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 wireline telephone 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, 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 are currently unable to provide either E-911 or the basic 911 described above are 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. The operator will then coordinate connecting the caller to the appropriate PSAP or emergency services provider. Our E-911 service does not support the calls of our WiFi phone, SoftPhone users and recently deployed V-phone. The emergency calls of our WiFi phone, SoftPhone users and V-phone are supported by the national call center.

If one of our customers experiences a broadband or power outage, or if a network failure were to occur, the customer will not be able to reach an emergency services provider.

Delays our customers encounter when making emergency services calls and any inability of the answering point to automatically recognize the caller's location or telephone number can have devastating consequences. Customers have attempted, and may in the future attempt, to hold us responsible for any loss, damage, personal injury or death suffered as a result. Some traditional phone companies also may be unable to provide the precise location or the caller's telephone number when their customers place emergency calls. However, traditional phone companies are covered by legislation exempting them from liability for failures of emergency calling services and we are not. This liability could be significant. In addition, we have lost, and may in the future lose, existing and prospective customers because of the limitations inherent in our emergency calling services. Any of these factors could cause us to lose revenues, incur greater expenses or cause our reputation or financial results to suffer.



***Flaws in our technology and systems could cause delays or interruptions of service, damage our reputation, cause us to lose customers and limit our growth.***

Although we have designed our service network to reduce the possibility of disruptions or other outages, our service may be disrupted by problems with our technology and systems, such as malfunctions in our software or other facilities and overloading of our network. Our customers have experienced interruptions in the past and may experience interruptions in the future as a result of these types of problems. Interruptions have in the past and may in the future cause us to lose customers and offer substantial customer credits, which could adversely affect our revenue and profitability. For example, during 2005 our service was significantly impaired on two separate occasions. In March 2005, a problem during a software upgrade to our call processing system caused most of our customers to experience intermittent service for several hours. In August 2005, one of our third-party carriers experienced an outage of approximately 90 seconds, which caused a failure in some of our gateways. As a result, during a period of several hours, approximately two out of three outbound calls from our customers to the public switched telephone network experienced an "all circuits busy" condition. Recently we've had other outages that affected smaller groups of customers at various times. In addition, because our systems and our customers' ability to use our services are Internet-dependent, our services may be subject to "hacker attacks" from the Internet, which could have a significant impact on our systems and services. If service interruptions adversely affect the perceived reliability of our service, we may have difficulty attracting and retaining customers and our brand reputation and growth may suffer.

***Our ability to provide our service is dependent upon third-party facilities and equipment, the failure of which could cause delays or interruptions of our service, damage our reputation, cause us to lose customers and limit our growth.***

Our success depends on our ability to provide quality and reliable service, which is in part dependent upon the proper functioning of facilities and equipment owned and operated by third parties and is, therefore, beyond our control. Unlike traditional wireline telephone service or wireless service, our service requires our customers to have an operative broadband Internet connection and an electrical power supply, which are provided by the customer's Internet service provider and electric utility company, respectively, and not by us. The quality of some broadband Internet connections may be too poor for customers to use our services properly. In addition, if there is any interruption to a customer's broadband Internet service or electrical power supply, that customer will be unable to make or receive calls, including emergency calls, using our service. We also outsource several of our network functions to third-party providers. For example, we outsource the maintenance of our regional data connection points, which are the facilities at which our network interconnects with the public switched telephone network. If our third-party service providers fail to maintain these facilities properly, or fail to respond quickly to problems, our customers may experience service interruptions. Our customers have experienced such interruptions in the past and will experience interruptions in the future. In addition, our new E-911 service is currently dependent upon several third-party providers. Interruptions in service from these vendors could cause failures in our customers' access to E-911 services. Interruptions in our service caused by third-party facilities have in the past caused and may in the future cause us to lose customers, or cause us to offer substantial customer credits, which could adversely affect our revenue and profitability. If interruptions adversely affect the perceived reliability of our service, we may have difficulty attracting new customers and our brand, reputation and growth will be negatively impacted.

***We may not be able to maintain adequate customer care during periods of growth or in connection with our addition of new and complex Vonage-enabled devices, which could adversely affect our ability to grow and cause our financial results to be negatively impacted.***

Good customer care is important to acquiring and retaining customers. In the recent past, we have not been able to expand our customer care operations quickly enough to meet the needs of our greatly increased customer base, and the quality of our customer care has suffered. For example, in the first half of 2006, our customers experienced longer than acceptable hold times when they called us for assistance. In the third quarter of 2006, our average monthly customer churn rate increased to 2.6% from 2.3% in the prior quarter and in the short-term may continue to increase. We believe this increase was due in part to our rapid growth and inability to hire enough qualified customer care employees which led to less than satisfactory customer care during these quarters. In the future, as we broaden our Vonage-enabled device offerings and our customers build increasingly complex home networking environments, we will face additional challenges in training our customer care staff. We face a high turnover rate among our customer care employees. We continue to hire and train customer care representatives at a rapid rate in order to meet the needs of our growing customer base. If we are unable to hire, train and retain sufficient personnel to provide adequate customer care, we may experience slower growth, increased costs and higher churn levels, which would cause our financial results to be negatively impacted.

***If we are unable to improve our process for local number portability provisioning, our growth may be negatively impacted.***

We support local number portability for our customers, which allows our customers to retain their existing telephone numbers when subscribing to our services. Transferring numbers is a manual process that in the past could have taken us 20 business days or longer, although we have taken steps to automate this process to reduce the delay. A new Vonage customer must maintain both Vonage service and the customer's existing telephone service during the transferring process. By comparison, transferring wireless telephone numbers among wireless service providers generally takes several hours, and transferring wireline telephone numbers among traditional wireline service providers generally takes a few days. The additional delay that we experience is due to our reliance on the telephone company from which the customer is transferring and to the lack of full automation in our process. Further, because we are not a regulated telecommunications provider, we must rely on the telephone companies, over whom we have no control, to transfer numbers. We also rely on two third parties who have contractual obligations to us to facilitate the transfer of customers' telephone numbers. Local number portability is considered an important feature by many potential customers, and if we fail to reduce related delays, we may experience increased difficulty in acquiring new customers.

***A higher rate of customer terminations would negatively impact our business by reducing our revenue or requiring us to spend more money to grow our customer base.***

Our rate of customer terminations, or average monthly customer churn, was 2.6% for the three months ended September 30, 2006. During those three months, approximately 129,368 of our customers terminated. Our churn rate could increase in the future if customers are not satisfied with our service. Other factors, including increased competition from other providers, also influence our churn rate.

Because of churn, we have to acquire new customers on an ongoing basis just to maintain our existing level of customers and revenues. As a result, marketing expense is an ongoing requirement of our business. If our churn rate increases, we will have to acquire even more new customers in order to maintain our existing revenues. We incur significant costs to acquire new customers, and those costs are an important factor in determining our net losses and achieving future profitability. Therefore, if we are unsuccessful in retaining customers or are required to spend significant amounts to acquire new customers beyond those budgeted, our revenue could decrease and our net losses could increase.

***We may require significant capital to pursue our growth strategy, but we may not be able to obtain additional financing on favorable terms or at all.***

We intend to continue spending substantial amounts on marketing and product development in order to grow our business. Although we believe we will achieve profitability in the future, we may need to obtain additional financing to respond to new competitive pressures or to respond to opportunities to acquire complementary businesses or technologies. Our significant losses to date may prevent us from obtaining additional funds on favorable terms or at all. For the three months ended September 30, 2006, we recorded a net loss of \$62.2 million. Because of these losses and our limited tangible assets, we do not fit traditional credit lending criteria, which, in particular, could make it difficult for us to obtain loans or to access the capital markets. For example, we discussed a revolving credit facility with commercial banks in the summer of 2005. As a result of those discussions, we believe most commercial lenders will require us to very significantly reduce our loss from operations before they will lend us money. In addition, the terms of our outstanding convertible notes provide for additional shares to be issued upon conversion if we sell shares of our common stock at a price that is less than the average trading price of our common stock over the 10-day period prior to any such sale, which might further limit our access to the capital markets. Finally, our ability to raise additional capital through the issuance of equity securities may be impaired due to the events surrounding our IPO. A failure to obtain additional financing could adversely affect our ability to grow and maintain our business.

***As a result of being a public company, we incur increased costs that may place a strain on our resources or divert our management's attention from other business concerns.***

As a public company, we incur additional legal, accounting and other expenses that we did not incur as a private company. The Exchange Act requires us to file annual, quarterly and current reports with respect to our business and financial condition, which requires us to incur legal and accounting expenses. The Sarbanes-Oxley Act requires us to maintain effective disclosure controls and procedures and internal controls for financial reporting. In order to maintain and improve the effectiveness of our disclosure controls and procedures and internal control over financial reporting, significant resources and management oversight are required. We expect the corporate governance rules and regulations of the SEC and the New York Stock Exchange will increase our legal and financial compliance costs and make some activities more time consuming and costly. These requirements may place a strain on our systems and resources and may divert our management's attention from other business concerns, which could have a material adverse effect on our business, financial condition and results of operations. In addition, we are hiring and will continue to hire additional legal, accounting and financial staff with appropriate public company experience and technical accounting knowledge, which will increase our operating expenses in future periods.

***Our rapid growth has placed substantial demands on our management and operations. If we fail to hire and train additional personnel or improve our controls and procedures to respond to this growth, our business, operating results and financial position could be harmed.***

Our business and operations have expanded rapidly since our inception in May 2000. For example, during the 21 months ended September 30, 2006, the number of our employees more than doubled, growing from 648 to 1,675, and we experienced high turnover among our customer care employees. To support our expanded customer base effectively and meet our growth objectives for the future, we must continue to successfully hire, train, motivate and retain our employees. We expect that significant further expansion will be necessary. In addition, in order to manage our expanded operations, we will need to continue to improve our management, operational and financial controls and our reporting systems and procedures. All of these measures will require significant expenditures and will demand the attention of management. If we are not able to hire, train and retain the necessary personnel,

specifically employees with expertise in information technology and engineering, or if these operational and reporting improvements are not implemented successfully, we may have to make significant additional expenditures and further draw management attention away from running our business to address these issues. The quality of our services could suffer, which could negatively affect our brand, operating results and financial position.

***Because much of our potential success and value lies in our use of internally developed systems and software, if we fail to protect them, it could negatively affect us.***

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

***We are currently subject to securities class action litigations, the unfavorable outcome of which might have a material adverse effect on our financial condition, results of operations and cash flows.***

A number of putative class action lawsuits have been filed against us, certain of our officers and directors, and the lead underwriters of our recent initial public offering, alleging, among other things, securities laws violations. We expect these complaints to be consolidated at some time in the future and intend to contest vigorously each lawsuit. We cannot, however, determine the outcome or resolution of these claims or the timing for their resolution. In addition to the expense and burden incurred in defending this litigation and any damages that we may suffer, our management's efforts and attention may be diverted from the ordinary business operations in order to address these claims. If the final resolution of this litigation is unfavorable to us, our financial condition, results of operations and cash flows may be materially adversely affected if our existing insurance coverage is unavailable or inadequate to resolve the matter.

***We may be subject to damaging and disruptive intellectual property litigation.***

We have been named as a defendant in several suits currently pending that relate to alleged patent infringement. See "Business Legal Proceedings Patent Litigation." In addition, we have been subject to other infringement claims in the past and may be subject to infringement claims in the future. We may be unaware of filed patent applications and issued patents that could relate to our products and services. Intellectual property litigation could:

be time-consuming and expensive;

divert attention and resources away from our daily business;

impede or prevent delivery of our products and services; and

require us to pay significant royalties, licensing fees and damages.

Parties making claims of infringement may be able to obtain injunctive or other equitable relief that could effectively block our ability to provide our services and could cause us to pay substantial damages. In the event of a successful claim of infringement, we may need to obtain one or more licenses from third parties, which may not be available at a reasonable cost, if at all. The defense of any lawsuit could result in time-consuming and expensive litigation, regardless of the merits of such claims, and could also result in damages, license fees, royalty payments and restrictions on our ability to provide our services, any of which could harm our business.

***Future disruptive new technologies could have a negative effect on our businesses.***

VoIP technology, which our business is based upon, did not exist and was not commercially viable until relatively recently. VoIP technology is having a disruptive effect on traditional telephone companies, whose businesses are based on other technologies. We also are subject to the risk of future disruptive technologies. If new technologies develop that are able to deliver competing voice services at lower prices, better or more conveniently, it could have a material adverse effect on us.

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

Many of the key responsibilities of our business have been assigned to a relatively small number of individuals. Our future success depends to a considerable degree on the vision, skills, experience and effort of our senior management, including Jeffrey Citron, our founder, Chairman and Chief Strategist, Michael Snyder, our Chief Executive Officer, John Rego, our Chief Financial Officer, and Louis Mamakos, our Chief Technology Officer. We may add additional senior personnel in the future.

If we lose the services of any of our key employees, or if members of our management team do not work well together, it would have an adverse effect on our business. In particular, Mr. Citron has been the driving force in the development of our business to date, and he will continue to be in charge of our overall strategy and be closely involved with our technology and other aspects of our business. However, Mr. Citron could decide to resign as our Chairman and Chief Strategist, which could have a material adverse effect on us.

***The past background of our founder, Chairman and Chief Strategist, Jeffrey A. Citron, may adversely affect our ability to enter into business relationships and may have other adverse effects on our business.***

Prior to joining Vonage, Mr. Citron was associated with Datek Securities Corporation and Datek Online Holdings Corp., including as an employee of, and consultant for, Datek Securities and, later, as one of the principal executive officers and largest stockholders of Datek Online. Datek Online, which was formed in early 1998 following a reorganization of the Datek business, was a large online brokerage firm. Datek Securities was a registered broker-dealer that engaged in a number of businesses, including proprietary trading and order execution services. During a portion of the time Mr. Citron was associated with Datek Securities, the SEC alleged that Datek Securities, Mr. Citron and other individuals participated in an extensive fraudulent scheme involving improper use of the Nasdaq Stock Market's Small Order Execution System, or SOES. Datek Securities (through its successor iCapital Markets LLC), Mr. Citron and other individuals entered into settlements with the SEC in 2002 and 2003, which resulted in extensive fines, bans from future association with securities brokers or dealers and enjoinders against future violations of certain U.S. securities laws. The NASD previously had imposed disciplinary action against Datek Securities, Mr. Citron and other individuals in connection with alleged violations of the rules and regulations regarding the SOES. These and other matters are discussed under "Information Concerning our Founder, Chairman and Chief Strategist."