

- ✓ Vonage Holdings Corp. (NASDAQ: VG), a provider of communications services, operates two distinct segments: (1) Consumer (26.5% of consolidated sales in 2020 but projected to be ~12.0% in 2023E), which provides Voice over Internet Protocol (VoIP) call services to ~800,000 residential subscribers; and (2) Vonage Communications Platform, or VCP (73.5% of revenue in 2020 but expected to be ~88.0% in 2023E), which is a commercially focused provider of cloud-based communications solutions, including application program interfaces (API) as well as unified communication (UCaaS) and contact center (CCaaS) services.
- ✓ In our view, the market is currently underappreciating Vonage's transition from being a provider of legacy residential VoIP services, which are cash-flow generative but in secular decline, toward becoming a fast-growing, cloud-based communications platform (CPaaS), offering video, voice, messaging, e-mail, verification, and artificial intelligence (AI) solutions to business customers. In February 2021 the company concluded a strategic review that maintained its current operating structure; however, we think the recent involvement of sometimes-activist investor Jana Partners, which in May 2021 disclosed a 2.3% (or 5.8 million share) stake that it has subsequently increased to almost 4% (or ~9.8 million shares), could be an incremental catalyst for VG on a range of corporate issues, including governance and disclosure, and/or prompt an ultimate reevaluation of strategic alternatives, including a separation or outright take-out transaction. As well, we would note that Legion Partners also holds a ~2.2% stake in VG and, per a March 2019 cooperation agreement, controls one of the company's eleven Board seats.
- ✓ Based on management commentary and peer and M&A valuations, VG's VCP and legacy Consumer businesses can be valued at \$21 per share and ~\$1 per share, respectively. Accounting for projected net debt of ~\$2 per share yields a base case sum-of-the-parts fair value of ~\$20 per share (with bull/bear cases of \$26.50 and \$13 per share, respectively).

Vonage Holdings Corp.

(NASDAQ: VG)

Date (9/14/21)

Price \$15.12/share

Market capitalization ~\$3.8B

Consumer: \$1 per share

VCP: \$21 per share

API: \$15/share

UC & CC: \$6/share

Net Debt: \$2 per share

SOTP: \$20 per share*

*SOTP may not add due to rounding

NOTE: This publication could be considered as advocating for corporate restructurings. Authors select companies for this report based on the potential for a future value-unlocking transaction. In many cases, these companies have or could come under activist investor pressure, media scrutiny, or general market speculation that a spin-off or asset sale is possible.



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The Background

Vonage Holdings Corp. (NASDAQ: VG), headquartered in Holmdel, NJ, was, for all intents and purposes, founded in 2001 by current chairman Jeffrey Citron (who owns ~3.5% of the shares) as a provider of Voice over Internet Protocol (VoIP) services, which allow customers to make voice calls using broadband internet (as opposed to using analog phone lines). The company went public in 2006 and in 2013 began to pivot, largely via acquisition (e.g., Vocalcity, Telesphere, SimpleSignal, iCore, Nexmo, TokBox, and NewVoiceMedia), from being a home phone provider toward becoming a global business cloud communications platform. Today, the company operates two reportable business segments (see Background #1): (1) Consumer (~26.5% of consolidated sales in 2020 but projected to be ~12.0% in 2023E), which comprises the company’s legacy residential VoIP communications business; and (2) Vonage Communications Platform, or VCP (73.5% of sales in 2020 but expected to be ~88.0% in 2023E), which includes the company’s Application Program Interfaces (API) as well as its Unified Communications (UCaaS) and Contact Center (CCaaS) services.

Background #1 Vonage: Consolidated Selected Financial Items, 2018–2023E

(\$ in millions)

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021E</u>	<u>2022E</u>	<u>2023E</u>
<u>Sales:</u>						
VCP	\$608.1	\$803.9	\$915.1	\$1,093.0	\$1,314.5	\$1,618.5
<u>Consumer</u>	<u>\$440.6</u>	<u>\$385.5</u>	<u>\$332.9</u>	<u>\$287.9</u>	<u>\$247.2</u>	<u>\$215.9</u>
Total	\$1,048.8	\$1,189.3	\$1,247.9	\$1,381.0	\$1,561.6	\$1,834.5
<u>Gross profit:</u>						
VCP	\$279.6	\$376.2	\$437.5	\$521.4	\$630.9	\$785.0
<u>Consumer</u>	<u>\$342.2</u>	<u>\$302.0</u>	<u>\$256.9</u>	<u>\$210.2</u>	<u>\$180.4</u>	<u>\$157.6</u>
Total	\$621.8	\$678.3	\$694.4	\$731.6	\$811.4	\$942.6
<u>Adjusted EBITDA:</u>						
VCP	(\$114.6)	(\$103.3)	(\$57.0)	\$4.4	\$23.7	\$78.2
<u>Consumer</u>	<u>\$292.3</u>	<u>\$261.4</u>	<u>\$227.2</u>	<u>\$184.5</u>	<u>\$155.4</u>	<u>\$134.0</u>
Total	\$177.7	\$158.1	\$170.2	\$188.9	\$179.1	\$212.2
Capital expenditures	(\$26.7)	(\$49.1)	(\$52.7)	(\$65.1)	(\$60.0)	(\$60.0)

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

For some context on the following discussion, for much of its history VG has been a leading provider of residential VoIP subscription services in the U.S. (as well as Canada and Europe), which primarily allow customers to make high-quality/low-cost voice calls using the internet (i.e., 3G/4G, LTE, cable internet and/or DSL) as opposed to using traditional/analog phone lines. While this legacy business experienced years of strong secular growth (and remains a solid cash flow contributor), it is currently in secular decline, a dynamic that will be described in more detail in the following pages. In response, beginning in 2013 the company began to pivot toward



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becoming a global cloud communications platform via a series of acquisitions, including Vocalcity, Telesphere, SimpleSignal, iCore, Nexmo, TokBox, and NewVoiceMedia, which, today, comprise the core of its commercial/business-focused Vonage Communications Platform (VCP) segment.

In terms of full year 2021 guidance (see Background #2), VG expects consolidated sales of \$1.383-\$1.394 billion (compared with \$1.248 billion in 2020), with total adjusted EBITDA of \$189-\$194 million (compared with \$170.2 million in 2020). By segment, at VCP, management expects segment sales of \$1.095-\$1.106 billion, including 20%-22% growth in service revenue to \$1.038-\$1.049 billion, with adjusted EBITDA of \$4.0-\$9.0 million (compared with a \$57 million loss in 2020). At Consumer, full year sales are expected to fall ~13.5% to ~\$288 million in 2021, with adjusted EBITDA of ~\$185 million (compared with \$227 million in 2020). For 3Q 2021 specifically, Vonage expects consolidated sales and adjusted EBITDA of \$345-\$349 million and \$46-\$48 million, respectively. By segment, at VCP, management expects September-quarter sales of \$276-\$280 million, reflecting service revenue growth of 20%-22%, with adjusted EBITDA of \$1.0-\$3.0 million. At Consumer, 3Q 2021 segment sales are expected to decline ~17% to \$69 million, with adjusted EBITDA of ~\$45 million.

Background #2 Vonage: 2021E Full Year Consolidated Financial Guidance Progression

	<u>2021E</u> <u>Initial</u>	<u>2021E</u> <u>Previous</u>	<u>2021E</u> <u>Current</u>
Total VCP revenue	\$1.038 - \$1.054 billion	\$1.062 - \$1.071 billion	\$1.095 - \$1.106 billion
VCP Service revenue	\$986 million - \$1.003 billion	\$1.010 - \$1.02 billion	\$1.038 - \$1.049 billion
Y-o-Y growth	15% - 17%	18% - 19%	20% - 22%
<u>Total Consumer revenue</u>	<u>~\$285 million</u>	<u>~\$285 million</u>	<u>~\$288 million</u>
Total consolidated sales	\$1.323 - \$1.339 billion	\$1.347 - \$1.356 billion	\$1.383 - \$1.394 billion
VCP adjusted EBITDA	\$5.0 - \$9.0 million	\$0.0 - \$5.0 million	\$4.0 - \$9.0 million
<u>Consumer adjusted EBITDA</u>	<u>\$185 - \$189 million</u>	<u>\$185 - \$194 million</u>	<u>~\$185 million</u>
Total adjusted EBITDA	\$190 - \$200 million	\$185 - \$194 million	\$189 - \$194 million
Capex	~\$60 million	~\$65 million	~\$65 million

Source: Company reports.

In the medium term, while the company has not formally provided any granular guidance for the Consumer segment, other than to forecast the generation of ~\$600 million in cash flow over the next five years (2021E-2025E), it has articulated specific targets for the VCP segment (see Background #3). For 2022E, the company expects Service sales to grow in the “low-20%” range, including “high-single digit to low-teens” growth in the Unified Communications/Contact Center (UC/CC) business and growth “approaching 30%” in Application Program Interfaces (API), with a segment adjusted EBITDA margin in the “low-single digits”. For 2023E, the company expects growth in Service sales to accelerate further into the “mid-20%” range, driven by growth again “approaching 30%” for API and “low-to-mid teens” growth at UC/CC. More broadly, the company has articulated the longer-term target of achieving what it terms the “Rule of 40”, which management calculates by adding the percentage rate of growth at VCP Services and the VCP segment’s adjusted EBITDA margin; to that end, the company’s goal is to have the sum of those



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two figures exceed 40% over the longer term (compared with “mid-20%” in 2022E and “30% plus” in 2023E).

Background #3 Vonage: 2022E-2023E Financial Targets for VCP Segment

(\$ in millions)

	<u>VCP segment</u>	
	<u>2022E</u>	<u>2023E</u>
Service revenue growth	Low-20% s	Mid-20% s
API	Approaching 30%	Approaching 30%
UCaaS & CCaaS	High-single to Low-teens %	Low-to-Mid teens %
VCP adj. EBITDA margin	Low-single digits	Low-to-Mid single digits
Rule of 40	Mid-20% s	30%-plus

Source: Company reports.

Consumer

The Consumer portion of VG’s business, which comprised 26.5% of consolidated sales in 2020 but is projected to be ~12.0% in 2023E, provides Voice over Internet Protocol (VoIP) services, which allow ~836,000 residential subscribers (at the end of 2Q 2021) to make high-quality (and, at less than \$30 per month, relatively low-cost) voice calls using broadband internet (as opposed to analog phone lines). While this legacy business, in which VG was a pioneer, drove years of strong secular growth at VG (i.e., growing from essentially zero at inception to ~\$900 million in 2008), a host of technological advancements as well as consumer behavior and competitive shifts have left the business in secular decline. In that regard, VG’s Consumer business has seen average annual top-line declines in the mid-single digits in the last 12 years (although the rate of decline has accelerated into the low teens since 2018). In 2020, Consumer segment sales fell ~13.5% to \$333 million, with an about 13% decline in adjusted EBITDA to \$227 million (on a margin of 68.2%). In the first six months of 2021, segment sales declined ~11% to \$152.5 million, with an ~18% contraction in adjusted EBITDA to about \$98 million (on a margin of 64.1%). For full year 2021, management expects Consumer segment sales to decline ~13.5% to ~\$288 million, with adjusted EBITDA of ~\$185 million (see Background #4). For 3Q 2021 specifically, management expect segment sales will decline ~17% to \$69 million, with adjusted EBITDA of ~\$45 million. Longer term, the company has indicated the expectation that the Consumer business will generate cash flow of ~\$600 million over the next five years (i.e., 2021-2025).

Background #4 Vonage: Consumer Segment, 2021 Financial Guidance Progression

	<u>2021E</u> <u>Initial</u>	<u>2021E</u> <u>Previous</u>	<u>2021E</u> <u>Current</u>
Total Consumer segment sales	~\$285 million	~\$285 million	~\$288 million
Consumer segment adj. EBITDA	\$185 - \$189 million	\$185 - \$194 million	~\$185 million

Source: Company reports.



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For our part, we project segment sales and adjusted EBITDA to decline at a compound annual rate of ~13.5% and ~16%, respectively, to ~\$216 million and \$134 million in 2023E (see Background #5).

Background #5 Vonage: Consumer Segment, Selected Financial Items (2018-2023E)

(\$ in millions)

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<i>6 mos.</i> <u>2020</u>	<i>6 mos.</i> <u>2021</u>	<u>2021E</u>	<u>2022E</u>	<u>2023E</u>
Sales	\$440.6	\$385.5	\$332.9	\$171.5	\$152.5	\$287.9	\$247.2	\$215.9
Service	\$394.4	\$340.5	\$292.0	\$152.3	\$129.0	\$243.0	\$204.5	\$175.4
Access & product	\$0.6	\$0.3	\$0.3	\$0.1	\$0.1	\$0.3	\$0.2	\$0.2
USF	\$45.7	\$44.7	\$40.6	\$19.1	\$23.4	\$44.7	\$42.4	\$40.3
Gross profit	\$342.2	\$302.0	\$256.9	\$134.3	\$111.2	\$210.20	\$180.43	\$157.62
Sales & marketing	-	-	\$12.4	\$6.4	\$7.6	\$14.4	\$13.5	\$13.0
Engineering & development	-	-	\$8.5	\$4.3	\$1.8	\$5.8	\$5.4	\$4.9
General & administrative	-	-	\$14.4	\$8.3	\$6.5	\$12.1	\$11.6	\$11.3
<u>Depreciation & amortization</u>	<u>\$8.7</u>	<u>\$6.1</u>	<u>\$3.7</u>	<u>\$2.3</u>	<u>\$0.6</u>	<u>\$1.4</u>	<u>\$1.4</u>	<u>\$1.3</u>
Income from operations	-	-	\$218.0	\$113.0	\$94.7	\$176.5	\$148.5	\$127.2
EBITDA	-	-	\$221.7	\$115.3	\$95.3	\$178.0	\$149.9	\$128.5
Adj. EBITDA	\$292.3	\$261.4	\$227.2	\$119.0	\$97.7	\$184.5	\$155.4	\$134.0
<u>Margins:</u>								
Gross margin	77.7%	78.4%	77.2%	78.3%	72.9%	73.0%	73.0%	73.0%
Operating margin	-	-	65.5%	65.9%	62.1%	61.3%	60.1%	58.9%
EBITDA margin	-	-	66.6%	67.2%	62.5%	61.8%	60.7%	59.5%
Adj. EBITDA margin	-	-	68.2%	69.4%	64.1%	64.1%	62.9%	62.0%
<u>Operating statistics:</u>								
Avg. monthly revenue per line	\$26.42	\$27.04	\$27.77	\$27.40	\$29.11	\$28.53	\$29.10	\$29.54
# of subscriber lines	1,287,649	1,087,819	909,965	998,475	836,243	709,773	585,562	494,800

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Vonage Communications Platform (VCP)

The VCP business, which comprised 73.5% of sales in 2020 but is expected to be ~88.0% in 2023E, is a business-to-business cloud communications platform providing unified communications (UCaaS), contact center (CCaaS), and application program interfaces (API) solutions to clients ranging from large enterprises to small and medium-sized businesses (SMB) in myriad industry verticals, including retail (20% of 2020 sales), professional services (12%), social media & gaming (11%), financial/insurance (9%), healthcare (8%), travel/transportation & hospitality (7%), technology (3%), manufacturing (3%), government/nonprofit (3%), and education (2% of 2020 sales). In terms of geography, in 2020 roughly 62% of the company's sales came from the Americas, while 23% and 15% stemmed from Europe, the Middle East and Africa (EMEA) and the Asia-Pacific (APAC) region, respectively.



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As mentioned earlier, VG began its pivot away from its legacy residential VoIP business in 2013; to that end, between November 2013-September 2015, the company acquired four privately held unified communications-as-a-service (UCaaS) companies with ~\$200 million in collective sales, for an aggregate price tag of ~\$361.5 million. These included Vocalcity (\$56 million in sales; purchased for \$130 million), Telesphere Networks (\$57 million in sales; acquired in November 2014 for \$114 million), SimpleSignal (~\$17 million in sales; bought for \$25.25 million in April 2015), and, lastly, iCore Networks (~\$71 million in sales and a purchase price of \$92 million). In June 2016, the company entered the API market, which allows software developers to embed communications capabilities (such as voice, video or messaging) into their applications, with the \$250 million purchase of privately held Nexmo, Inc., the sector’s second-largest player. In August 2018 it further expanded its offerings (e.g., into video) via the ~\$35 million purchase of TokBox. Subsequently, in November 2018, the company purchased NewVoiceMedia, a leading provider of contact center-as-a-service solutions with ~\$92 million in sales, for \$350 million. All told, VG estimates that its end-to-end suite of services opens a total addressable cloud communications market that will reach ~\$76 billion in 2023E (up from ~\$55 billion in 2020), which is sub-segmented into UCAas, CCaaS, and CPaaS markets of ~\$48 billion, \$11 billion, and \$17 billion, respectively.

In 2020, VCP posted ~14% top-line growth to \$915 million (see Background #8), with an adjusted EBITDA loss of \$57 million (compared with a \$103 million loss in 2019). In the first six months of 2021, the segment posted almost 22% growth to \$532 million and narrowed its EBITDA loss to less than \$1 million (from ~\$39 million in the prior-year period). For full year 2021 (see Background #6), the company expects VCP segment sales of \$1.095-\$1.106 billion, including 20%-22% growth in service revenue to \$1.038-\$1.049 billion, with adjusted EBITDA of \$4.0-\$9.0 million (compared with a \$57 million loss in 2020). For 3Q 2021 specifically, Vonage expects VCP segment sales of \$276-\$280 million, reflecting service revenue growth of 20%-22%, with adjusted EBITDA of \$1.0-\$3.0 million.

Background #6 Vonage: VCP Segment, 2021 Financial Guidance Progression

	<u>2021E</u> <u>Initial</u>	<u>2021E</u> <u>Previous</u>	<u>2021E</u> <u>Current</u>
Total VCP revenue	\$1.038 - \$1.054 billion	\$1.062 - \$1.071 billion	\$1.095 - \$1.106 billion
VCP Service revenue	\$986 million - \$1.003 billion	\$1.010 - \$1.02 billion	\$1.038 - \$1.049 billion
Y-o-Y growth	15% - 17%	18% - 19%	20% - 22%
VCP adjusted EBITDA	\$5.0 - \$9.0 million	\$0.0 - \$5.0 million	\$4.0 - \$9.0 million

Source: Company reports.

Looking into 2022E, Vonage expects VCP segment Service sales to grow in the “low-20%” range, including “high-single digit to low-teens” growth in the UC/CC business and API growth “approaching 30%”, with a segment adjusted EBITDA margin in the “low-single digits” (see Background #7). For 2023E, the company expects growth in VCP Service sales to accelerate further into the “mid-20%” range, driven by growth “approaching 30%” in API and “low-to-mid teens” growth at UC/CC. More broadly, the company has articulated the longer-term target of



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achieving what it terms the “Rule of 40”, which management calculates by adding the percentage rate of growth at VCP Services and the VCP segment’s adjusted EBITDA margin; to that end, the company’s goal is to have the sum of those two figures exceed 40% over the longer term (compared with “mid-20%” in 2022E and “30% plus” in 2023E).

Background #7 Vonage: 2022E-2023E Financial Targets for VCP Segment

	<u>VCP segment</u>	
	<u>2022E</u>	<u>2023E</u>
Service revenue growth	Low-20% s	Mid-20% s
API	Approaching 30%	Approaching 30%
UCaaS & CCaaS	High-single to Low-teens %	Low-to-Mid teens %
VCP adj. EBITDA margin	Low-single digits	Low-to-Mid single digits
Rule of 40	Mid-20% s	30%-plus

Source: Company reports.

For our part, we project segment sales to grow at a compound annual rate of ~21% through 2023E to ~\$1.62 billion, with adjusted EBITDA of ~\$78 million (see Background #8).

Background #8 Vonage: VCP Segment, Selected Financial Items (2018-2023E)

(\$ in millions)

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2020</u>	<u>2021</u>	<u>2021E</u>	<u>2022E</u>	<u>2023E</u>
Sales	\$608.1	\$803.9	\$915.1	\$436.5	\$531.9	\$1,093.0	\$1,314.5	\$1,618.5
Service	\$526.7	\$719.5	\$856.5	\$408.0	\$500.9	\$1,040	\$1,264	\$1,569
Access & product	\$50.1	\$46.2	\$36.6	\$19.2	\$17.4	\$29.3	\$26.3	\$25.0
USF	\$31.4	\$38.1	\$22.0	\$9.3	\$13.6	\$24.2	\$24.4	\$24.7
Gross profit	\$279.6	\$376.2	\$437.5	\$212.3	\$247.6	\$521.4	\$630.9	\$785.0
Sales & marketing	-	\$342.8	\$329.7	\$170.0	\$160.1	\$326.0	\$361.5	\$411.9
Engineering & development	-	\$58.9	\$73.0	\$34.7	\$41.2	\$82.0	\$105.2	\$129.5
General & administrative	-	\$140.7	\$167.7	\$75.4	\$81.8	\$163.95	\$190.60	\$210.41
<u>Depreciation & amortization</u>	<u>\$62.3</u>	<u>\$80.2</u>	<u>\$85.2</u>	<u>\$38.8</u>	<u>\$42.1</u>	<u>\$86.9</u>	<u>\$92.0</u>	<u>\$97.1</u>
Income from operations	-	(\$246.3)	(\$218.1)	(\$106.7)	(\$77.6)	(\$137.4)	(\$118.3)	(\$63.9)
EBITDA	-	(\$166.1)	(\$132.9)	(\$67.8)	(\$35.5)	(\$50.6)	(\$26.3)	\$33.2
Adj. EBITDA (as reported)	(\$114.6)	(\$103.3)	(\$57.0)	(\$38.6)	(\$0.7)	\$4.4	\$23.7	\$78.2
Margins:								
Gross margin	46.0%	46.8%	47.8%	48.6%	46.6%	47.7%	48.0%	48.5%
Operating margin	-	-30.6%	-23.8%	-24.4%	-14.6%	-12.6%	-9.0%	-4.0%
EBITDA margin	-	-20.7%	-14.5%	-15.5%	-6.7%	-4.6%	-2.0%	2.1%
Adj. EBITDA margin	-18.8%	-12.8%	-6.2%	-8.8%	-0.1%	0.4%	1.8%	4.8%
Rule of 40	-18.8%	23.8%	12.8%	11.4%	22.6%	21.8%	23.4%	29.0%

Source: Company reports, Bloomberg, and Institutional Research Group estimates.



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Balance Sheet and Cash Flow

At the end of 2Q 2021, VG had net debt of \$475.5 million, including unrestricted cash of \$40 million and debt of \$515.5 million (see Background #9). The company's debt is primarily comprised of \$170.5 million on a revolving credit facility due 2023 (carrying average interest of 2.88%) and \$345 million in 1.75% senior convertible notes due 2024 (with a conversion price of \$16.72). As well, we would note that the company has \$618.5 million of U.S. net operating loss carry forwards (NOLs) expiring at various times through 2037, along with an additional \$159.15 million in non-U.S. NOLs (primarily in the U.K.) that have no expiration date.

Background #9 Vonage: Balance Sheet Snapshot

(\$ in millions)

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2Q 2021</u>
Cash	\$5.1	\$23.6	\$43.1	\$40.0
Restricted cash	\$2.0	\$2.0	\$1.9	\$2.1
Debt	\$519.2	\$220.5	\$215.5	\$170.5
Convertible senior notes	-	\$276.7	\$290.8	\$298.1
Unamortized discount on debt	<u>\$0.8</u>	<u>\$7.1</u>	\$5.5	\$4.7
<u>Unamortized discount on debt</u>	=	<u>\$61.2</u>	<u>\$48.7</u>	<u>\$42.2</u>
Total	\$520.0	\$565.5	\$560.5	\$515.5
Net debt	\$514.9	\$541.9	\$517.4	\$475.5
Leverage ratio	2.9x	3.6x	3.3x	2.7x
Leverage ratio, net	2.9x	3.4x	3.0x	2.5x

Source: Company reports.

For 2021, VG has guided to ~\$65 million in capital spending (see Background #10) and indicated the expectation that the leverage ratio will fall below 2.3x by year-end. More broadly, per management commentary, the company's capital allocation framework is likely to focus on internal investments for growth at VCP, along with debt repayment and, to a lesser degree, tuck-in M&A (again, focused on the VCP segment).



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Background #10 Vonage: Sources and Uses of Cash Flow

(\$ in millions, except per share amounts)

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<i>6 mos.</i> <u>2020</u>	<i>6 mos.</i> <u>2021</u>	<u>2021E</u>	<u>2022E</u>	<u>2023E</u>
Net income	\$35.7	(\$19.5)	(\$36.2)	(\$12.2)	(\$0.3)	\$6.8	\$0.2	\$24.9
Depreciation & amortization	\$71.0	\$86.3	\$88.9	\$41.2	\$42.7	\$88.3	\$93.4	\$98.4
<u>Other</u>	<u>\$16.5</u>	<u>\$26.2</u>	<u>\$31.2</u>	<u>\$9.8</u>	<u>\$47.1</u>	<u>\$15.0</u>	<u>\$5.0</u>	<u>\$5.0</u>
Net cash from operations	\$123.2	\$92.9	\$83.9	\$38.8	\$89.5	\$110.1	\$98.6	\$128.3
Capital expenditures	(\$19.0)	(\$20.3)	(\$10.6)	(\$4.9)	(\$4.7)	(\$15.0)	(\$20.0)	(\$20.0)
Development & acquisition of software	(\$7.7)	(\$28.5)	(\$41.8)	(\$20.2)	(\$24.4)	(\$50.0)	(\$40.0)	(\$40.0)
<u>Purchase of intangibles</u>	<u>-</u>	<u>(\$0.3)</u>	<u>(\$0.3)</u>	<u>(\$0.2)</u>	<u>(\$0.1)</u>	<u>(\$0.1)</u>	<u>\$0.0</u>	<u>\$0.0</u>
Total	(\$26.7)	(\$49.1)	(\$52.7)	(\$25.2)	(\$29.2)	(\$65.1)	(\$60.0)	(\$60.0)
Free cash flow	\$96.5	\$43.8	\$31.2	\$13.6	\$60.3	\$45.0	\$38.6	\$68.3
Adjusted EBITDA (less capex)	\$151.0	\$109.0	\$117.5	\$55.1	\$67.8	\$123.8	\$119.1	\$152.2
Acquisitions	(\$380.5)	(\$3.0)	-	-	-	-	-	-
Repurchases	-	(\$10.0)	-	-	-	-	-	-
Stock option exercises	\$6.5	\$2.0	\$10.3	\$0.2	\$0.9	\$2.5	\$2.5	\$2.5

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Management, Governance and Ownership

In July 2020, Rory Read, former chief operating officer of Dell (NYSE: DELL) as well as the former head of its Virtustream subsidiary, replaced Alan Masarek (who took the helm in late 2014) as VG’s chief executive (CEO). Subsequently, Mr. Read has, in his contention, upgraded the senior leadership team with the August 2020 hiring of former Dell executive Joy Corso as chief marketing officer (CMO), as well as the January 2021 recruitment of former IBM (NYSE: IBM) executives Stephen Lasher and Jay Bellissimo as chief financial (CFO) and chief operating officer (COO), respectively. Altogether, executives, directors, and insiders own slightly less than 5% of VG’s outstanding shares (although the bulk of that is attributable to Jeffrey Citron, the company’s founder, former CEO, and current chairman, who owns ~3.5% of the company; see Background #11).

In terms of notable institutional ownership, we would note that Legion Partners, currently a 2.2% owner, has held shares since 2017 and, per a 2019 cooperation agreement, appointed an independent director, Michael McConnell, to VG’s Board. (Currently, VG’s Board has 11 members, of which 10, excluding VG’s chief executive, Mr. Read, are deemed independent. While the chairman, Mr. Citron, is somewhat oddly considered independent, we would note that the lead independent director is John Roberts.) In February 2020, the company initiated a strategic review of its Consumer business and indicated that it would explore, among other things, a potential divestiture (in pursuit of becoming a pure-play business SaaS provider). In November 2020, the company indicated that it had engaged advisors and would begin to market the segment for sale, but ultimately, in February 2021, it opted to end the review and retain the business.



HIDDEN OPPORTUNITIES

“Valuing possible breakups by providing sum-of-the-parts analysis.”

(Anecdotally, the company indicated that it engaged with ~70 interested parties but failed to receive any bids that met its internal valuation criteria, particularly relative to its expectation that the business would generate ~\$600 million of cash flow over the next five years.) Subsequently, in May 2020, Jana Partners disclosed a 2.3% (or 5.8 million share) stake in the company, which it has more recently increased to almost 4% (see Background #11).

Background #11 Vonage: Current Insider and Institutional Ownership

	<u>Shares held</u>	<u>% ownership</u>
<u> Holders:</u>		
BlackRock Inc.	32.7	13.0%
Vanguard Group	26.3	10.5%
Janus Henderson Group	15.4	6.1%
Jana Partners	9.8	3.9%
Park West Asset Management	9.6	3.8%
Jeffrey Citron	8.8	3.5%
Morgan Stanley	8.8	3.5%
State Street	7.8	3.1%
Goldman Sachs Group	5.6	2.2%
Legion Partners	5.6	2.2%
First Trust Advisors	5.4	2.1%
TimesSquare Capital Management	4.6	1.8%
Nantahala Capital Management	4.3	1.7%
Dimensional Fund Advisors	4.1	1.6%
Geode Capital Management	4.1	1.6%
Norges Bank	3.8	1.5%
Government Pension Fund Global	3.8	1.5%
Empyrean Capital Partners	3.6	1.4%
River Road Asset Management	3.6	1.4%
<u>Bank of New York Mellon</u>	<u>3.1</u>	<u>1.2%</u>
Total	170.8	67.8%

Insiders:

All executives, directors & insiders (25 persons)	11.9	4.7%
All insiders, ex- Jeffrey Citron (VG's founder & Chairman)	2.0	0.8%

Source: Company reports, and Bloomberg.



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The Breakdown

Based on the assumptions discussed throughout this report, we think it can be reasonably projected that VG could generate 2023E sales and adjusted EBITDA of almost \$1.835 billion and ~\$212 million, respectively (see Breakdown #1).

Breakdown #1 Vonage: Adjusted 2018-1H 2021 Results and 2021-2023 Forecasts

(\$ in millions)

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<i>6 mos.</i> <u>2020</u>	<i>6 mos.</i> <u>2021</u>	<u>2021E</u>	<u>2022E</u>	<u>2023E</u>
<u>Sales:</u>								
VCP	\$608.1	\$803.9	\$915.1	\$436.5	\$531.9	\$1,093.0	\$1,314.5	\$1,618.5
<u>Consumer</u>	<u>\$440.6</u>	<u>\$385.5</u>	<u>\$332.9</u>	<u>\$171.5</u>	<u>\$152.5</u>	<u>\$287.9</u>	<u>\$247.2</u>	<u>\$215.9</u>
Total	\$1,048.8	\$1,189.3	\$1,247.9	\$608.0	\$684.4	\$1,381.0	\$1,561.6	\$1,834.5
<u>Gross profit:</u>								
VCP	\$279.6	\$376.2	\$437.5	\$212.3	\$247.6	\$521.4	\$630.9	\$785.0
<u>Consumer</u>	<u>\$342.2</u>	<u>\$302.0</u>	<u>\$256.9</u>	<u>\$134.3</u>	<u>\$111.2</u>	<u>\$210.2</u>	<u>\$180.4</u>	<u>\$157.6</u>
Total	\$621.8	\$678.3	\$694.4	\$346.6	\$358.8	\$731.6	\$811.4	\$942.6
<u>Adjusted EBITDA:</u>								
VCP	(\$114.6)	(\$103.3)	(\$57.0)	(\$38.6)	(\$0.7)	\$4.4	\$23.7	\$78.2
<u>Consumer</u>	<u>\$292.3</u>	<u>\$261.4</u>	<u>\$227.2</u>	<u>\$119.0</u>	<u>\$97.7</u>	<u>\$184.5</u>	<u>\$155.4</u>	<u>\$134.0</u>
Total	\$177.7	\$158.1	\$170.2	\$80.4	\$97.0	\$188.9	\$179.1	\$212.2
Capital expenditures	(\$26.7)	(\$49.1)	(\$52.7)	(\$25.2)	(\$29.2)	(\$65.1)	(\$60.0)	(\$60.0)

Source: Company reports, Bloomberg, and Institutional Research Group estimates.



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Breakdown #2 Vonage: Public Comparables

(\$ in millions, except per share amounts; shares in millions)

9/13/2021	Vonage Holdings Corp	Agora Inc	Bandwidth Inc	8x8 Inc	Five9 Inc	Ooma Inc	RingCentral Inc	Sinch AB	Twilio Inc
Ticker	VG	API	BAND	EGHT	FIVN	OOMA	RNG	SINCH SS	TWLO
Price	\$15.12	\$30.51	\$108.57	\$24.02	\$170.39	\$21.54	\$220.50	\$182.95	\$336.01
Shares Out	251.9	96.8	23.1	112.0	67.7	23.5	81.4	726.8	166.9
M Cap	3,808.0	3,535.2	2,726.2	2,691.0	11,540.5	506.2	20,178.0	132,975.4	59,524.1
Net Debt	475.5	(826.1)	162.4	172.3	207.4	(30.0)	1,041.2	(11,190.0)	(4,913.3)
EV	4,283.5	2,709.1	2,888.6	2,863.3	11,747.9	476.2	21,219.2	121,785.4	54,610.8
Revenue									
2021E	1,385.5	162.3	485.8	527.5	587.5	168.0	1,543.9	15,686.0	2,682.9
2022E	1,523.0	205.3	579.1	610.6	712.4	189.0	1,907.5	22,248.7	3,489.1
2023E	1,742.5	281.0	683.4	709.7	900.8	207.0	2,366.1	25,193.0	4,589.8
EV / Sales									
2021E	3.1x	16.7x	5.9x	5.4x	20.0x	2.8x	13.7x	7.8x	20.4x
2022E	2.8x	13.2x	5.0x	4.7x	16.5x	2.5x	11.1x	5.5x	15.7x
Average		9.3x							
2023E	2.4x	9.6x	4.2x	4.0x	13.0x	2.3x	9.0x	4.8x	11.9x
Average		7.4x							
EBITDA									
2021E	192.3	(48.5)	50.1	0.7	106.4	13.3	227.6	1,178.9	226.6
2022E	206.3	(43.8)	51.8	22.8	141.5	12.4	272.8	2,760.4	291.1
2023E	257.0	(26.0)	74.3	44.6	186.8	15.3	363.0	3,371.7	456.3
EV / EBITDA									
2021E	22.0x	-	57.7x	-	-	35.8x	93.2x	-	-
2022E	20.5x	-	55.7x	-	83.0x	38.5x	77.8x	44.1x	-
2023E	16.5x	-	38.9x	64.2x	62.9x	31.1x	58.5x	36.1x	119.7x
EPS									
2021E	\$0.19	(\$0.35)	\$0.74	(\$0.14)	\$1.04	\$0.47	\$1.29	\$1.45	(\$0.28)
2022E	\$0.23	(\$0.30)	\$0.74	\$0.05	\$1.33	\$0.42	\$1.60	\$2.67	\$0.06
2023E	\$0.31	(\$0.14)	\$1.14	\$0.19	\$1.78	\$0.50	\$2.22	\$3.21	\$0.67
P/E									
2021E	80.9x	-	-	-	-	46.0x	-	-	-
2022E	66.3x	-	-	-	-	50.9x	-	68.5x	-
2023E	48.2x	-	95.4x	127.8x	96.0x	42.8x	99.5x	57.1x	-

Source: Company reports, Bloomberg, and Institutional Research Group estimates



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In terms of public peers, VG’s VPC business could be compared with a broad range of communication concerns, such as Agora Inc. (NASDAQ: API), Bandwidth Inc. (NASDAQ: BAND), 8x8 Inc. (NASDAQ: EGHT), Five9 Inc. (NASDAQ: FIVN), Ooma Inc. (NYSE: OOMA), RingCentral Inc. (NYSE: RNG), Sinch AB (SINCH SS), and Twilio Inc. (NYSE: TWLO), which, on average, trade at ~7.5x EV/2022E sales (see Breakdown #2), in a wide range of 2.5x-12.0x (see Breakdown #2). In terms of recent infrastructure software M&A activity, the average trailing-EV/sales multiple averaged ~8.5x (albeit in a wide range of 2.0-31.0x; see Background #3).

Breakdown #3 Vonage: Infrastructure Software Sector M&A, Selected Items

<u>Announcement</u>	<u>Target</u>	<u>Acquirer</u>	<u>Transaction</u>	<u>TV/LTM</u>	<u>TV/FY1</u>	<u>TV/LTM</u>
			<u>value (target</u>	<u>EBITDA</u>	<u>EBITDA</u>	<u>sales</u>
			<u>currency,</u>			
			<u>millions)</u>			
8/21/2019	Carbon Black Inc	VMware Inc	\$1,800	-	-	7.9x
8/21/2019	Pivotal Software Inc	VMware Inc	\$3,509	-	97.5x	5.1x
12/23/2018	MINDBODY Inc	Vista Equity Partners LLC	\$1,677	-	138.5x	7.3x
10/14/2018	SendGrid Inc	Twilio Inc	\$1,564	418.2x	-	11.4x
11/26/2017	Barracuda Networks Inc	Thoma Bravo LLC	\$1,272	39.6x	15.5x	3.4x
10/21/2019	Cision Ltd	Platinum Equity LLC	\$2,739	10.8x	-	3.7x
8/25/2016	Rackspace Hosting Inc	Apollo Global & Searchlight Capital	\$4,291	6.6x	5.8x	2.1x
11/30/2020	Slack Technologies	salesforce.com Inc	\$25,783	-	-	30.9x
4/25/2021	Proofpoint	Thoma Bravo LLC	\$10,327	282.9x	50.3x	9.5x
<u>5/31/2021</u>	Cloudera	KKR	\$4,445	<u>154.9x</u>	<u>16.8x</u>	<u>5.0x</u>
Avg.				152.2x	54.1x	8.6x

Source: DealBase by Chain Bridge Research.

Consumer Segment

Applying a multiple of 1.0x to 2022E EBITDA of ~\$134 million, which equates to an ~0.6x EV/sales multiple, yields a base case segment value of ~\$134 million, or \$1 per share (see Breakdown #4).

Breakdown #4 Vonage: Estimated Value of Consumer Business Based on 2023E EBITDA (and Sales)

(\$ in millions, except per share amounts; shares in millions)

	<u>Consumer</u>		
2022E Revenue		\$247.2	
<u>Revenue growth est.</u>		<u>-12.6%</u>	
2023E Revenue		\$215.9	
EBITDA margin		<u>62.0%</u>	
2023E EBITDA		\$134.0	
<u>Applied multiple</u>	<u>0.0x</u>	1.0x	<u>2.0x</u>
Enterprise value	\$0.0	\$134.0	\$267.9
Diluted shares	<u>260.0</u>	<u>260.0</u>	<u>260.0</u>
Per share basis	\$0.00	\$0.52	\$1.03
Implied sales multiple	0.0x	0.6x	1.2x

Source: Company reports, Bloomberg, and Institutional Research Group estimates.



HIDDEN OPPORTUNITIES

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Vonage Communications Platform (VCP) Segment

Applying a discounted blended multiple of ~3.5x to 2023E VCP segment sales of ~\$1.62 billion yields a base case value of \$5.48 billion, or ~\$21 per share (see Breakdown #5).

Breakdown #5 Vonage: Estimated Value of API and UC/CC Based on 2023E Sales

(\$ in millions, except per share amounts; shares in millions)

<u>VCP</u>			
2022E Revenue		\$1,314.5	
<u>Revenue growth est.</u>		<u>23.1%</u>	
2023E Revenue		\$1,618.5	
<u>Applied multiple</u>	<u>2.4x</u>	3.4x	<u>4.4x</u>
Enterprise value	\$3,851.6	\$5,470.1	\$7,088.7
Diluted shares	<u>260.0</u>	<u>260.0</u>	<u>260.0</u>
Per share basis	\$14.81	\$21.04	\$27.26

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Notably, the preceding valuation reflects a 2023E EV/sales multiple of 4.0x for VG’s API business and 2.5x for the remaining business lines, including UC/CC (see Breakdown #6).

Breakdown #6 Vonage: Estimated Value of VCP Segment’s API and UC/CC Businesses

(\$ in millions, except per share amounts; shares in millions)

<u>API</u>				<u>UC/CC (& Other)</u>			
2022E Revenue		\$732.9		2022E Revenue		\$581.5	
<u>Revenue growth est.</u>		<u>29.5%</u>		<u>Revenue growth est.</u>		<u>15.1%</u>	
2023E Revenue		\$949.2		2023E Revenue		\$669.4	
<u>Applied multiple</u>	<u>3.0x</u>	4.0x	<u>5.0x</u>	<u>Applied multiple</u>	<u>1.5x</u>	2.5x	<u>3.5x</u>
Enterprise value	\$2,847	\$3,796.6	\$4,746	Enterprise value	\$1,004	\$1,673.5	\$2,343
Diluted shares	<u>260.0</u>	<u>260.0</u>	<u>260.0</u>	Diluted shares	<u>260.0</u>	<u>260.0</u>	<u>260.0</u>
Per share basis	\$10.95	\$14.60	\$18.25	Per share basis	\$3.86	\$6.44	\$9.01

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Accounting for net debt of \$475.5 million yields a sum-of-the-parts valuation of roughly ~\$5.0 billion, or about \$20 per share (see Breakdown #7).



HIDDEN OPPORTUNITIES

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Breakdown #7 Vonage: Sum-of-the-Parts Fair Value Estimate

(\$ in millions, except per share amounts; shares in millions)

	<u>Consumer</u>	<u>VCP</u>	<u>Enterprise Value</u>	<u>Net Cash</u>	<u>Market Cap</u>
2021E Revenue	\$247.2	\$1,314.5			
2023E Revenue	\$215.9	\$1,618.5			
2023E EBITDA	\$134.0	-		(\$475.5)	
Applied multiple	<u>1.0x</u>	<u>3.4x</u>		<u>1.0x</u>	
Enterprise value	\$134.0	\$5,470.1	\$5,604.1	(\$475.5)	\$5,128.6
Diluted shares	<u>260.0</u>	<u>260.0</u>		<u>260.0</u>	<u>260.0</u>
Per share basis	\$0.52	\$21.04		(\$1.83)	\$19.73
Bull	\$1.03	\$27.26		(\$1.83)	\$26.47
Base	\$0.52	\$21.04		(\$1.83)	\$19.73
Bear	\$0.00	\$14.81		(\$1.83)	\$12.98

Source: Company reports, Bloomberg, and Institutional Research Group estimates.



HIDDEN OPPORTUNITIES

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The Wrap-Up

In our view, the market is currently underappreciating Vonage’s transition from being a provider of legacy residential VoIP services, which are cash-flow generative but in secular decline, toward becoming a fast-growing, cloud-based communications platform (CPaaS), offering video, voice, messaging, e-mail, verification, and artificial intelligence (AI) solutions to business customers. In February 2021 the company concluded a strategic review that maintained its current operating structure; however, we think the recent involvement of sometimes-activist investor, Jana Partners, which in May 2021 disclosed a 2.3% (or 5.8 million share) stake that it has subsequently increased to almost 4% (or ~9.8 million shares), could provide an incremental catalyst for the company on a range of corporate issues, including governance and disclosure, and/or prompt a reevaluation of strategic alternatives, including a separation or outright take-out transaction. As well, we would note that Legion Partners also holds a ~2.2% stake in VG and, per a March 2019 cooperation agreement, controls one of the company’s 11 Board seats.

Based on management commentary and peer and M&A valuations, VG’s VCP and legacy Consumer businesses can be valued at \$21 per share and ~\$1 per share, respectively. Accounting for projected net debt of ~\$2 per share yields a base case sum-of-the-parts fair value of ~\$20 per share (with bull/bear cases of \$26.50 and \$13 per share, respectively).

Risks, among others, include management execution, competition, technological obsolescence, cyber-attacks, regulation, leverage and/or a recession.

