VOCERA COMMUNICATIONS, INC.
Form 10-Q
November 05, 2018
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from to
Commission File Number: 001-35469

VOCERA COMMUNICATIONS, INC.
(Exact name of registrant as specified in its charter)

Delaware	94-3354663
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Vocera Communications, Inc.
525 Race Street
San Jose, CA 95126
(408) 882-5100
(Address and telephone number of principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuance to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definition of “large accelerated filer,” “accelerated filer,” “small reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨
Emerging growth company	¨		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding as of November 2, 2018
Common Stock, $0.0003 par value per share	30,549,176

VOCERA COMMUNICATIONS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018
INDEX

PART I: FINANCIAL INFORMATION

		Page No.
Item 1.	Financial Statements (Unaudited)	3
	Condensed Consolidated Balance Sheets	3
	Condensed Consolidated Statements of Operations	4
	Condensed Consolidated Statements of Comprehensive Loss	5
	Condensed Consolidated Statements of Cash Flows	6
	Notes to Unaudited Condensed Consolidated Financial Statements	8
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	25
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	32
Item 4.	Controls and Procedures	32
	PART II: OTHER INFORMATION	
Item 1.	Legal Proceedings	34
Item 1A.	Risk Factors	34
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	51
Item 3.	Defaults Upon Senior Securities	51
Item 4.	Mine Safety Disclosures	51
Item 5.	Other Information	51
Item 6.	Exhibits	52

Signatures

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)
Vocera Communications, Inc.
Condensed Consolidated Balance Sheets
(In Thousands, Except Share and Par Amounts)
(Unaudited)

	September 30, 2018	December 31, 2017 *As Adjusted
Assets		
Current assets		
Cash and cash equivalents	$ 32,971	$ 28,726
Short-term investments	181,982	52,507
Accounts receivable, net of allowance	36,982	35,105
Other receivables	2,289	1,331
Inventories	3,678	2,815
Prepaid expenses and other current assets	4,513	3,957
Total current assets	262,415	124,441
Property and equipment, net	7,058	5,751
Intangible assets, net	10,234	13,567
Goodwill	49,246	49,246
Deferred commissions	9,475	10,301
Other long-term assets	1,718	1,667
Total assets	$ 340,146	$ 204,973
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	$ 3,154	$ 2,678
Accrued payroll and other current liabilities	13,458	14,689
Deferred revenue, current	41,410	40,734
Total current liabilities	58,022	58,101
Deferred revenue, long-term	12,898	14,417
Convertible senior notes, net	108,942	—
Other long-term liabilities	2,907	4,455
Total liabilities	182,769	76,973
Commitments and contingencies (Note 9)		
Stockholders' equity		
Preferred stock, $0.0003 par value - 5,000,000 shares authorized as of September 30, 2018 and December 31, 2017; zero shares issued and outstanding	—	—
Common stock, $0.0003 par value - 100,000,000 shares authorized as of September 30, 2018 and December 31, 2017; 30,456,187 and 29,412,116 shares issued and outstanding as of September 30, 2018 and December 31, 2017, respectively	9	9
Additional paid-in capital	288,936	250,854
Accumulated other comprehensive loss	(323)	(191)
Accumulated deficit	(131,245)	(122,672)
Total stockholders’ equity	157,377	128,000
Total liabilities and stockholders’ equity	$ 340,146	$ 204,973

* See Note 1 for a summary of adjustments related to the adoption of the new revenue recognition standard.
The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

Vocera Communications, Inc.
Condensed Consolidated Statements of Operations
(In Thousands, Except Per Share Amounts)
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017 *As Adjusted	2018	2017 *As Adjusted
Revenue				
Product	$27,341	$26,018	$70,252	$67,062
Service	20,481	19,567	60,498	54,807
Total revenue	47,822	45,585	130,750	121,869
Cost of revenue				
Product	6,819	7,208	19,847	20,424
Service	9,865	9,241	30,213	28,358
Total cost of revenue	16,684	16,449	50,060	48,782
Gross profit	31,138	29,136	80,690	73,087
Operating expenses				
Research and development	7,993	6,644	22,630	20,944
Sales and marketing	15,654	14,840	45,942	45,008
General and administrative	6,438	6,088	18,973	17,767
Total operating expenses	30,085	27,572	87,545	83,719
Income (loss) from operations	1,053	1,564	(6,855)	(10,632)
Interest income	1,110	177	1,855	410
Interest expense	(2,106)	—	(3,103)	—
Other income (expense), net	(158)	(41)	(965)	1
Income (loss) before income taxes	(101)	1,700	(9,068)	(10,221)
Benefit from (provision for) income taxes	(148)	(309)	495	(1,050)
Net income (loss)	$(249)	$1,391	$(8,573)	$(11,271)
Net income (loss) per share				
Basic	$(0.01)	$0.05	$(0.29)	$(0.40)
Diluted	$(0.01)	$0.05	$(0.29)	$(0.40)
Weighted average shares used to compute net income (loss) per share				
Basic	30,230	29,130	29,861	28,439
Diluted	30,230	30,473	29,861	28,439

* See Note 1 for a summary of adjustments related to the adoption of the new revenue recognition standard.

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

Table of Contents

Vocera Communications, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(In Thousands)
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017 *As Adjusted	2018	2017 *As Adjusted
Net loss	$(249)	$ 1,391	$(8,573)	$(11,271)
Other comprehensive loss, net:				
Change in unrealized gain (loss) on investments, net of tax	70	(15)	(132)	(24)
Comprehensive loss	$(179)	$ 1,376	$(8,705)	$(11,295)

* See Note 1 for a summary of adjustments related to the adoption of the new revenue recognition standard.

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

Table of Contents

Vocera Communications, Inc.
Condensed Consolidated Statements of Cash Flows
(In Thousands)
(Unaudited)

	Nine months ended September 30,	
	2018	2017 * As Adjusted
Cash flows from operating activities		
Net loss	$(8,573)	$(11,271)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,668	5,755
Inventory provision	—	179
Change in lease-related performance obligations	298	(598)
Stock-based compensation expense	15,477	13,204
Amortization of debt discount and issuance costs	2,301	—
Other	24	28
Changes in operating assets and liabilities:		
Accounts receivable	(1,873)	(11,310)
Other receivables	(958)	96
Inventories	(863)	1,262
Prepaid expenses and other assets	(605)	(1,539)
Deferred commissions	826	(781)
Accounts payable	435	(436)
Accrued payroll and other liabilities	(3,389)	925
Deferred revenue	(843)	(687)
Net cash provided by (used in) operating activities	7,925	(5,173)
Cash flows from investing activities		
Purchase of property and equipment	(3,624)	(2,420)
Purchase of short-term investments	(171,039)	(59,608)
Maturities of short-term investments	41,431	45,963
Net cash used in investing activities	(133,232)	(16,065)
Cash flows from financing activities		
Cash from lease-related performance obligations	320	347
Proceeds from issuance of convertible senior notes, net of issuance costs	138,854	—
Payment for purchase of capped calls	(8,907)	—
Proceeds from issuance of common stock from the employee stock purchase plan	1,625	1,246
Proceeds from exercise of stock options	6,439	7,145
Tax withholdings paid on behalf of employees for net share settlement	(8,779)	(7,693)
Net cash provided by financing activities	129,552	1,045
Net decrease in cash and cash equivalents	4,245	(20,193)
Cash and cash equivalents at beginning of period	28,726	35,033
Cash and cash equivalents at end of period	$32,971	$14,840
Supplemental disclosure of non-cash investing and financing activities:		
Property and equipment in accounts payable and accrued liabilities	$142	$40

Table of Contents

* See Note 1 for a summary of adjustments related to the adoption of the new revenue recognition standard.

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

Table of Contents

Notes to Unaudited Condensed Consolidated Financial Statements

1. The Company and Summary of Significant Accounting Policies

Organization and Business

Vocera Communications, Inc. and its subsidiaries (collectively the “Company” or “Vocera”) is a provider of secure, integrated, intelligent communication and clinical workflow solutions, focused on empowering mobile workers in healthcare, hospitality, energy and other mission-critical mobile work environments, in the United States and internationally. The significant majority of the Company’s business is generated from sales of its solutions in the healthcare market to help its customers improve patient experience, improve staff resiliency and increase operational efficiency.

The Vocera communication and collaboration solution, which includes an intelligent enterprise software platform; a lightweight, wearable, voice-controlled communication badge; and smartphone applications, enables users to connect instantly with other staff simply by saying the name, function or group name of the desired recipient. It also delivers HIPAA-compliant secure text messages, alerts and alarms directly to a range of smartphones both inside and outside the hospital, replacing legacy pagers and in-building wireless phones.

Basis of Presentation

The Company’s unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the U.S. Securities and Exchange Commission, and include the accounts of Vocera and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated. Certain information and disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these unaudited interim condensed consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. The year-end condensed balance sheet data was derived from the Company’s audited financial statements but does not include all disclosures required by GAAP.

Effective January 1, 2018, the Company adopted the requirements of Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers, (ASC 606), as discussed in detail in Note 2. All amounts and disclosures set forth in this quarterly report on Form 10-Q have been updated to comply with ASC 606, as indicated by the "as adjusted" footnote.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company’s interim consolidated financial information. The results for the quarter presented are not necessarily indicative of the results to be expected for the year ending December 31, 2018 or for any other interim period or any other future year.

Except for the accounting policies for revenue recognition, deferred revenue and deferred commissions that were updated as a result of adopting ASC 606, the accounting policies followed in the preparation of these financial statements are consistent in all material respects with those presented in Note 1 to the consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Use of Estimates

The preparation of the accompanying unaudited condensed consolidated financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting periods. The estimates include, but are not limited to, revenue recognition, warranty reserves, inventory reserves, goodwill and intangible assets, stock-based compensation expense, provisions for income taxes and contingencies. Actual results could differ from these estimates, and such differences could be material to the Company’s financial position and results of operations.

Recently Adopted Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board (FASB) together with the International Accounting Standards Board issued converged guidance for revenue recognition that replaces most existing guidance, eliminates

industry-specific guidance and provides a unified model for determining how and when revenue from contracts with customers should be recognized. Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Table of Contents

The new guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method).
The Company adopted the new guidance on January 1, 2018 using the full retrospective method, which requires the Company to present its historical financial information for fiscal years 2017 and 2016 as if the new revenue guidance had been applied to all prior periods. Refer to Note 2 for the details of impacts to previously reported results.
In October 2016, the FASB issued amended guidance on the accounting for income taxes. The new guidance requires the recognition of the income tax consequences of an intercompany asset transfer, other than transfers of inventory, when the transfer occurs. The guidance is effective for reporting periods beginning after December 15, 2017, with early adoption permitted. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.
In January 2017, the FASB issued new guidance which clarifies the definition of a business to assist companies with evaluating whether transactions should be accounted for as acquisitions of assets or businesses. The new guidance requires a company to evaluate if substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets; if so, the set of assets and activities is not a business. The guidance also requires a business to include at least one substantive process and narrows the definition of outputs by more closely aligning it with how outputs are described in the guidance for revenue from contracts with customers. The new guidance is effective for the Company in the first quarter of 2018. Early adoption is permitted. The guidance should be applied prospectively to any transactions occurring within the period of adoption. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.
In May 2017, the FASB amended the scope of modification accounting for share-based payment arrangements. The guidance clarifies the type of changes to terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting. Specifically, under this guidance, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The new standard is effective for the Company in the first quarter of 2018. Early adoption is permitted. The guidance will be applied prospectively to awards modified on or after the adoption date. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.
Recent Accounting Pronouncements
In February 2016, the FASB amended lease accounting requirements to begin recording assets and liabilities arising from leases on the balance sheet. The new guidance will also require significant additional disclosures about the amount, timing and uncertainty of cash flows from leases. This new guidance will be effective beginning on January 1, 2019 under a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. The Company is currently evaluating the impact of the standard on its financial position or results of operations.
In June 2016, the FASB issued new guidance related to the accounting for credit losses on instruments for both financial services and non-financial services entities. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. The guidance will be effective beginning January 1, 2020. Early adoption is permitted. The Company is currently evaluating the impact of this new guidance on its consolidated financial statements.
In January 2017, the FASB issued new guidance to simplify the accounting for goodwill impairment. The guidance simplifies the measurement of goodwill impairment by removing step 2 of the goodwill impairment test, which requires the determination of the fair value of individual assets and liabilities of a reporting unit. The new guidance requires goodwill impairment to be measured as the amount by which a reporting unit's carrying value exceeds its fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amendments should be applied on a prospective basis. The new standard is effective for fiscal years

beginning after December 15, 2019 with early adoption permitted for interim or annual goodwill impairment tests performed after January 1, 2017. The Company is evaluating the impact of this new accounting guidance on its consolidated financial statements.

In February 2018, the FASB issued new guidance which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act and required certain disclosures about stranded tax effects. This standard will be effective for the Company beginning January 1, 2019 and may be applied either in the period of adoption or retrospectively. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements.

Table of Contents

2. Revenue, deferred revenue and deferred commissions

Effective January 1, 2018, the Company adopted ASC 606 using the full retrospective method, which requires the Company to present its historical financial information for fiscal years 2017 and 2016 as if the new revenue guidance had been applied to all prior periods.

The most significant impact of the standard relates to the timing of revenue recognition for software licenses sold with professional services where the Company did not have vendor specific objective evidence (“VSOE”) for professional services under current guidance. Under the new standard, the requirement to have VSOE for undelivered elements is eliminated and the Company will recognize revenue for software licenses upon transfer of control to its customers. Additionally, the new standard requires the capitalization and amortization of costs related to obtaining a contract, such as sales commissions, which were previously recorded as an expense to sales and marketing at the time they are incurred.

606 Adoption Impact to Previously Reported Results

The Company adjusted its condensed consolidated financial statements from amounts previously reported due to the adoption of ASC 606. Select condensed consolidated balance sheet line items, which reflects the adoption of ASC 606, are as follows:

Consolidated Balance Sheet	As of December 31, 2017		
(in thousands)	As Reported	Impact of Adoption	As Adjusted
Other receivables	$1,170	$161 (1)	$1,331
Deferred commissions	$—	$10,301 (2)	$10,301
Deferred revenue - current	$47,276	$(6,542) (1)	$40,734
Deferred revenue - long-term	16,438	(2,021) (1)	14,417
Total deferred revenue	$63,714	$(8,563)	$55,151
Stockholders' equity	$108,975	$19,025	$128,000

(1) Impact of cumulative change in revenue.

(2) Impact of cumulative change in commissions expense.

Select unaudited condensed consolidated statement of operations line items, which reflects the adoption of ASC 606, are as follows:

Consolidated Statement of Operations	Three months ended September 30, 2017			Nine months ended September 30, 2017		
(in thousands, except per share data)	As Reported	Impact of Adoption	As Adjusted	As Reported	Impact of Adoption	As Adjusted
Revenue						
Product	$23,249	$2,769	$26,018	$63,940	$3,122	$67,062
Service	19,051	516	19,567	53,105	1,702	54,807
Total Revenue	$42,300	$3,285	$45,585	$117,045	$4,824	$121,869
Gross Profit	$25,851	$3,285	$29,136	$68,263	$4,824	$73,087
Operating Expenses	$28,563	$(991)	$27,572	$84,500	$(781)	$83,719
Loss from Operations	$(2,712)	$4,276	$1,564	$(16,237)	$5,605	$(10,632)
Net Loss	$(2,885)	$4,276	$1,391	$(16,876)	$5,605	$(11,271)
Basic net income (loss) per share	$(0.10)	$0.15	$0.05	$(0.59)	$0.19	$(0.40)
Diluted net income (loss) per share	$(0.10)	$0.15	$0.05	$(0.59)	$0.19	$(0.40)

Table of Contents

The adoption impacted certain line items in the cash flows from operating activities as follows:

Cash flows from operating activities:	Nine months ended September 30, 2017		
(in thousands)	As Reported	Impact of Adoption	As Adjusted
Net loss	(16,876)	5,605	(11,271)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Deferred commissions	$ —	$ (781)	$ (781)
Deferred revenue	$ 4,137	$ (4,824)	$ (687)

The core principle of ASC 606 is to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This principle is achieved through applying the following five-step approach:

- Identification of the contract, or contracts, with a customer - A contract with a customer exists when (i) the Company enters into an enforceable contract with a customer that defines each party's rights regarding the goods or services to be transferred and identifies the payment terms related to these goods or services, (ii) the contract has commercial substance and, (iii) the Company determines that collection of substantially all consideration for goods or services that are transferred is probable based on the customer's intent and ability to pay the promised consideration. The Company applies judgment in determining the customer's ability and intention to pay, which is based on a variety of factors including the customer's historical payment experience or, in the case of a new customer, published credit and financial information pertaining to the customer. Customer payments received by the Company are non-refundable.
- Identification of the performance obligations in the contract - Performance obligations promised in a contract are identified based on the goods or services that will be transferred to the customer that are capable of being both: a) functionally distinct, whereby the customer can benefit from the goods or service either on their own or together with other resources that are readily available from third parties or from the Company, and b) contractually distinct, whereby the transfer of the goods or services is separately identifiable from other promises in the contract. To the extent a contract includes multiple promised goods or services, the Company applies judgment to determine whether promised goods or services are capable of being distinct and distinct in the context of the contract. If these criteria are not met the promised goods or services are accounted for as a combined performance obligation.
- Determination of the transaction price - The transaction price is determined based on the consideration to which the Company will be entitled in exchange for transferring goods or services to the customer.
- Allocation of the transaction price to the performance obligations in the contract - If the contract contains a single performance obligation, the entire transaction price is allocated to the single performance obligation. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance obligation based on a relative standalone selling price, or SSP, basis. The Company determines standalone selling price based on the price at which the performance obligation is sold separately. If the standalone selling price is not observable through past transactions, the Company estimates the standalone selling price taking into account available information such as market conditions and internally approved pricing guidelines related to the performance obligations.
- Recognition of revenue when, or as, the Company satisfies a performance obligation - The Company satisfies performance obligations either over time or at a point in time as discussed in further detail below. Revenue is recognized at the time the related performance obligation is satisfied by transferring a promised good or service to a

customer.

Disaggregation of Revenue

A typical sales arrangement involves multiple arrangements, such as the sales of the Company's proprietary communication Vocera Badge, perpetual software licenses, professional services, and maintenance and support services which entitle customers to unspecified upgrades, patch releases and telephone-based support. The following table depicts the disaggregation of revenue according to revenue type and is consistent with how the Company evaluates its financial performance:

Table of Contents

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2018	2017	2018	2017
Product revenue				
Device	$17,031	$16,524	$44,728	$45,572
Software	10,310	9,494	25,524	21,490
Total product	27,341	26,018	70,252	67,062
Service revenue				
Maintenance and support	16,023	13,837	45,493	38,507
Professional services and training	4,458	5,730	15,005	16,300
Total service	20,481	19,567	60,498	54,807
Total revenue	$47,822	$45,585	$130,750	$121,869

Device revenue - In transactions where the Company delivers hardware, the Company considers itself to be the principal in the transaction and records revenue and costs of goods sold on a gross basis. Hardware revenue is generally recognized upon transfer of control to the customer.

Software revenue - Revenue from the Company's software products is generally recognized upon transfer of control to the customer.

Maintenance and support revenue - The Company generates maintenance and support revenue primarily from post contract support (PCS) contracts, and, to a lesser extent, from sales of extended warranties on the Vocera Badge. The majority of software sales are in conjunction with PCS contracts, which generally have one-year terms. The Company recognizes revenue from PCS contracts ratably over the contractual service period. The service period typically commences upon transfer of control of the corresponding software products to the customer. The Company recognizes revenue from extended warranty contracts ratably over their contractual service period, which is typically one year. This period starts one year from the date on which the transfer of control on the underlying hardware occurs because the hardware generally carries a one-year warranty.

Professional services and training revenue - Professional services and training revenue is generated when the Company installs and configures its software and devices at new or existing customer sites. The Company recognizes revenue related to professional services as they are performed.

Contracts with multiple performance obligations - Some of the Company's contracts with customers contain multiple performance obligations. For these contracts, the Company accounts for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative stand-alone selling price basis. For deliverables that are routinely sold separately, such as maintenance and support on the core offerings, the Company determines SSP by evaluating renewals over the trailing 12-months. For those that are not sold routinely, the Company determines SSP based on its overall pricing trends and objectives, taking into consideration market conditions and other factors, including the value of the contracts and the products sold.

Contract balances - The timing of revenue recognition may differ from the timing of invoicing to customers. Accounts receivable are recorded at the invoiced amount. A receivable is recognized in the period the Company delivers goods or provides services or when the right to consideration is unconditional. Payment terms on invoiced amounts are typically 30 days. The balance of accounts receivable, net of allowance for doubtful accounts, as of September 30, 2018 and December 31, 2017 is presented in the accompanying consolidated balance sheets.

Costs to obtain and fulfill a contract - The Company capitalizes certain incremental contract acquisition costs consisting primarily of commissions paid and the related payroll taxes when customer contracts are signed. The Company determines whether costs should be deferred based on its sales compensation plans, if the commissions are incremental and would not have been incurred absent the execution of the customer contract. Sales commissions for renewals of customer contracts are not commensurate with the commissions paid for the acquisition of the initial contract given the substantive difference in commission rates in proportion to their respective contract values.

Commissions paid upon the initial acquisition of a contract are amortized over the estimated period of benefit, which may exceed the term of the initial contract. Accordingly, amortization of deferred costs is recognized on a systematic basis that is consistent with the pattern of revenue recognition allocated to each performance obligation and is included in sales and marketing expense in the condensed consolidated statements of operations. The Company determines its estimated

12

Table of Contents

period of benefit by evaluating the expected renewals of its customer contracts, the duration of its relationships with its customers and other factors. Deferred costs are periodically reviewed for impairment. Changes in the balance of total deferred commissions (contract asset) during the three and nine months ended September 30, 2018 are as follows:

(in thousands)	June 30, 2018	Additions	Commissions Recognized	September 30, 2018
Deferred commissions	$9,329	$ 1,283	$ (1,137)	$ 9,475

(in thousands)	December 31, 2017 *As Adjusted	Additions	Commissions Recognized	September 30, 2018
Deferred commissions	$ 10,301	$ 3,073	$ (3,899)	$ 9,475

Of the $9.5 million total deferred commissions balance as of September 30, 2018, the Company expects to recognize approximately 47.9% as commission expense over the next 12 months and the remainder thereafter.

Deferred revenue - The Company records deferred revenue when cash payments are received in advance of the performance under the contract. The current portion of deferred revenue represents the amounts that are expected to be recognized as revenue within one year of the consolidated balance sheet date. Changes in the balance of total deferred revenue (contract liability) during the three and nine months ended September 30, 2018 are as follows:

(in thousands)	June 30, 2018	Additions	Revenue Recognized	September 30, 2018
Deferred revenue	$53,408	$ 18,142	$ (17,242)	$ 54,308

(in thousands)	December 31, 2017 *As Adjusted	Additions	Revenue Recognized	September 30, 2018
Deferred revenue	$ 55,151	$ 56,226	$ (57,069)	$ 54,308

* See details above for the summary of adjustments to deferred commission and deferred revenue as a result of the adoption of ASC 606.

Revenue recognized during the three and nine months ended September 30, 2018 from deferred revenue balances at the beginning of the period was $15.5 million and $36.9 million, respectively. Revenue recognized during the three and nine months ended September 30, 2017 from deferred revenue balances at the beginning of the period was $12.2 million and $27.5 million, respectively.

The majority of the Company's "contracted not recognized" performance obligations are not subject to cancellation terms. The Company's "contracted not recognized" revenue, which represents revenue allocated to performance obligations for revenue contracted, and which includes deferred revenue and non-cancelable amounts that will be invoiced and recognized as revenue in future periods, was $117.2 million as of September 30, 2018, of which the Company expects to recognize approximately 63% of the revenue over the next 12 months and the remainder thereafter.

3. Fair Value of Financial Instruments

The Company's cash, cash equivalents and short-term investments are carried at their fair values with any differences from their amortized cost recorded in equity as unrealized gains (losses) on marketable securities. As a basis for determining the fair value of its assets and liabilities, the Company follows a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data which requires the Company to develop its own assumptions. This hierarchy requires the Company to use

Table of Contents

observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. For the nine months ended September 30, 2018, there have been no transfers between Level 1 and Level 2 fair value instruments and no transfers in or out of Level 3.
The Company's money market funds are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. The fair value of the Company's Level 2 fixed income securities are obtained from independent pricing services, which may use quoted market prices for identical or comparable instruments or model-driven valuations using observable market data or other inputs corroborated by observable market data. The Company does not have any financial instruments which are valued using Level 3 inputs.
In addition to its cash, cash equivalents and short-term investments, the Company measures the fair value of its Convertible Senior Notes on a quarterly basis for disclosure purposes. The Company considers the fair value of the Convertible Senior Notes at September 30, 2018 to be a Level 2 measurement due to limited trading activity of the Convertible Senior Notes. Refer to Note 8 to the consolidated financial statements for further information.
The Company's assets that are measured at fair value on a recurring basis, by level, within the fair value hierarchy as of September 30, 2018 and December 31, 2017, are summarized as follows (in thousands):

	September 30, 2018			December 31, 2017		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Assets						
Money market funds	$5,910	$—	$5,910	$3,232	$—	$3,232
Commercial paper	—	34,308	34,308	—	1,201	1,201
U.S. government agency securities	—	4,630	4,630	—	8,648	8,648
U.S. Treasury securities	—	3,485	3,485	—	5,561	5,561
Corporate debt securities	—	144,553	144,553	—	37,530	37,530
Total assets measured at fair value	$5,910	$186,976	$192,886	$3,232	$52,940	$56,172

4. Cash, Cash Equivalents and Short-Term Investments

The following tables present current and prior-year-end balances for cash, cash equivalents and short-term investments (in thousands):

	As of September 30, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair value
Cash and cash equivalents:				
Demand deposits and other cash	$22,067	$ —	$ —	$22,067
Money market funds	5,910	—	—	5,910
Commercial paper	4,995	—	(1)	4,994
Total cash and cash equivalents	32,972	—	(1)	32,971
Short-Term Investments:				
Commercial paper	29,328	—	(14)	29,314
U.S. government agency securities	4,653	—	(23)	4,630
U.S. Treasury securities	3,504	—	(19)	3,485
Corporate debt securities	144,763	3	(213)	144,553
Total short-term investments	182,248	3	(269)	181,982
Total cash, cash equivalents and short-term investments	$215,220	$ 3	$ (270)	$214,953

Table of Contents

	As of December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair value
Cash and cash equivalents:				
Demand deposits and other cash	$25,061	$ —	$ —	$25,061
Money market funds	3,232	—	—	3,232
Corporate debt securities	433	—	—	433
Total cash and cash equivalents	28,726	—	—	28,726
Short-Term Investments:				
Commercial paper	1,202	—	(1)	1,201
U.S. government agency securities	8,678	—	(30)	8,648
U.S. Treasury securities	5,586	—	(25)	5,561
Corporate debt securities	37,176	1	(80)	37,097
Total short-term investments	52,642	1	(136)	52,507
Total cash, cash equivalents and short-term investments	$81,368	$ 1	$ (136)	$81,233

The Company has determined that the unrealized losses on its short-term investments as of September 30, 2018 and December 31, 2017 do not constitute an “other than temporary impairment.” The unrealized losses for the short-term investments have all been in a continuous unrealized loss position for less than twelve months. The Company’s conclusion of no “other than temporary impairment” is based on the high credit quality of the securities, their short remaining maturity and the Company’s intent and ability to hold such loss securities until maturity.

Classification of the cash, cash equivalent and short-term investments by contractual maturity was as follows:

(in thousands)	One year or shorter	Between 1 and 2 years	Total
Balances as of September 30, 2018			
Cash and cash equivalents (1)	$32,971	$—	$32,971
Short-term investments	117,463	64,519	181,982
Cash, cash equivalents and short-term investments	$150,434	$64,519	$214,953
Balances as of December 31, 2017			
Cash and cash equivalents (1)	$28,726	$—	$28,726
Short-term investments	34,750	17,757	52,507
Cash, cash equivalents and short-term investments	$63,476	$17,757	$81,233

(1) Includes demand deposits and other cash, money market funds and other cash equivalent securities, all with 0-90 day maturity at purchase.

Table of Contents

5. Net Loss Per Share

The following table sets forth the computation of basic and diluted net loss per share (in thousands, except per share amounts):

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017 * As Adjusted	2018	2017 * As Adjusted
Numerator:				
Net income (loss)	$(249)	$ 1,391	$(8,573)	$(11,271)
Denominator:				
Weighted-average shares used to compute net income (loss) per common share - basic	30,230	29,130	29,861	28,439
Effect of potentially dilutive securities:				
Employee stock options and restricted stock units	—	1,343	—	—
Weighted average shares used to compute diluted income (loss) per common share	30,230	30,473	29,861	28,439
Net income (loss) per share				
Basic	$(0.01)	$ 0.05	$(0.29)	$(0.40)
Diluted	$(0.01)	$ 0.05	$(0.29)	$(0.40)

The following securities were not included in the calculation of diluted shares outstanding as the effect would have been anti-dilutive:

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2018	2017	2018	2017
Options to purchase common stock, including ESPP	962	2	1,176	1,735
Restricted stock units	1,911	—	1,964	2,216

6. Goodwill and Intangible Assets

Goodwill

As of September 30, 2018 and December 31, 2017, the Company had $49.2 million and $49.2 million of goodwill, respectively, with $41.2 million and $8.0 million allocated to the Company's Product and Services operating segments, respectively. As of September 30, 2018, there were no changes in circumstances indicating that the carrying values of goodwill or acquired intangibles may not be recoverable.

Intangible Assets

Acquisition-related intangible assets are amortized either straight-line, or over the life of the assets on a basis that resembles the economic benefit of the assets. This yields amortization in the latter case that is higher in earlier periods of the useful life.

Table of Contents

The estimated useful lives and carrying value of acquired intangible assets are as follows:

(in thousands)	Range of Useful Life (years)	September 30, 2018			December 31, 2017		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	3 to 7	$10,050	$ 7,124	$2,926	$10,050	$ 5,302	$4,748
Customer relationships	7 to 9	10,920	4,351	6,569	10,920	3,469	7,451
Backlog	3	1,400	1,023	377	1,400	650	750
Non-compete agreements	2 to 4	460	460	—	460	455	5
Trademarks	3 to 7	1,110	748	362	1,110	497	613
Intangible assets, net book value		$23,940	$ 13,706	$10,234	$23,940	$ 10,373	$13,567

Amortization expense was $1.0 million and $1.2 million for the three months ended September 30, 2018 and 2017, respectively. Amortization expense was $3.3 million and $3.5 million for the nine months ended September 30, 2018 and 2017, respectively.

Amortization of acquired intangible assets is reflected in the cost of revenue for developed technology and backlog and in operating expenses for the other intangible assets. The estimated future amortization of existing acquired intangible assets as of September 30, 2018 was as follows:

(in thousands)	Future amortization
2018 (remaining three months)	$ 1,001
2019	3,880
2020	1,251
2021	1,127
2022	1,050
2023	1,050
Thereafter	875
Future amortization expense	$ 10,234

Table of Contents

7. Balance Sheet Components

Inventories

(in thousands)	September 30, 2018	December 31, 2017
Raw materials	$ 274	$ 4
Finished goods	3,404	2,811
Total inventories	$ 3,678	$ 2,815

Property and equipment, net

(in thousands)	September 30, 2018	December 31, 2017
Computer equipment and software	$ 9,965	$ 8,832
Furniture, fixtures and equipment	2,261	1,764
Leasehold improvements	5,819	4,794
Manufacturing tools and equipment	1,990	2,624
Construction in process	371	157
Property and equipment, at cost	20,406	18,171
Less: Accumulated depreciation	(13,348)	(12,420)
Property and equipment, net	$ 7,058	$ 5,751

Depreciation and amortization expense was $0.9 million and $0.8 million for the three months ended September 30, 2018 and 2017, respectively. Depreciation and amortization expense was $2.3 million and $2.2 million for the nine months ended September 30, 2018 and 2017, respectively.

Net investment in sales-type leases

The Company has sales-type leases with terms of 2 to 4 years. Sales-type lease receivables are collateralized by the underlying equipment. The components of the Company's net investment in sales-type leases are as follows:

(in thousands)	September 30, 2018	December 31, 2017
Minimum payments to be received on sales-type leases	$ 2,246	$ 2,758
Less: Unearned interest income and executory costs	(1,345)	(1,469)
Net investment in sales-type leases	901	1,289
Less: Current portion	(525)	(916)
Non-current net investment in sales-type leases	$ 376	$ 373

There were no allowances for doubtful accounts on these leases as of September 30, 2018 and December 31, 2017. There is no guaranteed or unguaranteed residual value on the leased equipment. The current and non-current net investments in sales-type leases are reported as components of the consolidated balance sheet captions "other receivables" and "other long-term assets," respectively.

The minimum payments expected to be received for future years under sales-type leases as of September 30, 2018 were as follows:

Table of Contents

(in thousands)	Future lease payments
2018	$ 395
2019	1,038
2020	649
2021	139
2022	25
Total	$ 2,246

Accrued payroll and other current liabilities

(in thousands)	September 30, 2018	December 31, 2017
Payroll and related expenses	$ 6,921	$ 9,569
Accrued payables	2,487	1,801
Deferred rent, current portion	301	271
Lease financing, current portion	915	832
Product warranty	351	353
Customer prepayments	650	1,084
Sales and use tax payable	505	505
Other	1,328	274
Total accrued payroll and other current liabilities	$ 13,458	$ 14,689

The changes in the Company's product warranty reserve are as follows:

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2018	2017	2018	2017
Warranty balance at the beginning of the period	$306	$315	$353	$596
Warranty expense accrued for shipments during the period	131	118	345	376
Changes in estimate related to pre-existing warranties	(45)	(49)	(179)	(426)
Warranty settlements made	(41)	(73)	(168)	(235)
Total product warranty	$351	$311	$351	$311

8. Convertible Senior Notes

In May 2018, the Company issued $143.75 million aggregate principal amount of 1.50% Convertible Senior Notes due 2023, including $18.75 million aggregate principal amount of such notes pursuant to the exercise in full of options granted to the initial purchasers, collectively the "Notes." The Notes are unsecured, unsubordinated obligations and bear interest at a fixed rate of 1.50% per annum, payable semi-annually in arrears on May 15 and November 15 of each year, commencing on November 15, 2018. The total net proceeds from the offering, after deducting initial purchase discounts and estimated debt issuance costs, were approximately $138.9 million.

Each $1,000 principal amount of the Notes will initially be convertible into 31.0073 shares of the Company's common stock, the "Conversion Option," which is equivalent to an initial conversion price of approximately $32.25 per share, subject to adjustment upon the occurrence of specified events. The Notes will be convertible at the option of the holders at any time prior to the close of business on the business day immediately preceding February 15, 2023, only under the following circumstances:

(1) during any calendar quarter commencing after the calendar quarter ending on June 30, 2018 (and only during such calendar quarter), if the last reported sale price of the Company common stock for at least 20 trading days (whether or not

19

Table of Contents

consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price of the Notes on each applicable trading day;
(2) during the five business day period after any ten consecutive trading day period in which the trading price per $1,000 principal amount of the Notes for each day of that ten day consecutive trading day period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate of the Notes on such trading day; or
(3) upon the occurrence of specified corporate events (as set forth in the indenture governing the Notes).
On or after February 15, 2023 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their Notes at any time, regardless of the foregoing circumstances. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election. If certain specified fundamental changes occur (as set forth in the indenture governing the Notes) prior to the maturity date, holders of the Notes may require the Company to repurchase for cash all or any portion of their Notes at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest to, but excluding, the fundamental change repurchase date. In addition, if specific corporate events occur prior to the applicable maturity date, the Company will increase the conversion rate for a holder who elects to convert their notes in connection with such a corporate event in certain circumstances. It is the Company's current intent and policy to settle conversions through combination settlement which involves repayment of the principal portion in cash and any excess of the conversion value over the principal amount in shares of its common stock. During the three and nine months ended September 30, 2018, the conditions allowing holders of the Notes to convert have not been met. The Notes are therefore not convertible during the three and nine months ended September 30, 2018 and are classified as long-term debt.
In accounting for the transaction, the Notes were separated into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar debt instrument that does not have an associated convertible feature. The carrying amount of the equity component representing the Conversion Option was $33.4 million and was determined by deducting the fair value of the liability component from the par value of the Notes. The equity component was recorded in additional paid-in capital and will be remeasured as long as it continues to meet the conditions for equity classification. The excess of the principal amount of the liability component over its carrying amount, the "debt discount," is amortized to interest expense over the contractual term of the Notes at an effective interest rate of 7.6%.
In accounting for the debt issuance costs of $4.9 million related to the Notes, the Company allocated the total amount incurred to the liability and equity components of the Notes based on their relative values. Issuance costs attributable to the liability component were $3.8 million and will be amortized to interest expense using the effective interest method over the contractual term of the Notes. Issuance costs attributable to the equity component were $1.1 million and are included with the equity component in additional paid-in capital.
The Notes consist of the following:

(in thousands)	September 30, 2018
Liability:	
Principal	$143,750
Unamortized debt discount	(31,282)
Unamortized issuance costs	$(3,526)
Net carrying amount	$108,942
Stockholders' equity:	
Debt discount for conversion option	$33,350
Issuance costs	$(1,136)

Net carrying amount	$32,214

The total estimated fair value of the Notes as of September 30, 2018 was approximately $178.6 million. The fair value was determined based on the closing trading price per $100 of the Notes as of the last day of trading for the period. The fair value of the Notes is primarily affected by the trading price of the Company’s common stock and market interest rates. Based on the closing price of the Company’s common stock of $36.58 on September 28, 2018, the if-converted value of the Notes of $163.1 million was greater than their principal amount.

Table of Contents

Interest expense related to the Notes is as follows:

(in thousands)	Three months ended September 30, 2018	Nine months ended September 30, 2018
Contractual interest expense	$ 539	$ 803
Amortization of debt discount	$ 1,408	$ 2,067
Amortization of issuance costs	$ 159	$ 233
Total interest expense	$ 2,106	$ 3,103

Capped Calls

In connection with the pricing of the Notes, the Company entered into privately negotiated capped call transactions with certain counterparties, the "Capped Calls." The Capped Calls each have an initial strike price of approximately $32.25 per share, subject to certain adjustments, which correspond to the initial conversion price of the Notes. The Capped Calls have initial cap prices of $38.94 per share, subject to certain adjustments. The Capped Calls cover, subject to anti-dilution adjustments, approximately 4.5 million shares of the Company's common stock. Conditions that cause adjustments to the initial strike price of the Capped Calls mirror conditions that result in corresponding adjustments for the Notes. The Capped Calls are generally intended to reduce or offset the potential dilution to the Company's common stock upon any conversion of the Notes with such reduction or offset, as the case may be, subject to a cap based on the cap price. For accounting purposes, the Capped Calls are separate transactions, and not part of the terms of the Notes. As these transactions meet certain accounting criteria, the Capped Calls are recorded in stockholders' equity and are not accounted for as derivatives. The cost of $8.9 million incurred in connection with the Capped Calls was recorded as a reduction to additional paid-in capital.

The net impact to the Company's stockholders' equity, included in additional paid-in capital, of the above components of the Notes is as follows:

(in thousands)	September 30, 2018
Conversion option	$ 33,350
Purchase of capped calls	$ (8,907)
Issuance costs	$ (1,136)
Total	$ 23,307

Impact on Earnings Per Share

The Notes will not have an impact on the Company's diluted earnings per share until they meet the criteria for conversion, as discussed above, as the Company intends to settle the principal amount of the Notes in cash upon conversion. Under the treasury stock method, in periods when the Company report net income, the Company is required to include the effect of additional shares that may be issued under the Notes when the price of its' common stock exceeds the conversion price. However, upon conversion, there will be no economic dilution from the Notes until the average market price of the Company's common stock exceeds the cap price of $38.94 per share, as exercise of the capped calls offsets any dilution from the Notes from the conversion price up to the cap price. Capped Calls are excluded from the calculation of diluted earnings per share, as they would be anti-dilutive under the treasury stock method.

9. Commitments and Contingencies

Non-cancelable Material Commitments

The Company is required to purchase unused, non-cancelable, non-returnable raw material inventory that was purchased by its contract manufacturers based on committed finished goods orders from the Company, certain long lead-time raw materials based on the Company's forecast and current work-in-progress materials. As of September 30, 2018 and December 31, 2017, approximately $10.9 million and $4.4 million, respectively, of such inventory was purchased and held by the third-party manufacturers which was subject to these purchase guarantees.

Table of Contents

Leases

The Company leases office space for its headquarters and subsidiaries under non-cancelable operating leases, which will expire between December 2018 and February 2023. The Company recognizes rent expense on a straight-line basis over the lease period, and has accrued for rent expense incurred but not paid. Facilities rent expense was $0.7 million and $0.6 million for the three months ended September 30, 2018 and 2017, respectively. Facilities rent expense was $2.0 million and $1.9 million for the nine months ended September 30, 2018 and 2017, respectively.
Future minimum lease payments at September 30, 2018 under non-cancelable operating leases are as follows:

(in thousands)	Operating leases
2018 (remaining three months)	$ 582
2019	2,222
2020	2,078
2021	1,837
2022	612
2023	35
Total minimum lease payments	$ 7,366

Indemnifications

The Company undertakes, in the ordinary course of business, to (i) defend customers and other parties from certain third-party claims associated with allegations of trade secret misappropriation, infringement of copyright, patent or other intellectual property rights, tortious damage to persons or property or breaches of certain Company obligations relating to confidentiality (e.g., safeguarding protected health information) and (ii) indemnify and hold harmless such parties from certain resulting damages, costs and other liabilities. The term of these undertakings may be perpetual and the maximum potential liability of the Company under certain of these undertakings is not determinable. Based on its historical experience, the Company believes the liability associated with these undertakings is minimal.

The Company has entered into indemnification agreements with its directors and officers that may require the Company to indemnify its directors and officers against liabilities that may arise by reason of their status or service as directors or officers, other than liabilities arising from willful misconduct of the individual. The Company currently has directors and officers insurance. As there has been no significant history of losses, no expense accrual has been made.

Litigation

From time to time, the Company may be involved in lawsuits, claims, investigations and proceedings, consisting of intellectual property, commercial, employment and other matters which arise in the ordinary course of business. The Company defends itself vigorously against any such claims. Although the outcome of these matters is currently not determinable, management expects that any losses from existing matters that are probable or reasonably possible of being incurred as a result of these matters would not be material to the financial statements as a whole.

Table of Contents

10. Stock-based Compensation and Awards

Stock Option Activity

A summary of the stock option activity for the nine months ended September 30, 2018 is presented below:

	Options Outstanding			
	Number of options	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value (in thousands)
Outstanding at December 31, 2017	1,332,063	$ 13.48	5.36	$ 22,298
Options granted	—	—		
Options exercised	(435,326)	14.79		
Options canceled	(2,774)	4.97		
Outstanding at September 30, 2018	893,963	$ 12.88	4.88	$ 21,191

At September 30, 2018, there was $0.1 million of unrecognized compensation cost related to options which is expected to be recognized over a weighted-average period of 0.45 years. As of September 30, 2018, there were 2,375,322 shares that remained available for future issuance of options, restricted stock units (“RSUs”) or other equity awards under the 2012 Equity Incentive Plan.

Employee Stock Purchase Plan

In March 2012, the Company’s 2012 Employee Stock Purchase Plan (the “ESPP”) was approved. During the nine months ended September 30, 2018, employees purchased 78,563 shares of common stock at an average price of $20.69. During the nine months ended September 30, 2017, employees purchased 89,813 shares of common stock at an average purchase price of $13.87. As of September 30, 2018, there were 800,166 shares available for future issuance under the ESPP.

Table of Contents

The following Black-Scholes option-pricing assumptions were used for each respective period for the ESPP:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Expected term (in years)	0.50	0.50	0.50	0.50
Volatility	37.8%	30.0%	29.0% - 37.8%	30.0% - 32.0%
Risk-free interest rate	2.09%	1.02%	1.39% - 2.09%	0.61% - 1.02%
Dividend yield	0%	0%	0%	0%

Restricted Stock Units

A summary of RSU activity for the nine months ended September 30, 2018 is presented below:

	Restricted Stock Units	
	Number of shares	Weighted Average Grant Date Fair Value per Share
Outstanding at December 31, 2017	2,045,589	$ 18.84
Granted	837,571	25.94
Vested	(865,397)	17.09
Forfeited	(107,039)	21.10
Outstanding at September 30, 2018	1,910,724	$ 22.61

At September 30, 2018, there was $33.4 million of unrecognized compensation cost related to RSUs, which is expected to be recognized over a weighted-average period of 1.73 years.

Allocation of Stock-Based Compensation Expense

The following table presents the allocation of stock-based compensation expense:

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2018	2017	2018	2017
Cost of revenue	$923	$749	$2,636	$2,117
Research and development	802	507	2,164	1,542
Sales and marketing	1,755	1,653	4,906	4,697
General and administrative	2,014	1,809	5,771	4,848
Total stock-based compensation	$5,494	$4,718	$15,477	$13,204

Table of Contents

11. Segments

The Company has two operating segments, which are both reportable business segments: (i) Product and (ii) Service, both of which are comprised of Vocera's and its wholly-owned subsidiaries' results of operations.

The following table presents a summary of the operating segments:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2018	2017 * As Adjusted	2018	2017 * As Adjusted
Revenue				
Product	$27,341	$ 26,018	$70,252	$67,062
Service	20,481	19,567	60,498	54,807
Total revenue	47,822	45,585	130,750	121,869
Cost of revenue				
Product	6,819	7,208	19,847	20,424
Service	9,865	9,241	30,213	28,358
Total cost of revenue	16,684	16,449	50,060	48,782
Gross profit				
Product	20,522	18,810	50,405	46,638
Service	10,616	10,326	30,285	26,449
Total gross profit	31,138	29,136	80,690	73,087
Operating expenses	30,085	27,572	87,545	83,719
Interest income (expense), net and other	(1,154)	136	(2,213)	411
Loss before income taxes	$(101)	$ 1,700	$(9,068)	$(10,221)

12. Income Taxes

The Company recorded a $0.5 million benefit from income taxes and $1.1 million provision for income taxes for the nine months ended September 30, 2018 and 2017, respectively. The benefit recorded for the nine months ended September 30, 2018 was primarily due to a reduction in the U.S. valuation allowance attributable to indefinite lived intangibles becoming a source of future taxable income to realize the deferred tax asset recorded for the U.S. federal net operating loss generated in the current year. This deferred tax asset will have an indefinite carryforward period as a result of recently enacted tax law changes. The benefit recorded was offset by taxes on international operations and state income taxes. The provision for the nine months ended September 30, 2017 was primarily due to the accretion of the deferred tax liability associated with indefinite lived intangibles, taxes on international operations and state income taxes as well as the accretion of a deferred tax liability associated with goodwill related to acquisitions.

As of September 30, 2018, the Company has provided a valuation allowance against certain federal and state deferred tax assets. Management continues to evaluate the realizability of deferred tax assets and the related valuation allowance. If management's assessment of the deferred tax assets or the corresponding valuation allowance were to change, the Company would record the related adjustment to income during the period in which management makes the determination.

As of September 30, 2018, there were no material changes to either the nature or the amounts of the uncertain tax positions previously determined for the year ended December 31, 2017.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

25

Table of Contents

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and in our other Securities and Exchange Commission, or SEC, filings, including our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on March 5, 2018. These discussions contain forward-looking statements reflecting our current expectations that involve risks and uncertainties which are subject to safe harbors under the Securities Act of 1933, as amended, or the Securities Act, and the Securities Exchange Act of 1934, as amended, or the Exchange Act. These forward-looking statements include, but are not limited to, statements concerning our plans, objectives, expectations and intentions, future financial position, future revenues, projected costs, expectations regarding demand and acceptance for our technologies, growth opportunities and trends in the market in which we operate, prospects and plans and objectives of management. The words "anticipates," "believes," "estimates," "expects," "intends," "may," "plans," "projects," "will," "would" and similar expr intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements, and you should not place undue reliance on our forward-looking statements. These forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those in the forward-looking statements, including, without limitation, the risks set forth in Part II, Item 1A, "Risk Factors" in this Quarterly Report on Form 10-Q and in our other filings with the Securities and Exchange Commission. We do not assume any obligation to update any forward-looking statements.

Business Overview

We are a provider of secure, integrated, intelligent communication solutions, focused on empowering mobile workers in healthcare, hospitality, energy and other mission-critical mobile work environments, in the United States and internationally. Today, the significant majority of our business is generated from sales of our solutions in the healthcare market to help our customers improve patient safety and experience, improve staff resiliency and increase operational efficiency.

We primarily sell products, software maintenance and professional services directly to end users. Total revenue increased 7.3% from $121.9 million for the nine months ended September 30, 2017 to $130.8 million for the nine months ended September 30, 2018. For the nine months ended September 30, 2018, we recorded a net loss of $8.6 million compared to a net loss of $11.3 million for the nine months ended September 30, 2017.

Our diverse customer base ranges from large hospital systems to small local hospitals, as well as other healthcare facilities and customers in non-healthcare markets. We do not rely on any one customer for a substantial portion of our revenue. While we have international customers in other English speaking countries such as Canada, the United Kingdom, Australia, New Zealand and parts of the Middle East, most of our customers are located in the United States. International customers represented 10.9%, 10.2% and 10.4% of our revenue in the nine months ended September 30, 2018, and the years ended December 31, 2017 and 2016, respectively. We believe certain international markets represent attractive growth opportunities. We are exploring plans to expand our presence in other English-speaking markets and enter non-English speaking markets.

We outsource the manufacturing of our hardware products. Our outsourced manufacturing model allows us to scale our business without the significant capital investment and on-going expenses required to establish and maintain manufacturing operations. We work closely with our contract manufacturer, SMTC Corporation, and key suppliers to manage the procurement, quality and cost of components. We seek to maintain an optimal level of finished goods inventory to meet our forecast for sales and unanticipated shifts in sales volume and mix.

Convertible Senior Notes

In May 2018, we issued $143.75 million aggregate principal amount of 1.50% Convertible Senior Notes due 2023, including $18.75 million aggregate principal amount of such notes pursuant to the exercise in full of options granted to the initial purchasers, collectively the "Notes." The total net proceeds from the offering, after deducting initial purchase discounts and debt issuance costs, were approximately $138.9 million.

In connection with the pricing of the Notes, we entered into privately negotiated capped call transactions with certain counterparties, the "Capped Calls." The Capped Calls each have an initial strike price of approximately $32.25 per share, subject to certain adjustments, which correspond to the initial conversion price of the Notes. The Capped Calls

have initial cap prices of $38.94 per share, subject to certain adjustments. The Capped Calls cover, subject to anti-dilution adjustments, approximately 4.5 million shares of our common stock. We used proceeds of $8.9 million to purchase the Capped Calls, which were recorded as a reduction to additional paid-in capital. For further discussion on the Capped Calls, please refer to Note 8 in the notes to the condensed consolidated financial statements.

We expect to use the remaining net proceeds for general corporate purposes, which may include funding research and development, increasing working capital, acquisitions or investments in complementary businesses, products or technologies and capital expenditures.

Table of Contents

Critical Accounting Policies and Estimates

There have been no changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates described in our Annual Report on Form 10-K for the year ended December 31, 2017, except as disclosed in Note 1 to the condensed consolidated financial statements "Recently Adopted Accounting Pronouncement."

Results of Operations

The following table presents our results of operations for the periods indicated. The period-to-period comparisons of results are not necessarily indicative of results for future periods.

	Three months ended September 30,				Nine months ended September 30,			
Consolidated statement of operations data:	2018		2017		2018		2017	
	(unaudited)							
(in thousands)	Amount	% Revenue	Amount	% Revenue	Amount	% Revenue	Amount	% Revenue
Revenue								
Product	$27,341	57.2 %	$26,018	57.1 %	$70,252	53.7 %	$67,062	55.0 %
Service	20,481	42.8	19,567	42.9	60,498	46.3	54,807	45.0
Total revenue	47,822	100.0	45,585	100.0	130,750	100.0	121,869	100.0
Cost of revenues								
Product	6,819	14.3	7,208	15.8	19,847	15.2	20,424	16.8
Service	9,865	20.6	9,241	20.3	30,213	23.1	28,358	23.2
Total cost of revenues	16,684	34.9	16,449	36.1	50,060	38.3	48,782	40.0
Gross profit	31,138	65.1	29,136	63.9	80,690	61.7	73,087	60.0
Operating expenses:								
Research and development	7,993	16.7	6,644	14.6	22,630	17.3	20,944	17.2
Sales and marketing	15,654	32.7	14,840	32.5	45,942	35.1	45,008	36.9
General and administrative	6,438	13.5	6,088	13.4	18,973	14.5	17,767	14.6
Total operating expenses	30,085	62.9	27,572	60.5	87,545	66.9	83,719	68.7
Income (loss) from operations	1,053	2.2	1,564	3.4	(6,855)	(5.2)	(10,632)	(8.7)
Interest income	1,110	2.3	177	0.4	1,855	1.4	410	0.3
Interest expense	(2,106)	(4.4)	—	—	(3,103)	(2.4)	—	—
Other income (expense), net	(158)	(0.3)	(41)	(0.1)	(965)	(0.7)	1	—
Income (loss) before income taxes	(101)	(0.2)	1,700	3.7	(9,068)	(6.9)	(10,221)	(8.4)
Benefit from (provision for) income taxes	(148)	(0.3)	(309)	(0.6)	495	0.4	(1,050)	(0.8)
Net income (loss)	$(249)	(0.5)%	$1,391	3.1 %	$(8,573)	(6.6)%	$(11,271)	(9.2)%

Table of Contents

Revenue:

	Three months ended September 30,				Nine months ended September 30,			
	2018	2017	Change		2018	2017	Change	
(in thousands)	Amount	Amount	Amount	%	Amount	Amount	Amount	%
Product revenue								
Device	$17,031	$16,524	$507	3.1 %	$44,728	$45,572	$(844)	(1.9)%
Software	10,310	9,494	816	8.6	25,524	21,490	4,034	18.8
Total product	27,341	26,018	1,323	5.1	70,252	67,062	3,190	4.8
Service revenue								
Maintenance and support	16,023	13,837	2,186	15.8	45,493	38,507	6,986	18.1
Professional services and training	4,458	5,730	(1,272)	(22.2)	15,005	16,300	(1,295)	(7.9)
Total service	20,481	19,567	914	4.7	60,498	54,807	5,691	10.4
Total revenue	$47,822	$45,585	$2,237	4.9 %	$130,750	$121,869	$8,881	7.3

Three months ended September 30, 2018 compared to the three months ended September 30, 2017.

Total revenue increased $2.2 million, or 4.9%, for the three months ended September 30, 2018 compared to the three months ended September 30, 2017.

Product revenue increased $1.3 million, or 5.1%, for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. Device revenue increased $0.5 million, or 3.1%, and software revenue increased $0.8 million, or 8.6%, for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The increase in device revenue was driven primarily by an increase in unit sales of badges and related accessories. The increase in software revenue is primarily due to an increase in sales of new software licenses and expansions of existing customer licenses.

Service revenue increased $0.9 million, or 4.7%, for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. Software maintenance and support revenue increased $2.2 million, or 15.8%, and professional services and training revenue decreased $1.3 million, or 22.2%, for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The increase in software maintenance and support revenue was primarily the result of having a larger customer base purchasing software maintenance contracts. The decrease in professional services and training revenue was due to decreases in implementation services for our solutions.

Nine months ended September 30, 2018 compared to the nine months ended September 30, 2017.

Total revenue increased $8.9 million, or 7.3%, for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017.

Product revenue increased $3.2 million, or 4.8%, for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. Device revenue decreased $0.8 million, or 1.9%, and software revenue increased $4.0 million, or 18.8%, for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. The decrease in device revenue, was driven primarily by a decrease in unit sales of badges and related accessories. This was largely as a result of large shipments to our US government customers in the nine months ended September 30, 2017. The increase in software revenue is primarily due to an increase in sales of new software licenses and expansions of existing customer licenses.

Service revenue increased $5.7 million, or 10.4%, for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. Software maintenance and support revenue increased $7.0 million, or 18.1%, and professional services and training revenue decreased $1.3 million or 7.9% for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. The increase in software maintenance and support revenue was primarily the result of having a larger customer base purchasing software maintenance contracts. The decrease in professional services and training revenue was due to decreases in implementation services for our solutions.

28

Table of Contents

Cost of revenue:

	Three months ended September 30,				Nine months ended September 30,			
	2018	2017	Change		2018	2017	Change	
(in thousands)	Amount	Amount	Amount	%	Amount	Amount	Amount	%
Cost of revenue								
Product	$6,819	$7,208	$(389)	(5.4)%	$19,847	$20,424	$(577)	(2.8)%
Service	9,865	9,241	624	6.8	30,213	28,358	1,855	6.5
Total cost of revenue	$16,684	$16,449	$235	1.4 %	$50,060	$48,782	$1,278	2.6 %
Gross margin								
Product	75.1 %	72.3 %	2.8 %		71.7 %	69.5 %	2.2 %	
Service	51.8 %	52.8 %	(1.0)%		50.1 %	48.3 %	1.8 %	
Total gross margin	65.1 %	63.9 %	1.2 %		61.7 %	60.0 %	1.7 %	

Three months ended September 30, 2018 compared to the three months ended September 30, 2017.

Cost of product revenue decreased $0.4 million or 5.4% for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. This was driven by a higher mix of software revenue along with a lower concentration of third party hardware revenue. Product gross margin as a percentage of product revenue increased in the three months ended September 30, 2018 compared to the three months ended September 30, 2017, due primarily to a higher mix of software revenue.

Cost of service revenue increased $0.6 million, or 6.8%, for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The cost of service revenue increased primarily due to increased headcount. Service gross margin as a percentage of service revenue decreased for the three months ended September 30, 2018 compared to the three months ended September 30, 2017 due primarily to a decrease in professional services and training revenue.

Nine months ended September 30, 2018 compared to the nine months ended September 30, 2017.

Cost of product revenue decreased $0.6 million or 2.8% for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. This was driven by a higher mix of software revenue along with a lower concentration of third party hardware revenue. Product gross margin as a percentage of product revenue increased in the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 due primarily to a higher mix of software revenue.

Cost of service revenue increased $1.9 million, or 6.5%, for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. The cost of service revenue increased primarily due to increased headcount. Service gross margin as a percentage of service revenue increased for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 due primarily to a higher mix of software maintenance and support.

Table of Contents

Operating expenses:

	Three months ended September 30,				Nine months ended September 30,			
	2018	2017	Change		2018	2017	Change	
(in thousands)	Amount	Amount	Amount	%	Amount	Amount	Amount	%
Operating expenses								
Research and development	$7,993	$6,644	$1,349	20.3%	$22,630	$20,944	$1,686	8.1%
Sales and marketing	15,654	14,840	814	5.5	45,942	45,008	934	2.1
General and administrative	6,438	6,088	350	5.7	18,973	17,767	1,206	6.8
Total operating expenses	$30,085	$27,572	$2,513	9.1 %	$87,545	$83,719	$3,826	4.6%

Three months ended September 30, 2018 compared to the three months ended September 30, 2017.

Research and development expense. Research and development expense increased $1.3 million or 20.3% for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. This was primarily due to a a $0.9 million increase in compensation and benefits due to increased headcount as well as a $0.3 million increase in outside services and development.

Sales and marketing expense. Sales and marketing expense increased $0.8 million or 5.5% for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. This was primarily due to a $0.4 million increase in compensation and benefits from higher headcount. The increase was also the result of a $0.2 million increase in travel expense and $0.2 million increase in marketing development.

General and administrative expense. General and administrative expense increased $0.4 million, or 5.7%, for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. This was primarily due to an increase in outside services.

Nine months ended September 30, 2018 compared to the nine months ended September 30, 2017.

Research and development expense. Research and development expense increased $1.7 million, or 8.1%, for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. This was primarily due to $1.2 million increase in compensation and benefits due to increased headcount as well as a $0.7 million increase due to outside services for new product development offset by a $0.2 million decrease in travel expense.

Sales and marketing expense. Sales and marketing expense increased $0.9 million, or 2.1%, for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. This was primarily due to a $0.6 million increase in compensation and benefits as well as a $0.5 million increase in marketing development offset by a $0.2 million decrease in outside services.

General and administrative expense. General and administrative expense increased $1.2 million, or 6.8%, for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. This increase was primarily due to a $0.6 million increase in compensation resulting from increased stock compensation expense as well as a $0.8 million increase in outside services.

Interest Income and Other Expense, Net:

	Three months ended September 30,			Nine months ended September 30,		
(in thousands)	2018	2017	Change	2018	2017	Change
Interest income	$1,110	$177	$ 933	$1,855	$410	$1,445
Interest expense	(2,106)	—	(2,106)	(3,103)	—	(3,103)
Other income (expense), net	(158)	(41)	(117)	(965)	1	(966)

Three months ended September 30, 2018 compared to the three months ended September 30, 2017.

Interest income. Interest income increased $0.9 million for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. This increase was due to having higher cash balances as a result of the issuance of the Notes combined with a higher rate of return on our investments. For further discussion on the Notes, please refer to Note 8 to the condensed consolidated financial statements.

30

Interest expense. For the three months ended September 30, 2018 we had interest expense of $2.1 million resulting from the amortization of debt discount and debt issuance costs and the contractual interest incurred on the issuance of the Notes.

Other income (expense), net. The change in other income (expense) in the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was primarily due to foreign exchange fluctuations.

Nine months ended September 30, 2018 compared to the nine months ended September 30, 2017.

Interest income. Interest income increased $1.4 million for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. This increase was due to having higher cash balances as a result of the issuance of the Notes combined with a higher rate of return on our investments.

Interest expense. For the nine months ended September 30, 2018 we had interest expense of $3.1 million resulting from the amortization of debt discount and debt issuance costs and the contractual interest incurred on the issuance of the Notes.

Other income (expense), net. The change in other income (expense) in the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 was primarily due to foreign exchange fluctuations.

Liquidity and Capital Resources

As of September 30, 2018, we had cash and cash equivalents and short-term investments of $215.0 million. We believe that our existing sources of liquidity will satisfy our working capital and capital requirements for at least the next twelve months and the foreseeable future.

	Nine months ended September 30,	
(in thousands)	2018	2017
Consolidated Statements of Cash Flow Data:		
Net cash provided by (used in) operating activities	$7,925	$(5,173)
Net cash used in investing activities	(133,232)	(16,065)
Net cash provided by financing activities	129,552	1,045
Net decrease in cash and cash equivalents	$4,245	$(20,193)

Operating activities

Cash provided by operating activities was $7.9 million for the nine months ended September 30, 2018, due to a net loss of $8.6 million, offset by non-cash items such as stock-based compensation of $15.5 million, amortization of debt discount and issuance costs of $2.3 million, increase in lease-related performance liabilities of $0.3 million and depreciation and amortization of $5.7 million for property and equipment and acquired intangible assets. With respect to changes in assets and liabilities, we experienced an increase in accounts receivable of $1.9 million, an increase of $1.0 million in other receivables, an increase of $0.9 million in inventories, an increase of $0.6 million in prepaid expenses and other assets, a decrease in deferred commissions of $0.8 million, an increase of $0.4 million in accounts payable, a decrease of $3.4 million in accrued payroll and other liabilities and a $0.8 million decrease in deferred revenue.

Cash used in operating activities was $5.2 million for the nine months ended September 30, 2017, due to a net loss of $11.3 million, a reduction in lease-related performance obligations of $0.6 million, offset by non-cash items such as stock-based compensation of $13.2 million and depreciation and amortization of $5.8 million for property and equipment and acquired intangible assets. With respect to changes in assets and liabilities, we experienced a decrease of $1.3 million in inventories and a $0.9 million increase in accrued payroll and other liabilities. These factors were offset by certain cash outflows, including an increase in accounts receivable of $11.3 million, an increase of $0.8 in deferred commissions, an increase of $1.5 million in prepaid expenses and other assets and a decrease of $0.4 million in accounts payable and a decrease of $0.7 million in deferred revenue.

Investing activities

Cash used in investing activities was $133.2 million for the nine months ended September 30, 2018, due to $41.4 million of short-term investment maturities, offset by $171.0 million for purchases of short-term investments. An additional $3.6 million of cash was used for the purchase of property and equipment and leasehold improvements.

Cash used in investing activities was $16.1 million for the nine months ended September 30, 2017 due to $59.6 million for purchases of short-term investments, offset by $46.0 million of short-term investment maturities. An additional $2.4 million of cash was used for the purchase of property and equipment and leasehold improvements.

Financing activities

Cash provided by financing activities was $129.6 million for the nine months ended September 30, 2018, attributable to $138.9 million of proceeds from issuance of the Notes, net of issuance costs, $6.4 million of proceeds from stock option exercises, $1.6 million of proceeds from issuance of common stock from the employee stock purchase plan and $0.3 million of cash from lease-related performance obligations. This was partially offset by $8.9 million cash paid for the capped call that we purchased at the time of the issuance of the Notes and $8.8 million cash paid for employee taxes paid on net share settlement.

Cash provided by financing activities was $1.0 million for the nine months ended September 30, 2017, attributable to $7.1 million of proceeds from stock option exercises and $1.2 million of proceeds from issuance of common stock from the employee stock purchase plan and $0.3 million of cash from lease-related performance obligations. This was partially offset by a $7.7 million cash paid for employee taxes paid on net share settlement.

Off-Balance Sheet Arrangements

During the nine months ended September 30, 2018, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities that would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Refer to Note 9 to the condensed consolidated financial statements, “Commitments and Contingencies,” for a discussion of our non-cancelable purchase commitments.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. To achieve this objective, historically we have invested in money market funds. With the proceeds from our two public offerings in 2012 and the issuance of our convertible senior notes in 2018, we have invested in a broader portfolio of high credit quality short-term securities. To minimize the exposure due to an adverse shift in interest rates, we maintain an average portfolio duration of one year or less.

Our primary exposure to market risk is interest income and expense sensitivity, which is affected by changes in the general level of the interest rates in the United States. However, because of the short-term nature of our interest-bearing securities, a 10% change in market interest rates would not be expected to have a material impact on our consolidated financial condition or results of operations.

Historically our operations have consisted of research and development and sales activities in the United States. As a result, our financial results have not been materially affected by factors such as changes in foreign currency exchange rates or economic conditions in foreign markets. We are developing plans to expand our international presence. Accordingly, we expect that our exposure to changes in foreign currency exchange rates and economic conditions may increase in future periods.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in reports filed under the Exchange Act is accumulated and communicated to management, including principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

As of September 30, 2018, we carried out an evaluation under the supervision of, and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based on our evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2018.

Changes in Internal Control over Financial Reporting

Except for the implementation of certain internal controls related to the adoption of ASC 606, there was no change in our internal control over financial reporting which occurred during the period covered by this Quarterly Report on Form 10-Q which has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. We implemented

32

Table of Contents

certain internal controls to ensure we adequately evaluated our contracts and properly assessed the impact of the new revenue recognition standard on our financial statements to facilitate the adoption effective January 1, 2018. In addition, we have made some changes to certain internal controls to reflect new processes that were implemented as a result of the adoption of ASC 606.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we may be involved in lawsuits, claims, investigations and proceedings, consisting of intellectual property, commercial, employment and other matters which arise in the ordinary course of business.

Item 1A. Risk Factors

Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below, together with all of the other information set forth in this Quarterly Report on Form 10-Q. Our business, financial condition, results of operations or future prospects could be materially and adversely harmed if any of the following risks, or other risks or uncertainties that are not yet identified or that we currently believe are immaterial, actually occur. The trading price of our common stock could decline due to any of these risks or uncertainties, and, as a result, you may lose all or part of your investment.

Risks related to our business and industry

We have incurred significant losses in the past, and will likely experience losses in the future.

We have incurred significant losses in the past and reported a net loss of $8.6 million for the nine months ended September 30, 2018. As of September 30, 2018, we had an accumulated deficit of $131.2 million. If we cannot make consistent progress toward future profitability, our business and our stock price may be adversely affected.

Our ability to be profitable in the future depends upon continued demand for our solutions from existing and new customers. Further market adoption of our solutions, including increased penetration within our existing customers, depends upon our ability to improve quality of care and patient and staff satisfaction and increase hospital efficiency and productivity, and bring value to customers outside of healthcare. In addition, our profitability will be affected by, among other things, our ability to execute on our business strategy, the timing and size of orders, the pricing and costs of our solutions, macroeconomic conditions affecting the health care industry and the extent to which we invest in sales and marketing, research and development and general and administrative resources.

We depend on sales to the healthcare market for substantially all of our revenue, and a decrease in sales in the healthcare market would harm our business.

To date, substantially all of our revenue has been derived from sales to the healthcare market and, in particular, hospitals. Sales to the healthcare market accounted for 97%, 97% and 97% of our revenue for the nine months ended September 30, 2018 and for the years ended December 31, 2017 and 2016, respectively. We anticipate that sales to the healthcare market will represent a significant portion of our revenue for the foreseeable future.

Most of our solutions require a substantial upfront investment by new customers. The cost of the initial deployment depends on the number of users and departments involved, the size and age of the hospital and the condition of the existing wireless infrastructure, if any, within the hospital. Even if hospital personnel determine that our solutions provide compelling benefits over their existing communications methods, their hospitals may not have, or may not be willing to spend, the resources necessary to install and maintain wireless infrastructure to initially deploy and support our solutions or expand our solutions to other departments or users. Hospitals face significant budget constraints from unpredictable patient population trends and commercial reimbursements, and increasing demands from, and competition for, patients. In addition, both governmental and commercial hospitals are experiencing lower Medicare reimbursement rates and higher compliance demands, and as part of the tax reform law that came into effect in December 2017, the tax penalty for violating the individual health insurance mandate under the Patient Protection and Affordable Care Act of 2010 (ACA) was set to zero effective in 2019, essentially repealing it. The President of the United States and members of Congress have also attempted to repeal or amend the ACA, as well as continue to undertake other healthcare reforms. As a consequence of these regulatory and other factors, we may experience slowdowns and deferral of orders for our solutions that could negatively impact our sales. We might not be able to sustain or increase our revenue from sales of our solutions, or achieve the growth rates that we envision, if hospitals continue to face significant budgetary constraints and reduce their spending on communications systems.

While we are seeking to increase sales of our solutions to non-healthcare customers, we do not anticipate non-healthcare markets to represent a significant portion of our revenue for the foreseeable future.

Table of Contents

If we fail to offer high-quality services and support for any of our solutions, our operating results and our ability to sell those solutions in the future will be harmed.

Our ability to sell our solutions is dependent upon our professional services and technical support teams providing high-quality services and support. Our professional services team assists our customers with their wireless infrastructure assessment, clinical workflow design, communication solution configuration, clinical integration, training and project management during the pre-deployment and deployment stages. Once our solutions are deployed within a customer's facility, the customer typically depends on our technical support team to help resolve technical issues, assist in optimizing the use of our solutions and facilitate adoption of new functionality. If we do not effectively assist our customers in deploying our solutions, succeed in helping our customers quickly resolve technical and other post-deployment issues, or provide effective ongoing support services, our ability to expand the use of our solutions with existing customers and to sell our solutions to new customers will be harmed. If deployment of our solutions is deemed unsatisfactory, we may incur significant costs to attain and sustain customer satisfaction or, in extreme cases, our customers may choose not to deploy our solutions. As we rapidly hire new services and support personnel, we may inadvertently hire underperforming people who will have to be replaced, or fail to effectively train such employees, leading in some instances to slower growth, additional costs and poor customer relations. In addition, the failure of channel partners to provide high-quality services and support in markets outside the United States could also harm sales of our solutions.
As we continue to pursue opportunities for larger deals that have greater technical complexity, including deals that require more complex integrations with our customer's workflows, we may experience a longer time period for our solutions to deploy and as a result, our revenue recognition for these deals may be delayed. Additionally, as we enter agreements with new and existing customers for larger and more complex deals across multiple sites, we have been, and may continue to be, required to agree to customer acceptance clauses. Delays may occur in obtaining customer acceptance regardless of the quality of our products and services, and may cause us to defer revenue recognition where such acceptance provisions are substantive in nature, or they may require us to incur additional professional services or other costs in an effort to obtain such customer acceptance.

Our sales cycle can be lengthy and unpredictable