

VOCERA COMMUNICATIONS, INC.

Form 10-Q

November 05, 2018

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

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FORM 10-Q

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(Mark One)

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

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

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Delaware 94-3354663  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)  
Vocera Communications, Inc.  
525 Race Street  
San Jose, CA 95126  
(408) 882-5100  
(Address and telephone number of principal executive offices)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant 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  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

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.

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

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

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FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018  
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## 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.



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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.

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
		*As Adjusted		*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.

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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





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\* 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.

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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.

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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.

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## 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 (in thousands)	As of December 31, 2017		
	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 (in thousands, except per share data)	Three months ended September 30, 2017			Nine months ended September 30, 2017		
	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 )

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

Cash flows from operating activities: (in thousands)	Nine months ended September 30, 2017		
	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:

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(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	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

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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	Additions	Commissions Recognized	September 30, 2018
	*As Adjusted			
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	Additions	Revenue Recognized	September 30, 2018
	*As Adjusted			
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



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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

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	As of December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Unrealized 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.

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## 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:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	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.



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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

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## 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:

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	Future
(in thousands)	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,	December 31,
	2018	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		Nine months	
	ended		ended	
	September		September	
	30,		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



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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.

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Interest expense related to the Notes is as follows:

	Three months ended September 30, 2018	Nine months ended September 30, 2018
(in thousands)		
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:

	September 30, 2018
(in thousands)	
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.



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## 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.

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## 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			Aggregate
	Number of	Weighted	Weighted average remaining contractual term	intrinsic
	options	average	(in years)	value
		exercise		(in
		price		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.

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

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

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## 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:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
(in thousands)		* As Adjusted		* 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

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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 expressions are 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.

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## 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.

Consolidated statement of operations data: (in thousands)	Three months ended September 30, 2018 (unaudited)				Nine months ended September 30, 2018				2017			
	Amount	% Revenue	Amount	% Revenue	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)%				



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## Revenue:

(in thousands)	Three months ended September 30, 2018				Nine months ended September 30, 2018			
	2018 Amount	2017 Amount	Change Amount	% Change	2018 Amount	2017 Amount	Change Amount	% Change
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.



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## Cost of revenue:

(in thousands)	Three months ended September 30,				Nine months ended September 30,			
	2018	2017	Change		2018	2017	Change	
	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.

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## Operating expenses:

(in thousands)	Three months ended September 30,			Nine months ended September 30,		
	2018	2017	Change	2018	2017	Change
	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 \$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:

(in thousands)	Three months ended September 30,			Nine months ended September 30,		
	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.



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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.

(in thousands)	Nine months ended September 30,	
	2018	2017
<b>Consolidated Statements of Cash Flow Data:</b>		
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 million 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.

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### 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

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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.

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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.

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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, which may cause our revenue and operating results to fluctuate significantly.

Our sales cycles can be lengthy and unpredictable. Our sales efforts involve educating our customers about the use and benefits of our solutions, including the technical capabilities of our solutions and the potential cost savings and productivity gains achievable by deploying them. Customers typically undertake a significant evaluation process, which frequently involves not only our solutions but also their existing communications methods and those of our competitors, and can result in a lengthy sales cycle, that sometimes exceeds twelve months. We spend substantial time, effort and money in our sales efforts without any assurance that our efforts will produce sales. Similarly, our increasing dependence on larger, hospital-wide deployments may increase fluctuations in our revenue and operating results because the failure to complete a significant sale, or the loss of a large customer, will have a greater impact on those results. In addition, purchases of our solutions are frequently subject to budget constraints, multiple approvals, and unplanned administrative, processing and other delays. We have experienced and may continue to experience elongated sales cycles due to ongoing uncertainty surrounding past and future healthcare reform legislation, the impact of shifting federal government budgets, changes to Medicare and Medicaid reimbursement and potential future statutes and rulemaking.

Our business has gone through cycles of expansion, relative stability and contraction, and if we are not able to manage such cycles effectively, our operating results may suffer.

We have experienced periods of expansion, relative stability and contraction in our revenues and operations in the past. Such fluctuations have placed, and may continue to place, strains on our management systems, infrastructure and

other resources. Especially during growth periods, we hire additional direct sales, professional services and marketing personnel domestically and internationally, acquire complementary businesses, technologies or assets, and increase our investment in research and development. Our future operating results depend to a large extent on our ability to successfully implement such plans and manage such investments. To do so successfully we must, among other things:

- manage our expenses in line with our operating plans and current business environment;
- maintain and enhance our operational, financial and management controls, reporting systems and procedures;
- integrate acquired businesses, technologies or assets;
- manage operations in multiple locations and time zones; and
- develop and deliver new solutions and enhancements to existing solutions efficiently and reliably.

We expect to incur costs associated with the investments made to support our business strategy before the anticipated benefits or the returns are realized, if any. If we are unable to grow our business or manage our future growth effectively, we may not be able to take advantage of market opportunities or develop new solutions or enhancements to existing solutions. We may also fail to

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satisfy customer requirements, maintain quality, execute our business plan or respond to competitive pressures, which could result in lower revenue and a decline in the share price of our common stock.

Our revenue and operating results have fluctuated, and are likely to continue to fluctuate, making our quarterly results difficult to predict, which may cause us to miss analyst expectations and may cause the price of our common stock to decline.

Our operating results have been and may continue to be difficult to predict, even in the near term, and are likely to fluctuate as a result of a variety of factors, many of which are outside of our control.

Comparisons of our revenue and operating results on a period-to-period basis may not be meaningful. You should not rely on our past results as an indication of our future performance. Each of the following factors, among others, could cause our operating results to fluctuate from quarter to quarter:

- the financial health of our healthcare customers and budgetary constraints on their ability to upgrade their communications;
- the availability of government funding for healthcare facilities operated by the United States federal, state and local governments;
- changes in the regulatory environment affecting our healthcare customers, including impediments to their ability to obtain reimbursement for their services;
- our ability to expand our sales and marketing operations;
- our ability to successfully integrate acquired businesses;
- the announcement of new significant contracts or relationships;
- the procurement and deployment cycles of our healthcare customers and the length of our sales cycles;
- changes in how healthcare operating and capital budgets are administered within the enterprise;
- changes in customer deployment timelines;
- variations in the amount of orders booked in a prior quarter but not delivered until later quarters;
- our mix of solutions and the varying revenue recognition rules that apply;
- pricing, including discounts by us or our competitors;
- our ability to expand into non-healthcare markets;
- our ability to develop significant new reseller relationships and maintain existing reseller relationships;
- the financial health of our resellers;
- our ability to successfully deploy our solutions in a timely manner;
- our ability to sell and integrate third-party products and services and our customer's satisfaction with those third-party products and services;
- our ability to forecast demand and manage lead times for the manufacture of our solutions;
- our ability to develop and introduce new solutions and features to existing solutions that achieve market acceptance;
- fluctuations in foreign currencies in the international markets in which we operate; and

future accounting pronouncements and changes in accounting policies, including our ability to implement the new procedures and processes necessary to accurately recognize and forecast our revenue under the new revenue recognition standard.

If we do not achieve the anticipated strategic or financial benefits from our acquisitions or if we cannot successfully integrate them, our business and operating results could be harmed.

We have acquired, and in the future may acquire, complementary businesses, technologies or assets that we believe to be strategic. We may not achieve the anticipated strategic or financial benefits, or be successful in integrating any acquired businesses, technologies or assets. If we cannot effectively integrate the acquired business and products into our business, we may not achieve market acceptance for, or derive significant revenue from, these new solutions. Integrating newly acquired businesses, technologies and assets could strain our resources, could be expensive and time consuming, and might not be successful. Our recent acquisitions expose us, and we will be further exposed, if we

acquire or invest in additional businesses, technologies or assets, to a number of risks, including that we may:

- experience technical issues as we integrate acquired businesses, technologies or assets into our existing solutions;
- encounter difficulties leveraging our existing sales and marketing organizations, and direct sales channels, to increase our revenue from acquired businesses, technologies or assets;
- find that the acquisition does not further our business strategy, we overpaid for the acquisition or the economic conditions underlying our acquisition decision have changed;
- have difficulty retaining key personnel of acquired businesses;
- suffer disruption to our ongoing business and diversion of our management's attention as a result of transition or integration issues and the challenges of managing geographically or culturally diverse enterprises;



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experience unforeseen and significant problems or liabilities associated with quality, technology and legal contingencies relating to the acquisition, such as intellectual property or employment matters; and incur substantial costs to integrate the acquired business.

If we were to proceed with one or more additional significant acquisitions in which the consideration included cash, we could be required to use a substantial portion of our available cash. To the extent we issue shares of capital stock or other rights to purchase capital stock, including options and warrants, the ownership of existing stockholders would be diluted. In addition, acquisitions may result in the incurrence of debt, contingent liabilities, large write-offs, or other unanticipated costs, events or circumstances, any of which could harm our operating results.

In addition, from time to time we may enter into negotiations for acquisitions that are not ultimately consummated. These negotiations could result in significant diversion of management time, as well as substantial out-of-pocket costs.

We could be required to record adjustments to our recorded asset balance for intangible assets, including goodwill, that could significantly impact our operating results.

Our balance sheet includes significant intangible assets, including goodwill and other acquired intangible assets. The determination of related estimated useful lives and whether these assets have been impaired involves significant judgment and is subject to factors and events over which we have no control. The introduction of new competitive products or services into our markets could impair the value of our intangible assets if they create market conditions that adversely affect the competitiveness of our products and services. Further, declines in our market capitalization may be an indicator that our intangible assets or goodwill carrying values exceed their fair values, which could lead to potential impairment charges that could impact our operating results.

Developments in the healthcare industry and governing regulations have negatively affected and may continue to negatively affect our business.

Substantially all of our revenue is derived from customers in the healthcare industry, in particular, hospitals. The healthcare industry is highly regulated and is subject to changing political, legislative, regulatory and other influences. Developments generally affecting the healthcare industry, including new regulations or new interpretations of existing regulations, could adversely affect spending on information technology and capital equipment by reducing funding, changing healthcare pricing or delivery or creating impediments for obtaining healthcare reimbursements, which together with declining admission trends, could cause our sales to decline and negatively impact our business. For example, the margins of our hospital customers are modest, and potential decreases in reimbursement for healthcare costs may reduce the overall solvency of our customers or cause further deterioration in their financial or business condition.

Since 2009, three significant bills were signed into law that impact the U.S. healthcare system. Those bills include The Health Information Technology for Economic and Clinical Health Act, enacted under Title XIII of the American Recovery and Reinvestment Act of 2009 (HITECH Act), the ACA, and the Health Care and Education Reconciliation Act of 2010. Together, these acts have driven substantive changes over several years to the operating processes, reimbursements and rules governing the U.S. healthcare system. Further, the President of the United States and members of Congress have stated their intent to significantly revise, repeal or reduce funding under the ACA. Uncertainty surrounding the status of the ACA and its regulations may impact the spending of our healthcare customers, and we cannot predict the effect on our business of any new legislation and regulations that may be adopted if the ACA is significantly changed or repealed.

We believe that our healthcare customers are unsure of the impact of the elements of those acts, as well as the related efforts to amend or repeal the ACA will have on their business, and cannot predict the timing and requirements of the final rules issued by the U.S. Department of Health and Human Services (HHS) for these statutes, making managing their business operations more difficult. Further, as has been experienced since 2010, as rules and agency guidance pursuant to these statutes are implemented and revised by HHS, a number of aspects of the acts have been interpreted,

modified or delayed. For example, sudden changes in the rules for individuals buying insurance through state or federal health insurance exchanges, and individual and employer mandates to have and offer insurance coverage, had challenged hospitals' abilities to forecast patient utilization and revenues, and to set operational plans and budget accordingly. We believe that it is likely that additional legislative changes by Congress and rulemaking by HHS will continue.

Federal budget activities also impact our customers. Our customers include healthcare facilities run by the Department of Defense and the U.S. Department of Veterans Affairs. During the nine months ended September 30, 2018 and the year ended December 31, 2017, we generated approximately 20% and 18%, respectively of our revenue from these customers. Our reseller to the Department of Defense and the U.S. Department of Veterans Affairs represented 45% and 27% of our accounts receivable as of September 30, 2018 and December 31, 2017, respectively. These customers have been and may continue to be impacted by budgetary and legislative actions.

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In addition, many state governments are changing or expanding their healthcare laws, adding additional complexity to understanding the potential impacts.

We are unable to predict the full impact of these new and changing rules on our hospital customers and others in the healthcare industry. Impacts of these rules have affected and could continue to affect materially our customers' ability to budget for or purchase our products. The healthcare industry has changed significantly in recent years and we expect that significant changes will continue to occur. We cannot provide assurance that the markets for our solutions will continue to exist at current levels or that we will have adequate technical, financial and marketing resources to react to changes in those markets.

We primarily compete in the rapidly evolving and competitive healthcare market, and if we fail to effectively respond to competitive pressures, our business and operating results could be harmed.

We believe that the primary competition for our solutions has consisted of traditional methods using wired and wireless phones, pagers and overhead intercoms. While we believe that our system is superior to these legacy methods, our solutions require a significant infrastructure investment by a hospital and many hospitals' spending is severely constrained by other priorities.

Manufacturers and distributors of product categories such as cellular phones, smartphone applications, pagers, mobile radios and in-building wireless telephones also sell their products to hospitals as components of communication solutions. Of these product categories, in-building wireless telephones and pagers represent the most significant current competition for the sale of our solutions. The market for in-building wireless phones is dominated by communications companies such as Cisco Systems, Ascom and Spectralink. In addition, the growing proliferation of smartphones and related applications, including cloud-based applications, represents another category of competitive offerings. Although our customers value secure text-messaging using smartphones, we do not believe most of our potential customers would consider that feature alone an adequate substitute for a comprehensive multi-mode communication solution. Some customers may choose solutions that are not HIPAA-compliant, given their budget constraints. Furthermore, in clinical integrations and middleware we compete with companies including Connexall and Philips Healthcare.

While we do not currently have a directly comparable single competitor that provides a solution as richly-featured as Vocera's solution for the healthcare market, we could face such competition in the future. Potential competitors in the healthcare or communications markets include large, multinational companies with significantly more resources to dedicate to product development and sales and marketing. These companies, which may include electronic health record vendors or other large software companies, may have existing relationships within the hospital, which may enhance their ability to gain a foothold in our market. For example, some of the electronic health record vendors have started to offer secure text messaging as an additional service and have said they plan to expand these offerings to compete more directly with us. Customers may prefer to purchase a more highly integrated or bundled solution from a single provider or an existing supplier rather than a new supplier, regardless of performance or features.

Accordingly, if we fail to effectively respond to competitive pressures, we could experience pricing pressure, reduced profit margins, higher sales and marketing expenses, lower revenue and the loss of market share, any of which would harm our business, operating results or financial condition.

If we fail to increase market awareness of our brand and solutions, and expand our sales and marketing operations, our business could be harmed.

We intend to continue to add personnel and resources in sales and marketing as we focus on expanding awareness of our brand and solutions and capitalize on sales opportunities with new and existing customers. Our efforts to improve sales of our solutions will result in an increase in our sales and marketing expense and general and administrative expense, and these efforts may not be successful. Some newly hired sales and marketing personnel may subsequently be determined to be unproductive and have to be replaced, resulting in operational and sales delays and incremental costs. If we are unable to significantly increase the awareness of our brand and solutions or effectively manage the

costs associated with these efforts, our business, financial condition and operating results could be harmed.

Failure to protect our information technology infrastructure against cyber-based attacks, network security breaches, service interruptions, or data corruption could significantly disrupt our operations and adversely affect our business and operating results.

We rely on information technology and telephone networks and systems, including the Internet, to process and transmit sensitive electronic information and to manage or support a variety of business processes and activities, including sales, billing, customer service, procurement and supply chain. We use enterprise information technology systems to record, process, and summarize financial information and results of operations for internal reporting purposes and to comply with regulatory financial reporting, legal, and tax requirements. Our information technology systems, some of which are managed by third-parties, may be susceptible to damage, disruptions or shutdowns due to computer viruses, attacks by computer hackers, failures during the process of upgrading or replacing software, databases or components thereof, power outages, hardware failures, telecommunication failures, user errors

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or catastrophic events. Although we have developed systems and processes that are designed to protect confidential information and prevent data loss and other security breaches, including systems and processes designed to reduce the impact of a security breach at a third-party vendor, such measures cannot provide absolute security. If our systems are breached or suffer severe damage, disruption or shutdown and we are unable to effectively resolve the issues in a timely manner, our business and operating results may significantly suffer and we may be subject to litigation, government enforcement actions or potential liability. Security breaches could also cause us to incur significant remediation costs, result in product development delays, disrupt key business operations, adversely impact customer relationships, damage our reputation and divert attention of management and key information technology resources.

We depend on a number of sole source and limited source suppliers, and if we are unable to source our components from them, our business and operating results could be harmed.

We depend on sole and limited source suppliers for several hardware components of our solutions, including our batteries and integrated circuits. We purchase inventory generally through individual purchase orders. Any of these suppliers could cease production of our components, cease to provide the necessary levels of support for our use of their components, experience capacity constraints, material shortages, work stoppages, financial difficulties, cost increases or other reductions or disruptions in output, cease operations or be acquired by, or enter into exclusive arrangements with, a competitor. These suppliers typically rely on purchase orders rather than long-term contracts with their suppliers, and as a result, even if available, the supplier may not be able to secure sufficient materials at reasonable prices or of acceptable quality to build our components in a timely manner. Any of these circumstances could cause interruptions or delays in the delivery of our solutions to our customers, and this may force us to seek components from alternative sources, which may not have the required specifications, or be available in time to meet demand or on commercially reasonable terms, if at all. Any of these circumstances may also force us to redesign our solutions if a component becomes unavailable in order to incorporate a component from an alternative source. Our solutions incorporate multiple software components obtained from licensors on a non-exclusive basis, such as voice recognition software, software supporting the runtime execution of our software platform, and database and reporting software. Our license agreements can be terminated for cause. In many cases, these license agreements specify a limited term and are only renewable beyond that term with the consent of the licensor. If a licensor terminates a license agreement for cause, objects to its renewal or conditions renewal on modified terms and conditions, we may be unable to obtain licenses for equivalent software components on reasonable terms and conditions, including licensing fees, warranties or protection from infringement claims. Some licensors may discontinue licensing their software to us or support of the software version used in our solutions. In such circumstances, we may need to redesign our solutions at substantial cost to incorporate alternative software components or be subject to higher royalty costs. Any of these circumstances could adversely affect the cost and availability of our solutions.

Third-party licensors generally require us to incorporate specific license terms and conditions in our agreements with our customers. If we are alleged to have failed to incorporate these license terms and conditions, we may be subject to claims by these licensors, incur significant legal costs defending ourselves against such claims and, if such claims are successful, be subject to termination of licenses, monetary damages, or an injunction against the continued distribution of one or more of our solutions.

Because we depend on contract manufacturers and original design manufacturers, our operations could be harmed and we could lose sales if we encounter problems with these manufacturers.

We do not have internal manufacturing capabilities and rely upon a contract manufacturer, SMTC, to produce the primary hardware component of our solutions. We have entered into a manufacturing agreement with SMTC that is terminable by either party with advance notice and that may also be terminated for a material uncured breach. We expect to enter into additional contract manufacturing agreements as we expand our business. We also rely on original design manufacturers, or ODMs, to produce accessories, including batteries, chargers and attachments. Any of these

suppliers could cease production of our components, cease to provide the necessary levels of support for our use of their components, experience capacity constraints, material shortages, work stoppages, financial difficulties, cost increases or other reductions or disruptions in output, cease operations or be acquired by, or enter into exclusive arrangements with, a competitor. If SMTC, or another contract manufacturer or an ODM is unable or unwilling to continue manufacturing components of our solutions in the volumes and timeframes that we require, fails to meet our quality specifications or significantly increases its prices, we may not be able to deliver our solutions to our customers with the quantities, quality and performance that they expect in a timely manner. As a result, we could lose sales and our operating results could be harmed.

SMTC, other contract manufacturers or ODMs may experience problems that could impact the quantity and quality of hardware components of our solution, including disruptions in their manufacturing operations due to equipment breakdowns, labor strikes or shortages, component or material shortages and cost increases. SMTC, other contract manufacturers and these ODMs generally rely on purchase orders rather than long-term contracts with their suppliers, and as a result, may not be able to secure sufficient components or other materials at reasonable prices or of acceptable quality to build components of our solutions in a timely manner.

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The majority of the hardware components of our solution are manufactured in Asia or Mexico, and adverse changes in political or economic circumstances in those locations could also disrupt our supply and quality of components of our solutions. In addition, U.S. government officials have recently changed and proposed additional changes in trade, fiscal or tax policies, and any such changes in the U.S. or in other countries from which we source components of our products could adversely affect our business.

Companies occasionally encounter unexpected difficulties in ramping up production of new products, and we may experience such difficulties with future generations of our products. SMTC, other contract manufacturers and our ODMs also manufacture products for other companies. Generally, our orders represent a relatively small percentage of the overall orders received by SMTC, other contract manufacturers and these ODMs from their customers; therefore, fulfilling our orders may not be a priority in the event SMTC, other contract manufacturers or an ODM is constrained in its ability to fulfill all of its customer obligations. In addition, if SMTC, other contract manufacturers or an ODM is unable or unwilling to continue manufacturing components of our solutions, we may have to identify one or more alternative manufacturers. The process of identifying and qualifying a new contract manufacturer or ODM can be time consuming, and we may not be able to substitute suitable alternative manufacturers in a timely manner or at an acceptable cost. Additionally, transitioning to a new manufacturer may cause us to incur additional costs and delays if the new manufacturer has difficulty manufacturing components of our solutions to our specifications or quality standards.

If we fail to forecast our manufacturing requirements accurately, or fail to properly manage our inventory with our contract manufacturer, we could incur additional costs and experience manufacturing delays, which can adversely affect our operating results.

We place orders with our contract manufacturers, including SMTC, and we and our contract managers place orders with suppliers based on forecasts of customer demand. Because of our international low cost sourcing strategy, our lead times are long and cause substantially more risk to forecasting accuracy than would result were lead times shorter. Our forecasts are based on multiple assumptions, each of which may introduce errors into our estimates affecting our ability to meet our customers' demands for our solutions. We also may face additional forecasting challenges due to product transitions in the components of our solutions, or to our suppliers discontinuing production of materials and subcomponents required for our solutions. If demand for our solutions increases significantly, we may not be able to meet demand on a timely basis, and we may need to expend a significant amount of time working with our customers to allocate limited supply and maintain positive customer relations, or we may incur additional costs in order to source additional materials and subcomponents to produce components of our solutions or to expedite the manufacture and delivery of additional inventory. If we underestimate customer demand, our contract manufacturer may have inadequate materials and subcomponents on hand to produce components of our solutions, which could result in manufacturing interruptions, shipment delays, deferral or loss of revenue, and damage to our customer relationships. Conversely, if we overestimate customer demand, we and our contract manufacturers may purchase more inventory than required for actual customer orders, resulting in excess or obsolete inventory, thereby increasing our costs and harming our operating results.

If hospitals do not have and are not willing to install, upgrade and maintain the wireless infrastructure required to effectively operate our solutions, then they may experience technical problems or not purchase our solutions at all.

The effectiveness of our solutions depends upon the quality and compatibility of the communications environment that our healthcare customers maintain. Our solutions require voice-grade wireless, or Wi-Fi, installed through large enterprise environments, which can vary from hospital to hospital and from department to department within a hospital. Many hospitals have not installed a voice-grade wireless infrastructure. If potential customers do not have a wireless network that can properly and fully interoperate with our solutions, then such a network must be installed, or an existing Wi-Fi network must be upgraded or modified, for example, by adding access points in stairwells, for our solutions to be fully functional. The additional costs of installing or upgrading a Wi-Fi network may dissuade

potential customers from installing our solutions. Furthermore, if changes to a customer's physical or information technology environment cause integration issues or degrade the effectiveness of our solutions, or if the customer fails to upgrade or maintain its environment as may be required for software releases or updates or to ensure our solution's effectiveness, the customer may not be able to fully utilize our solutions or may experience technical problems, or these changes may impact the performance of other wireless equipment being used. If such circumstances arise, prospective customers may not purchase or existing customers may not expand their use of or deploy upgraded versions of our solutions, thereby harming our business and operating results.

If we fail to achieve and maintain certification for certain U.S. federal standards, our sales to U.S. government customers will suffer.

We believe that a significant opportunity exists to continue to sell our products to healthcare facilities in the Veterans Administration and Department of Defense (DoD). These customers require independent certification of compliance with specific requirements relating to encryption, security, interoperability and scalability, including Federal Information Processing Standard (FIPS) 140-2 and, as to DoD, certification by its Joint Interoperability and Test Command and under its Information Assurance Certification



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and Accreditation Process. We have received certification under certain of these standards for military-specific configurations of our solution incorporating our badges. We continue to carry out further compliance activities and recertifications, as required. A failure on our part to achieve and maintain compliance and to respond to new threats and vulnerabilities, both as to current products and as to new product versions, could adversely impact our revenue.

Our efforts to sell our solutions in non-healthcare markets may not be successful.

In recent years, we have actively engaged in sales efforts to customers outside the healthcare markets, including hospitality, energy and other mobile work environments. We may not be successful in further penetrating the non-healthcare markets upon which we are initially focusing, or other new markets. To date, our solutions have been selected by over 270 customers in non-healthcare markets. Total revenue from non-healthcare customers accounted for 3%, 3% and 3% of our revenue for the nine months ended September 30, 2018 and the years ended December 31, 2017 and 2016, respectively. If we cannot maintain these customers by providing solutions that meet their requirements, if we cannot successfully expand our solutions in non-healthcare markets, or if adoption of our solutions remains slow, we may not obtain significant revenue from these markets. We may experience challenges as we expand in non-healthcare markets, including pricing pressure on our solutions and technical issues as we adapt our solutions for the requirements of new markets. Our solutions also may not contain the functionality required by these non-healthcare markets or may be too expensive or may not sufficiently differentiate us from competing solutions such that customers can justify deploying our solutions.

If we fail to successfully develop and introduce new solutions and features to existing solutions, our revenue, operating results and reputation could suffer.

Our success depends, in part, upon our ability to develop and introduce new solutions and features to existing solutions that meet existing and new customer requirements. We may not be able to develop and introduce new solutions or features on a timely basis or in response to customers' changing requirements, or that sufficiently differentiate us from competing solutions such that customers can justify deploying our solutions. We expect to incur costs associated with the development and introduction of new solutions before the anticipated benefits or the returns are realized, if at all. We may experience technical problems and additional costs as we introduce new features to our software platform, deploy future models of our wireless badges, which can require customers to perform software upgrades to their systems, and integrate new solutions with existing customer clinical systems and workflows. In addition, we may face technical difficulties as we expand into non-English speaking countries and incorporate non-English speech recognition capabilities into our solutions. We also may incur substantial costs or delays in the manufacture of any additional new products or models as we seek to optimize production methods and processes at our contract manufacturer. In addition, we expect that we will at least initially achieve lower gross margins on new models, while endeavoring to reduce manufacturing costs over time. If any of these problems were to arise, our revenue, operating results and reputation could suffer.

We generally recognize revenue from maintenance and support contracts and subscription arrangements over the contract term, and changes in sales may not be immediately reflected in our operating results.

We generally recognize revenue from our customer maintenance and support contracts, extended warranty contracts and subscription arrangements ratably over the contract term, which is typically 12 months, in some cases subject to an early termination right. Revenue from our maintenance and support contracts accounted for 35%, 32% and 33% of our revenue for the nine months ended September 30, 2018 and the years ended December 31, 2017 and 2016, respectively. A portion of the revenue we report in each quarter is derived from the recognition of deferred revenue relating to maintenance and support contracts entered into during previous quarters. Consequently, a decline in new or renewed maintenance and support, extended warranty contracts or subscription agreements by our customers in any one quarter may not be immediately reflected in our revenue for that quarter. Such a decline, however, will negatively

affect our revenue in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our services and potential changes in our rate of renewals may not be fully reflected in our operating results until future periods.

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Our success depends upon our ability to attract, integrate and retain key personnel, and our failure to do so could harm our ability to grow our business.

Our success depends, in part, on the continuing services of our senior management and other key personnel, and our ability to continue to attract, integrate and retain highly skilled personnel, particularly in engineering, sales and marketing. Competition for highly skilled personnel is intense, particularly in the Silicon Valley where our headquarters are located. If we fail to attract, integrate and retain key personnel, our ability to grow our business could be harmed.

The members of our senior management and other key personnel are at-will employees, and may terminate their employment at any time without notice. If one or more members of our senior management terminate their employment, we may not be able to find qualified individuals to replace them on a timely basis or at all and our senior management may need to divert their attention from other aspects of our business. Former employees may also become employees of a competitor. We may also have to pay additional compensation to attract and retain key personnel. We also anticipate hiring additional engineering, marketing and sales, and services personnel to grow our business. Often, significant amounts of time and resources are required to train these personnel. We may incur significant costs to attract, integrate and retain them, and we may lose them to a competitor or another company before we realize the benefit of our investments in them.

Our international operations subject us, and may increasingly subject us in the future, to operational, financial, economic and political risks abroad.

Although we derive a relatively small portion of our revenue from customers outside the United States, we believe that non-U.S. customers could represent an increasing share of our revenue in the future. During the nine months ended September 30, 2018 and the years ended December 31, 2017 and 2016, we generated 10.9%, 10.2% and 10.4% of our revenue, respectively, from customers outside of the United States, including Canada, the United Kingdom, Australia, New Zealand and Middle Eastern countries including the United Arab Emirates, Saudi Arabia and Qatar. In 2014, we opened a new innovation center in India and a sales office in Dubai, United Arab Emirates. Accordingly, we are subject to risks and challenges that we would not otherwise face if we conducted our business solely in the United States, including:

- challenges incorporating non-English speech recognition capabilities into our solutions as we expand into non-English speaking jurisdictions;
- difficulties integrating our solutions with wireless infrastructures with which we do not have experience;
- difficulties integrating local dialing plans and applicable PBX standards;
- challenges associated with delivering support, training and documentation in several languages;
- difficulties in staffing and managing personnel and resellers;
- the need to comply with a wide variety of foreign laws and regulations, including increasingly stringent data privacy regulations, requirements for export controls for encryption technology, employment laws, changes in tax laws and tax audits by government agencies;
- political and economic instability in, or foreign conflicts that involve or affect, the countries of our customers;
- adverse effects on us directly, or on our customers and suppliers, of changes in trade, fiscal or tax policies, including the imposition of tariffs;
- difficulties in collecting accounts receivable and longer accounts receivable payment cycles;
- exposure to competitors who are more familiar with local markets;
- risks associated with the Foreign Corrupt Practices Act and local anti-bribery law compliance;
- difficulties associated with resolving contract disputes in foreign countries with varied legal systems;
- limited or unfavorable intellectual property protection in some countries; and
- currency exchange rate fluctuations, which could affect the price of our solutions relative to locally produced solutions.

Any of these factors could harm our existing international business, impair our ability to expand into international markets or harm our operating results.

Our solutions are highly complex and may contain software or hardware defects that could harm our reputation and operating results.

Our solutions incorporate complex technology, are deployed in a variety of complex hospital environments and must interoperate with many different types of devices and hospital systems. While we test the components of our solutions for defects and errors prior to release, we or our customers may not discover a defect or error until after we have deployed our solution, integrated it into the hospital environment and our customer has commenced general use of the solution. In addition, our solutions in some cases are integrated with hardware and software offered by “middleware” vendors in order to interoperate with nurse call systems, device alarms and other hospital systems. Our software may also be deployed on third party devices, including devices we resell,

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which creates additional complexity because we share control of the customer experience. If we cannot successfully integrate our solutions with these vendors as needed or if any hardware or software of these vendors, contains any defect or error, then our solutions may not perform as designed, or may exhibit a defect or error.

Any defects or errors in, or which are attributed to our solutions, or to products or services we resell, could result in:

- delayed market acceptance of our affected solutions;
- loss of revenue or delay in revenue recognition;
- loss of customers or inability to attract new customers;
- diversion of engineering or other resources for remedying the defect or error;
- damage to our brand and reputation;
- delay in delivery of information;
- increased service and warranty costs, including potential replacement costs for product recalls or returns; and
- legal actions by our customers and hospital patients, including product liability claims.

If any of these occur, our operating results and reputation could be harmed.

We face potential liability related to the privacy and security of personal information collected through our solutions.

In connection with our healthcare business, we handle and have access to personal health information subject in the United States to the Health Insurance Portability and Accountability Act of 1996 (HIPAA) or HITECH, regulations issued pursuant to these statutes, state privacy and security laws and regulations, and associated contractual obligations as a “business associate” of healthcare providers. These statutes, regulations and contractual obligations impose numerous requirements regarding the use and disclosure of personal health information with which we must comply. Our failure to accurately anticipate the application or interpretation of these statutes, regulations and contractual obligations as we develop our solutions, a failure by us to comply with their requirements (e.g., evolving encryption and security requirements) or an allegation that defects in our products have resulted in noncompliance by our customers could create material civil and/or criminal liability for us, resulting in adverse publicity and negatively affecting our business.

In addition, the use and disclosure of personal health information is subject to laws and regulations in other jurisdictions in which we do business or expect to do business in the future. Any developments stemming from enactment or modification of these laws and regulations, or the failure by us to comply with their requirements or to accurately anticipate the application or interpretation of these laws could create material liability to us, result in adverse publicity and negatively affect our business.

For example, the European Union previously adopted the Data Protection Directive (DPD), imposing strict regulations and establishing a series of requirements regarding the storage of personally identifiable information on computers or recorded on other electronic media. This has been implemented by all EU member states through national laws. DPD provides for specific regulations requiring all non-EU countries doing business with EU member states to provide adequate data privacy protection when receiving personal data from any of the EU member states. In May 2016, the EU formally adopted the General Data Protection Regulation (GDPR), which applied to all EU member states starting in May 2018 and replaced the current DPD. The GDPR regulation introduces new data protection requirements in the EU and substantial fines for breaches of the data protection rules. It will increase our responsibility and liability in relation to personal data that we process and we may be required to put in place additional mechanisms ensuring compliance with the new EU data protection rules. Additionally, Canada’s Personal Information and Protection of Electronic Documents Act, as well as a variety of provincial statutes, provides Canadian residents with privacy protections in regard to transactions with businesses and organizations in the private sector and sets out ground rules for how private sector organizations may collect, use and disclose personal information in the course of commercial activities. A finding that we have failed to comply with applicable laws and regulations regarding the collection, use and disclosure of personal information could create liability for us, result in adverse publicity and negatively affect our business.

Any legislation or regulation in the area of privacy and security of personal information could affect the way we operate our services and could harm our business. For example, the European Court of Justice invalidated the U.S.-EU

Safe Harbor framework that had been in place since 2000, which allowed companies to meet certain EU legal requirements for the transfer of personal data from the European Economic Area to the United States. While other adequate legal mechanisms to lawfully transfer such data remain, the invalidation of the U.S.-EU Safe Harbor framework may result in different European data protection regulators applying differing standards for the transfer of personal data, which could result in increased regulation, cost of compliance and limitations on data transfer for us and our customers. The costs of compliance with, and the other burdens imposed by, these and other laws or regulatory actions may prevent us from selling our solutions or increase the costs associated with selling our solutions, and may affect our ability to invest in or jointly develop solutions in the United States and in foreign jurisdictions. Further, we cannot assure you that our privacy and security policies and practices will be found sufficient to protect us from liability or adverse publicity relating to the privacy and security of personal information.

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The failure of our equipment lease customers to pay us under leasing agreements with them that we do not sell to third party lease finance companies could harm our revenue and operating results.

In 2012, we began offering our solutions to our customers through multi-year equipment lease agreements. In connection with each sale, we recognize product-related revenue at the net present value of the lease payment stream once our obligations related to such sale have been met. We sell the bulk of these leases, including the related accounts receivables, to third party lease finance companies on a non-recourse basis. We will have to retain unsold leases in-house, which will expose us to the creditworthiness of such lease customers over the lease term. For the leases that we retain in-house, our ability to collect payments from a customer or to recognize revenue for the sale could be impaired if the customer fails to meet its obligations to us such as in the case of its bankruptcy filing or deterioration in its financial position, or has other creditworthiness issues, any of which could harm our revenue and operating results.

If our efforts to protect the security of information collected by our customers are unsuccessful, we could become subject to costly government enforcement actions and private litigation, and our sales and reputation could suffer.

The nature of our business involves the receipt and storage of information about our customers. We have implemented programs to detect and alert us to data security incidents. However, because the techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently and may be difficult to detect for long periods of time, we may be unable to anticipate these techniques or implement adequate preventive measures. Companies are increasingly subject to a wide variety of security incidents, cyber-attacks and other attempts to gain unauthorized access. These threats can come from a variety of sources, ranging in sophistication from an individual hacker to malfeasance by employees, consultants or other service providers to state-sponsored attacks. Cyber threats may be generic, or they may be custom-crafted against our information systems. In recent times, cyber-attacks have become more prevalent and much harder to detect and defend against. Our network and storage applications may be vulnerable to cyber-attack, malicious intrusion, malfeasance, loss of data privacy or other significant disruption and may be subject to unauthorized access by hackers, employees, consultants or other service providers. In addition, hardware, software or applications we develop or procure from third parties may contain defects in design or manufacture or other problems that could unexpectedly compromise information security. Unauthorized parties may also attempt to gain access to our systems or facilities through fraud, trickery or other forms of deceiving our employees, contractors and temporary staff. If we experience significant data security breaches or fail to detect and appropriately respond to significant data security breaches, we could be exposed to government enforcement actions and private litigation, as well as potentially incur significant costs and diversion of resources to comply with our contractual obligations to notify our customers of such security breaches, particularly with respect to any protected health information affected. In addition, our customers could lose confidence in our ability to protect their information, which could cause them to discontinue using our products or purchasing from us altogether.

Our use of open source and non-commercial software components could impose risks and limitations on our ability to commercialize our solutions.

Our solutions contain software modules licensed under open source and other types of non-commercial licenses, including the GNU Public License, the Apache License and others. We also may incorporate open source and other licensed software into our solutions in the future. Use and distribution of such software may entail greater risks than use of third-party commercial software, as licenses of these types generally do not provide warranties or other contractual protections regarding infringement claims or the quality of the code. Some of these licenses require the release of our proprietary source code to the public if we combine our proprietary software with open source software in certain manners. This could allow competitors to create similar products with lower development effort and time and ultimately result in a loss of sales for us.

The terms of many open source and other non-commercial licenses have not been judicially interpreted and there is a risk that such licenses could be construed in a manner that could impose unanticipated conditions or restrictions on our ability to commercialize our solutions. In such event, in order to continue offering our solutions, we could be required to seek licenses from alternative licensors, which may not be available on a commercially reasonable basis or at all, to re-engineer our solutions or to discontinue the sale of our solutions in the event we cannot obtain a license or re-engineer our solutions on a timely basis, any of which could harm our business and operating results. In addition, if an owner of licensed software were to allege that we had not complied with the conditions of the corresponding license agreement, we could incur significant legal costs defending ourselves against such allegations. In the event such claims were successful, we could be subject to significant damages, be required to disclose our source code, or be enjoined from the distribution of our solutions.



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Claims of intellectual property infringement could harm our business.

Vigorous protection and pursuit of intellectual property rights has resulted in protracted and expensive litigation for many companies in our industry. Although claims of this kind have not materially affected our business to date, there can be no assurance of the absence of such claims in the future. Any claims or proceedings against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time, result in the diversion of significant operational resources, or require us to enter into royalty or licensing agreements, any of which could harm our business and operating results.

Intellectual property lawsuits are subject to inherent uncertainties due to the complexity of the technical issues involved, and we cannot be certain that we will be successful in defending ourselves against intellectual property claims. In addition, we currently have a limited portfolio of issued patents compared to many other industry participants, and therefore may not be able to effectively utilize our intellectual property portfolio to assert defenses or counterclaims in response to patent infringement claims or litigation brought against us by third parties. Further, litigation may involve patent holding companies or other adverse patent owners who have no relevant products and against whom our potential patents may provide little or no deterrence.

Many potential litigants have the capability to dedicate substantially greater resources to enforce their intellectual property rights and to defend claims that may be brought against them. Furthermore, a successful claimant could secure a judgment that requires us to pay substantial damages or prevents us from distributing certain solutions or performing certain services. We might also be required to seek a license and pay royalties for the use of such intellectual property, which may not be available on commercially acceptable terms or at all. Alternatively, we may be required to develop non-infringing technology, which could require significant effort and expense and may ultimately not be successful.

If we are unable to protect our intellectual property rights, our competitive position could be harmed or we could be required to incur significant expenses to enforce our rights.

Our success depends, in part, on our ability to protect our proprietary technology. We protect our proprietary technology through patent, copyright, trade secret and trademark laws in the United States and similar laws in other countries. We also protect our proprietary technology through licensing agreements, nondisclosure agreements and other contractual provisions. These protections may not be available in all cases or may be inadequate to prevent our competitors from copying, reverse engineering or otherwise obtaining and using our technology, proprietary rights or solutions in an unauthorized manner. The laws of some foreign countries may not be as protective of intellectual property rights as those in the United States, and mechanisms for enforcement of intellectual property rights may be inadequate. In addition, third parties may seek to challenge, invalidate or circumvent our patents, trademarks, copyrights and trade secrets, or applications for any of the foregoing. Our competitors may independently develop technologies that are substantially equivalent, or superior, to our technology or design around our proprietary rights. In each case, our ability to compete could be significantly impaired.

To prevent unauthorized use of our intellectual property rights, it may be necessary to prosecute actions for infringement or misappropriation of our proprietary rights. Any such action could result in significant costs and diversion of our resources and management's attention, and there can be no assurance that we will be successful in such action. Furthermore, many of our current and potential competitors have the ability to dedicate substantially greater resources to enforce their intellectual property rights than us. Accordingly, despite our efforts, we may not be able to prevent third parties from infringing or misappropriating our intellectual property. While we plan to continue to protect our intellectual property with, among other things, patent protection, there can be no assurance that:

- current or future U.S. or foreign patent applications will be approved;
- our issued patents will protect our intellectual property and not be held invalid or unenforceable if challenged by third parties;
- we will succeed in protecting our technology adequately in all key jurisdictions in which we develop technology, or we or our competitors operate; or

others will not independently develop similar or competing products or methods or design around any patents that may be issued to us.

Our failure to obtain patents with claims of a scope necessary to cover our technology, or the invalidation of our patents, or our inability to protect any of our intellectual property, may weaken our competitive position and harm our business and operating results. We might be required to spend significant resources to monitor and protect our intellectual property rights. We may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Any litigation, whether or not it is resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel, which may harm our business, operating results and financial condition.

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Product liability or other liability claims could cause us to incur significant costs, adversely affect the sales of our solutions and harm our reputation.

Our solutions are utilized by healthcare professionals and others in the course of providing patient care. As a result patients, family members, physicians, nurses or others may allege we are responsible for harm to patients or healthcare professionals due to defects in, the malfunction of, the characteristics of, or the operation of, our solutions. Any such allegations could harm our reputation and ability to sell our solutions. For example, we are currently a defendant, along with several other healthcare and equipment providers, in a litigation involving the death of a patient undergoing surgery at a hospital of one of our customers. The Company plans to defend itself vigorously in this matter, but the outcome of any litigation is inherently uncertain.

Our solutions utilize lithium-ion batteries and electronic components that may overheat or otherwise malfunction as a result of physical or environmental damage. Components of our solutions emit radio frequency (RF) emissions which have been alleged, in connection with cellular phones, to have adverse health consequences. Magnets in our badges may emit electromagnetic radiation and may be alleged to interfere with implanted medical or other devices. While these components of our solutions comply with applicable guidelines, some may allege that these components of our solutions cause adverse health consequences. Also, applicable guidelines may change making these components of our solutions non-compliant. Any such allegations or non-compliance, or any regulatory developments, could negatively impact the sales of our solutions, require costly modifications to our solutions, and harm our reputation. Although our customer agreements contain terms and conditions, including disclaimers of liability, that are intended to reduce or eliminate our potential liability, we could be required to spend significant amounts of management time and resources to defend ourselves against product liability, tort, warranty or other claims. If any such claims were to prevail, we could be forced to pay damages, comply with injunctions or stop distributing our solutions. Even if potential claims do not result in liability to us, investigating and defending against these claims could be expensive and time consuming and could divert management's attention away from our business. We maintain general liability insurance coverage, including coverage for errors and omissions; however, this coverage may not be sufficient to cover large claims against us or otherwise continue to be available on acceptable terms. Further, the insurer could attempt to disclaim coverage as to any particular claim.

We may require additional capital to support our business growth, and such capital may not be available.

We intend to continue to make investments to support business growth and may require additional funds to respond to business challenges, which include the need to develop new solutions or enhance existing solutions, enhance our operating infrastructure, expand our sales and marketing capabilities, expand into non-healthcare markets, and acquire complementary businesses, technologies or assets. Accordingly, we may need to engage in additional equity or debt financing to secure funds. Equity and debt financing, however, might not be available when needed or, if available, might not be available on terms satisfactory to us. If we raise additional funds through equity financing, our stockholders may experience dilution. Debt financing, if available, may involve covenants restricting our operations or our ability to incur additional debt. If we are unable to obtain adequate financing or financing on terms satisfactory to us in the future, our ability to continue to support our business growth and to respond to business challenges could be significantly limited as we may have to delay, reduce the scope of or eliminate some or all of our initiatives, which could harm our operating results.

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Some of our solutions are, and others could become, subject to regulation by the U.S. Food and Drug Administration or similar foreign agencies, which could increase our operating costs.

We provide certain products that are, and others that may become, subject to regulation by the Food and Drug Administration (FDA) and similar agencies in other countries, or the jurisdiction of these agencies could be expanded in the future to include our solutions. The FDA regulates certain products, including software-based products, as “medical devices” based, in part, on the intended use of the product and the risk the device poses to the patient should the device fail to perform properly. For example, the clinical alert notification solution we acquired as part of our acquisition of Extension Healthcare and the clinical communications product we acquired from mVisum are regulated by the FDA as Class II medical devices. Although we have concluded that our wireless badge is a general-purpose communications device not subject to FDA regulation, the FDA could disagree with our conclusion, or changes in our solutions or the FDA’s evolving regulation could lead to FDA regulation of our solutions. Any of our products deemed to be medical devices would be subject to the 2.3% excise tax under the ACA; however, currently there is a moratorium on the medical device tax until January 1, 2020. Canada and many other countries in which we sell or may sell our solutions could also have similar regulations applicable to our solutions, some of which may be subject to change or interpretation. We may incur substantial operating costs if we are required to register our solutions or components of our solutions as regulated medical devices under U.S. or foreign regulations, obtain premarket approval from the FDA or foreign regulatory agencies, and satisfy the extensive reporting requirements. In addition, failure to comply with these regulations could result in enforcement actions and monetary penalties.

Our business is subject to the risks of earthquakes, fire, floods and other natural catastrophic events, and to interruption by man-made problems such as power disruptions or terrorism.

Our corporate headquarters are located in the San Francisco Bay Area, a region known for seismic activity, and many critical components of our solutions are sourced in Asia and Mexico, regions known to suffer natural disasters. A significant natural disaster, such as an earthquake, fire or a flood, occurring at our headquarters, our other facilities or where our contract manufacturer or its suppliers are located, could harm our business, operating results and financial condition. In addition, acts of terrorism could cause disruptions in our business, the businesses of our customers and suppliers, or the economy as a whole. We also rely on information technology systems to communicate among our workforce located worldwide, and in particular, our senior management, general and administrative, and research and development activities that are coordinated with our corporate headquarters in the San Francisco Bay Area. Any disruption to our internal communications, whether caused by a natural disaster or by man-made problems, such as power disruptions, in the San Francisco Bay Area, Asia or Mexico could delay our research and development efforts, cause delays or cancellations of customer orders or delay deployment of our solutions, which could harm our business, operating results and financial condition.

If we do not maintain effective internal control over financial reporting or disclosure controls and procedures in the future, the accuracy and timeliness of our financial reporting may be adversely affected.

The Sarbanes-Oxley Act requires, among other things, that we assess the effectiveness of our internal control over financial reporting annually and disclosure controls and procedures quarterly. In particular, we must obtain confidence in our internal control over financial reporting to allow management to report on the effectiveness of our internal control over financial reporting as required by Section 404 of the Sarbanes-Oxley Act. To the extent we find a material weakness or other deficiency in our internal control over financial reporting, the accuracy and timeliness of our financial reporting may be adversely affected.

Multiple negative consequences could ensue if a material weakness in our internal control over financial reporting is identified in the future, or we are not able to comply with the requirements of Section 404 in a timely manner, or we do not maintain effective controls. For example, our reported financial results could be materially misstated or could

be restated, we could receive an adverse opinion regarding our controls from our independent registered public accounting firm, or we could be subject to investigations or sanctions by regulatory authorities. All of these outcomes would require additional financial and management resources, and the market price of our stock could decline.

We will continue to incur substantial costs as a result of operating as a public company and our management devotes substantial time to public company compliance obligations.

As a public company, we incur substantial legal, accounting and other expenses. The Sarbanes-Oxley Act, Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and rules subsequently implemented by the SEC and our stock exchange, impose various requirements on public companies, including certain corporate governance practices. Our management and other personnel devote a substantial amount of time to these compliance requirements. Moreover, these rules and regulations, along with compliance with accounting principles and regulatory interpretations of such principles, as amended by the JOBS Act, have increased and will

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continue to increase our legal, accounting and financial compliance costs and have made and will continue to make some activities more time-consuming and costly.

We face risks related to securities litigation that could result in significant legal expenses and settlement or damage awards.

We have in the past been, and may in the future become, subject to claims and litigation alleging violations of the securities laws or other related claims, which could harm our business and require us to incur significant costs. For example, a purported securities class action was filed in August 2013 in the United States District Court for the Northern District of California against us and certain of our officers and directors. The suit purported to allege claims for allegedly misleading statements regarding our business and financial results. This suit was settled in 2016. The settlement, which called for payment of \$9 million, was funded entirely and directly by our insurance carriers and paid during the three months ended September 30, 2016. Regardless of the outcome, these matters or future litigation may require significant attention from management and could result in significant legal expenses, settlement costs or damage awards that could have a material impact on our financial position, results of operations and cash flows.

The SEC “conflict minerals” rule has caused us to incur additional expenses, could limit the supply and increase the cost of certain metals used in manufacturing our products and could make us less competitive in our target markets.

We are required to disclose the origin, source and chain of custody of specified minerals, known as conflict minerals, that are necessary to the functionality or production of products manufactured or contracted to be manufactured. The SEC requires companies to obtain sourcing data from suppliers, engage in supply chain due diligence and file annually with the SEC a specialized disclosure report on Form SD covering the prior calendar year. The rule could limit our ability to source at competitive prices and to secure sufficient quantities of certain minerals used in the manufacture of our products, as the number of suppliers that provide conflict-free minerals may be limited. In addition, we have incurred, and may continue to incur, costs associated with complying with the rule, such as costs related to auditing our compliance with the rules, costs related to the determination of the origin, source and chain of custody of the minerals used in our products, the adoption of conflict minerals-related governance policies, processes and controls and possible changes to products or sources of supply as a result of such activities. Within our supply chain, we may not be able to sufficiently verify the origins of the relevant minerals used in our products through the data collection and due diligence procedures that we implement, which may harm our reputation. Furthermore, we may encounter challenges in satisfying those customers that require that all of the components of our products be certified as conflict free, and if we cannot satisfy these customers, they may choose a competitor’s products. We continue to investigate the presence of conflict materials within our supply chain.

## Risks Related to the Notes

We have indebtedness in the form of convertible senior notes.

As a result of the Notes offering, we incurred \$143.75 million principal amount of indebtedness, the principal amount of which we may be required to pay at maturity in 2023. Holders of the Notes will have the right to require us to repurchase their Notes upon the occurrence of a “fundamental change” (as defined in the indenture governing the Notes) at a purchase price equal to 100% of the principal amount of the Notes to be purchased, plus accrued and unpaid interest, if any. In addition, the indenture for the Notes provides that we are required to repay amounts due under the indenture in the event that there is an event of default for the Notes that results in the principal, premium, if any, and interest, if any, becoming due prior to maturity date of the Notes. There can be no assurance that we will be able to repay this indebtedness when due, or that we will be able to refinance this indebtedness on acceptable terms or at all. In addition, this indebtedness could, among other things:

heighten our vulnerability to adverse general economic conditions and heightened competitive pressures; require us to dedicate a larger portion of our cash flow from operations to interest payments, limiting the availability of cash for other purposes; limit our flexibility in planning for, or reacting to, changes in our business and industry; and impair our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, general corporate purposes or other purposes.

In addition, our ability to purchase the Notes or repay prior to maturity any accelerated amounts under the Notes upon an event of default or pay cash upon conversions of the Notes may be limited by law, by regulatory authority or by agreements governing our indebtedness outstanding at the time. Our failure to repurchase Notes at a time when the repurchase is required by the indenture

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(whether upon a fundamental change or otherwise under the indenture) or pay cash payable on future conversions of the Notes (unless we elect to deliver solely shares of our common stock to settle such conversion) as required by the indenture would constitute a default under the indenture. A default under the indenture or the fundamental change itself could also lead to a default under agreements governing any future indebtedness. If the repayment of any related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness, repurchase the Notes or make cash payments upon conversions thereof.

Provisions in the indenture for the notes may deter or prevent a business combination that may be favorable to you.

If a fundamental change occurs prior to the maturity date of the Notes, holders of the Notes will have the right, at their option, to require us to repurchase all or a portion of their Notes. In addition, if a make-whole fundamental change occurs prior to the maturity date, we will in some cases be required to increase the conversion rate for a holder that elects to convert its notes in connection with such make-whole fundamental change. Furthermore, the indenture for the Notes prohibits us from engaging in certain mergers or acquisitions unless, among other things, the surviving entity assumes our obligations under the Notes. These and other provisions in the indenture could deter or prevent a third party from acquiring us even when the acquisition may be favorable to our stockholders.

The accounting method for convertible debt securities that may be settled in cash, such as the Notes, could have a material effect on our reported financial results.

Under Accounting Standards Codification 470-20, Debt with Conversion and Other Options ("ASC 470-20"), an entity must separately account for the liability and equity components of the convertible debt instruments (such as the Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the Notes is that the equity component is required to be included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet at the issuance date and the value of the equity component would be treated as debt discount for purposes of accounting for the debt component of the Notes. We are required to record a non-cash interest expense for the amortization of this debt discount for the term of the Notes which will adversely affect our financial results while the Notes are outstanding.

In addition, under certain circumstances, convertible debt instruments (such as the Notes) that may be settled entirely or partly in cash may be accounted for utilizing the treasury stock method, the effect of which is that the shares issuable upon conversion of such Notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of such Notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable, or otherwise elect not to, use the treasury stock method in accounting for the shares issuable upon conversion of the Notes, then our diluted earnings per share could be adversely affected.

The capped call transactions may affect the value of the Notes and our common stock.

In connection with the issuance of the Notes, we entered into capped call transactions with certain financial institutions (the option counterparties). The capped call transactions are expected generally to reduce the potential dilution upon any conversion of the Notes and/or offset any cash payments we are required to make in excess of the principal amount upon conversion of the Notes, with such reduction and/or offset subject to a cap. In connection with establishing their initial hedges of the capped call transactions, the option counterparties and/or their respective affiliates purchased shares of our common stock and/or entered into various derivative transactions with respect to our common stock. This activity could have increased (or reduced the size of any decrease in) the market price of our



common stock or the Notes at that time. In addition, the option counterparties and/or their respective affiliates may modify their hedge positions by entering into or unwinding various derivatives with respect to our common stock and/or purchasing or selling our common stock in secondary market transactions (and are likely to do so during any observation period related to a conversion of notes or following any repurchase of notes by us on any fundamental change repurchase date or otherwise). This activity could also cause or avoid an increase or a decrease in the price of our common stock or the Notes. The potential effect, if any, of these transactions and activities on the price of our common stock or the Notes will depend in part on market conditions and cannot be ascertained at this time. Any of these activities could adversely affect the value of our common stock.

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### Risks related to our common stock

The market price of our common stock has been, and may continue to be, volatile, and your investment in our stock could suffer a decline in value.

There has been significant volatility in the market price and trading volume of equity securities, which is often unrelated or disproportionate to the financial performance of the companies issuing the securities. These broad market fluctuations may negatively affect the market price of our common stock. The market price of our common stock could fluctuate significantly in response to the factors described in this “Risk Factors” section and elsewhere in this Form 10-Q and other factors, many of which are beyond our control, including:

- actual or anticipated variation in anticipated operating results of us or our competitors;
- the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;
- announcements by us or our competitors of new solutions, new or terminated significant contracts, commercial relationships or capital commitments;
- changes in the regulatory environment affecting our healthcare customers, including impediments to their ability to obtain reimbursement for their services, and other actual or anticipated legal or regulatory developments in the United States or foreign countries;
- actual or anticipated developments in our competitors’ businesses or the competitive landscape generally;
- failure of securities analysts to maintain coverage of us, changes in financial estimates by any securities analysts who follow our company, or our failure to meet these estimates or the expectations of investors;
- developments or disputes concerning our intellectual property or other proprietary rights;
- commencement of, or our involvement in, litigation;
- announced or completed acquisitions of businesses, technologies or assets by us or our competitor;
- changes in operating performance and stock market valuations of other technology companies generally, or those in our industry in particular;
- price and volume fluctuations attributable to inconsistent trading volume levels of our common stock;
- our decision to seek additional equity or debt financing;
- our public float relative to the total number of shares of our common stock that are issued and outstanding;
- price and volume fluctuations in the overall stock market, including as a result of trends in the economy as a whole;
- rumors and market speculation involving us or other companies in our industry;
- the dissemination of adverse or misleading reports or opinions about our business;
- any major change in our management;
- unfavorable economic conditions and slow or negative growth of our markets; and
- other events or factors, including those resulting from war or incidents of terrorism.

If securities or industry analysts issue an adverse or misleading opinion regarding our stock or do not publish research or reports about our business, our stock price could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us and our business. We do not control these analysts or the content and opinions included in their reports. The price of our common stock could decline if one or more analysts downgrade our common stock or if those analysts issue other unfavorable commentary or cease publishing reports about us or our business. If one or more analysts cease coverage of our company or fail to regularly publish reports about our company, we could lose visibility in the financial market, which in turn could cause our stock price to decline. Further, securities or industry analysts may elect not to provide research coverage of our common stock and such lack of research coverage may adversely affect the market price of our common stock.



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We have never paid cash dividends on our capital stock, and we do not anticipate paying any dividends in the foreseeable future.

We have never paid cash dividends on any of our capital stock and currently intend to retain our future earnings to fund the development and growth of our business. As a result, capital appreciation, if any, of our common stock will be the sole source of gain for the foreseeable future.

Our charter documents and Delaware law could discourage, delay or prevent a change of control of our company or change in our management that stockholders consider favorable and cause our stock price to decline.

Certain provisions of our restated certificate of incorporation and restated bylaws and Delaware law could discourage, delay or prevent a change of control of our company or change in our management that the stockholders of our company consider favorable. These provisions:

- authorize the issuance of “blank check” preferred stock that our board of directors could issue to increase the number of outstanding shares and to discourage a takeover attempt;

- prohibit stockholder action by written consent, requiring all stockholder actions to be taken at a meeting of stockholders;

- establish advance notice procedures for nominating candidates to our board of directors or proposing matters that can be acted upon by stockholders at stockholder meetings;

- limit the ability of our stockholders to call special meetings of stockholders;

- prohibit stockholders from cumulating their votes for the election of directors;

- permit newly created directorships resulting from an increase in the authorized number of directors or vacancies on our board of directors to be filled only by majority vote of our remaining directors, even if less than a quorum is then in office;

- provide that our board of directors is expressly authorized to make, alter or repeal our bylaws;

- establish a classified board of directors so that not all members of our board are elected at one time;

- provide that our directors may be removed only for “cause” and only with the approval of the holders of at least 66 2/3rds percent of our outstanding stock; and

- require super-majority voting to amend certain provisions in our certificate of incorporation and bylaws.

Section 203 of the Delaware General Corporation Law may also discourage, delay or prevent a change of control of our company.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit

Index      Exhibit title  
Number

31.01	<u>Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.02	<u>Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32.01+	<u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Schema Linkbase Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Labels Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document

This certification shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VOCERA COMMUNICATIONS, INC.

Date: November 5, 2018 By: /S/ Brent D. Lang

Brent D. Lang  
Chief Executive Officer

Date: November 5, 2018 By: /S/ Justin R. Spencer

Justin R. Spencer  
Chief Financial Officer  
(Principal Financial Officer)