

VOCERA COMMUNICATIONS, INC.

Form 10-Q

August 03, 2018

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _____ to _____

Commission File Number: 001-35469

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

Delaware 94-3354663
(State or other jurisdiction of (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)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of 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 and post 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 August 2, 2018
Common Stock, \$0.0003 par value per share	30,166,113

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FOR THE QUARTERLY PERIOD ENDED JUNE 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)

	June 30, 2018	December 31, 2017 *As Adjusted
Assets		
Current assets		
Cash and cash equivalents	\$27,480	\$ 28,726
Short-term investments	178,825	52,507
Accounts receivable, net of allowance	33,489	35,105
Other receivables	1,518	1,331
Inventories	3,923	2,815
Prepaid expenses and other current assets	3,648	3,957
Total current assets	248,883	124,441
Property and equipment, net	6,980	5,751
Intangible assets, net	11,273	13,567
Goodwill	49,246	49,246
Deferred commissions	9,329	10,301
Other long-term assets	1,304	1,667
Total assets	\$327,015	\$ 204,973
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	\$3,302	\$ 2,678
Accrued payroll and other current liabilities	11,569	14,689
Deferred revenue, current	40,003	40,734
Total current liabilities	54,874	58,101
Deferred revenue, long-term	13,405	14,417
Convertible senior notes, net	107,374	—
Other long-term liabilities	2,930	4,455
Total liabilities	178,583	76,973
Commitments and contingencies (Note 9)		
Stockholders' equity		
Preferred stock, \$0.0003 par value - 5,000,000 shares authorized as of June 30, 2018 and December 31, 2017; zero shares issued and outstanding	—	—
Common stock, \$0.0003 par value - 100,000,000 shares authorized as of June 30, 2018 and December 31, 2017; 30,091,970 and 29,412,116 shares issued and outstanding as of June 30, 2018 and December 31, 2017, respectively		9
Additional paid-in capital	279,812	250,854
Accumulated other comprehensive loss	(393) (191
Accumulated deficit	(130,996) (122,672
Total stockholders' equity	148,432	128,000
Total liabilities and stockholders' equity	\$327,015	\$ 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 June 30,		Six months ended June 30,	
	2018	2017 *As Adjusted	2018	2017 *As Adjusted
Revenue				
Product	\$21,824	\$20,992	\$42,911	\$41,044
Service	20,862	18,666	40,017	35,240
Total revenue	42,686	39,658	82,928	76,284
Cost of revenue				
Product	6,683	6,807	13,028	13,216
Service	10,352	9,962	20,348	19,117
Total cost of revenue	17,035	16,769	33,376	32,333
Gross profit	25,651	22,889	49,552	43,951
Operating expenses				
Research and development	7,323	7,371	14,637	14,300
Sales and marketing	15,266	15,246	30,288	30,168
General and administrative	6,176	5,984	12,535	11,679
Total operating expenses	28,765	28,601	57,460	56,147
Loss from operations	(3,114)	(5,712)	(7,908)	(12,196)
Interest income	530	128	745	233
Interest expense	(997)	—	(997)	—
Other income (expense), net	(528)	(67)	(807)	42
Loss before income taxes	(4,109)	(5,651)	(8,967)	(11,921)
Benefit from (provision for) income taxes	555	(361)	643	(741)
Net loss	\$(3,554)	\$(6,012)	\$(8,324)	\$(12,662)
Net loss per share				
Basic and diluted	\$(0.12)	\$(0.21)	\$(0.28)	\$(0.45)
Weighted average shares used to compute net loss per share				
Basic and diluted	29,867	28,422	29,673	28,088

* 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 June 30,		Six months ended June 30,	
	2018	2017	2018	2017
		*As		*As
		Adjusted		Adjusted
Net loss	\$(3,554)	\$(6,012)	\$(8,324)	\$(12,662)
Other comprehensive loss, net:				
Change in unrealized gain (loss) on investments, net of tax	(119)	38	(202)	210
Comprehensive loss	\$(3,673)	\$(5,974)	\$(8,526)	\$(12,452)

* 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)

	Six months ended June 30,	
	2018	2017 * As Adjusted
Cash flows from operating activities		
Net loss	\$(8,324)	\$(12,662)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,776	3,791
Inventory provision	—	86
Change in lease-related performance obligations	(568)	(423)
Stock-based compensation expense	9,983	8,486
Amortization of debt discount and issuance costs	733	—
Other	24	14
Changes in operating assets and liabilities:		
Accounts receivable	1,621	(901)
Other receivables	(187)	59
Inventories	(1,109)	958
Prepaid expenses and other assets	672	(821)
Deferred commissions	972	210
Accounts payable	(184)	(622)
Accrued payroll and other liabilities	(4,256)	(456)
Deferred revenue	(1,742)	235
Net cash provided by (used in) operating activities	1,411	(2,046)
Cash flows from investing activities		
Purchase of property and equipment	(1,929)	(1,741)
Purchase of short-term investments	(148,228)	(38,792)
Maturities of short-term investments	21,707	38,101
Net cash used in investing activities	(128,450)	(2,432)
Cash flows from financing activities		
Cash from lease-related performance obligations	89	—
Proceeds from issuance of convertible senior notes, net of issuance costs	139,058	—
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	1,962	5,967
Tax withholdings paid on behalf of employees for net share settlement	(8,034)	(6,210)
Net cash provided by financing activities	125,793	1,003
Net decrease in cash and cash equivalents	(1,246)	(3,475)
Cash and cash equivalents at beginning of period	28,726	35,033
Cash and cash equivalents at end of period	\$27,480	\$31,558
Supplemental disclosure of non-cash investing and financing activities:		
Costs related to the convertible senior notes in accounts payable and accrued liabilities	\$204	\$—
Property and equipment in accounts payable and accrued liabilities	\$909	\$341

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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”) and 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 will replace most existing guidance,

eliminate industry-specific guidance and provide 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.

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 using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. The Company has not yet determined the future effect 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 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 will be effective for reporting periods beginning after December 15, 2017, with early adoption permitted. The Company is currently evaluating the impact of this new guidance on its consolidated financial statements, but does not expect that it will have a material impact on its 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 will be 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 guidance is not expected to have a material impact on the Company's 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 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 Company does not expect the guidance to have a material impact on the Company's 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 June 30, 2017			Six months ended June 30, 2017		
	As Reported	Impact of Adoption	As Adjusted	As Reported	Impact of Adoption	As Adjusted
Revenue						
Product	\$20,658	\$ 334	\$20,992	\$40,691	\$ 353	\$41,044
Service	17,792	874	18,666	34,054	1,186	35,240
Total Revenue	\$38,450	\$ 1,208	\$39,658	\$74,745	\$ 1,539	\$76,284
Gross Profit	\$21,681	\$ 1,208	\$22,889	\$42,412	\$ 1,539	\$43,951
Operating Expenses	\$28,732	\$(131)	\$28,601	\$55,937	\$ 210	\$56,147
Loss from Operations	\$(7,051)	\$ 1,339	\$(5,712)	\$(13,525)	\$ 1,329	\$(12,196)
Net Loss	\$(7,351)	\$ 1,339	\$(6,012)	\$(13,991)	\$ 1,329	\$(12,662)
Basic and diluted net loss per share	\$(0.26)	\$ 0.05	\$(0.21)	\$(0.50)	\$ 0.05	\$(0.45)

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

(in thousands)	Six months ended June 30, 2017		
	As Reported	Impact of Adoption	As Adjusted
Cash flows from operating activities:			
Net loss	(13,991)	1,329	(12,662)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Deferred commissions	\$—	\$ 210	\$ 210
Deferred revenue	\$1,774	\$(1,539)	\$ 235

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 June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Product revenue				
Device	\$ 15,049	\$ 14,990	\$ 27,697	\$ 29,048
Software	6,775	6,002	15,214	11,996
Total product	21,824	20,992	42,911	41,044
Service revenue				
Maintenance and support	15,505	12,670	29,470	24,670
Professional services and training	5,357	5,996	10,547	10,570
Total service	20,862	18,666	40,017	35,240
Total revenue	\$ 42,686	\$ 39,658	\$ 82,928	\$ 76,284

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 SSP 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 June 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 six months ended June 30, 2018 are as follows:

(in thousands)	March 31, 2018	Additions	Commissions Recognized	June 30, 2018
Deferred commissions	\$9,734	\$ 991	\$ (1,396)	\$9,329

(in thousands)	December 31, 2017 *As Adjusted	Additions	Commissions Recognized	June 30, 2018
Deferred commissions	\$ 10,301	\$ 1,790	\$ (2,762)	\$9,329

Of the \$9.3 million total deferred commissions balance as of June 30, 2018, the Company expects to recognize approximately 53.1% 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 six months ended June 30, 2018 are as follows:

(in thousands)	March 31, 2018	Additions	Revenue Recognized	June 30, 2018
Deferred revenue	\$54,360	\$ 17,581	\$ (18,533)	\$53,408

(in thousands)	December 31, 2017 *As Adjusted	Additions	Revenue Recognized	June 30, 2018
Deferred revenue	\$ 55,151	\$ 38,083	\$ (39,826)	\$53,408

* 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 six months ended June 30, 2018 from deferred revenue balances at the beginning of the period was \$15.5 million and \$27.1 million, respectively. Revenue recognized during the three and six months ended June 30, 2017 from deferred revenue balances at the beginning of the period was \$12.4 million and \$22.8 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 \$108.8 million as of June 30, 2018, of which the Company expects to recognize approximately 79% 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 observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. For the six

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months ended June 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 June 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 June 30, 2018 and December 31, 2017, are summarized as follows (in thousands):

	June 30, 2018			December 31, 2017		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Assets						
Money market funds	\$3,750	\$—	\$3,750	\$3,232	\$—	\$3,232
Commercial paper	—	53,183	53,183	—	1,201	1,201
U.S. government agency securities	—	5,828	5,828	—	8,648	8,648
U.S. Treasury securities	—	4,813	4,813	—	5,561	5,561
Corporate debt securities	—	124,131	124,131	—	37,530	37,530
Total assets measured at fair value	\$3,750	\$187,955	\$191,705	\$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 June 30, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair value
Cash and cash equivalents:				
Demand deposits and other cash	\$14,600	\$ —	\$ —	\$14,600
Money market funds	3,750	—	—	3,750
Commercial paper	9,132	—	(2)	9,130
Total cash and cash equivalents	27,482	—	(2)	27,480
Short-Term Investments:				
Commercial paper	44,088	—	(35)	44,053
U.S. government agency securities	5,859	—	(31)	5,828
U.S. Treasury securities	4,838	—	(25)	4,813
Corporate debt securities	124,374	3	(246)	124,131
Total short-term investments	179,159	3	(337)	178,825
Total cash, cash equivalents and short-term investments	\$206,641	\$ 3	\$ (339)	\$206,305

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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 June 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 June 30, 2018			
Cash and cash equivalents (1)	\$27,480	\$—	\$27,480
Short-term investments	107,707	71,118	178,825
Cash, cash equivalents and short-term investments	\$135,187	\$71,118	\$206,305
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 June 30,		Six months ended June 30,	
	2018	2017	2018	2017
		* As Adjusted		* As Adjusted
Numerator:				
Net loss	\$(3,554)	\$(6,012)	\$(8,324)	\$(12,662)
Denominator:				
Weighted-average shares used to compute net loss per common share - basic and diluted	29,867	28,422	29,673	28,088
Net income (loss) per share				
Basic and diluted	\$(0.12)	\$(0.21)	\$(0.28)	\$(0.45)

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 June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Options to purchase common stock, including ESPP	1,236	1,586	1,283	1,889
Restricted stock units	1,955	2,336	1,991	2,241

6. Goodwill and Intangible Assets

Goodwill

As of June 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 June 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.

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

(in thousands)	Range of Useful Life (years)	June 30, 2018		December 31, 2017		Net Carrying Amount	
		Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization		
Developed technology	3 to 7	\$10,050	\$ 6,517	\$ 3,533	\$10,050	\$ 5,302	\$ 4,748
Customer relationships	7 to 9	10,920	4,057	6,863	10,920	3,469	7,451
Backlog	3	1,400	969	431	1,400	650	750
Non-compete agreements	2 to 4	460	460	—	460	455	5
Trademarks	3 to 7	1,110	664	446	1,110	497	613
Intangible assets, net book value		\$23,940	\$ 12,667	\$ 11,273	\$23,940	\$ 10,373	\$ 13,567

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Amortization expense was \$1.0 million and \$1.2 million for the three months ended June 30, 2018 and 2017, respectively. Amortization expense was \$2.3 million and \$2.4 million for the six months ended June 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 June 30, 2018 was as follows:

(in thousands)	Future amortization
2018 (remaining six months)	\$ 2,040
2019	3,880
2020	1,251
2021	1,127
2022	1,050
2023	1,050
Thereafter	875
Future amortization expense	\$ 11,273

7. Balance Sheet Components

Inventories

(in thousands)	June 30, 2018	December 31, 2017
Raw materials	\$ 76	\$ 4
Finished goods	3,847	2,811
Total inventories	\$ 3,923	\$ 2,815

Property and equipment, net

(in thousands)	June 30, 2018	December 31, 2017
Computer equipment and software	\$9,495	\$ 8,832
Furniture, fixtures and equipment	2,190	1,764
Leasehold improvements	5,898	4,794
Manufacturing tools and equipment	2,709	2,624
Construction in process	128	157
Property and equipment, at cost	20,420	18,171
Less: Accumulated depreciation	(13,440)	(12,420)
Property and equipment, net	\$6,980	\$ 5,751

Depreciation and amortization expense was \$0.8 million and \$0.7 million for the three months ended June 30, 2018 and 2017, respectively. Depreciation and amortization expense was \$1.5 million and \$1.4 million for the six months ended June 30, 2018 and 2017, respectively.

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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)	June 30, December 31,	
	2018	2017
Minimum payments to be received on sales-type leases	\$2,513	\$ 2,758
Less: Unearned interest income and executory costs	(1,377)	(1,469)
Net investment in sales-type leases	1,136	1,289
Less: Current portion	(635)	(916)
Non-current net investment in sales-type leases	\$501	\$ 373

There were no allowances for doubtful accounts on these leases as of June 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 June 30, 2018 were as follows:

(in thousands)	Future lease payments
2018	\$ 821
2019	993
2020	603
2021	93
2022	3
Total	\$ 2,513

Accrued payroll and other current liabilities

(in thousands)	June 30, December 31,	
	2018	2017
Payroll and related expenses	\$5,862	\$ 9,569
Accrued payables	2,362	1,801
Deferred rent, current portion	293	271
Lease financing, current portion	910	832
Product warranty	306	353
Customer prepayments	620	1,084
Sales and use tax payable	512	505
Other	704	274
Total accrued payroll and other current liabilities	\$11,569	\$ 14,689

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

	Three months ended June 30,		Six months ended June 30,	
(in thousands)	2018	2017	2018	2017
Warranty balance at the beginning of the period	\$303	\$499	\$353	\$596
Warranty expense accrued for shipments during the period	129	120	215	258
Changes in estimate related to pre-existing warranties	(75)	(225)	(134)	(377)
Warranty settlements made	(51)	(79)	(128)	(162)
Total product warranty	\$306	\$315	\$306	\$315

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 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 months ended June 30, 2018, the conditions allowing holders of the Notes to convert have not been met. The Notes are therefore not convertible during the three months ended June 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

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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 consisted of the following:

(in thousands)	June 30, 2018
Liability:	
Principal	\$ 143,750
Unamortized debt discount	(32,691)
Unamortized issuance costs	\$(3,685)
Net carrying amount	\$ 107,374
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 June 30, 2018 was approximately \$161.4 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 \$29.89 on June 29, 2018, the if-converted value of the Notes of \$133.2 million was less than their principal amount.

Interest expense related to the Notes is as follows:

(in thousands)	June 30, 2018
Contractual interest expense	\$ 264
Amortization of debt discount	\$ 659
Amortization of issuance costs	\$ 74
Total interest expense	\$ 997

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.

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

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

Impact on Earnings Per Share

The Notes will not have an impact on the Company's diluted earnings per share until the average market price of the Company's common stock exceeds the conversion price of \$32.25 per share, as the Company intends to settle the principal amount of the Notes in cash upon conversion. The Company is required under the treasury stock method to compute the potentially dilutive shares of common stock related to the Notes for periods net income is reported. 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 June 30, 2018 and December 31, 2017, approximately \$9.6 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.

Leases

The Company leases office space for its headquarters and subsidiaries under non-cancelable operating leases, which will expire between December 2017 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 June 30, 2018 and 2017, respectively. Facilities rent expense was \$1.3 million and \$1.2 million for the six months ended June 30, 2018 and 2017, respectively.

Future minimum lease payments at June 30, 2018 under non-cancelable operating leases are as follows:

(in thousands)	Operating leases
2018 (remaining six months)	\$ 1,170
2019	2,235
2020	2,085
2021	1,836
2022	612
2023	35
Total minimum lease payments	\$ 7,973

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

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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.

10. Stock-based Compensation and AwardsStock Option Activity

A summary of the stock option activity for the six months ended June 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	(116,210)	16.88		
Options canceled	(2,774)	4.97		
Outstanding at June 30, 2018	1,213,079	\$ 13.18	4.29	\$ 20,280

At June 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 0.59 years. As of June 30, 2018, there were 2,379,220 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 six months ended June 30, 2018, employees purchased 78,563 shares of common stock at an average price of \$20.69. During the six months ended June 30, 2017, employees purchased 89,813 shares of common stock at an average purchase price of \$13.87. As of June 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		Six months ended June 30,	
	June 30, 2018	2017	2018	2017
Expected term (in years)	0.50	0.50	0.50	0.50
Volatility	29.0% - 37.8%	30.0%	29.0% - 37.8%	30.0% - 32.0%
Risk-free interest rate	1.39% - 2.09%	1.02%	1.39% - 2.09%	0.61% - 1.02%
Dividend yield	0%	0%	0%	0%

Restricted Stock Units

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

	Restricted Stock Units		Weighted Average Grant Date Fair Value per Share
	Number of shares		
Outstanding at December 31, 2017	2,045,589		\$ 18.84
Granted	794,187		25.60
Vested	(793,680)		17.20
Forfeited	(90,667)		20.45
Outstanding at June 30, 2018	1,955,429		\$ 22.17

At June 30, 2018, there was \$37.6 million of unrecognized compensation cost related to RSUs, which is expected to be recognized over a weighted-average period of 1.93 years.

Allocation of Stock-Based Compensation Expense

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

(in thousands)	Three months		Six months	
	ended June 30, 2018	2017	ended June 30, 2018	2017
Cost of revenue	\$966	\$848	\$1,713	\$1,368
Research and development	755	623	1,362	1,035
Sales and marketing	1,655	1,779	3,151	3,044
General and administrative	2,020	1,653	3,757	3,039
Total stock-based compensation	\$5,396	\$4,903	\$9,983	\$8,486

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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 June 30,		Six months ended June 30,	
	2018	2017	2018	2017
(in thousands)	* As Adjusted		* As Adjusted	
Revenue				
Product	\$21,824	\$20,992	\$42,911	\$41,044
Service	20,862	18,666	40,017	35,240
Total revenue	42,686	39,658	82,928	76,284
Cost of revenue				
Product	6,683	6,807	13,028	13,216
Service	10,352	9,962	20,348	19,117
Total cost of revenue	17,035	16,769	33,376	32,333
Gross profit				
Product	15,141	14,185	29,883	27,828
Service	10,510	8,704	19,669	16,123
Total gross profit	25,651	22,889	49,552	43,951
Operating expenses	28,765	28,601	57,460	56,147
Interest income (expense), net and other	(995)	61	(1,059)	275
Loss before income taxes	\$(4,109)	\$(5,651)	\$(8,967)	\$(11,921)

12. Income Taxes

The Company recorded a \$0.6 million benefit from income taxes and \$0.7 million provision for income taxes for the six months ended June 30, 2018 and 2017, respectively. The benefit recorded for the six months ended June 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 six months ended June 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 June 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 June 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