VOCERA COMMUNICATIONS, INC.
Form 10-Q
August 03, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from to
Commission File Number: 001-35469

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

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

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

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

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

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

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

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

Class	Outstanding as of July 31, 2017
Common Stock, $0.0003 par value per share	29,104,088

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FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2017
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PART I: FINANCIAL INFORMATION

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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, 2017	December 31, 2016
Assets		
Current assets		
Cash and cash equivalents	$31,558	$ 35,033
Short-term investments	39,715	39,033
Accounts receivable, net of allowance	25,043	24,142
Other receivables	1,152	1,211
Inventories	3,512	4,556
Prepaid expenses and other current assets	4,118	3,364
Total current assets	105,098	107,339
Property and equipment, net	6,499	5,894
Intangible assets, net	15,827	18,200
Goodwill	49,246	49,246
Other long-term assets	1,461	1,394
Total assets	$178,131	$ 182,073
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	$2,905	$ 3,231
Accrued payroll and other current liabilities	14,961	15,896
Deferred revenue, current	39,349	43,845
Total current liabilities	57,215	62,972
Deferred revenue, long-term	17,425	11,155
Other long-term liabilities	4,625	4,505
Total liabilities	79,265	78,632
Commitments and contingencies (Note 7)		
Stockholders' equity		
Preferred stock, $0.0003 par value - 5,000,000 shares authorized as of June 30, 2017 and December 31, 2016; zero shares issued and outstanding	—	—
Common stock, $0.0003 par value - 100,000,000 shares authorized as of June 30, 2017 and December 31, 2016; 28,923,746 and 27,568,103 shares issued and outstanding as of June 30, 2017 and December 31, 2016, respectively	9	8
Additional paid-in capital	240,407	230,605
Accumulated other comprehensive loss	(78)	(69)
Accumulated deficit	(141,472)	(127,103)
Total stockholders’ equity	98,866	103,441
Total liabilities and stockholders’ equity	$178,131	$ 182,073

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,	
	2017	2016	2017	2016
Revenue				
Product	$20,658	$17,702	$40,691	$31,504
Service	17,792	13,450	34,054	26,425
Total revenue	38,450	31,152	74,745	57,929
Cost of revenue				
Product	6,807	5,944	13,216	10,393
Service	9,962	6,134	19,117	11,784
Total cost of revenue	16,769	12,078	32,333	22,177
Gross profit	21,681	19,074	42,412	35,752
Operating expenses				
Research and development	7,371	4,428	14,300	8,400
Sales and marketing	15,377	12,747	29,958	24,773
General and administrative	5,984	4,625	11,679	8,961
Total operating expenses	28,732	21,800	55,937	42,134
Loss from operations	(7,051)	(2,726)	(13,525)	(6,382)
Interest income	128	199	233	377
Other income (expense), net	(67)	(137)	42	(151)
Loss before income taxes	(6,990)	(2,664)	(13,250)	(6,156)
Provision for income taxes	(361)	(42)	(741)	(134)
Net loss	$(7,351)	$(2,706)	$(13,991)	$(6,290)
Net loss per share				
Basic and diluted	$(0.26)	$(0.10)	$(0.50)	$(0.24)
Weighted average shares used to compute net loss per share				
Basic and diluted	28,422	26,624	28,088	26,501

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,	
	2017	2016	2017	2016
Net loss	$(7,351)	$(2,706)	$(13,991)	$(6,290)
Other comprehensive loss, net:				
Change in unrealized gain (loss) on investments, net of tax	(6)	38	(9)	210
Comprehensive loss	$(7,357)	$(2,668)	$(14,000)	$(6,080)

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,	
	2017	2016
Cash flows from operating activities		
Net loss	$(13,991)	$(6,290)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,791	1,456
Inventory provision	86	119
Change in lease-related performance obligations	(423)	(450)
Stock-based compensation expense	8,486	5,691
Other	14	6
Changes in operating assets and liabilities:		
Accounts receivable	(901)	3,484
Other receivables	59	123
Inventories	958	(1,773)
Prepaid expenses and other assets	(821)	94
Accounts payable	(622)	548
Accrued payroll and other liabilities	(456)	(30)
Deferred revenue	1,774	1,202
Net cash provided by (used in) operating activities	(2,046)	4,180
Cash flows from investing activities		
Purchase of property and equipment	(1,741)	(3,013)
Purchase of short-term investments	(38,792)	(68,692)
Maturities of short-term investments	38,101	68,464
Sales of short-term investments	—	4,231
Net cash provided by (used in) investing activities	(2,432)	990
Cash flows from financing activities		
Cash from lease-related performance obligations	—	940
Proceeds from issuance of common stock from the employee stock purchase plan	1,246	786
Proceeds from exercise of stock options	5,967	523
Tax withholdings paid on behalf of employees for net share settlement	(6,210)	(1,624)
Net cash provided by financing activities	1,003	625
Net increase (decrease) in cash and cash equivalents	(3,475)	5,795
Cash and cash equivalents at beginning of period	35,033	20,572
Cash and cash equivalents at end of period	$31,558	$26,367
Supplemental disclosure of non-cash investing and financing activities:		
Property and equipment in accounts payable and accrued liabilities	$341	$401

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 (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 quality of care, patient and staff experience and increase operational efficiency.

The Vocera Communication System, 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 securely delivers text messages and alerts directly to and from smartphones, replacing legacy pagers. Our new Engage software is an event-driven, communication and workflow collaboration solution for the hospital environment. It features an advanced clinical rules engine and interoperates with data from multiple clinical systems. This enables the prioritization of notifications, including patient context, and sends messages to the right care team members on their mobile devices. Our software applications help improve care coordination, patient safety and patient satisfaction.

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, 2016. 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.

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, 2017 or for any other interim period or any other future year.

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, 2016.

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.

Revenue Recognition

The Company derives revenue from the sales of communication badges, perpetual software licenses for software that is essential to the functionality of the communication badges, smartphones, software maintenance, extended product warranty and professional services. The Company also derives revenue from the sale of licenses for software that is not essential to the functionality of the communication badges, which may include Clinical Integration and Vocera smartphone applications as well as certain subscription-based revenues including Vocera Care Experience. The

Company’s revenue recognition policy has not changed from that described in its Annual Report on Form 10-K for the year ended December 31, 2016.

Transfer of sales-type leases to third-parties

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Proceeds from transfers of sales-type leases to third-party financial companies are allocated between the net investment in sales-type leases and the executory cost component for remaining service obligations based on relative present value. The difference between the amount of proceeds allocated to the net investment in lease and the carrying value of the net investment in lease is included in product revenue. Proceeds allocated to the executory cost component are accounted for as financing liabilities.

For the six months ended June 30, 2017 and 2016, the Company transferred zero and $2.5 million, respectively, of lease receivables in non-recourse sales to third-party financial companies, with immaterial net losses. For the six months ended June 30, 2017 and 2016, the Company recorded zero and $0.9 million, respectively, of financing liabilities for future performance of executory service obligations. For lease receivables retained as of June 30, 2017 and December 31, 2016, the Company recorded $1.6 million and $1.9 million of net investment in sales-type leases, respectively, equivalent to the minimum lease payments less the unearned interest portion.

Recently Adopted Accounting Pronouncement

In March 2016, the Financial Accounting Standards Board (FASB) issued new guidance related to accounting for stock-based payment award transactions. The guidance is designed to simplify several aspects of accounting for share-based payment award transactions, including the income tax consequences, classification of awards as either equity or liabilities, classification on the statement of cash flows and forfeiture rate calculations. The guidance eliminates the requirement to delay the recognition of excess tax benefits until they reduce current taxes payable. Under this standard, previously unrecognized excess tax benefits shall be recognized on a modified retrospective basis. However, as of January 1, 2017, the previously unrecognized excess tax benefits of $10.4 million had no impact on the Company's accumulated deficit balance as the related U.S. deferred tax assets were fully offset by a valuation allowance. The guidance also requires excess tax benefits and deficiencies to be recognized prospectively in the provision for income taxes rather than additional paid-in capital. The Company therefore determined that adoption of the new guidance had no material impact on the condensed consolidated statement of operations and the condensed consolidated statement of cash flows. Further, the new guidance eliminates the requirement to estimate forfeitures and reduce stock compensation expense during the vesting period. Instead, companies can elect to account for actual forfeitures as they occur and record any previously unrecognized compensation expense for estimated forfeitures up to the period of adoption as a retrospective adjustment to beginning retained earnings. The Company has made the election to account for actual forfeitures as they occur starting in fiscal year 2017. During the six months ended June 30, 2017, the Company recorded a retrospective adjustment to accumulated deficit of $0.4 million

Recent Accounting Pronouncements

In May 2014, the 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.

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 currently plans to adopt using the full retrospective method, however, such determination could change depending on a number of factors including system readiness, the magnitude of the potential impact on the financial results, and its ability to gather sufficient data to assess the impact on prior period financial statements timely.

Public entities are required to adopt the new guidance for annual reporting periods beginning December 15, 2017, including interim periods. The Company will adopt the new guidance on January 1, 2018.

The Company anticipates the new guidance to have a material impact on its consolidated financial statements. While the Company is continuing to assess all potential impacts of the standard, the Company currently believes the most significant impact relates to the timing of revenue recognition for software licenses sold with professional services as it 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 which are currently expensed at the time of sale. The Company is continuing to assess the impact of this guidance on its consolidated financial statements, as well as the determination of the method of adoption.

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.

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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.

2. 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 months ended June 30, 2017, 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.

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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, 2017 and December 31, 2016, are summarized as follows (in thousands):

	June 30, 2017			December 31, 2016		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Assets						
Money market funds	$5,857	$—	$5,857	$4,996	$—	$4,996
Commercial paper	—	1,058	1,058	—	1,322	1,322
U.S. government agency securities	—	2,884	2,884	—	4,177	4,177
U.S. Treasury securities	—	1,299	1,299	—	2,045	2,045
Corporate debt securities	—	34,824	34,824	—	33,166	33,166
Total assets measured at fair value	$5,857	$40,065	$45,922	$4,996	$40,710	$45,706

The Company had no liabilities as of June 30, 2017 and December 31, 2016 that were measured at fair value on a recurring basis.

3. 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, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair value
Cash and cash equivalents:				
Demand deposits and other cash	$25,351	$ —	$ —	$25,351
Money market funds	5,857	—	—	5,857
Commercial paper	350	—	—	350
Total cash and cash equivalents	31,558	—	—	31,558
Short-Term Investments:				
Commercial paper	708	—	—	708
U.S. government agency securities	2,885	—	(1)	2,884
U.S. Treasury securities	1,301	—	(2)	1,299
Corporate debt securities	34,842	3	(21)	34,824
Total short-term investments	39,736	3	(24)	39,715
Total cash, cash equivalents and short-term investments	$71,294	$ 3	$ (24)	$71,273

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	As of December 31, 2016			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair value
Cash and cash equivalents:				
Demand deposits and other cash	$28,360	$ —	$ —	$28,360
Money market funds	4,996	—	—	4,996
Commercial paper	549	—	—	549
Corporate debt securities	1,128	—	—	1,128
Total cash and cash equivalents	35,033	—	—	35,033
Short-Term Investments:				
Commercial paper	773	—	—	773
U.S. government agency securities	4,176	1	—	4,177
U.S. Treasury securities	2,045	—	—	2,045
Corporate debt securities	32,052	1	(15)	32,038
Total short-term investments	39,046	2	(15)	39,033
Total cash, cash equivalents and short-term investments	$74,079	$ 2	$ (15)	$74,066

The Company has determined that the unrealized losses on its short-term investments as of June 30, 2017 and December 31, 2016 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, 2017			
Cash and cash equivalents (1)	$31,558	$ —	$31,558
Short-term investments	34,619	5,096	39,715
Cash, cash equivalents and short-term investments	$66,177	$ 5,096	$71,273
Balances as of December 31, 2016			
Cash and cash equivalents (1)	$35,033	$ —	$35,033
Short-term investments	39,033	—	39,033
Cash, cash equivalents and short-term investments	$74,066	$ —	$74,066

(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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4. 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,	
	2017	2016	2017	2016
Numerator:				
Net loss	$(7,351)	$(2,706)	$(13,991)	$(6,290)
Denominator:				
Weighted-average shares used to compute net loss per common share - basic and diluted	28,422	26,624	28,088	26,501
Net loss per share				
Basic and diluted	$(0.26)	$(0.10)	$(0.50)	$(0.24)

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

	Three months ended June 30,		Six months ended June 30,	
(in thousands)	2017	2016	2017	2016
Options to purchase common stock, including ESPP	1,586	3,049	1,889	3,087
Restricted stock units	2,336	1,808	2,241	1,589

5. Goodwill and Intangible Assets

Goodwill

As of June 30, 2017 and December 31, 2016, 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, 2017, 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:

		June 30, 2017			December 31, 2016		
(in thousands)	Range of Useful Life (years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	3 to 7	$10,050	$ 4,074	$5,976	$10,050	$ 2,845	$7,205
Customer relationships	7 to 9	10,920	2,874	8,046	10,920	2,280	8,640
Backlog	3	1,400	420	980	1,400	78	1,322
Non-compete agreements	2 to 4	460	422	38	460	389	71
Trademarks	3 to 7	1,110	323	787	1,110	148	962
Intangible assets, net book value		$23,940	$ 8,113	$15,827	$23,940	$ 5,740	$18,200

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Amortization expense was $1.2 million and $0.2 million for the three months ended June 30, 2017 and 2016, respectively. Amortization expense was $2.4 million and $0.4 million for the six months ended June 30, 2017 and 2016, 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, 2017 was as follows:

(in thousands)	Future amortization
2017 (remaining six months)	$ 2,170
2018	4,424
2019	3,880
2020	1,251
2021	1,127
2022	1,050
Thereafter	1,925
Future amortization expense	$ 15,827

6. Balance Sheet Components

Inventories

(in thousands)	June 30, 2017	December 31, 2016
Raw materials	$ 84	$ 103
Finished goods	3,428	4,453
Total inventories	$ 3,512	$ 4,556

Property and equipment, net

(in thousands)	June 30, 2017	December 31, 2016
Computer equipment and software	$ 9,534	$ 8,971
Furniture, fixtures and equipment	1,793	1,726
Leasehold improvements	4,790	4,144
Manufacturing tools and equipment	3,019	3,019
Construction in process	—	74
Property and equipment, at cost	19,136	17,934
Less: Accumulated depreciation	(12,637)	(12,040)
Property and equipment, net	$ 6,499	$ 5,894

Depreciation and amortization expense was $0.7 million and $0.5 million for the three months ended June 30, 2017 and 2016, respectively. Depreciation and amortization expense was $1.4 million and $1.1 million for the six months ended June 30, 2017 and 2016, respectively.

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Net investment in sales-type leases

The Company has sales-type leases with terms of 0.75 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, 2017	December 31, 2016
Minimum payments to be received on sales-type leases	$3,393	$ 3,566
Less: Unearned interest income and executory costs	(1,796)	(1,704)
Net investment in sales-type leases	1,597	1,862
Less: Current portion	(951)	(1,066)
Non-current net investment in sales-type leases	$646	$ 796

There were no allowances for doubtful accounts on these leases as of June 30, 2017 and December 31, 2016. 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, 2017 were as follows:

(in thousands)	Future lease payments
2017 (remaining six months)	$ 838
2018	1,429
2019	743
2020	383
2021	—
Total	$ 3,393

Accrued payroll and other current liabilities

(in thousands)	June 30, 2017	December 31, 2016
Payroll and related expenses	$10,020	$ 10,385
Accrued payables	2,127	2,334
Deferred rent, current portion	248	229
Lease financing, current portion	716	801
Product warranty	315	596
Customer prepayments	617	769
Sales and use tax payable	505	451
Other	413	331
Total accrued payroll and other current liabilities	$14,961	$ 15,896

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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)	2017	2016	2017	2016
Warranty balance at the beginning of the period	$499	$620	$596	$806
Warranty expense accrued for shipments during the period	120	178	258	350
Changes in estimate related to pre-existing warranties	(225)	(39)	(377)	(240)
Warranty settlements made	(79)	(121)	(162)	(278)
Total product warranty	315	638	$315	$638
Less: Long-term portion	—	(36)	—	$(36)
Current portion of warranty balance at the end of the period	$315	$602	$315	$602

7. 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, 2017 and December 31, 2016, approximately $5.2 million and $5.4 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 March 2022. 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 $0.6 million and $0.6 million for the three months ended June 30, 2017 and 2016, respectively. Facilities rent expense was $1.2 million and $1.2 million for the six months ended June 30, 2017 and 2016, respectively.

Future minimum lease payments at June 30, 2017 under non-cancelable operating leases are as follows:

(in thousands)	Operating leases
2017 (remaining six months)	$ 1,164
2018	2,205
2019	2,030
2020	1,687
2021	1,595
2022	402
Total minimum lease payments	$ 9,083

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.

8. Stock-based Compensation and Awards

Stock Option Activity

A summary of the stock option activity for the six months ended June 30, 2017 is presented below:

	Options outstanding			
	Number of Options	Weighted Average Exercise Price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value (in thousands)
Outstanding at December 31, 2016	2,436,845	$ 10.71	5.09	$ 20,643
Options granted	—			
Options exercised	(847,419)	7.04		
Options canceled	(18,198)	12.37		
Outstanding at June 30, 2017	1,571,228	$ 12.68	5.32	$ 21,625

At June 30, 2017, there was $1.0 million of unrecognized compensation cost related to options which is expected to be recognized over a weighted-average period of 1.11 years. As of June 30, 2017, there were 1,223,529 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, 2017, employees purchased 89,813 shares of common stock at an average purchase price of $13.87. During the six months ended June 30, 2016, employees purchased 87,937 shares of common stock at an average purchase price of $8.93. As of June 30, 2017, there were 654,327 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 June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Expected term (in years)	0.50	0.50	0.50	0.50
Volatility	30.0%	38.0%	30.0% - 32.0%	38.0% - 41.5%
Risk-free interest rate	1.02%	0.38%	0.61% - 1.02%	0.33% - 0.38%
Dividend yield	0%	0%	0%	0%

Restricted Stock Units

A summary of RSU activity for the six months ended June 30, 2017 is presented below:

	Restricted Stock Units	
	Number of shares	Weighted Average Grant Date Fair Value per Share
Outstanding at December 31, 2016	2,128,735	$ 13.17
Granted	927,087	24.90
Vested	(663,450)	12.04
Forfeited	(56,263)	14.55
Outstanding at June 30, 2017	2,336,109	$ 18.11

At June 30, 2017, there was $36.4 million of unrecognized compensation cost related to RSUs, which is expected to be recognized over a weighted-average period of 2.16 years.

Allocation of Stock-Based Compensation Expense

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

	Three months ended June 30,		Six months ended June 30,	
(in thousands)	2017	2016	2017	2016
Cost of revenue	$848	$324	$1,368	$593
Research and development	623	304	1,035	530
Sales and marketing	1,779	1,278	3,044	2,288
General and administrative	1,653	1,239	3,039	2,280
Total stock-based compensation	$4,903	$3,145	$8,486	$5,691

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9. 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,	
(in thousands)	2017	2016	2017	2016
Revenue				
Product	$20,658	$17,702	$40,691	$31,504
Service	17,792	13,450	34,054	26,425
Total revenue	38,450	31,152	74,745	57,929
Cost of Revenue				
Product	6,807	5,944	13,216	10,393
Service	9,962	6,134	19,117	11,784
Total cost of revenue	16,769	12,078	32,333	22,177
Gross profit				
Product	13,851	11,758	27,475	21,111
Service	7,830	7,316	14,937	14,641
Total gross profit	21,681	19,074	42,412	35,752
Operating expenses	28,732	21,800	55,937	42,134
Interest income (expense), net and other	61	62	275	226
Loss before income taxes	$(6,990)	$(2,664)	$(13,250)	$(6,156)

10. Income Taxes

The Company recorded a $0.7 million and $0.1 million provision for income taxes for the six months ended June 30, 2017 and 2016, respectively. The provision for the six months ended June 30, 2017 was primarily due to the accretion of the deferred tax liability associated with goodwill from previous acquisitions, taxes on international operations and state income taxes. The provision for the six months ended June 30, 2016 was primarily due to taxes on international operations and state income taxes.

As of June 30, 2017, 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, 2017, 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, 2016.

11. Business Acquisitions

Acquisition of Extension Healthcare

On October 27, 2016, the Company acquired all of the outstanding equity interest of Extension Healthcare for $52.5 million in cash. Refer to the Company's report on Form 10-K for the year ended December 31, 2016, for disclosures related to the identifiable assets acquired and liabilities assumed in connection with the acquisition. The Company did not have any adjustments to previously recorded amounts in the purchase price allocation.

The results of operations of Extension Healthcare are included in the Company's consolidated results of operations beginning in the fourth quarter of fiscal 2016. The Company determined that it is impracticable to provide comparative pro forma financial information related to the acquisition for the period ended June 30, 2016 as Extension

Healthcare did not historically prepare

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financial statements in accordance with GAAP for interim financial reporting and significant estimates of amounts to be included in such pro forma financial information would be required and subject to an inordinate level of subjectivity.

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

Forward-Looking Statements

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, 2016, filed with the SEC on March 15, 2017. These discussions contain forward-looking statements reflecting our current expectations that involve risks and uncertainties which are subject to safe harbors under the Securities Act of 1933, as amended, or the Securities Act, and the Securities Exchange Act of 1934, as amended, or the Exchange Act. These forward-looking statements include, but are not limited to, statements concerning our plans, objectives, expectations and intentions, future financial position, future revenues, projected costs, expectations regarding demand and acceptance for our technologies, growth opportunities and trends in the market in which we operate, prospects and plans and objectives of management. The words "anticipates," "believes," "estimates," "expects," "intends," "may," "plans," "projects," "will," "would" and similar expr intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements, and you should not place undue reliance on our forward-looking statements. These forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those in the forward-looking statements, including, without limitation, the risks set forth in Part II, Item 1A, "Risk Factors" in this Quarterly Report on Form 10-Q and in our other filings with the Securities and Exchange Commission. We do not assume any obligation to update any forward-looking statements.

Business Overview

We are a provider of secure, integrated, intelligent communication solutions, focused on empowering mobile workers in healthcare, hospitality, energy and other mission-critical mobile work environments, in the United States and internationally. Today, the significant majority of our business is generated from sales of our solutions in the healthcare market to help our customers improve patient safety and experience and increase operational efficiency. We primarily sell products, software maintenance and professional services directly to end users. Total revenue increased 29.0% from $57.9 million for the six months ended June 30, 2016 to $74.7 million for the six months ended June 30, 2017. For the six months ended June 30, 2017, we recorded a net loss of $14.0 million compared to a net loss of $6.3 million for the six months ended June 30, 2016.

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, Singapore and parts of the Middle East, most of our customers are located in the United States. International customers represented 10.7%, 10.6% and 8.8% of our revenue in the six months ended June 30, 2017, and the years ended December 31, 2016 and 2015, respectively. We believe certain international markets represents attractive opportunities growth. We are exploring plans to expand our presence in other English-speaking markets and enter non-English speaking markets.

U.S. hospital spending on information technology is influenced by regulatory requirements and reimbursement earn-back incentives from federal healthcare reform. In addition, as patient volumes and reimbursement levels continue to fluctuate for many healthcare providers, hospitals exercise strong expense, also impacting capital purchases and departmental operating budgets through which our solutions are purchased. Despite this volatility, healthcare providers are placing increased emphasis on and investment in solutions for communication and care coordination, a trend that we believe is favorable for us.

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.

In the fourth quarter of 2016, we acquired all of the outstanding equity interest of Extension Healthcare for $52.5 million in cash. In addition, $2.5 million has been set aside for retention bonuses for key employees of which $0.5 million was paid in December 2016 and $2.0 million will be paid over the next two years.

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Extension Healthcare was a leading provider of clinical, event-driven communication and workflow collaboration software for the hospital environment. Extension Healthcare was known in the market for its clinical integration software solution Engage, which features an advanced clinical rules engine that unifies data from multiple sources simultaneously, enables prioritization of notifications, adds patient context, and sends messages to the right care team members on their mobile devices. The Engage platform allows clinicians to be away from the bedside while staying informed about their patients.

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, 2016.

Results of Operations

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

	Three months ended June 30,				Six months ended June 30,			
Consolidated statement of operations data:	2017		2016		2017		2016	
	(unaudited)							
(in thousands)	Amount	% Revenue	Amount	% Revenue	Amount	% Revenue	Amount	% Revenue
Revenue								
Product	$20,658	53.7 %	$17,702	56.8 %	$40,691	54.4 %	$31,504	54.4 %
Service	17,792	46.3	13,450	43.2	34,054	45.6	26,425	45.6
Total revenue	38,450	100.0	31,152	100.0	74,745	100.0	57,929	100.0
Cost of revenues								
Product	6,807	17.7	5,944	19.1	13,216	17.7	10,393	17.9
Service	9,962	25.9	6,134	19.7	19,117	25.6	11,784	20.3
Total cost of revenues	16,769	43.6	12,078	38.8	32,333	43.3	22,177	38.2
Gross profit	21,681	56.4	19,074	61.2	42,412	56.7	35,752	61.8
Operating expenses:								
Research and development	7,371	19.2	4,428	14.2	14,300	19.1	8,400	14.5
Sales and marketing	15,377	40.0	12,747	40.9	29,958	40.1	24,773	42.8
General and administrative	5,984	15.5	4,625	14.8	11,679	15.6	8,961	15.5
Total operating expenses	28,732	74.7	21,800	69.9	55,937	74.8	42,134	72.8
Loss from operations	(7,051)	(18.3)	(2,726)	(8.7)	(13,525)	(18.1)	(6,382)	(11.0)
Interest income	128	0.3	199	0.5	233	0.3	377	0.7
Other income (expense), net	(67)	(0.2)	(137)	(0.3)	42	0.1	(151)	(0.3)
Loss before income taxes	(6,990)	(18.2)	(2,664)	(8.5)	(13,250)	(17.7)	(6,156)	(10.6)
Provision for income taxes	(361)	(0.9)	(42)	(0.2)	(741)	(1.0)	(134)	(0.3)
Net loss	$(7,351)	(19.1)%	$(2,706)	(8.7)%	$(13,991)	(18.7)%	$(6,290)	(10.9)%

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Revenue:

	Three months ended June 30,				Six months ended June 30,			
	2017	2016	Change		2017	2016	Change	
(in thousands)	Amount	Amount	Amount	%	Amount	Amount	Amount	%
Product revenue								
Device	$14,837	$12,031	$2,806	23.3%	$28,958	$22,434	$6,524	29.1%
Software	5,821	5,671	150	2.6	11,733	9,070	2,663	29.4
Total product	20,658	17,702	2,956	16.7	40,691	31,504	9,187	29.2
Service revenue								
Maintenance and support	12,583	10,573	2,010	19.0	24,435	20,725	3,710	17.9
Professional services and training	5,209	2,877	2,332	81.1	9,619	5,700	3,919	68.8
Total service	17,792	13,450	4,342	32.3	34,054	26,425	7,629	28.9
Total revenue	$38,450	$31,152	$7,298	23.4%	$74,745	$57,929	$16,816	29.0

Three months ended June 30, 2017 compared to the three months ended June 30, 2016.

Total revenue increased $7.3 million, or 23.4%, for the three months ended June 30, 2017 compared to the three months ended June 30, 2016.

Product revenue increased $3.0 million, or 16.7%, for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. Device revenue increased $2.8 million, or 23.3%, and software revenue increased $0.2 million, or 2.6%, for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. The increase in device revenue, which related entirely to our Communication solution, was driven primarily by an increase in unit sales of badges, third party devices and related accessories from new customers making initial purchases and existing customers expanding deployments within their facilities to new departments and users. The increase in software revenue is primarily due to increased sales of our communications software licenses and expansions of existing customer licenses.

Service revenue increased $4.3 million, or 32.3%, for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. Software maintenance and support revenue increased $2.0 million, or 19.0%, and professional services and training revenue increased $2.3 million, or 81.1%, for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. The increase in software maintenance and support revenue was primarily the result of having a larger customer base purchasing software maintenance contracts. The increase in professional services and training revenue was due to increases in implementation services for our solutions.

Six months ended June 30, 2017 compared to the six months ended June 30, 2016.

Total revenue increased $16.8 million, or 29.0%, for the six months ended June 30, 2017 compared to the six months ended June 30, 2016.

Product revenue increased $9.2 million, or 29.2%, for the six months ended June 30, 2017 compared to the six months ended June 30, 2016. Device revenue increased $6.5 million, or 29.1%, and software revenue increased $2.7 million, or 29.4%, for the six months ended June 30, 2017 compared to the six months ended June 30, 2016. The increase in device revenue, which related entirely to our Communication solution, was driven primarily by an increase in unit sales of badges, third party devices and related accessories from new customers making initial purchases and existing customers expanding deployments within their facilities to new departments and users. The increase in software revenue is primarily due to increased sales of our communications software licenses and expansions of existing customer licenses.

Service revenue increased $7.6 million, or 28.9%, for the six months ended June 30, 2017 compared to the six months ended June 30, 2016. Software maintenance and support revenue increased $3.7 million, or 17.9%, and professional services and training revenue increased $3.9 million, or 68.8%, for the six months ended June 30, 2017 compared to the six months ended June 30, 2016. The increase in software maintenance and support revenue was primarily the result of having a larger customer base purchasing software maintenance contracts. The increase in professional services and training revenue was due to increases in implementation services for our solutions.

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Cost of revenue:

	Three months ended June 30,				Six months ended June 30,			
	2017	2016	Change		2017	2016	Change	
(in thousands)	Amount	Amount	Amount	%	Amount	Amount	Amount	%
Cost of revenue								
Product	$6,807	$5,944	$863	14.5%	$13,216	$10,393	$2,823	27.2%
Service	9,962	6,134	3,828	62.4	19,117	11,784	7,333	62.2
Total cost of revenue	$16,769	$12,078	$4,691	38.8%	$32,333	$22,177	$10,156	45.8%

Gross margin												
Product	67.0	%	66.4	%	0.6	%	67.5	%	67.0	%	0.5	%
Service	44.0	%	54.4	%	(10.4	)%	43.9	%	55.4	%	(11.5	)%
Total gross margin	56.4	%	61.2	%	(4.8	)%	56.7	%	61.7	%	(5.0	)%

Three months ended June 30, 2017 compared to the three months ended June 30, 2016.

Cost of product revenue increased $0.9 million, or 14.5% for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. This was in line with the growth in product revenue which was driven by higher device volume. Product gross margin as a percentage of product revenue increased in the three months ended June 30, 2017 compared to the three months ended June 30, 2016 due primarily to absorption of fixed manufacturing overhead costs.

Cost of service revenue increased $3.8 million, or 62.4%, for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. The cost of service revenue increased primarily due to increased headcount to support the growth in the number of deployments of our solutions. Service gross margin as a percentage of service revenue decreased for the three months ended June 30, 2017 compared to the three months ended June 30, 2016 due to increased headcount to support the growth in the number of deployments of our solutions and the impact of our recent acquisition.

Six months ended June 30, 2017 compared to the six months ended June 30, 2016.

Cost of product revenue increased $2.8 million, or 27.2% for the six months ended June 30, 2017 compared to the six months ended June 30, 2016. This was in line with the growth in product revenue which was driven by higher unit volumes of both internal and third party devices. Product gross margin as a percentage of product revenue increased in the six months ended June 30, 2017 compared to the six months ended June 30, 2016 due primarily to higher software sales and absorption of fixed manufacturing overhead costs.

Cost of service revenue increased $7.3 million, or 62.2%, for the six months ended June 30, 2017 compared to the six months ended June 30, 2016. The cost of service revenue increased primarily due to increased headcount to support the growth in the number of deployments of our solutions. Service gross margin as a percentage of service revenue decreased for the six months ended June 30, 2017 compared to the six months ended June 30, 2016 due to increased headcount to support the growth in the number of deployments of our solutions and the impact of our recent acquisition.

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Operating expenses:

	Three months ended June 30,				Six months ended June 30,			
	2017	2016	Change		2017	2016	Change	
(in thousands)	Amount	Amount	Amount	%	Amount	Amount	Amount	%
Operating expenses								
Research and development	$7,371	$4,428	$2,943	66.5%	$14,300	$8,400	$5,900	70.2%
Sales and marketing	15,377	12,747	2,630	20.6	29,958	24,773	5,185	20.9
General and administrative	5,984	4,625	1,359	29.4	11,679	8,961	2,718	30.3
Total operating expenses	$28,732	$21,800	$6,932	31.8%	$55,937	$42,134	$13,803	32.8%

Three months ended June 30, 2017 compared to the three months ended June 30, 2016.

Research and development expense. Research and development expense increased $2.9 million or 66.5% for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. This increase was primarily driven from increased headcount related to our recent acquisition which resulted in a $2.3 million increase in compensation The increase was also driven by a $0.4 million increase in outside services and a $0.1 million increase in travel expense.

Sales and marketing expense. Sales and marketing expense increased $2.6 million, or 20.6%, for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. This increase was primarily driven from increased headcount and intangibles related to our recent acquisition which resulted in a $2.1 million increase in compensation and a $0.3 million increase in amortization expense. The increase was also driven by a $0.3 million increase in outside services.

General and administrative expense. General and administrative expense increased $1.4 million, or 29.4%, for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. This increase was primarily due to a $1.2 million increase in compensation due to increased headcount from our recent acquisition.

Six months ended June 30, 2017 compared to the six months ended June 30, 2016.

Research and development expense. Research and development expense increased $5.9 million or 70.2% for the six months ended June 30, 2017 compared to the six months ended June 30, 2016. This increase was primarily driven from increased headcount related to our recent acquisition which resulted in a $4.6 million increase in compensation, $0.6 million increase in outside services and a $0.2 million increase in travel expense.

Sales and marketing expense. Sales and marketing expense increased $5.2 million, or 20.9%, for the six months ended June 30, 2017 compared to the six months ended June 30, 2016. This increase was primarily driven from increased headcount and intangibles related to our recent acquisition which resulted in a $3.7 million increase in compensation and a $0.7 million increase in amortization expense. The increase was also driven by a $0.5 million increase in outside services.

General and administrative expense. General and administrative expense increased $2.7 million, or 30.3%, for the six months ended June 30, 2017 compared to the six months ended June 30, 2016. This increase was primarily due to a $2.5 million increase in compensation due to increased headcount from our recent acquisition.

Interest Income and Other Expense, Net:

	Three months ended June 30,			Six months ended June 30,		
(in thousands)	2017	2016	Change	2017	2016	Change
Interest income	$128	$199	$ (71)	$233	$377	$ (144)
Other income (expense), net	(67)	(137)	70	42	(151)	193

Three months ended June 30, 2017 compared to the three months ended June 30, 2016.

Interest income. Interest income did not significantly change for the three months ended June 30, 2017 compared to the three months ended June 30, 2016.

Other income (expense), net. The change in other expense in the three months ended June 30, 2017 compared to the three months ended June 30, 2016 was primarily due to foreign exchange fluctuations.

Six months ended June 30, 2017 compared to the six months ended June 30, 2016.

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Interest income. Interest income did not significantly change for the six months ended June 30, 2017 compared to the six months ended June 30, 2016.

Other income (expense), net. The change in other expense in the six months ended June 30, 2017 compared to the six months ended June 30, 2016 was primarily due to foreign exchange fluctuations.

Liquidity and Capital Resources

As of June 30, 2017, we had cash and cash equivalents and short-term investments of $71.3 million and no debt. 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.

	Six months ended June 30,	
(in thousands)	2017	2016
Consolidated Statements of Cash Flow Data:		
Net cash provided by (used in) operating activities	$(2,046)	$4,180
Net cash provided by (used in) investing activities	(2,432)	990
Net cash provided by financing activities	1,003	625
Net increase (decrease) in cash and cash equivalents	$(3,475)	$5,795

Operating activities

Cash used in operating activities was $2.0 million for the six months ended June 30, 2017, due to a net loss of $14.0 million and a reduction in lease-related performance obligations of $0.4 million, offset by non-cash items such as stock-based compensation of $8.5 million and depreciation and amortization of $3.8 million for property and equipment and acquired intangible assets. With respect to changes in assets and liabilities, we experienced a decrease of $1.0 million in inventories and a $1.8 million increase in deferred revenue. These factors were offset by certain cash outflows, including an increase in accounts receivable of $0.9 million, which was attributable to current period billings being in excess of collections on prior periods' invoices, an increase of $0.8 million in prepaid expenses and other assets, a decrease of $0.6 million in accounts payable and a decrease of $0.5 million in accrued payroll and other liabilities.

Cash provided by operating activities was $4.2 million for the six months ended June 30, 2016, due to a net loss of $6.3 million, a reduction in lease-related performance obligations of $0.5 million, partially offset by non-cash items such as stock-based compensation of $5.7 million and depreciation and amortization of $1.5 million for property and equipment and acquired intangible assets. With respect to changes in assets and liabilities, we experienced a decrease in accounts receivable of $3.5 million, which was attributable to collections on prior periods' invoices exceeding the current period billings, an increase of $0.5 million in accounts payable and a $1.2 million increase in deferred revenue. These factors were offset by certain cash outflows, including an increase of $1.8 million in inventories.

Investing activities

Cash used in investing activities was $2.4 million for the six months ended June 30, 2017, due to $38.1 million of short-term investment maturities, offset by $38.8 million for purchases of short-term investments. An additional $1.7 million of cash was used for the purchase of property and equipment and leasehold improvements.

Cash provided by investing activities was $1.0 million for the six months ended June 30, 2016 due to $68.7 million for purchases of short-term investments, offset by $68.5 million and $4.2 million of short-term investment maturities and investment sales, respectively. An additional $3.0 million of cash was used for the purchase of property and equipment and leasehold improvements.

Financing activities

Cash provided by financing activities was $1.0 million for the six months ended June 30, 2017, attributable to $6.0 million of proceeds from stock option exercises and $1.2 million of proceeds from issuance of common stock from the employee stock purchase plan, partially offset by $6.2 million cash paid for employee taxes paid on net share settlement.

Cash provided by financing activities was $0.6 million for the six months ended June 30, 2016, attributable to $0.5 million of proceeds from stock option exercises, $0.8 million of proceeds from issuance of common stock from the employee stock purchase

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plan and $0.9 million of cash from lease-related performance obligations. This was partially offset by a $1.6 million cash paid for employee taxes paid on net share settlement.

Off-Balance Sheet Arrangements

During the six months ended June 30, 2017, 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 7 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, 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 June 30, 2017, 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 June 30, 2017.

Changes in Internal Control over Financial Reporting

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.

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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 $14.0 million for the six months ended June 30, 2017. As of June 30, 2017, we had an accumulated deficit of $141.5 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 of our Vocera Communication solution in 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 of our Vocera Communication solution to the healthcare market and, in particular, hospitals. Sales of our Vocera Communication solution to the healthcare market accounted for 95%, 94% and 93% of our revenue for the six months ended June 30, 2017 and for the years ended December 31, 2016 and 2015, respectively. We anticipate that sales of our Vocera Communication solution will represent a significant portion of our revenue for the foreseeable future.

Our success depends in part upon the deployment of our Vocera Communication solution by new hospital customers, the expansion and upgrade of our solution at existing customers, and our ability to continue to provide on a timely basis cost-effective solutions that meet the requirements of our hospital customers. Our Vocera Communication solution requires a substantial upfront investment by customers. Typically, our hospital customers initially deploy our solution for specific users in specific departments before expanding our solution into other departments or for other users. 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 Vocera Communication solution provides 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 solution or expand our solution 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 penalties from the implementation of the Patient Protection and Affordable Care Act of 2010 (ACA) and now face new uncertainty as the President of the United States and members of the legislature have announced their intention to attempt to repeal or reform the ACA, as well as other healthcare reform. As a

consequence, we may experience slowdowns and deferral of orders for our solution that could negatively impact our sales. We might not be able to sustain or increase our revenue from sales of our Vocera Communication solution, or achieve the growth rates that we envision, if hospitals continue to face significant budgetary constraints and reduce their spending on communications systems.

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While we are seeking to increase sales of our Vocera Communications solution to non-healthcare customers, we do not anticipate that sales of our Vocera Communication solution in non-healthcare markets will represent a significant portion of our revenue for the foreseeable future.

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 solution. 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, we may experience a longer time period for the deals 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 of nine to twelve months or more. We spend substantial time, effort and money in our sales efforts without any assurance that our efforts will produce sales. In addition, purchases of our solutions are frequently subject to budget constraints, multiple approvals, and unplanned administrative, processing and other delays. For example, we experienced elongated sales cycles due to uncertainty surrounding healthcare reform and lower hospital admission trends in 2013 and 2014, and it is possible that the current uncertainty about healthcare will extend hospital sales cycles. Hospitals in the U.S. continue to face significant uncertainty over the continuing impact of federal government budgets, and continuing changes in the implementation and deadlines for compliance with the ACA, the potential repeal or reform of the ACA, changes to Medicare and Medicaid reimbursement, Federal budgeting in the VA and DoD, and other healthcare reform legislation, as well as 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 fluctuation has 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.

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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 at all. 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 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 result in 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;
- 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 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 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;
- our ability to successfully deploy our solutions;
- our ability to forecast demand and manage lead times for the manufacture of our solutions; and
- our ability to develop and introduce new solutions and features to existing solutions that achieve market acceptance.

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 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 communications 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 the 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;
- 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.

We completed the acquisition of Extension Healthcare in October 2016, which is a significantly larger acquisition than any that we have completed to date, and each of the factors identified above present challenges to our achieving the success that we anticipate

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from this acquisition. We used a significant portion of our available cash for our recent purchase of Extension Healthcare. 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.

With the acquisition of Extension Healthcare, our balance sheet now 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 profit margins of our hospital customers are modest, and pending changes 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 drive 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 the legislature have stated their intent to significantly revise or repeal 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 that a number of the elements of those acts, as well as the related efforts to reform 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, have challenged hospitals' abilities to forecast patient utilization and revenues, and to set operational plans and budget accordingly.

Federal budget activities also impact our customers. We believe that it is likely that additional legislative changes by Congress and rulemaking by HHS will continue. Our customers include healthcare facilities run by the Department of Defense and the U.S. Department of Veterans Affairs. These potential customers have been and may continue to be impacted by budgetary and legislative actions.

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

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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 Vocera Communication solution 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 solution requires 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 solution. 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. While we consider secure text-messaging using smartphones a feature valued by many customers, 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.

While we do not currently have a directly comparable single competitor that provides a solution as richly-featured as the Vocera Communication system 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. 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. In addition, our acquisition of Extension Healthcare may introduce us to a broader set of competitors.

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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.

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 Vocera Communication solution, 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 upon a contract manufacturer 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 Vocera Communication solution. 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 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 components of our Vocera Communication 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

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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. The majority of the components of our Vocera Communication 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 proposed 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 manufacturer, SMTC, and we and SMTC 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 SMTC 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 Vocera Communication solution, then they may experience technical problems or not purchase our solution at all.

The effectiveness of our Vocera Communication solution 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 Vocera Communication

solution, 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 Vocera Communication solution to be fully functional. The additional cost of installing or upgrading a Wi-Fi network may dissuade potential customers from installing our solution. Furthermore, if changes to a customer's physical or information technology environment cause integration issues or degrade the effectiveness of our solution, 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 solution 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 Vocera Communication solution, thereby harming our business and operating results.

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

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 or catastrophic events. Although we have developed systems and processes that are designed to protect customer 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 and divert attention of management and key information technology resources.

Our efforts to sell our communications 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 Vocera Communication solution has been selected by over 270 customers in non-healthcare markets. Total revenue from non-healthcare customers accounted for 2%, 3% and 2% of our revenue for the six months ended June 30, 2017 and the years ended December 31, 2016 and 2015. If we cannot maintain these customers by providing communications solutions that meet their requirements, if we cannot successfully expand our communications solutions in non-healthcare markets, or if adoption of our solutions is 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 communications solutions also may not contain the functionality required by these non-healthcare markets 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 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 Vocera Communication solution. 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

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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 33%, 34% and 37% of our revenue for the six months ended June 30, 2017 and the years ended December 31, 2016 and 2015, 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.

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 six months ended June 30, 2017 and the years ended December 31, 2016 and 2015, we generated 10.7%, 10.6% and 8.8% of our revenue, respectively, from customers outside of the United States, including Canada, the United Kingdom, Australia, the Republic of Ireland and New Zealand. 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;
- 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;

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- 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. If we cannot successfully integrate our solution with these vendors as needed or if any hardware or software of these vendors contains any defect or error, then our solution may not perform as designed, or may exhibit a defect or error.
Any defects or errors in, or which are attributed to, our solutions, 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; 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 communications business, we handle and have access to personal health information subject in the United States to 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 EU adopted the 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, which will apply to all EU member states beginning May 2018 and will replace the current DPD. The 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.

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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.

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 badges and related hardware accessories 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 plan to 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 equipment 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. In addition, our customers could further 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

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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.

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

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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.

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. It is possible that 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.
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.

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 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. 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. 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. 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.

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

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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.

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 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, 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.

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 (once such opinion is required under the Sarbanes-Oxley Act), 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 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.

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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 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-K 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;

- 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 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;

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- 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.

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 Number	Exhibit title
10.01	Vocera Communications, Inc. 2012 Equity Incentive Plan (amended May 31, 2017)
31.01	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.
31.02	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.
32.01+	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.
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: August 3, 2017 By: /S/ Brent D. Lang
Brent D. Lang
Chief Executive Officer

Date: August 3, 2017 By: /S/ Justin R. Spencer
Justin R. Spencer
Chief Financial Officer
(Principal Financial Officer)

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