

VOCERA COMMUNICATIONS, INC.

Form 10-Q

November 14, 2013

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

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

94-3354663  
(I.R.S. Employer Identification No.)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

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

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

Class Outstanding at November 6, 2013

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Common Stock, \$0.0003 par value per share	24,892,350
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FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2013  
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## PART I: FINANCIAL INFORMATION

## Item 1. Financial Statements (Unaudited)

Vocera Communications, Inc.

Condensed Consolidated Balance Sheets

(In Thousands, Except Share and Par Amounts)

(Unaudited)

	September 30, 2013	December 31, 2012
Assets		
Current assets		
Cash and cash equivalents	\$ 18,285	\$ 92,521
Short-term investments	106,947	34,989
Accounts receivable, net of allowance	20,260	21,697
Other receivables	954	550
Inventories	4,798	2,772
Prepaid expenses and other current assets	2,517	2,808
Total current assets	153,761	155,337
Property and equipment, net	5,651	3,631
Intangible assets, net	1,725	2,267
Goodwill	5,575	5,575
Other long-term assets	783	495
Total assets	\$ 167,495	\$ 167,305
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	\$ 2,963	\$ 2,854
Accrued payroll and other current liabilities	8,616	11,754
Deferred revenue, current	23,982	22,451
Total current liabilities	35,561	37,059
Deferred revenue, long-term	6,066	5,882
Other long-term liabilities	1,672	1,239
Total liabilities	43,299	44,180
Commitments and contingencies (Note 7)		
Stockholders' equity		
Preferred stock, \$0.0003 par value - 5,000,000 shares authorized as of September 30, 2013 and December 31, 2012; zero shares issued and outstanding	—	—
Common stock, \$0.0003 par value - 100,000,000 shares authorized as of September 30, 2013 and December 31, 2012; 24,866,334 and 24,229,356 shares issued and outstanding as of September 30, 2013 and December 31, 2012, respectively	8	7
Additional paid-in capital	186,777	177,081
Accumulated other comprehensive income	2	5
Accumulated deficit	(62,591	) (53,968
Total stockholders' equity	124,196	123,125
Total liabilities and stockholders' equity	\$ 167,495	\$ 167,305

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenue				
Product	\$15,666	\$16,851	\$43,966	\$47,643
Service	10,401	9,117	29,810	26,322
Total revenue	26,067	25,968	73,776	73,965
Cost of revenue				
Product	5,635	5,237	15,581	16,138
Service	4,155	3,743	12,409	11,134
Total cost of revenue	9,790	8,980	27,990	27,272
Gross profit	16,277	16,988	45,786	46,693
Operating expenses				
Research and development	3,798	3,043	10,830	8,248
Sales and marketing	11,791	8,532	32,702	24,064
General and administrative	4,073	3,745	11,000	10,449
Total operating expenses	19,662	15,320	54,532	42,761
(Loss) income from operations	(3,385)	) 1,668	(8,746)	) 3,932
Interest income	87	60	170	86
Interest expense and other finance charges	—	—	—	(74)
Other (expense) income, net	76	50	(55)	) (1,442)
(Loss) income before income taxes	(3,222)	) 1,778	(8,631)	) 2,502
Benefit from (provision for) income taxes	120	(41)	) 8	(420)
Net (loss) income	(3,102)	) 1,737	(8,623)	) 2,082
Less: undistributed earnings attributable to participating securities	—	(9)	) —	(1,299)
Net (loss) income attributable to common stockholders	\$(3,102)	) \$1,728	\$(8,623)	) \$783
Net (loss) income per share attributable to common stockholders				
Basic	\$(0.13)	) \$0.08	\$(0.35)	) \$0.05
Diluted	\$(0.13)	) \$0.07	\$(0.35)	) \$0.04
Weighted average shares used to compute net (loss) income per share attributable to common stockholders				
Basic	24,747	22,450	24,530	15,973
Diluted	24,747	25,337	24,530	18,751

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 Income (Loss)

(In Thousands)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net (loss) income	\$ (3,102	) \$ 1,737	\$ (8,623	) \$ 2,082
Other comprehensive income (loss), net:				
Change in unrealized gain (loss) on investments, net	89	110	(3	) (81
Comprehensive (loss) income	\$ (3,013	) \$ 1,847	\$ (8,626	) \$ 2,001

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

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Vocera Communications, Inc.

Condensed Consolidated Statements of Cash Flows

(In Thousands)

(Unaudited)

	Nine months ended September 30,	
	2013	2012
Cash flows from operating activities		
Net (loss) income	\$(8,623	) \$2,082
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,798	1,932
Change in non-cash interest	(52	) (39
Loss on disposal of property and equipment	—	2
Allowance for doubtful accounts	14	—
Inventory write-down	136	207
Change in lease-related performance liabilities	(104	) —
Stock-based compensation expense	6,113	2,671
Excess tax benefits from employee stock plans	—	(300
Change in fair value of warrant liability	—	1,631
Changes in operating assets and liabilities:		
Accounts receivable	1,424	(4,862
Other receivables	(508	) 638
Inventories	(2,161	) (72
Prepaid expenses and other assets	2	(951
Accounts payable	47	(1,231
Accrued and other liabilities	(3,121	) 1,102
Deferred revenue	1,715	3,004
Net cash (used in) provided by operating activities	(3,320	) 5,814
Cash flows from investing activities		
Purchase of property and equipment	(3,484	) (1,379
Purchase of short-term investments	(113,199	) (87,383
Maturities of short-term investments	41,290	13,986
Net cash used in investing activities	(75,393	) (74,776
Cash flows from financing activities		
Cash from lease-related performance obligations	743	713
Principal payments on long-term borrowings	—	(8,333
Proceeds from initial public offering, net of offering costs	—	72,217
Proceeds from follow-on public offering, net of offering costs	—	35,996
Payment for repurchase of early exercised options	(14	) (6
Excess tax benefits from employee stock plans	—	300
Proceeds from issuance of common stock from the employee stock purchase plan	2,572	—
Proceeds from exercise of stock options	1,426	863
Tax withholdings paid on behalf of employees for net share settlement	(476	) —
Proceeds from exercise of common stock warrants	226	—
Net cash provided by financing activities	4,477	101,750
Net (decrease) increase in cash and cash equivalents	(74,236	) 32,788
Cash and cash equivalents at beginning of period	92,521	14,898
Cash and cash equivalents at end of period	\$18,285	\$47,686

Supplemental disclosure of non-cash investing and financing activities:

Costs related to the initial public offering in accounts payable and accrued liabilities	\$—	\$190
Property and equipment in accounts payable and accrued liabilities	112	—

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

Vocera Communications, Inc. (“Vocera” or the “Company”) is a provider of mobile communication solutions focused on addressing the challenges facing hospitals, as well as hospitality, power and other businesses with mission-critical communication needs, in the U.S. and internationally. Vocera helps its healthcare customers improve patient safety and satisfaction, and increase hospital efficiency and productivity through its Voice Communication, Secure Messaging, and Care Experience solutions, which are installed in more than 1,000 organizations worldwide. The Voice Communication solution, which includes a lightweight, wearable, voice-controlled communication badge, smartphone applications and an intelligent enterprise software platform, enables users to connect instantly with other staff simply by saying the name, function or group name of the desired recipient. The Secure Messaging solution securely delivers text messages and alerts directly to and from smartphones, replacing legacy pagers. Our Vocera Care Experience is a hosted, software solution suite that coordinates and streamlines patient-to-provider and provider-to-provider communication across the continuum of care. The solution is used to provide personalized patient instructions and education, alert and notify physicians and caregivers of patients’ changing care plans, and track patient satisfaction pre, during, and post-hospitalization. Vocera Care Experience is complemented by the Company’s Experience Innovation Network, a membership-based program to spread the adoption of leading strategies to improve patient and staff experience.

The Company was incorporated in Delaware on February 16, 2000. The Company formed wholly-owned subsidiaries Vocera Communications UK Ltd and Vocera Communications Australia Pty Ltd. in 2005, and Vocera Hand-Off Communications, Inc., Vocera Canada, Ltd. and ExperiaHealth, Inc. in 2010. In August 2013, we merged Vocera Hand-Off Communications, Inc. and ExperiaHealth, Inc. into our parent company, Vocera Communications, Inc. The Company completed its initial public offering (“IPO”) of common stock on April 2, 2012 in accordance with the Securities Act of 1933, as amended (“Securities Act”). The Company sold 5,000,000 shares and certain of its stockholders sold 1,727,500 shares, including 877,500 shares for the underwriters’ over-allotment option, through a firm commitment underwritten, public offering. The shares were sold at the initial public offering price of \$16.00 per share, before underwriting discounts and commissions and offering costs. The Company recorded proceeds of \$70.5 million for the IPO, net of offering expenses and underwriters’ discounts and commissions.

The Company completed a follow-on offering of common stock on September 12, 2012 in accordance with the Securities Act. The Company sold 1,337,500 shares and certain of its stockholders sold 4,211,250 shares. Included in both of these sales was 723,750 shares for the underwriters’ over-allotment option, through a firm commitment underwritten, public offering. The shares were sold at the public offering price of \$28.75 per share for aggregate gross offering proceeds of \$38.4 million to the Company and \$121.1 million to the selling stockholders. The Company recorded proceeds of \$36.0 million for the follow-on offering, net of offering expenses and underwriters’ discounts and commissions.

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 (“U.S. 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 note disclosures normally included in the financial statements prepared in accordance with U.S. 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, 2012. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. 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, 2013 or for any other interim period or any other future year.

Use of Estimates

The preparation of the accompanying unaudited condensed consolidated financial statements in conformity with U.S. 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, useful lives assigned to

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long-lived assets, excess and obsolete inventory charges, warranty reserves, 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.

Fair Value of Financial Instruments

The carrying value of the Company's operating financial instruments, including accounts receivable, deposits, accounts payable, accrued liabilities and accrued compensation, approximates fair value due to their short maturities. Cash and cash equivalents and short-term investments are carried at fair value.

Cash Equivalents and Short-term Investments

The Company's cash equivalents and short-term investments consist of money market funds, commercial paper, U.S. government agency notes, U.S. Treasury notes, municipal debt and corporate debt. These investments are classified as available-for-sale securities and are carried at fair value with the unrealized gains and losses reported as a component of stockholders' equity. Management determines the appropriate classification of its investments at the time of purchase and re-evaluates the available-for-sale designations as of each balance sheet date. Investments with an original purchase maturity of less than three months are classified as cash equivalents, all those with longer maturities are classified as short-term investments.

Deferred Costs of Revenue

When the Company's products have been delivered, but the product revenue associated with the arrangement has been deferred as a result of not meeting the revenue recognition criteria, the Company also defers the related inventory costs for the delivered items. The Company includes such deferred cost of revenue as part of "Prepaid expenses and other current assets" in the accompanying condensed, consolidated balance sheet.

Revenue recognition

The Company derives revenue from the sales of communication badges, smartphone application software, perpetual software licenses for enterprise software that is essential to the functionality of the communication badges, software maintenance, extended 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. 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, 2012.

A portion of the Company's sales are made through multi-year lease agreements with customers. When these arrangements are considered sales-type leases, upon delivery of leased products to customers, the Company recognizes revenue for such products in an amount equal to the net present value of the minimum lease payments. Unearned income is recognized as part of product revenue under the effective interest method. The Company recognizes revenue related to executory costs when such executory costs are incurred.

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 three months and nine months ended September 30, 2013, the Company transferred \$0.2 million and \$1.0 million, respectively, of lease receivables with immaterial net gains in each period. For the three months and nine months ended September 30, 2013, the Company recorded \$0.2 million and \$0.7 million, respectively, of financing liabilities for future performance of executory service obligations. For lease receivables retained as of September 30, 2013, the Company recorded \$1.1 million of net investment in sales-type leases, equivalent to the minimum lease payments less the unearned interest portion.

Related party transactions

During the nine months ended September 30, 2013 the Company billed a related party, the University of Chicago Medical Center ("UCMC"), \$0.5 million for consulting services. One of the Company's board members, Sharon O'Keefe is also on the board of the UCMC. These transactions were recorded at arms-length prices.



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## Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board ("FASB") issued new disclosure guidance related to the presentation of the statement of comprehensive income. This guidance eliminated the previous option to report other comprehensive income ("OCI") and its components in the consolidated statement of stockholders' equity. The Company adopted this accounting standard effective January 1, 2012; the adoption had no material impact on the financial position or results of operations of the Company. In February 2013, the FASB resolved the deferred guidance on OCI reclassifications with a new rule effective in the first quarter of 2013, which was adopted but did not have a material impact.

In July 2013, the FASB issued new guidance for the gross versus net presentation of unrecognized tax benefits. The FASB concluded that an unrecognized tax benefit should be presented as a reduction of a deferred tax asset for a net operating loss ("NOL") or other tax credit carryforward when settlement in this manner is available under the tax law. The new guidance is effective for the Company's first quarter of 2014, applied prospectively. The Company has the option to apply the rule retrospectively and early adoption is permitted. Adoption of this standard is not expected to impact the financial position or results of operations of the Company.

## 2. Fair value of financial instruments

The Company's cash and 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 established 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 nine months ended September 30, 2013 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's assets that are measured at fair value on a recurring basis, by level, within the fair value hierarchy as of September 30, 2013 and December 31, 2012, are summarized as follows (in thousands):

	September 30, 2013			December 31, 2012		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Assets						
Money market funds	\$989	\$—	\$989	\$45,040	\$—	\$45,040
Commercial paper	—	4,134	4,134	—	32,487	32,487
U.S. government agency securities	—	11,514	11,514	—	10,001	10,001
U.S. Treasury securities	—	5,257	5,257	—	—	—
Municipal debt securities	—	4,785	4,785	—	—	—
Corporate debt securities	—	85,447	85,447	—	—	—
Total assets measured at fair value	\$989	\$111,137	\$112,126	\$45,040	\$42,488	\$87,528

The Company had no liabilities as of September 30, 2013 and December 31, 2012 that were measured at fair value on a recurring basis.

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## 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 September 30, 2013			Fair value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Cash and cash equivalents:				
Demand deposits and other cash	\$ 13,106	\$—	\$—	\$ 13,106
Money market funds	989	—	—	989
Commercial paper	2,000	—	—	2,000
Corporate debt securities	2,190	—	—	2,190
Total cash and cash equivalents	18,285	—	—	18,285
Short-Term Investments:				
Commercial paper	2,134	—	—	2,134
U.S. government agency securities	11,511	5	(2	) 11,514
U.S. Treasury securities	5,254	3	—	5,257
Municipal debt securities	4,781	4	—	4,785
Corporate debt securities	83,265	11	(19	) 83,257
Total short-term investments	106,945	23	(21	) 106,947
Total cash, cash equivalents and short-term investments	\$ 125,230	\$ 23	\$(21	) \$ 125,232

The company has determined that the unrealized losses on cash equivalents and short-term investments as of September 30, 2013 do not constitute an "other than temporary impairment."

	As of December 31, 2012			Fair value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Cash and cash equivalents:				
Demand deposits and other cash	\$ 39,982	\$—	\$—	\$ 39,982
Money market funds	45,040	—	—	45,040
Commercial paper	7,498	1	—	7,499
Total cash and cash equivalents	92,520	1	—	92,521
Short-Term Investments:				
Commercial paper	24,987	1	—	24,988
U.S. government agency securities	9,998	3	—	10,001
Total short-term investments	34,985	4	—	34,989
Total cash, cash equivalents and short-term investments	\$ 127,505	\$ 5	\$—	\$ 127,510

The tables above exclude restricted cash, primarily held in certificates of deposit, of \$0.3 million as of September 30, 2013 and December 31, 2012 which is classified in prepaids and other current assets on the balance sheet.

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

(in thousands)	One year or shorter	Between 1 and 2 years	Total
Balances as of September 30, 2013			
Cash and cash equivalents (1)	\$18,285	\$—	\$18,285
Short-term investments	77,668	29,279	106,947
Cash, cash equivalents and short-term investments	\$95,953	\$29,279	\$125,232
Balances as of December 31, 2012			
Cash and cash equivalents (1)	\$92,521	\$—	\$92,521
Short-term investments	34,989	—	34,989
Cash, cash equivalents and short-term investments	\$127,510	\$—	\$127,510

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

#### 4. Net (loss) income per share

Basic and diluted net (loss) income per common share is presented in conformity with the two-class method required for participating securities. Immediately prior to the completion of the Company's IPO in April 2012, holders of Series A through Series F convertible preferred stock were each entitled to receive non-cumulative dividends at the annual rate of 8% per share per annum, respectively, payable prior and in preference to any dividends on any shares of the Company's common stock. In the event a dividend were to be paid on common stock, the holders of convertible preferred stock were entitled to a proportionate share of any such dividend as if they were holders of common stock (on an as-if converted basis). The holders of the convertible preferred stock did not have a contractual obligation to share the losses of the Company. The Company considered its convertible preferred stock as participating securities. Additionally, the Company considers shares issued upon the early exercise of options subject to repurchase and unvested restricted shares to be participating securities as the holders of these shares have a non-forfeitable right to dividends. In accordance with the two-class method, earnings allocated to these participating securities and the related number of outstanding shares of the participating securities, which include contractual participation rights in undistributed earnings, have been excluded from the computation of basic and diluted net (loss) income per common share.

Under the two-class method, net (loss) income attributable to common stockholders is determined by allocating undistributed earnings, calculated as net (loss) income less income attributable to participating securities between common stock and participating securities. In computing net (loss) income attributable to common stockholders for calculation of diluted net (loss) income per share, undistributed earnings are re-allocated to reflect the potential impact of dilutive securities. Basic net (loss) income per common share is computed by dividing the net (loss) income attributable to common stockholders by the weighted-average number of common shares outstanding during the period. All participating securities are excluded from basic weighted-average common shares outstanding. Diluted net (loss) income per share attributable to common stockholders is computed by dividing the net (loss) income attributable to common stockholders for calculation of diluted net (loss) income per share by the weighted-average number of common shares outstanding, including potential dilutive common shares assuming the dilutive effect of outstanding stock options using the treasury stock method.

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

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Numerator:				
Net (loss) income	\$ (3,102	) \$ 1,737	\$ (8,623	) \$ 2,082
Less: undistributed earnings attributable to participating securities	—	(9	) —	(1,299
Net (loss) income attributable to common stockholders	(3,102	) 1,728	(8,623	) 783
Reallocation of undistributed earnings attributable to participating securities	—	1	—	26
Net (loss) income attributable to common stockholders for diluted net income (loss) per share	\$ (3,102	) \$ 1,729	\$ (8,623	) \$ 809
Denominator:				
Weighted-average shares used to compute net (loss) income per common share - basic	24,747	22,450	24,530	15,973
Effect of potentially dilutive securities:				
Employee stock options and restricted stock units	—	2,818	—	2,688
Stock warrants	—	69	—	90
Weighted average shares used to compute diluted income (loss) per common share	24,747	25,337	24,530	18,751
Net (loss) income per share attributable to common stockholders				
Basic	\$ (0.13	) \$ 0.08	\$ (0.35	) \$ 0.05
Diluted	\$ (0.13	) \$ 0.07	\$ (0.35	) \$ 0.04

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

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Options to purchase common stock	3,347	405	3,324	339
Common stock subject to repurchase	20	—	28	—
Warrants to purchase common stock	44	—	44	—
Restricted stock units	714	1	579	27
Restricted stock awards	12	—	12	—

## 5. Goodwill and intangible assets

### Goodwill

As of September 30, 2013 and December 31, 2012, the Company had \$5.6 million of goodwill acquired. Goodwill is tested for impairment at the reporting unit level at least annually or more often if events or changes in circumstances indicate the carrying value may not be recoverable. The Company performed the annual required test of impairment of goodwill as of September 30, 2013, using the qualitative approach (or "Step Zero") as permitted by FASB's rules for goodwill impairment testing. The Company's annual impairment test did not indicate impairment at any of its reporting units. No impairment was recorded in 2012 or 2013.



Triggering event for impairment analysis

During the three months ended June 30, 2013, the Company experienced a 37% one-day decrease in share price following an earnings announcement on May 2, 2013 of below-guidance results for the first quarter of 2013 and reduced forward guidance

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for fiscal year 2013, which was considered a triggering event for further inquiry for both goodwill and the acquired intangibles. A "Step Zero" impairment assessment for goodwill and intangible assets was performed as part of this analysis. As of September 30, 2013, however, there were no changes in circumstances indicating that the carrying values of goodwill or acquired intangibles may not be recoverable.

## Intangible assets

The fair values for acquired intangible assets were determined by management using the valuations performed by independent valuation specialists. Acquisition related intangible assets are amortized over the life of the assets on a basis that resembles the economic benefit of the assets. This results in amortization that is higher in earlier periods of the useful life. The estimated useful lives and carrying value of acquired intangible assets are as follows:

(in thousands)	Weighted Average Useful Life (years)	September 30, 2013			December 31, 2012		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	9	\$2,350	\$1,366	\$984	\$2,350	\$1,117	\$1,233
Developed technology	6	1,880	1,172	708	1,880	896	984
Trademarks	7	70	40	30	70	30	40
Non-compete agreements	2	70	67	3	70	60	10
Intangible assets		\$4,370	\$2,645	\$1,725	\$4,370	\$2,103	\$2,267

Amortization expense was \$0.2 million and \$0.2 million for the three months ended September 30, 2013 and September 30, 2012, respectively. Amortization expense was \$0.5 million and \$0.7 million for the nine months ended September 30, 2013 and September 30, 2012, respectively.

Amortization of acquired intangible assets is reflected in cost of revenue and operating expenses. The estimated future amortization of existing acquired intangible assets as of September 30, 2013 was as follows:

(in thousands)	Future amortization
2013 (remaining three months)	\$185
2014	567
2015	389
2016	258
2017	156
2018	106
Thereafter	64
Future amortization expense	\$1,725

## 6. Balance Sheet Components

## Inventories

(in thousands)	September 30, 2013	December 31, 2012
Raw materials	\$698	\$23
Finished goods	4,100	2,749
Total inventories	\$4,798	\$2,772

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## Property and equipment, net

(in thousands)	September 30, 2013	December 31, 2012
Computer equipment and software	\$7,180	\$4,127
Furniture, fixtures and equipment	923	886
Leasehold improvements	2,113	1,654
Manufacturing tools and equipment	3,075	2,710
Construction in process	461	1,100
Property and equipment, at cost	13,752	10,477
Less: Accumulated depreciation	(8,101)	(6,846)
Property and equipment, net	\$5,651	\$3,631

Depreciation and amortization expense was \$0.5 million and \$0.4 million for the three months ended September 30, 2013 and September 30, 2012, respectively. Depreciation and amortization expense was \$1.3 million and \$1.3 million for the nine months ended September 30, 2013 and September 30, 2012, respectively.

## Accrued payroll and other current liabilities

(in thousands)	September 30, 2013	December 31, 2012
Payroll and related expenses	\$4,681	\$7,844
Accrued payables	1,686	1,978
Deferred rent, current portion	530	591
Lease financing, current portion	486	212
Product warranty	213	297
Sales and use tax payable	570	397
Other	450	435
Total accrued payroll and other current liabilities	\$8,616	\$11,754

The Company generally provides for the estimated costs of product warranties at the time the related revenue is recognized. Costs are estimated based on historical and projected product failure rates, historical and projected repair or replacement costs, and knowledge of specific product failures (if any). The product warranty includes parts and labor over a period of one year. The Company provides no warranty for software. The Company regularly re-evaluates its estimates to assess the adequacy of the recorded warranty liabilities and to adjust the amounts as necessary.

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

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Balance at the beginning of the period	\$202	\$776	\$297	\$983
Warranty expense accrued for shipments in period	175	228	349	850
Changes in liability related to pre-existing warranties	203	(194)	430	(472)
Warranty settlements made	(367)	(217)	(863)	(768)
Balance at the end of the period	\$213	\$593	\$213	\$593

## 7. Commitments and contingencies

## Non-cancelable purchase commitments

The Company enters into non-cancelable purchase commitments with its third-party manufacturer whereby the Company is required to purchase any inventory held by the third party manufacturer that have been purchased by them based on confirmed orders from the Company. As of September 30, 2013 and December 31, 2012, approximately \$4.2 million and \$4.1 million,



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respectively, of raw material inventory was purchased and held by the third-party manufacturer which was subject to such purchase requirements.

Leases

The Company leases office space for its headquarters and subsidiaries under non-cancelable operating leases, which will expire between April 2014 and April 2017. 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 \$0.5 million and \$0.5 million for the three months ended September 30, 2013 and September 30, 2012, respectively. Facilities rent expense was \$1.5 million and \$1.4 million for the nine months ended September 30, 2013 and September 30, 2012, respectively.

Future minimum lease payments at September 30, 2013 under non-cancelable operating leases are as follows:

(in thousands)	Operating leases
2013 (remaining three months)	\$396
2014	1,536
2015	1,476
2016	436
2017	28
Total minimum lease payments	\$3,872

Contingencies

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 right, or tortious damage to persons or property and (ii) indemnify and hold harmless such parties from certain resulting damages, costs and other liabilities. The term of these undertakings may be perpetual and the maximum potential liability of the Company under certain of these undertakings is not determinable. Based on its historical experience, the Company believes the liability associated with these undertakings is minimal.

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

Securities Litigation

On August 1, 2013, a purported securities class action entitled *Michael Brado v. Vocera Communications Inc., et al.* was filed in the United States District Court for the Northern District of California, against the Company and certain of its officers, its board of directors, a former director and the underwriters for the Company's initial public offering.

A second purported securities class action, entitled *Duncan v. Vocera Communications Inc., et al.*, was filed on August 21, 2013, also in the Northern District of California, against the same parties. On September 27, 2013, the Court ordered the matters related. The suits purport to allege claims under Sections 11, 12(a)(2) and 15 of the Securities Act of 1933 and Section 10(b) and 20(a) of the Exchange Act of 1934 for allegedly misleading statements in the registration statement for the Company's initial public offering and in subsequent communications regarding its business and financial results. The suits are purportedly brought on behalf of purchasers of the Company's securities between March 28, 2012 and May 3, 2013, and seek compensatory damages, rescission, fees and costs, as well as equitable and injunctive or other relief. The plaintiffs' motion for consolidation of the actions and for appointment of lead plaintiff has been granted, and we anticipate that the plaintiffs will file an amended consolidated complaint in approximately two months. No response to the current complaints is due at this time.

Due to the inherent uncertainties of litigation, the Company cannot accurately predict the ultimate outcome of this matter. The Company is unable at this time to determine whether the outcome of the litigation would have a material impact on its results of operations, financial condition or cash flow. The Company has not established any reserve for any potential liability relating to this lawsuit.



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## 8. Stock-based Compensation and Awards

## Equity Incentive Plans

The Company has three equity incentive plans: the 2000 Stock Option Plan (the "2000 Plan"), the 2006 Stock Option Plan (the "2006 Plan") and the 2012 Stock Option Plan (the "2012 Plan"). On March 26, 2012, all shares that were reserved under the 2006 Plan but not subject to outstanding awards became available for grant under the 2012 Plan. No additional shares will be issued under the 2006 Plan. The 2000 Plan terminated in March 2010 and no additional shares will be issued under this plan. All options currently outstanding under the 2000 Plan and the 2006 Plan continue to be governed by the terms and conditions of those plans. Under the 2012 Plan, the Company has the ability to issue incentive stock options ("ISOs"), stock appreciation rights, restricted stock, restricted stock units ("RSUs"), performance awards and stock bonuses. The ISOs will be granted at a price per share not less than the fair value at date of grant. Options granted to date generally vest over a four-year period with 25% vesting at the end of one year and the remaining vest monthly thereafter. Options granted generally are exercisable up to 10 years. As of September 30, 2013, there were 415,465 shares which remained available for future issuance of options, RSUs or other grant types under the 2012 Plan.

## Early Exercise of Stock Options

The Company typically allows employees to exercise options granted under the 2000 and 2006 Plans prior to vesting. The unvested shares are subject to the Company's repurchase right at the original purchase price. The proceeds initially are recorded as an accrued liability from the early exercise of stock options (see Note 6, "Accrued payroll and other current liabilities") and reclassified to common stock as the Company's repurchase right lapses. As of September 30, 2013 and December 31, 2012, 20,381 and 48,260 shares held by employees were subject to repurchase at an aggregate price of \$0.1 million and \$0.2 million, respectively.

## Exercise of common stock warrants

During the nine months ended September 30, 2013 holders of common stock warrants exercised 34,142 shares for cash proceeds of \$0.2 million. There were no cash exercises in the prior year-to-date period. During the nine months ended September 30, 2012 holders of common stock warrants net exercised warrants for the purchase of 104,037 shares and received 75,462 shares. There were no such cashless exercises in the current year-to-date period.

## Stock Option Activity

A summary of the stock option activity for the nine months ended September 30, 2013 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, 2012	3,187,559	\$7.51	6.8	\$56,362
Options granted	606,960	16.79		
Options exercised	(364,590)	) 3.63		
Options canceled	(109,702)	) 13.17		
Options expired	(8,453)	) 21.75		
Outstanding at September 30, 2013	3,311,774	\$9.41	6.8	\$33,974

At September 30, 2013, there was \$8.6 million of unrecognized net compensation cost related to options which is expected to be recognized over a weighted-average period of 2.6 years. The Company did not grant non-employee options in either of the nine months ended September 30, 2013 or 2012.

The Company uses the Black-Scholes option-pricing model to calculate the fair value of stock options on their grant date. This model requires the following inputs: the estimated fair value of the underlying common stock, the expected term of the option, the expected volatility of the underlying common stock over the expected life of the option, the risk-free interest rate and expected dividend yield.





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The following assumptions were used for each respective period for employee stock options:

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Expected Term (in years)	5.38	5.48	5.38 - 5.43	5.48 - 5.60
Volatility	46.7%	48.7%	46.7% - 48.1%	47.9% - 48.7%
Risk-free interest rate	1.8%	0.72%	0.81% - 1.80%	0.72% - 1.03%
Dividend yield	0%	0%	0%	0%

**Employee Stock Purchase Plan**

In March 2012, the Company's 2012 Employee Stock Purchase Plan (the "ESPP") was approved. The ESPP allows eligible employees to purchase shares of the Company's common stock at a discount through payroll deductions of up to 15% of their eligible compensation, subject to any plan limitations. The ESPP generally provides for six-month offering periods, except for the first offering period which was for eleven months. Additionally, in April 2013, the Company's compensation committee determined the next offering period under the ESPP, which will commence on August 15, 2013, will last for a duration of three months (expiring on November 14, 2013) and, following the expiration of such offering period, offering periods thereafter will commence on November 15, 2013, and May 15, 2014 and so on, each consisting of a single six-month purchase period.

At the end of each offering period, employees are able to purchase shares at 85% of the lower of the fair market value of the Company's common stock on the first trading day of the offering period or on the last day of the offering period. During the three months ended September 30, 2013, employees purchased 69,065 shares of common stock at an average purchase price of \$14.14. During the nine months ended September 30, 2013, employees purchased 184,849 shares of common stock at an average purchase price of \$13.92. As of September 30, 2013, 224,110 shares remained available for future issuance under the ESPP.

The following assumptions were used for each respective period for the ESPP:

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Expected Term (in years)	0.25	0.88	0.25 - 0.50	0.88
Volatility	33.3%	50.8%	33.3%	50.8%
Risk-free interest rate	0.05%	0.18%	0.05% - 0.13%	0.18%
Dividend yield	0%	0%	0%	0%

**Restricted Stock Awards and Restricted Stock Units**

In 2012, the Company began incorporating restricted stock awards and RSUs as an element of the Company's compensation plans. In February 2012, the Company granted certain of its directors restricted stock which vests 50% on the first anniversary of the grant and 50% on the second anniversary of the grant. Since May 2012, the Company has granted certain employees RSUs, which vest one-third on the first anniversary of the grant date, one-third on the second anniversary of the grant date and one-third upon the third anniversary of the grant date.

A summary of restricted stock and RSU activity for the nine months ended September 30, 2013 is presented below:

	Restricted Stock Awards		Restricted Stock Units	
	Number of shares	Weighted Average Grant Date Fair Value per Share	Number of shares	Weighted Average Grant Date Fair Value per Share
Outstanding at December 31, 2012	24,152	\$12.42	373,908	\$25.34
Granted	—	—	482,862	16.82
Vested	(12,076)	) 12.42	(93,795)	) 24.97
Forfeited	—	—	(48,576)	) 23.91
Outstanding at September 30, 2013	12,076	\$12.42	714,399	\$19.70

At September 30, 2013, there was \$0.1 million of unrecognized net compensation cost related to restricted stock awards which is expected to be recognized over a weighted-average period of 0.4 years. At September 30, 2013, there was \$11.2 million of



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unrecognized net compensation cost related to RSUs which is expected to be recognized over a weighted-average period of 2.2 years.

#### Allocation of Stock-Based Compensation Expense

Stock-based compensation expense is recognized based on a straight-line amortization method over the respective vesting period of the award and has been reduced for estimated forfeitures. The Company estimated the expected forfeiture rate based on its historical experience, considering voluntary termination behaviors, trends of actual award forfeitures, and other events that will impact the forfeiture rate. To the extent the Company's actual forfeiture rate is different from the estimate, the stock-based compensation expense is adjusted accordingly.

The following table presents the stock-based compensation allocation of expense (both for employees and non-employees):

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Cost of revenue	\$272	\$149	\$707	\$254
Research and development	194	149	632	285
Sales and marketing	816	452	2,121	722
General and administrative	1,111	643	2,653	1,410
Total stock-based compensation	\$2,393	\$1,393	\$6,113	\$2,671

#### 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 from operations. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker (CODM), or decision making group, in deciding how to allocate resources and in assessing performance. The Company's CODM is its Chief Executive Officer.

The CODM regularly receives information related to revenue, cost of revenue, and gross profit for each operating segment, and uses this information to assess performance and make resource allocation decisions. All other financial information, including operating expenses and assets, is prepared and reviewed by the CODM on a consolidated basis. Assets are not a measure used to assess the performance of the Company by the CODM; therefore, the Company does not report assets by segment internally or in its financial statements.

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The following table presents a summary of the operating segments:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenue				
Product	\$15,666	\$16,851	\$43,966	\$47,643
Service	10,401	9,117	29,810	26,322
Total revenue	26,067	25,968	73,776	73,965
Cost of Revenue				
Product	5,635	5,237	15,581	16,138
Service	4,155	3,743	12,409	11,134
Total cost of revenue	9,790	8,980	27,990	27,272
Gross profit				
Product	10,031	11,614	28,385	31,505
Service	6,246	5,374	17,401	15,188
Total gross profit	16,277	16,988	45,786	46,693
Operating expenses	19,662	15,320	54,532	42,761
Interest (expense) income, net and other	163	110	115	(1,430)
(Loss) income before income taxes	\$(3,222)	\$1,778	\$(8,631)	\$2,502

#### 10. Income Taxes

The income tax provision was \$8,000 benefit and \$420,000 expense for the nine months ended September 30, 2013 and 2012, respectively. The income tax provision was \$120,000 benefit and \$41,000 expense for the three months ended September 30, 2013 and 2012. The tax benefit (expense) in both periods in 2013 as well as in 2012 was primarily due to state income taxes and foreign taxes related to our international operations. The Company is forecasting an annual effective tax rate of a negative 0.87% for the nine months ended September 30, 2013, as compared to a positive 16.80% annual effective tax rate for the nine months ended September 30, 2012. This change is primarily due to state and foreign tax expense on a consolidated pre-tax loss in 2013, as opposed to consolidated pre-tax income in 2012.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities in the financial statements and their respective tax bases using tax rates expected to be in effect during the years in which the basis differences reverse.

The Company determines its valuation allowance on deferred tax assets by considering both positive and negative evidence in order to ascertain whether it is more likely than not that deferred tax assets will be realized. Realization of deferred tax assets is dependent upon the generation of future taxable income, if any, the timing and amount of which are uncertain. Due to the history of losses the Company has generated in past years and the \$8.6 million net loss for the nine months ended September 30, 2013, the Company believes that it is not more likely than not that its deferred tax assets can be realized as of September 30, 2013. Accordingly, the Company has maintained the full valuation allowance on its deferred tax assets previously determined for the year ended December 31, 2012.

While the Company generated pretax profit in 2012, management believes it is appropriate to obtain confirmatory evidence that the Company's results of operations will sustain this profitability in 2013 and thereafter, before reversing a portion of the valuation allowance to earnings.

The Company will review on a quarterly basis its conclusions about the appropriate amount of its deferred income tax asset valuation allowance. If the Company generates profits, it is likely that the US valuation allowance position may be reversed in the foreseeable future. The Company expects a significant benefit in the period the valuation allowance reversal is recorded and a significantly higher effective tax rate in periods following the valuation allowance reversal.

As of September 30, 2013, 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, 2012.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations  
Forward-Looking Statements

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

Business overview

We are a provider of mobile communication solutions focused on addressing the challenges facing hospitals, as well as hospitality, power and other businesses with mission-critical communication needs, in the U.S. and internationally. Vocera helps its healthcare customers improve patient safety and satisfaction, and increase hospital efficiency and productivity through its Voice Communication, Secure Messaging, and Care Experience solutions, which are installed in more than 1,000 organizations worldwide. Our Voice Communication solution, which includes a lightweight, wearable, voice-controlled communication badge, an intelligent enterprise software platform and applications for smartphone applications for iPhone and Android-based phones, enables users to connect instantly with other hospital staff simply by saying the name, function or group name of the desired recipient. Our Secure Messaging solution securely delivers text messages and alerts directly to and from smartphones, replacing legacy pagers. Our Vocera Care Experience is a hosted, software solution suite that coordinates and streamlines patient-to-provider and provider-to-provider communication across the continuum of care. The solution is used to provide personalized patient instructions and education, alert and notify physicians and caregivers of patients' changing care plans, and track patient satisfaction pre, during, and post-hospitalization. Vocera Care Experience is complemented by the Company's Experience Innovation Network, a membership-based program to spread the adoption of leading strategies to improve patient and staff experience.

At the core of our Voice Communication solution is a patent-protected software platform that we introduced in 2002. We have significantly enhanced and added features and functionality to this solution through ongoing development based on frequent interactions with our customers. Our software platform is built upon a scalable architecture and recognizes more than 100 voice commands. Users can instantly communicate with others using the Vocera communication badge, or through Vocera Connect smartphone applications available for iPhone and Android -based smartphones, as well as Cisco wireless IP phones and other mobile devices. Our Voice Communication solution can also be integrated with nurse call and other clinical systems to immediately and efficiently alert hospital workers to patient needs. Since inception we have shipped over 500,000 communication badges to our customers.

We outsource the manufacturing of our 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 sales and unanticipated shifts in sales volume and mix.

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 have very low customer revenue concentrations. Our largest end-customers represented 1.9% and 2.7% of revenue for the nine months ended September 30, 2013 and the year ended 2012, respectively. While we have international customers in other English speaking countries such as Canada, the United Kingdom and Australia, most of our customers are located in the United States. International customers represented 10.2% and 10.7% of our revenue in the nine months ended September 30, 2013 and the year ended 2012, respectively. We plan to expand our presence in other international markets.