VOCERA COMMUNICATIONS, INC.
Form 10-Q
November 14, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

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FORM 10-Q

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(Mark One)

x 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

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

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

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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, or a smaller reporting company.

| | | | |
|---|---|---|---|
| Large accelerated filer | ¨ | Accelerated filer | ¨ |
| Non-accelerated filer | x | 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 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 at November 6, 2013 |
|---|---|

| | |
|---|---|
| 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 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair value |
| 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 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair value |
| 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:

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

| | | September 30, 2013 | | | December 31, 2012 | | |
|---|---|---|---|---|---|---|---|
| (in thousands) | Weighted Average Useful Life (years) | 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:

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

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

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

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To date, substantially all of our revenue has been derived from sales of our Voice Communication solution, including product maintenance and related services. Revenue declined 0.3% from $74.0 million for the nine months ended September 30, 2012 to $73.8 million for the nine months ended September 30, 2013. Revenue increased 0.4% from $26.0 million for the three months ended September 30, 2012 to $26.1 million for the three months ended September 30, 2013. For the nine months ended September 30, 2013, we recorded a net loss of $8.6 million.

We believe the impact of a number of elements of healthcare reform including changing payment methodologies, the rise of private and public health insurance exchanges, changing payment incentives and disincentives for hospital patient satisfaction and readmissions, and changing patient mix are challenging many of our healthcare customers to forecast their revenues and budgets in the coming year. These impacts have resulted in increased hospital scrutiny of all expenses. We believe the primary impact on our business is an elongation of sales cycles, and the delay of some customer expansions or equipment renewals. In the third quarter of 2013, we continued to see these effects, which have slowed certain sales processes and resulting revenues.

For federal hospitals, our third quarter represents their year-end, and that had a significant impact on our third quarter purchase orders, driving the largest quarterly purchase orders we have achieved for federal healthcare business, especially for VA hospitals.

Consistent with the second quarter of 2013, the commercial hospital environment remained unsettled in the third quarter, and, we continued to see slowed spending behaviors. As a result, commercial hospital purchase orders remained soft in the third quarter.

We believe that ongoing uncertainty about the impact of healthcare reform and the new insurance exchanges will continue at least through the fourth quarter of 2013. While we think the elongated approval cycles experienced this year are likely to continue into 2014, hospitals are still choosing our complete, integrated solution for critical communications in care settings. Additionally,we believe our market position has been strengthened by recently-announced new products.

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, 2012.

Components of operating results

Revenue. We generate revenue from the sale of products and services. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collection is probable. Revenue is comprised of the following:

- Product. Our solutions include both hardware and software. We refer to hardware revenue as device revenue, which includes revenue from sales of our communication badges and badge accessories, including batteries, battery chargers, lanyards, clips and other ancillary badge components. Software revenue is derived primarily from the sale of perpetual licenses to our Voice Communication solution. We derive additional software revenue from the sale of term licenses which can be renewed on a subscription basis. Product revenue is generally recognized upon shipment of hardware and perpetual licenses and, in the case of term licenses, ratably over the applicable term.
- Service. We receive service revenue from sales of software maintenance, extended warranties and professional services. Software maintenance is typically invoiced annually in advance, recorded as deferred revenue and recognized as revenue ratably over the service period. Our professional services revenue is based on both time and materials, and fixed price contracts, and is recognized as the services are provided. Extended warranties are invoiced in advance, recorded as deferred revenue and recognized ratably over the extended warranty period.

Cost of revenue. Cost of revenue is comprised of the following:

- Cost of product. Cost of product is comprised primarily of materials costs, software license costs, warranty and manufacturing overhead for test engineering, material requirements planning and our shipping and receiving functions. Cost of product also includes facility costs, information technology costs and write-offs for excess and obsolete inventory, as well as depreciation and amortization expenses. As we introduce new products, we expect material costs will increase as a percent of revenue for a period of time.
- Cost of service. Cost of service is comprised primarily of employee wages, benefits and related personnel expenses of our technical support team, our professional consulting personnel and our training teams. Cost of service also includes

facility and information technology costs. We expect our cost of service will increase as we continue to invest in support services to meet the needs of our customer base.

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Operating expenses. Operating expenses are comprised of the following:

- Research and development. Research and development expenses consist primarily of employee wages, benefits and related personnel expenses, hardware materials and consultant fees and expenses related to the design, development, testing and enhancements of our solutions. We intend to continue to invest in improving the functionality of our solutions and the development of new solutions. As a result, we expect research and development expense to increase for the foreseeable future.
- Sales and marketing. Sales and marketing expenses consist primarily of employee wages, benefits and related personnel expenses, as well as trade shows, events, marketing programs to generate awareness and demand, and industry memberships. Sales commissions are earned when an order is received from a customer and, as a result, in some cases these commissions are expensed in an earlier period than the period in which the related revenue is recognized. Historically, our bookings have tended to peak in the fourth quarter of each year driving higher sales commissions, and to be lowest in the first quarter. We intend to continue to expand our direct sales force for the foreseeable future and, accordingly, expect sales and marketing expenses to increase.
- General and administrative. General and administrative expenses consist primarily of employee wages, benefits and related personnel expenses, consulting, audit fees, legal fees and other general corporate expenses. We expect general and administrative expense to increase for the foreseeable future due to the significant costs we expect to incur as we continue to build and maintain the infrastructure necessary to comply with the regulatory requirements of being a public company and as we add personnel to support our growth.

Interest income, interest expense and other expense, net.

- Interest income. Interest income consists primarily of interest income earned on our cash and cash equivalent balances. Our interest income will vary each reporting period depending on our average cash and cash equivalent balances during the period and market interest rates.
- Interest expense. Interest expense includes interest expense related to debt and financing obligations.
- Other (expense) income, net. Other (expense) income, net consisted primarily of a stipend for market research regarding the industry in which our company operates that we provided to a market research firm and the change in the fair value of our convertible preferred stock warrants. Our convertible preferred stock warrants were classified as liabilities and, as such, were marked-to-market at each balance sheet date with the corresponding gain or loss from the adjustment recorded as other (expense) income, net. Upon the consummation of the initial public offering, on April 2, 2012, these warrants converted into warrants to purchase common stock and are no longer marked-to-market. Other (expense) income, net also includes any foreign exchange gains and losses.

Provision for income taxes. We are subject to income taxes in certain countries where we sell our solutions. We anticipate that in the future as we expand our sale of solutions to customers outside the United States, we may become subject to taxation based on the foreign statutory rates in additional countries where these sales take place and our effective tax rate could fluctuate accordingly. Currently, each of our international subsidiaries is operating under cost plus agreements where the U.S. parent company reimburses the international subsidiary for its costs plus an arm's length profit.

Income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances have been established to reduce deferred tax assets to the amount reasonably expected to be realized. Changes in valuation allowances are reflected as component of provision for income taxes.

At September 30, 2013, we had a valuation allowance against our deferred tax assets. While we generated pretax profit in 2012, our management believes it is appropriate to obtain confirmatory evidence that our results of operations will sustain this profitability in the future, before reversing a portion of the valuation allowance to earnings.

We will review on a quarterly basis our conclusions about the appropriate amount of its deferred income tax asset valuation allowance. If we generate profits, it is likely that the US valuation allowance position may be reversed in the foreseeable future. We expect 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.

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.

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| | Three months ended September 30, | | | | Nine months ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| Consolidated statement of operations data: | 2013 | | 2012 | | 2013 | | 2012 | |
| | (unaudited) | | | | | | | |
| (in thousands) | Amount | % Revenue | Amount | % Revenue | Amount | % Revenue | Amount | % Revenue |
| Revenue | | | | | | | | |
| Product | $15,666 | 60.1 % | $16,851 | 64.9 % | $43,966 | 59.6 % | $47,643 | 64.4 % |
| Service | 10,401 | 39.9 | 9,117 | 35.1 | 29,810 | 40.4 | 26,322 | 35.6 |
| Total revenue | 26,067 | 100.0 | 25,968 | 100.0 | 73,776 | 100.0 | 73,965 | 100.0 |
| Cost of revenues | | | | | | | | |
| Product | 5,635 | 21.6 | 5,237 | 20.2 | 15,581 | 21.1 | 16,138 | 21.8 |
| Service | 4,155 | 15.9 | 3,743 | 14.4 | 12,409 | 16.8 | 11,134 | 15.1 |
| Total cost of revenues | 9,790 | 37.6 | 8,980 | 34.6 | 27,990 | 37.9 | 27,272 | 36.9 |
| Gross profit | 16,277 | 62.4 | 16,988 | 65.4 | 45,786 | 62.1 | 46,693 | 63.1 |
| Operating expenses: | | | | | | | | |
| Research and development | 3,798 | 14.6 | 3,043 | 11.7 | 10,830 | 14.7 | 8,248 | 11.2 |
| Sales and marketing | 11,791 | 45.2 | 8,532 | 32.9 | 32,702 | 44.3 | 24,064 | 32.5 |
| General and administrative | 4,073 | 15.6 | 3,745 | 14.4 | 11,000 | 14.9 | 10,449 | 14.1 |
| Total operating expenses | 19,662 | 75.4 | 15,320 | 59.0 | 54,532 | 73.9 | 42,761 | 57.8 |
| (Loss) income from operations | (3,385 ) | (13.0 ) | 1,668 | 6.4 | (8,746 ) | (11.9 ) | 3,932 | 5.3 |
| Interest income | 87 | 0.3 | 60 | 0.2 | 170 | 0.2 | 86 | 0.1 |
| Interest expense | — | — | — | — | — | — | (74 ) | (0.1 ) |
| Other (expense) income, net | 76 | 0.3 | 50 | 0.2 | (55 ) | (0.1 ) | (1,442 ) | (1.9 ) |
| (Loss) income before income taxes | (3,222 ) | (12.4 ) | 1,778 | 6.8 | (8,631 ) | (11.7 ) | 2,502 | 3.4 |
| Benefit from (provision for) income taxes | 120 | 0.5 | (41 ) | (0.2 ) | 8 | — | (420 ) | (0.6 ) |
| Net (loss) income | $(3,102 ) | (11.9 )% | $1,737 | 6.7 % | $(8,623 ) | (11.7 )% | $2,082 | 2.8 % |

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Comparison of the three months and nine months ended September 30, 2013 and 2012

Revenue:

| | Three months ended September 30, | | | | Nine months ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2013 | 2012 | Change | | 2013 | 2012 | Change | |
| (in thousands) | Amount | Amount | Amount | % | Amount | Amount | Amount | % |
| Product revenue | | | | | | | | |
| Devices | $11,587 | $12,140 | $(553) | (4.6)% | $33,892 | $34,802 | $(910) | (2.6)% |
| Software | 4,079 | 4,711 | (632) | (13.4) | 10,074 | 12,841 | (2,767) | (21.5) |
| Total product | 15,666 | 16,851 | (1,185) | (7.0) | 43,966 | 47,643 | (3,677) | (7.7) |
| Service revenue | | | | | | | | |
| Maintenance and support | 8,132 | 6,687 | 1,445 | 21.6 | 23,136 | 19,158 | 3,978 | 20.8 |
| Professional services and training | 2,269 | 2,430 | (161) | (6.6) | 6,674 | 7,164 | (490) | (6.8) |
| Total service | 10,401 | 9,117 | 1,284 | 14.1 | 29,810 | 26,322 | 3,488 | 13.3 |
| Total revenue | $26,067 | $25,968 | $99 | 0.4 | $73,776 | $73,965 | $(189) | (0.3) |

Three months ended September 30, 2012 compared to three months ended September 30, 2013.

Total revenue for the three months ended September 30, 2013 increased $0.1 million, or 0.4%, from the three months ended September 30, 2012.

Product revenue for the three months ended September 30, 2013 decreased $1.2 million, or 7.0%, from the three months ended September 30, 2012. Device revenue for the three months ended September 30, 2013 decreased $0.6 million, or 4.6%, and software revenue decreased $0.6 million, or 13.4% from the three months ended September 30, 2012. The decrease in device revenue, which related entirely to our Voice Communication solution, was primarily due to a decrease in unit sales of badges and related accessories and a slight decrease in average selling price. The decrease in software revenue was mainly a result of a decrease in sales of Voice Communication software licenses, primarily attributable to lower sales to existing customers to support enterprise expansions offset by a slightly higher average selling price.

We believe that our revenue for the three months ended September 30, 2013 was adversely affected by the uncertainty surrounding healthcare reform as well as negative admission trends industry-wide. These issues are affecting many of our customers, both government and non-government, resulting in budgetary pressures and conservative spending by hospitals. The U.S Government budget sequestration has also limited hospital spending. We further believe the primary impact this is having on our business is elongating the sales cycle. All discretionary hospital spending and capital investments remain under strict scrutiny, resulting in an extended sales cycle.

Service revenue for the three months ended September 30, 2013 increased $1.3 million, or 14.1%, from the three months ended September 30, 2012. Software maintenance and support revenue for the three months ended September 30, 2013 increased $1.4 million, or 21.6%, and professional services and training revenue decreased $0.2 million, or 6.6% from the three months ended September 30, 2012. The increase in software maintenance and support revenue was primarily a result of a larger customer base increasing software maintenance revenue by $0.9 million and an increase in extended warranty revenue of $0.5 million. The decrease in professional services and training revenue is due to a decrease in the number of deployments because of lower sales activity in prior quarters.

Nine months ended September 30, 2012 compared to nine months ended September 30, 2013.

Total revenue for the nine months ended September 30, 2013 decreased $0.2 million, or 0.3%, from the nine months ended September 30, 2012.

Product revenue for the nine months ended September 30, 2013 decreased $3.7 million, or 7.7%, from the nine months ended September 30, 2012. Device revenue for the nine months ended September 30, 2013 decreased $0.9 million, or 2.6%, and software revenue decreased $2.8 million, or 21.5% from the nine months ended September 30,

2012. The decrease in device revenue, which related entirely to our Voice Communication solution, was driven primarily by lower average selling price due to a promotion in the three months ended June 30, 2013, partially offset by an increase in unit sales of badges and related accessories. The decrease in software revenue was a result of a decrease in sales of Voice Communication software licenses,

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primarily attributable to lower sales to existing customers to support enterprise expansions. Average selling prices were essentially unchanged. We believe that our revenue for the nine months ended September 30, 2013 was adversely affected by the macro conditions affecting the U.S. healthcare industry as described above.

Service revenue for the nine months ended September 30, 2013 increased $3.5 million, or 13.3% from the nine months ended September 30, 2012. Software maintenance and support revenue for the nine months ended September 30, 2013 increased $4.0 million, or 20.8%, and professional services and training revenue decreased $0.5 million, or 6.8% from the nine months ended September 30, 2012. The increase in software maintenance and support revenue was primarily a result of a larger customer base increasing software maintenance revenue by $2.4 million and an increase in extended warranty revenue of $1.6 million. Professional services and training revenue decreased due to a decrease in the number of new deployments and expansions of our Voice Communication solution at established customers, which offset the initiation of a number of new customer contracts.

Cost of revenue:

| | Three months ended September 30, | | | | Nine months ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2013 | 2012 | Change | | 2013 | 2012 | Change | |
| (in thousands) | Amount | Amount | Amount | % | Amount | Amount | Amount | % |
| Cost of revenue | | | | | | | | |
| Product | $5,635 | $5,237 | $398 | 7.6 % | $15,581 | $16,138 | $(557 ) | (3.5 )% |
| Service | 4,155 | 3,743 | 412 | 11.0 | 12,409 | 11,134 | 1,275 | 11.5 |
| Total cost of revenue | $9,790 | $8,980 | $810 | 9.0 | $27,990 | $27,272 | $718 | 2.6 |
| | | | | | | | | |
| Gross margin | | | | | | | | |
| Product | 64.0 % | 68.9 % | (4.9 )% | | 64.6 % | 66.1 % | (1.5 )% | |
| Service | 60.1 | 58.9 | 1.2 | | 58.4 | 57.7 | 0.7 | |
| Total gross margin | 62.4 | 65.4 | (3.0 ) | | 62.1 | 63.1 | (1.0 ) | |

Three months ended September 30, 2012 compared to three months ended September 30, 2013.

Cost of product revenue for the three months ended September 30, 2013 increased $0.4 million, or 7.6%, from the three months ended September 30, 2012. The cost of product revenue increased due to an increase in the number of units sold and increases in operations and warranty expenses offset by a decrease in average cost of the B3000 badges. Product gross margin as a percentage of revenue decreased in the 2013 period compared to the corresponding period in 2012, due primarily to a lower mix of software revenue and higher operations and warranty expenses. We do not expect the cost to manufacture the B3000 to decline substantially throughout the remainder of 2013.

Cost of service revenue for the three months ended September 30, 2013 increased $0.4 million, or 11.0%, from the three months ended September 30, 2012. This increase was primarily due to a $0.4 million increase in employee wages and other personnel costs in our services organization to support growth in customer deployments and technical support. Services headcount increased from 74 to 79 between September 30, 2012 and September 30, 2013. Service gross margin as a percentage of revenue increased in the 2013 period compared to the corresponding period in 2012 due to better utilization of our services personnel.

Nine months ended September 30, 2012 compared to nine months ended September 30, 2013.

Cost of product revenue for the nine months ended September 30, 2013 decreased $0.6 million, or 3.5%, from the nine months ended September 30, 2012. The cost of product revenue decreased primarily due to a decrease in average cost of the B3000 badges, offset by increases in operations and warranty expenses. Product gross margin as a percentage of revenue decreased due primarily to a lower mix of software revenue and higher overhead and warranty expenses, offset by lower device costs.