

VOCERA COMMUNICATIONS, INC.

Form 10-Q

November 13, 2012

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

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended September 30, 2012

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

Indicate by check mark whether the registrant has submitted electronically 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 <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input checked="" type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

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 9, 2012
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Common Stock, \$0.0003 par value per share

23,979,082 shares

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QUARTERLY REPORT ON FORM 10-Q  
FOR THE QUARTERLY PERIOD ENDED September 30, 2012

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Signatures

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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, 2012	December 31, 2011
Assets		
Current assets		
Cash and cash equivalents	\$47,686	\$14,898
Short-term investments	73,355	—
Accounts receivable, net of allowance of \$0 at September 30, 2012 and December 31, 2011, respectively	20,643	15,782
Other receivables	227	865
Inventories	3,228	3,363
Restricted cash	304	303
Prepaid expenses and other current assets	2,249	2,851
Total current assets	147,692	38,062
Property and equipment, net	2,616	2,701
Other long-term assets	352	339
Intangible assets, net	2,485	3,141
Goodwill	5,575	5,575
Total assets	\$158,720	\$49,818
Liabilities, Convertible Preferred Stock and Stockholders' Equity (Deficit)		
Current liabilities		
Accounts payable	\$2,911	\$4,087
Product warranty	593	983
Accrued payroll and other accruals	9,367	10,143
Deferred revenue, current	20,562	18,220
Borrowings, current	—	6,500
Total current liabilities	33,433	39,933
Deferred revenue, long-term	4,935	4,273
Borrowings, long-term	—	1,833
Other long-term liabilities	814	165
Total liabilities	39,182	46,204
Commitments (Note 9)		
Convertible preferred stock; \$0.0003 par value - no shares and 26,103,736 shares authorized as of September 30, 2012 and December 31, 2011, respectively; zero and 12,171,980 issued and outstanding shares as of September 30, 2012 and December 31, 2011, respectively	—	53,013
Stockholders' equity (deficit)		
Preferred stock, \$0.0003 par value - 5,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$0.0003 par value - 100,000,000 shares and 30,423,297 shares authorized as of September 30, 2012 and December 31, 2011, respectively; 23,862,450 and 3,780,490 issued and outstanding shares as of September 30, 2012 and December 31, 2011, respectively	7	1

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Additional paid-in capital	174,391	7,461	
Accumulated other comprehensive loss	(81	)	—
Accumulated deficit	(54,779	)	(56,861 )
Total stockholders' equity (deficit)	119,538	(49,399	)
Total liabilities, convertible preferred stock and stockholders' equity (deficit)	\$ 158,720	\$ 49,818	

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,	
	2012	2011	2012	2011
Revenue				
Product	\$ 16,851	\$ 13,087	\$ 47,643	\$ 36,648
Service	9,117	7,314	26,322	21,149
Total revenue	25,968	20,401	73,965	57,797
Cost of revenue				
Product	5,237	4,290	16,138	11,968
Service	3,743	3,861	11,134	10,569
Total cost of revenue	8,980	8,151	27,272	22,537
Gross profit	16,988	12,250	46,693	35,260
Operating expenses				
Research and development	3,043	2,379	8,248	6,970
Sales and marketing	8,532	7,542	24,064	20,717
General and administrative	3,745	3,197	10,449	8,278
Total operating expenses	15,320	13,118	42,761	35,965
Income (loss) from operations	1,668	(868)	3,932	(705)
Interest income	60	5	86	13
Interest expense and other finance charges	—	(112)	(74)	(234)
Other income (expense), net	50	132	(1,442)	(1,085)
Income (loss) before income taxes	1,778	(843)	2,502	(2,011)
Provision for income taxes	(41)	(57)	(420)	(231)
Net income (loss)	\$ 1,737	\$ (900)	\$ 2,082	\$ (2,242)
Net income (loss) per common share - basic	\$ 0.08	\$ (0.25)	\$ 0.05	\$ (0.68)
Net income (loss) per common share - diluted	\$ 0.07	\$ (0.25)	\$ 0.04	\$ (0.68)
Weighted average common shares outstanding - basic	22,450	3,589	15,973	3,284
Weighted average common shares outstanding - diluted	25,337	3,589	18,751	3,284

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,	
	2012	2011	2012	2011
Net income (loss)	\$1,737	\$(900	) \$2,082	\$(2,242
Other comprehensive loss, net:				
Decrease (increase) in unrealized loss on investments, net	110	—	(81	) —
Comprehensive income (loss)	\$1,847	\$(900	) \$2,001	\$(2,242

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,	
	2012	2011
Cash flows from operating activities		
Net income (loss)	\$2,082	\$(2,242 )
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,276	521
Amortization of intangible assets	656	755
Non-cash interest income	(39 )	—
Loss on disposal of property and equipment	2	—
Bad debt expense	—	44
Inventory write-down	207	18
Stock-based compensation expense	2,642	566
Non-employee stock-based compensation expense	29	455
Excess tax benefits from employee stock plans - operating	(300 )	—
Change in fair value of warrant liability	1,631	915
Change in fair value of option liability	—	413
Changes in assets and liabilities		
Accounts receivable	(4,862 )	(7,539 )
Other assets	638	(244 )
Inventories	(72 )	71
Prepaid expenses and other current assets	(937 )	(660 )
Other long term assets	(14 )	(258 )
Accounts payable	(1,231 )	102
Accrued liabilities	1,489	869
Warranty reserve	(390 )	185
Deferred revenue	3,004	4,446
Other long term liabilities	3	18
Net cash provided by (used in) operating activities	5,814	(1,565 )
Cash flows from investing activities		
Purchase of property and equipment	(1,379 )	(1,840 )
Purchase of short-term investments	(87,383 )	—
Maturities of short-term investments	13,986	—
Purchase of restricted cash	—	(1 )
Net cash used in investing activities	(74,776 )	(1,841 )
Cash flows from financing activities		
Cash from lease-related performance obligations	713	—
Borrowings	—	4,500
Principal payments on long-term borrowings	(8,333 )	(1,072 )
Proceeds from initial public offering, net of offering costs	72,217	—
Proceeds from secondary public offering, net of offering costs	35,996	—
Payment for repurchase of early exercised options	(6 )	—
Excess tax benefits from employee stock plans - financing	300	—
Proceeds from exercise of stock options	863	1,878



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Proceeds from exercise of preferred stock warrants	—	—	
Common stock issuance costs	—	(1,407	)
Net cash provided by financing activities	101,750	3,899	
Net increase in cash and cash equivalents	32,788	493	
Cash and cash equivalents at beginning of period	14,898	8,642	
Cash and cash equivalents at end of period	\$47,686	\$9,135	
Supplemental disclosure of non-cash investing and financing activities			
Costs related to the initial public offering in accounts payable and accrued liabilities	\$ 190	\$ 138	
Property and equipment in accounts payable and accrued liabilities	—	33	

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 critical communication challenges facing hospitals today. Vocera helps its customers improve patient safety and satisfaction, and increase hospital efficiency and productivity through its Voice Communication, Secure Messaging, and Care Transition solutions. The Voice Communication solution, which includes a lightweight, wearable, voice-controlled communication badge and a software platform, enables users to connect instantly with other hospital 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. The Care Transition solution is a hosted voice and text based software application that captures, manages and monitors patient information when responsibility for the patient is transferred or “handed-off” from one caregiver to another, or when the patient is discharged from the hospital. These three solutions are complemented by the Company's ExperiaHealth business, which is focused on improving patient experience.

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 1,727,000 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 for aggregate gross offering proceeds of \$80.0 million to the Company and \$27.6 million to the selling stockholders. The Company recorded net proceeds of \$70.5 million for the IPO, after subtraction of underwriters' discounts and commissions, and offering expenses incurred in both 2011 and 2012.

The Company completed a secondary 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 net proceeds of \$36.0 million for the secondary offering, after subtraction of underwriters' discounts and commissions and offering expenses.

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 significant 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 prospectus filed with the Securities and Exchange Commission on September 7, 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, 2012 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



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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 long-lived assets, warranty reserves, the valuation of common and preferred stock and related warrants and options, 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 financial instruments, including cash and cash equivalents, accounts receivable, deposits, accounts payable, accrued liabilities and accrued compensation approximates fair value due to their short maturities. Cash and cash equivalents are carried at fair value. The carrying value of the Company's line of credit and bank loans approximate fair value based on current rates offered to the Company for similar debt instruments.

### Cash Equivalents and Short-term Investments

The Company's cash equivalents and short-term investments consist of commercial paper, corporate debt securities and U.S. agency notes. 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 reevaluates the available-for-sale designations as of each balance sheet date. The Company classifies its investments as either short-term or long-term based on each instrument's underlying contractual maturity date. Investments with maturities of less than 12 months are classified as short-term and those with maturities greater than 12 months are classified as long-term. Investments with an original maturity of less than three months are classified as cash equivalents.

### Revenue recognition

The Company derives revenue from the sales of communication badges, smartphones, perpetual software licenses for 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.

Revenue is recognized when:

- there is persuasive evidence that an arrangement exists, in the form of a written contract, amendments to that contract, or purchase orders from a third party;
- delivery has occurred or services have been rendered;
- the price is fixed or determinable;
- collectability is probable and/or reasonably assured based on customer creditworthiness and past history of collection.

A typical sales arrangement involves multiple elements, such as sales of communication badges, perpetual software licenses, professional services and maintenance services which entitle customers to unspecified upgrades, bug fixes, patch releases and telephone support. Revenue from the sale of communication badges and perpetual software licenses is recognized upon shipment or delivery at the customers' premises as, with few exceptions, the contractual provisions governing sales of these products do not include any provisions that might adversely affect revenue recognition. In the exceptional case of an acceptance clause, revenue is deferred until all acceptance conditions are satisfied. Revenue from the sale of maintenance services on software licenses is recognized over the period during which the services are provided, which is generally one year. Revenue from professional services is recognized either on a time and materials basis as the services are provided, or on a fixed fee basis based on milestones; both of which generally take place over a period of two to twelve weeks.

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For contracts that were signed prior to January 1, 2010 and were not materially modified after that date, the Company recognizes revenue on such arrangements in accordance with the discussion under the authoritative guidance for Software Revenue Recognition, for all elements under such arrangements, as the Company's software licenses sold as part of such multiple element arrangements are considered essential to the functionality of the communications system. The arrangement consideration is allocated between each element in a multiple element arrangement based on vendor-specific objective evidence, or VSOE, of fair value. The Company applied the residual method whereby only the fair value of the undelivered element, based on VSOE, is deferred and the remaining residual fee is recognized when delivered. The Company established VSOE of fair value for maintenance services based on actual renewal rates. The VSOE of fair value for professional services is based on the rates charged for those services when sold independently from a software license.

In October 2009, the Financial Accounting Standards Board ("FASB") amended the guidance for revenue recognition for tangible products containing software components that function together to deliver the products essential functionality and also amended the accounting guidance for multiple element arrangements. The Company concluded that both standards were applicable to the Company's products and arrangements and elected to early adopt these standards on a prospective basis for revenue arrangements entered into or materially modified on or after January 1, 2010. Under the new guidance, tangible products, containing both software and non-software components that function together to deliver a tangible product's essential functionality, will no longer be subject to software revenue accounting.

The amended guidance for multiple element arrangements:

- provides updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated and how the consideration should be allocated;
- requires an entity to allocate revenue in an arrangement using best evidence of selling price, or BESP, if a vendor does not have vendor specific evidence, or VSOE, of fair value or third party evidence, or TPE, of fair value;
- eliminates the use of the residual method and require an entity to allocate revenue using the relative selling price method.

Under the new guidance, tangible products and the essential software licenses that work together with such tangible products to provide them their essential functionality are now not subject to software revenue recognition accounting rules (non-software elements), while non-essential software licenses are still governed under software revenue recognition rules (software elements). In such multiple element arrangements, the Company first allocates the total arrangement consideration based on the relative selling prices of the software group of elements as a whole and to the non-software elements. For its multiple-element arrangements, the Company allocates revenue to each element based on a selling price hierarchy at the arrangement inception. The selling price for each element is based upon the following selling price hierarchy: VSOE if available, third party evidence, or TPE, if VSOE is not available, or best estimate of selling price, or BESP, if neither VSOE nor TPE are available. The Company then further allocates consideration within the software group to the respective elements within that group following the authoritative guidance for software revenue recognition and the Company's policies as described above.

The Company allocates revenue to all deliverables based on their relative selling prices, which for the majority of the Company's products and services is based on VSOE of fair value. The Company has established VSOE of fair value for its communication badges, smartphones, software maintenance, extended warranty, and professional services. VSOE of fair value is established based on selling prices when the elements are sold separately and such selling prices fall within a relatively narrow band or through actual maintenance renewal rates. The Company establishes best evidence of selling price, or BESP, considering multiple factors including normal pricing and discounting practices, which considers market conditions, internal costs and gross margin objectives. The Company established BESP for perpetual licenses based on a range of actual discounts off list price, as the actual selling prices for perpetual licenses fall within a relatively narrow range.

Each element is accounted for as a separate unit of accounting provided the following criteria are met: the delivered products or services have value to the customer on a standalone basis; and for an arrangement that includes a general right of return relative to the delivered products or services, delivery or performance of the undelivered product or service is considered probable and is substantially controlled by us. The Company considers a deliverable to have

standalone value if the product or service is sold

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separately by us or another vendor or could be resold by the customer. Further, the Company's revenue arrangements do not include a general right of return. The Company limits the amount of revenue recognized for delivered elements to an amount that is not contingent upon future delivery of additional products or services or meeting of any specified performance conditions. The adoption of the amended revenue recognition guidance did not result in any significant changes to the individual deliverables to which the Company allocates revenue as the fair value for most of the deliverables is based on VSOE, or the timing of revenue recognized from the individual deliverables.

The Company also derives revenue from the provision of hosted services on a subscription basis and software sold under term licenses. Revenue from the sale of these products and services are not sold as part of multiple element arrangements and such arrangements are recognized ratably over the term of the arrangement.

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 the nine months ended September 30, 2012, the Company transferred \$2.6 million of lease receivables, recording an immaterial net gain and \$0.7 million of financing liabilities for future performance of executory service obligations. For lease receivables retained as of September 30, 2012 the Company recorded \$0.1 million of net investment in sales-type leases, equivalent to the minimum lease payments less the unearned interest portion.

### Recent Accounting Pronouncements

In June 2011, the FASB issued new disclosure guidance related to the presentation of the statement of comprehensive income. This guidance eliminates the current option to report other comprehensive income and its components in the consolidated statement of stockholders' equity. The requirement to present reclassification adjustments out of accumulated other comprehensive income on the face of the consolidated statement of income has been deferred. The Company adopted this accounting standard effective January 1, 2012; the adoption of this standard did not have a material impact on the financial position or results of operations of the Company.

In September 2011, the FASB issued new accounting guidance that simplifies goodwill impairment tests. The new guidance states that a "qualitative" assessment may be performed to determine whether further impairment testing is necessary. An entity will no longer be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that the fair value of the reporting unit is less than its carrying amount. Prior to the amendment, entities were required to test goodwill for impairment, on at least an annual basis, by first comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit is calculated as being less than its carrying amount, then the second step of the quantitative test is to be performed to measure the amount of impairment loss, if any. The Company adopted this accounting standard effective January 1, 2012; the adoption of this standard did not have a material impact on the financial position or results of operations of the Company.

The Company qualifies as an "emerging growth company" pursuant to the provisions of the JOBS Act, enacted on April 5, 2012. Section 102 of the JOBS Act provides that an "emerging growth company" can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. However, the Company is choosing to "opt out" of such extended transition period, and as a result, the Company will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies. The decision to opt out of the extended transition period is irrevocable.





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In July 2012, the FASB issued amended guidance that simplifies how entities test indefinite-lived intangible assets other than goodwill for impairment. After an assessment of certain qualitative factors, if it is determined to be more likely than not that an indefinite-lived asset is impaired, entities must perform the quantitative impairment test. Otherwise, the quantitative test is optional. The amended guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the financial position or results of operations of the Company.

## 2. Fair value of financial instruments

The carrying values of the Company's cash and cash equivalents and short-term investments approximate their fair value due to their short-term nature. 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, 2012 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 cash and money market funds, which include bank deposits, are classified within Level 1 of the fair value hierarchy because they are valued using bank balances or quoted market prices. The Company's other cash equivalents and short-term investments are also classified within Level 1 of the fair value hierarchy because the fair values used by the professional pricing service have been confirmed with quoted prices in active markets. The Company's preferred stock warrants were classified within Level 3 of the fair value hierarchy because they were valued based on unobservable inputs and management's judgment due to the absence of quoted market prices, inherent lack of liquidity and the long-term nature of such financial instruments. These assumptions are inherently subjective and involve significant management judgment.

The Company's assets and liabilities that are measured at fair value on a recurring basis, by level, within the fair value hierarchy as of September 30, 2012 and December 31, 2011, are summarized as follows (in thousands):

	September 30, 2012				December 31, 2011			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Assets</b>								
Money market funds	\$21,509	\$—	\$—	\$21,509	\$—	\$—	\$—	\$—
Certificates of deposits	996	—	—	996	—	—	—	—
Commercial paper	62,362	—	—	62,362	—	—	—	—
U.S. government and agency securities	9,997	—	—	9,997	—	—	—	—
Total assets measured at fair value	\$94,864	\$—	\$—	\$94,864	\$—	\$—	\$—	\$—
<b>Liabilities</b>								
Convertible preferred stock warrants	\$—	\$—	\$—	\$—	\$—	\$—	\$1,853	\$1,853
Total liabilities measured at fair value	\$—	\$—	\$—	\$—	\$—	\$—	\$1,853	\$1,853

The Company performed a fair value assessment of the preferred stock warrant inputs at the end of each reporting period. The fair value of the preferred stock warrant liability was estimated using an option pricing model that takes into account the contract terms as well as multiple inputs such as the Company's stock price, risk-free interest rates and expected volatility that the Company could not corroborate with market data. These warrants to purchase preferred stock were converted into warrants



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to purchase shares of common stock at the applicable conversion rate for the related common stock upon the closing of the Company's IPO on April 2, 2012. The warrants were revalued and converted upon the closing of the IPO, and as such, as of September 30, 2012 the convertible preferred stock warrant liability is zero.

For the period from January 1, 2012 through April 2, 2012, the Company valued these preferred stock warrants using a stock price of \$16.00 - \$23.40, risk-free interest rates of 0.07% - 0.66%, and expected volatility of 45% - 50%. For the year ending December 31, 2011 the Company used a stock price of \$13.32 - \$14.16, risk-free interest rates of 0.10% - 6.0%, and expected volatility of 45% - 50%. Any change in fair value is recognized as a component of other income (expense), net, in the consolidated statements of operations.

The following table presents a reconciliation of the preferred stock warrants measured and recorded at fair value on a recurring basis, using significant unobservable inputs (Level 3) for the three months and nine months ended September 30, 2012 and 2011, respectively:

(in thousands)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Fair value at beginning of period	\$—	\$2,073	\$1,853	\$1,127
Change in fair value	—	(286	) 1,631	915
Exercise of preferred stock warrants	—	—	(343	) (255
Conversion of preferred stock warrants to common stock warrants	—	—	(3,141	) —
Fair value at end of period	\$—	\$1,787	\$—	\$1,787

The estimated fair value of the Company's current and long-term borrowings based on a market approach was approximately \$8.3 million as of December 31, 2011 and represented a Level 2 valuation. The Company did not have any current or long-term borrowings as of September 30, 2012. When determining the estimated fair value of the Company's debt, the Company used a commonly accepted valuation methodology and market-based risk measurements, such as credit risk.

### 3. Cash, Cash Equivalents and Short-Term Investments

The following table presents cash, cash equivalents and available-for-sale investments for the periods presented (in thousands):

	As of September 30, 2012			Fair value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Cash and cash equivalents:				
Demand deposits and other cash	\$26,177	\$—	\$—	\$26,177
Money market funds	21,509	—	—	21,509
Total cash and cash equivalents	47,686	—	—	47,686
Short-Term Investments:				
Commercial paper	62,444	—	(82	) 62,362
Certificates of deposit	996	—	—	996
U.S. government and agency securities	9,996	1	—	9,997
Total short-term investments	73,436	1	(82	) 73,355
Total cash, cash equivalents and short-term investments	\$121,122	\$1	\$(82	) \$121,041

At December 31, 2011, the Company did not have any cash equivalents or short-term investments.

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4. Income (loss) per share

Basic and diluted net income (loss) per common share is presented in conformity with the two-class method required for participating securities. Holders of Series A through Series F 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 is paid on common stock, the holders of 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 preferred stock do not have a contractual obligation to share the losses of the Company. The Company considered its preferred stock to be 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 income (loss) per common share.

Under the two-class method, net income (loss) attributable to common stockholders is determined by allocating undistributed earnings, calculated as net income less income attributable to participating securities between common stock and participating securities. In computing net income (loss) attributable to common stockholders for calculation of diluted net income (loss) per share, undistributed earnings are re-allocated to reflect the potential impact of dilutive securities. Basic net income (loss) per common share is computed by dividing the net income (loss) 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 income (loss) per share attributable to common stockholders is computed by dividing the net income (loss) attributable to common stockholders for calculation of diluted net income (loss) 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 income (loss) per share (in thousands, except per share amounts):

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Numerator:				
Net income (loss)	\$ 1,737	\$(900)	) \$2,082	\$(2,242)
Less: undistributed earnings attributable to participating securities	(9)	) —	(1,299)	) —
Net income (loss) attributable to common stockholders	1,728	(900)	) 783	(2,242)
Reallocation of undistributed earnings attributable to participating securities	1	—	26	—
Net income (loss) attributable to common stockholders for diluted net income (loss) per share	\$ 1,729	\$(900)	) \$809	\$(2,242)
Denominator:				
Weighted-average shares used to compute basic net income (loss) per common share	22,450	3,589	15,973	3,284
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	25,337	3,589	18,751	3,284
Net income (loss) per share				
Net income (loss) per common share - basic	\$0.08	\$(0.25)	) \$0.05	\$(0.68)
Net income (loss) per common share - diluted	\$0.07	\$(0.25)	) \$0.04	\$(0.68)

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)	2012	2011	2012	2011
Convertible preferred stock (on an if converted basis)	—	12,917	—	12,917
Options to purchase common stock	405	3,475	339	3,475
Common stock subject to repurchase	—	200	—	200
Warrants to purchase convertible preferred stock	—	213	—	213
Restricted stock units	1	—	27	—

## 5. Goodwill and intangible assets

### Goodwill

As of both December 31, 2011 and September 30, 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, 2012, using the qualitative approach (or "Step Zero") as permitted by FASB's recently-modified 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. As of September 30, 2012, no changes in circumstances indicate that goodwill carrying values may not be recoverable.



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## 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:

	Weighted Average Useful Life (years)	September 30, 2012			December 31, 2011		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Trademarks	6.9	\$70	\$27	\$43	\$70	\$16	\$54
Non-Compete Agreements	2.0	70	49	21	70	13	57
Customer Relationships	8.6	2,350	1,010	1,340	2,350	690	1,660
Developed Technology	6.0	1,880	799	1,081	1,880	510	1,370
Intangible assets		\$4,370	\$1,885	\$2,485	\$4,370	\$1,229	\$3,141

Amortization expense was \$0.2 million and \$0.3 million for the three months ended September 30, 2012 and September 30, 2011, respectively. Amortization expense was \$0.7 million and \$0.8 million for the nine months ended September 30, 2012 and September 30, 2011, 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, 2012 was as follows (in thousands):

2012 (remaining three months)	\$216
2013	727
2014	567
2015	389
2016	258
2017	156
Thereafter	172
Future amortization expense	\$2,485

## 6. Balance Sheet Components

## Inventories

(in thousands)	September 30, 2012	December 31, 2011
Raw Materials	\$28	\$250
Finished Goods	3,200	3,113
Total Inventories	\$3,228	\$3,363

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## Property and Equipment

(in thousands)	September 30, 2012	December 31, 2011
Computer equipment and software	\$4,343	\$3,712
Furniture, fixtures and equipment	1,006	1,018
Leasehold improvements	1,762	1,493
Manufacturing tools and equipment	3,340	3,027
Construction in process	111	90
	10,562	9,340
Less: Accumulated depreciation	(7,946	) (6,639
Property and equipment, net	\$2,616	\$2,701

Depreciation and amortization expense was \$0.4 million and \$0.2 million for the three months ended September 30, 2012 and September 30, 2011, respectively. Depreciation and amortization expense was \$1.3 million and \$0.5 million for the nine months ended September 30, 2012 and September 30, 2011, respectively.

## Accrued Liabilities

(in thousands)	September 30, 2012	December 31, 2011
Payroll and related expenses	\$6,449	\$4,424
Uninvoiced purchases	1,349	1,741
Preferred stock warrant liability	—	1,853
Deferred rent	571	500
Exercise of unvested stock options	242	373
Customer prepayments	105	387
Sales and use tax payable	426	343
Other	225	522
Total accrued payroll and other accruals	\$9,367	\$10,143

## 7. Product Warranties

The Company generally provides for the estimated costs of hardware 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 specific hardware warranty includes parts and labor over a period generally ranging from one to three years. The Company provides no warranty for software. The Company regularly re-evaluates its estimates to assess the adequacy of the recorded warranty liabilities and adjust the amounts as necessary.

A reconciliation of the changes in the Company's warranty reserve is as follows:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Balance at the beginning of the period	\$776	\$724	\$983	\$605
Warranty expenses accrued	34	435	645	1,142
Warranty settlements made	(217	) (369	) (1,035	) (957
Balance at the end of the period	\$593	\$790	\$593	\$790



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### 8. Borrowings

#### Term loan and revolving line of credit

In June 2004, the Company entered into a loan and security agreement with a bank, most recently amended in December 2010 (the "Amendment"). The Amendment renewed the revolving line of credit at \$5.0 million, and increased the term loan from \$2.0 million to \$5.0 million. Subsequent to the Company's IPO, on April 3, 2012, the Company paid off in full the outstanding revolving line of credit of \$4.5 million and the outstanding term loan balance of \$3.3 million. The following provides details of each of the two separate forms of credit extended under the loan and security agreement:

#### Revolving line of credit:

The Amendment allowed the Company to borrow up to \$5.0 million based on the Company's working capital. The borrowing base was calculated based on up to 80% of eligible accounts receivable. Any outstanding balances above the availability on the borrowing base would be paid down or cash secured by the Company. Interest was payable monthly with the principal due at maturity. Borrowing under the line of credit bore interest at the bank's prime rate plus 1%, provided that in no event would the prime rate be deemed to be less than the 30-Day LIBOR rate plus 2.5%. As of December 31, 2011, the Company had drawn down \$4.5 million under this line of credit. On February 13, 2012, the Company repaid \$4.5 million under the line of credit, on March 23, 2012 the Company drew down \$4.5 million, and on April 3, 2012 the Company repaid the full amount outstanding on the line of credit of \$4.5 million using a portion of the proceeds from the IPO. This line of credit expired in April 2012.

#### Term loan:

The Amendment allowed the Company to borrow up to \$5.0 million under a term loan; on December 13, 2010, the Company borrowed the full \$5.0 million available. Approximately \$1.0 million of the proceeds from this borrowing was used to pay off the previous term loan which was outstanding at the close of the Amendment. This loan was to be repaid with six interest only payments, followed by 30 equal monthly installments of principal plus interest, which began on June 13, 2011. Interest was calculated at the bank's prime rate plus 1.5% provided that in no event would the prime rate be deemed to be less than the 30-day LIBOR rate plus 2.5%.

The agreement imposed various limitations on the Company, including without limitation, on its ability to: (i) transfer all or any part of its businesses or properties, merge or consolidate, or acquire all or substantially all of the capital stock or property of another company; (ii) engage in a new business; (iii) incur additional indebtedness or liens with respect to any of its properties; (iv) pay dividends or make any other distribution on or purchase of, any of its capital stock; (v) make investments in other companies; (vi) make payments in respect of any subordinated debt. The agreement also contained certain customary representations and warranties, additional covenants, notice and indemnification provisions, and events of default, including changes of control, cross-defaults to other debt, judgment defaults and material adverse changes to the Company's business. In addition, the Loan Agreement required the Company to maintain an adjusted quick ratio of 1.10:1, which is defined as unrestricted cash plus eligible accounts receivable; divided by current liabilities plus all other bank debt less the current portion of deferred revenue. The loan agreement also required the Company to maintain minimum net income levels on a quarterly basis.

### 9. Commitments

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. The Company has never incurred costs to

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defend lawsuits or settle claims related to these undertakings and, as a result, the Company believes the corresponding estimated fair value 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.

#### 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 December 31, 2011 and September 30, 2012, approximately \$4.9 million and \$4.2 million, 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 December 2012 and March 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.

Future minimum lease payments at September 30, 2012 under non-cancelable operating leases are as follows (in thousands):

2012 (remaining three months)	\$ 329
2013	1,461
2014	1,474
2015	1,480
2016	440
Thereafter	30
Total minimum lease payments	\$5,214

## 10. 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.

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## 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 Liabilities), and reclassified to common stock as the Company's repurchase right lapses. As of September 30, 2012 and December 31, 2011, 63,472 and 112,967 shares held by employees were subject to repurchase at an aggregate price of \$0.2 million and \$0.4 million, respectively.

## 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 provides for six-month offering periods, except for the first offering period which is for 11 months, and 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.

## Stock Option Activity

A summary of the stock option activity for the nine months ended September 30, 2012 is presented below:

	Shares Available for Grant	Number of Options	Weighted Average Exercise Price	Weighted average contractual term (in years)	Aggregate intrinsic value (in thousands)
Outstanding at December 31, 2011	1,101,111	3,808,222	\$3.57	6.68	\$28,682
Shares removed from the plan	(167,166	) —			
Options granted	(534,870	) 534,870	\$22.81		
Options exercised	—	(731,602	) \$2.03		
Options canceled	38,658	(38,658	) \$5.35		
Options expired	5,399	(5,399	) \$2.68		
Early exercised options repurchased and added back to the pool	1,454	—			
Outstanding at September 30, 2012	444,586	3,567,433	\$6.75	6.68	\$86,181

At September 30, 2012, there was \$7.5 million of unrecognized net compensation cost related to options which is expected to be recognized over a weighted-average period of 2.8 years. The Company did not grant non-employee options in either of the three or nine months ended September 30, 2012. For the three and nine months ended September 30, 2011 the Company granted 400,000 non-employee options which were fully vested on the date of grant. In connection with this grant the Company recognized \$446,000 immediately. The fair value of these options was calculated using the Black Scholes option pricing model using the following assumptions: expected term of 10.0 years, volatility of 52.4%, interest rate of 2.09% and dividend yield of 0%.

On March 27, 2012, the Company granted to a certain member of the board of directors options to purchase an aggregate of 33,333 shares of common stock at an exercise price of \$16.00. The aggregate intrinsic value, which was \$0.2 million. at March 31, 2012, has increased to \$0.5 million at September 30, 2012. Aggregate intrinsic value represents the difference between the



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Company's closing stock price on the last trading day of the period, which was \$30.91 per share as of September 30, 2012, and the exercise price multiplied by the number of related options.

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 major inputs: the estimated fair value of the underlying common stock, the expected life 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.

The following assumptions were used for each respective period:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2,012	2,011
Expected Term (in years)	5.48	5.77	5.48 - 5.60	5.49 - 5.72
Volatility	48.0%	44.7%	47.9% - 48.7%	44.7% - 45.0%
Interest Rate	0.72%	1.73%	0.72% - 1.03%	1.73% - 2.48%
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. In May 2012, the Company 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 activity for the nine months ended September 30, 2012 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, 2011	—	—	—	—
Granted	24,152	\$12.42	300,660	\$25.12
Vested	—	—	—	—
Forfeited	—	—	(2,200)	\$24.15
Outstanding at September 30, 2012	24,152	\$12.42	298,460	\$25.13

At September 30, 2012, there was \$0.2 million of unrecognized net compensation cost related to restricted stock awards which is expected to be recognized over a weighted-average period of 1.4 years. At September 30, 2012, there was \$6.4 million of unrecognized net compensation cost related to RSUs which is expected to be recognized over a weighted-average period of 2.7 years.

**11. Segments**

The Company has two operating segments which are both reportable business segments: (i) Product and (ii) Service, both of which are comprised of Vocera's and its wholly-owned subsidiaries' results 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.

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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.

The following table presents a summary of the operating segments:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Revenue				
Product	\$16,851	\$13,087	\$47,643	\$36,648
Service	9,117	7,314	26,322	21,149
Total revenue	25,968	20,401	73,965	57,797
Gross profit				
Product	11,614	8,797	31,505	24,680
Service	5,374	3,453	15,188	10,580
Total gross profit	16,988	12,250	46,693	35,260
Research and development	3,043	2,379	8,248	6,970
Sales and marketing	8,532	7,542	24,064	20,717
General and administrative	3,745	3,197	10,449	8,278
Income (loss) from operations	1,668	(868)	3,932	(705)
Interest income	60	5	86	13
Interest expense and other finance charges	—	(112)	(74)	(234)
Other income (expense), net	50	132	(1,442)	(1,085)
Income (loss) before income taxes	\$1,778	\$(843)	\$2,502	\$(2,011)

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## Supplemental information

The following table presents the Company's revenue by product line:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Revenue				
Product				
Devices	\$12,140	\$9,513	\$34,802	\$26,852
Software	4,711	3,574	12,841	9,796
Total product	16,851	13,087	47,643	36,648
Service				
Maintenance and support	6,687	5,536	19,158	15,705
Professional services and training	2,430	1,778	7,164	5,444
Total service	9,117	7,314	26,322	21,149
Total revenue	\$25,968	\$20,401	\$73,965	\$57,797

The Company's revenue by geographic region, based on customer location, is summarized as follows:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Revenue				
United States	\$23,332	\$18,770	\$65,502	\$53,049
International	2,636	1,631	8,463	4,748
Total revenue	\$25,968	\$20,401	\$73,965	\$57,797

## 12. Income Taxes

Income tax expense was immaterial for the three months ended September 30, 2012 and 2011. Income tax expense for the nine months ended September 30, 2012 was \$0.4 million and for the nine months ended September 30, 2011 was \$0.2 million. The difference in effective tax rate of 16.8% for the nine months ended September 30, 2012 and 13.0% for the year ended December 31, 2011 is primarily due to increased profitability in the U.S. which has resulted in increases in both Federal and state taxes.

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.

In assessing the ability to realize deferred tax assets, the Company's management considers whether it is more likely than not that some portion or all of a deferred tax asset will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of sufficient future taxable income during the periods in which those temporary differences become deductible. A valuation allowance is recorded for loss carryforwards and other deferred tax assets where it is more likely than not that such deferred tax assets will not be realized. The Company believes it is more likely than not that it would not be able to utilize these deferred tax assets in the future and as a result the Company has recorded a full valuation allowance on the U.S. federal and state deferred tax assets through September 30, 2012. The Company continues to review its conclusions about the appropriate amount of its deferred income tax asset valuation allowance in light of circumstances existing in current periods and considering the expected future period results. In the future, if the Company determines based on its current and expected future profitability that these deferred tax assets are more likely than not to be realized, a release of all or part of the related valuation allowance could result in an immediate material income tax benefit in the period of adjustment and material income tax provisions in periods beyond this adjustment. Such release of the valuation allowance could occur in the foreseeable future provided the Company results continue to remain positive.





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As of September 30, 2012, 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, 2011.

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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 critical communication challenges facing hospitals today. We help our customers improve patient safety and satisfaction, and increase hospital efficiency and productivity through our Voice Communication, Secure Messaging, and Care Transition solutions. Our Voice Communication solution, which includes a lightweight, wearable, voice-controlled communication badge and a software platform, 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 Care Transition solution is a hosted voice and text based software application that captures, manages and monitors patient information when responsibility for the patient is transferred or "handed-off" from one caregiver to another, or when the patient is discharged from the hospital.

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 client applications available for BlackBerry, iPhone and Android 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. We have shipped over 400,000 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.

To date, substantially all of our revenue has been derived from sales of our Voice Communication solution, including product maintenance and related services. Revenue grew 28.0% from \$57.8 million for the nine months ended

September 30, 2011 to \$74.0 million for the nine months ended September 30, 2012. For the nine months ended September 30, 2012, we recorded net income of \$2.1 million.

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. For 2011, our largest end customer represented only 2.8% of revenue. While we have international customers in other English speaking countries such as Canada,

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the United Kingdom and Australia, most of our customers are located in the United States. International customers represented 11.4% and 8.2% of our revenue for the nine months ended September 30, 2012 and September 30, 2011, respectively. We are developing plans to expand our presence in other English speaking markets and enter non-English speaking markets.

We qualify as an “emerging growth company” pursuant to the provisions of the JOBS Act, enacted on April 5, 2012. Section 102 of the JOBS Act provides that an “emerging growth company” can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. However, we have chosen to “opt out” of such extended transition period, and as a result, we will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies. The decision to opt out of the extended transition period is irrevocable.

Critical Accounting Policies and Estimates

There have been no material changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates described in the final prospectus for our public offering filed pursuant to Rule 424(b) under the Securities Act with the Securities and Exchange Commission on September 7, 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, badge accessories, including batteries, battery chargers, lanyards, clips and other ancillary badge components, and our Vocera smartphone. 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.

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.

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**Sales and marketing.** Sales and marketing expenses consist primarily of employee wages, benefits and related personnel expenses, as well as trade shows, marketing and public relations programs and advertising. 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 income (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 resulting from our credit facility and security agreement, which was paid in full on April 3, 2012. We expect interest expense to fluctuate in the future with changes in our borrowings.

**Other income (expense), net.** Other income (expense), 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 income (expense), 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 income (expense), net also includes any foreign exchange gains and losses.

**Provision for income taxes.** We are subject to income taxes in the countries where we sell our solutions. Historically, we have primarily been subject to taxation in the United States because we have sold the majority of our solutions to customers in the United States. We anticipate that in the future as we expand our sale of solutions to customers outside the United States, we will become subject to taxation based on the foreign statutory rates in the countries where these sales took 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 a reasonable 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 are established when necessary to reduce deferred tax assets to the amount expected to be realized. Changes in valuation allowances are reflected as component of provision for income taxes.

## 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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(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Consolidated statement of operations data: (unaudited)				
Revenue				
Product	\$16,851	\$13,087	\$47,643	\$36,648
Service	9,117	7,314	26,322	21,149
Total revenue	25,968	20,401	73,965	57,797
Cost of revenues				
Product	5,237	4,290	16,138	11,968
Service	3,743	3,861	11,134	10,569
Total cost of revenues	8,980	8,151	27,272	22,537
Gross profit	16,988	12,250	46,693	35,260
Operating expenses:				
Research and development	3,043	2,379	8,248	6,970
Sales and marketing	8,532	7,542	24,064	20,717
General and administrative	3,745	3,197	10,449	8,278
Total operating expenses	15,320	13,118	42,761	35,965
Income (loss) from operations	1,668	(868)	3,932	(705)
Interest income	60	5	86	13
Interest expense	—	(112)	(74)	(234)
Other income (expense)	50	132	(1,442)	(1,085)
Income (loss) before income taxes	1,778	(843)	2,502	(2,011)
Provision for income taxes	(41)	(57)	(420)	(231)
Net income (loss)	\$1,737	\$(900)	\$2,082	\$(2,242)

## Comparison of the three and nine months ended September 30, 2011 and 2012

## Revenue:

	Three months ended September 30,					Nine months ended September 30,				
	2012		2011		Change	2012		2011		Change
(in thousands)	Amount	% Revenue	Amount	% Revenue	Amount%	Amount	% Revenue	Amount	% Revenue	Amount %
Revenue										
Product	\$16,851	64.9 %	\$13,087	64.1 %	\$3,764 28.8 %	\$47,643	64.4 %	\$36,648	63.4 %	\$10,995 30.0 %
Service	9,117	35.1 %	7,314	35.9 %	1,803 24.7 %	26,322	35.6 %	21,149	36.6 %	5,173 24.5 %
Total revenue	\$25,968	100.0 %	\$20,401	100.0 %	\$5,567 27.3 %	\$73,965	100.0 %	\$57,797	100.0 %	\$16,168 28.0 %

Total revenue increased \$5.6 million, or 27.3%, from the three months ended September 30, 2011 to the three months ended September 30, 2012. Total revenue increased \$16.2 million, or 28.0%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. We achieved these growth rates in revenues in the three and nine month periods ended September 30, 2012, from the comparable prior year periods, notwithstanding a lower volume than we had expected of orders in the third quarter of 2012. This lower quarterly order volume was largely due to delays in the issuance of government orders which we are continuing to pursue.

Three months ended September 30, 2011 compared to three months ended September 30, 2012

Product revenue increased \$3.8 million, or 28.8% from the three months ended September 30, 2011 to the three months ended September 30, 2012. Device revenue increased \$2.6 million, or 27.6%, and software revenue increased \$1.1 million, or 31.8%. The increase in device revenue, which relates entirely to our Voice Communication solution,



was driven primarily by existing

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customers expanding deployments within their facilities to new departments and users, new customers making initial purchases, and customers replacing badges and related accessories.

A portion of the increase in device revenue was due to higher average selling prices as a result of lower discounts and a change in mix, as customers purchase the B3000 badge, which has a higher list price than the B2000 badge. The list prices for our products did not change substantially in the three months ended September 30, 2012. The increase in software revenue was a result of an increase in sales of Voice Communication software licenses to new and existing customers.

Service revenue increased \$1.8 million, or 24.7% from the three months ended September 30, 2011 to the three months ended September 30, 2012. Software maintenance and support revenue increased \$1.2 million, or 20.8%, and professional services and training revenue increased \$0.7 million, or 36.7%. An increase of \$0.9 million in software maintenance and support revenue was primarily a result of a larger customer base. The increase in professional services and training revenue included \$0.4 million as a result of an increase in professional services related to our ExperiaHealth services, which are focused on helping customers improve the patient experience.

Nine months ended September 30, 2011 compared to nine months ended September 30, 2012

Product revenue increased \$11.0 million, or 30.0%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. Device revenue increased \$8.0 million, or 29.6%, and software revenue increased \$3.0 million, or 31.1%. The increase in device revenue, which related entirely to our Voice Communication solution, was driven primarily by an increase in unit sales of badges and related accessories from new customers making initial purchases, existing customers expanding deployments within their facilities to new departments and users, and customers replacing badges. A portion of the increase in device revenue was a result of higher average selling prices for our communications badge as customers purchased the B3000 badge, which has a higher list price than the B2000 badge. The list prices for our products did not change substantially in the nine months ended September 30, 2012. The increase in software revenue was a result of an increase in sales of Voice Communication software licenses to new and existing customers.

Service revenue increased \$5.2 million, or 24.5% from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. Software maintenance and support revenue increased \$3.5 million, or 22.0%, and professional services and training revenue increased \$1.7 million, or 31.6%. An increase of \$2.9 million in software maintenance and support revenue was primarily a result of a larger customer base with the remaining increase resulting from an increase in extended warranty contracts related to our communications badge. The increase in professional services and training revenue included \$1.0 million as a result of an increase in professional services related to our ExperiaHealth services, with the remaining increase due to an increase in the number of customer deployments for our Voice Communication solution.

Cost of revenue:

	Three months ended September 30,				Nine months ended September 30,				
	2012	2011	Change		2012	2011	Change		
	Amount	Amount	Amount	%	Amount	Amount	Amount	%	%
Cost of revenue									
Product	\$5,237	\$4,290	\$947	22.1	\$16,138	\$11,968	\$4,170	34.8	%
Service	3,743	3,861	(118)	(3.1)	11,134	10,569	565	5.3	%
Total cost of revenue	\$8,980	\$8,151	\$829	10.2	\$27,272	\$22,537	\$4,735	21.0	%
Gross margin									
Product	68.9	%67.2	% 1.7	%	66.1	%67.3	% (1.2)	%	%
Service	58.9	%47.2	% 11.7	%	57.7	%50.0	% 7.7	%	%
Total gross margin	65.4	%60.0	% 5.4	%	63.1	%61.0	% 2.1	%	%

Three months ended September 30, 2011 compared to three months ended September 30, 2012

Cost of product revenue increased \$0.9 million, or 22.1%, from the three months ended September 30, 2011 to the three months ended September 30, 2012. The increase in cost of product revenue was primarily due to higher unit shipments and the change in product mix from B2000 badges to B3000 badges. This was offset by a decrease in warranty expenses of \$0.3 million due to

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lower anticipated product return rates. Gross margin as a percentage of product revenue increased in the three months ended September 30, 2012 compared to the three months ended September 30, 2011 as we incurred lower manufacturing costs for the B3000 badges and Voice Software license sales increased to new and existing customers. Cost of service revenue decreased \$0.1 million, or 3.1%, from the three months ended September 30, 2011 to the three months ended September 30, 2012. Gross margin as a percentage of revenue increased for the three months ended September 30, 2012 compared to the three months ended September 30, 2011 due to higher utilization of our services personnel.

Nine months ended September 30, 2011 compared to nine months ended September 30, 2012

Cost of product revenue increased \$4.2 million, or 34.8%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. The increase in cost of product revenue was primarily due to higher unit shipments and the change in product mix from B2000 badges to B3000 badges. This was offset by a decrease in warranty expenses of \$0.4 million due to lower anticipated product return rates. Gross margin as a percentage of product revenue decreased in the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011, due to the higher cost of the B3000 badge, which was released in October 2011. The higher badge costs were partially offset by higher margins from an increase in software revenue.

Cost of service revenue increased \$0.6 million, or 5.3%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. This increase was primarily due to a \$0.7 million increase in employee wages and other personnel costs in our services organization to support growth in customer deployments and technical support. Gross margin as a percentage of service revenue increased for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011 due to higher utilization of our services personnel.

Operating expenses:

	Three months ended September 30,				Nine months ended September 30,							
	2012	2011	Change	2012	2011	Change	2012	2011	Change			
	Amount	% Revenue	Amount	% Revenue	Amount	% Revenue	Amount	% Revenue	Amount	% Revenue		
Operating expenses:												
Research and development	\$3,043	11.7 %	\$2,379	11.7 %	\$664	27.9 %	\$8,248	11.2 %	\$6,970	12.1 %	\$1,278	18.3 %
Sales and marketing	8,532	32.9 %	7,542	37.0 %	990	13.1 %	24,064	32.5 %	20,717	35.8 %	3,347	16.2 %
General and administrative	3,745	14.4 %	3,197	15.7 %	548	17.1 %	10,449	14.1 %	8,278	14.3 %	2,171	26.2 %
Total operating expenses	\$15,320	59.0 %	\$13,118	64.3 %	\$2,202	16.8 %	\$42,761	57.8 %	\$35,965	62.2 %	\$6,796	18.9 %

Three months ended September 30, 2011 compared to three months ended September 30, 2012

Research and development expense. Research and development expense increased \$0.7 million, or 27.9%, from the three months ended September 30, 2011 to three months ended September 30, 2012. This increase was primarily due to higher employee wages and other personnel costs associated with an increase in headcount from 47 as of September 30, 2011 to 55 as of September 30, 2012, and higher stock-based compensation expense. This was offset by lower consulting expenses associated with the B3000 development program.

Sales and marketing expense. Sales and marketing expense increased \$1.0 million, or 13.1%, from the three months ended September 30, 2011 to the three months ended September 30, 2012. This increase was primarily due to a \$1.0 million increase in employee wages and other personnel costs associated with an increase in headcount from 104 as of September 30, 2011, to 132 as of September 30, 2012.

General and administrative expense. General and administrative expense increased \$0.5 million, or 17.1%, from the three months ended September 30, 2011 to the three months ended September 30, 2012. This increase was due to a \$0.3 million increase in employee wages and other personnel costs, a \$0.3 million increase in bonuses due to an amendment to the executive compensation plan and expansion of eligible employees, and a \$0.1 million increase in stock-based compensation expense. This was offset by a \$0.1 million decrease in outside consulting and services fees.

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Nine months ended September 30, 2011 compared to nine months ended September 30, 2012.

Research and development expense. Research and development expense increased \$1.3 million, or 18.3%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. This increase was primarily due to higher employee wages and other personnel costs associated with an increase in headcount from 47 as of September 30, 2011 to 55 as of September 30, 2012 and higher stock-based compensation expense. This was offset by lower consulting expenses associated with the B3000 development program.

Sales and marketing expense. Sales and marketing expense increased \$3.3 million, or 16.2%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. This increase was primarily due to a \$2.8 million increase in employee wages and other personnel costs associated with an increase in headcount from 104 as of September 30, 2011, to 132 as of September 30, 2012 and a \$0.5 million increase in stock-based compensation expense.

General and administrative expense. General and administrative expense increased \$2.2 million, or 26.2%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. This increase was due to a \$1.0 million increase in employee wages and other personnel costs, a \$1.0 million increase in bonuses due to an amendment to the executive compensation plan and expansion of eligible employees and a \$0.3 million increase in stock-based compensation expense.

Other income (expense):

(in thousands)	Three months ended September 30,			Nine months ended September 30,		
	2012	2011	Change	2012	2011	Change
Interest income	\$60	\$5	\$55	\$86	\$13	\$73
Interest expense	—	(112)	) 112	(74	)(234	) 160
Other income (expense), net	50	132	(82	)(1,442	)(1,085	) (357

Three months ended September 30, 2011 compared to three months ended September 30, 2012

Interest income. Interest income increased from the three months ended September 30, 2011 to the three months ended September 30, 2012 due to higher cash balances.

Interest expense. Interest expense decreased due to lower borrowings for three months ended September 30, 2012, as we repaid all outstanding borrowings under our credit facility and term loan in April 2012. If we borrow funds in the future, we expect that interest expense will fluctuate with changes in our borrowings.

Other income (expense), net. Other income decreased \$0.1 million. In the three months ended September 30, 2011, we recorded a \$0.3 million gain from the change in fair market value of convertible preferred warranty and a \$0.2 million loss on foreign exchange translation. For the three months ended September 30, 2012, we did not have any preferred stock warrants outstanding and recorded a gain on foreign exchange translation of \$0.1 million.

Nine months ended September 30, 2011 compared to nine months ended September 30, 2012

Interest income. Interest income increased from the nine months ended September 30, 2011 to September 30, 2012 due to higher cash balances.

Interest expense. Interest expense decreased due to lower borrowings for the nine months ended September 30, 2012.

Other income (expense), net. The \$0.4 million increase in other expenses for the nine months ended September 30, 2012 is due primarily to \$0.7 million of higher preferred warrant liability expense, offset by a \$0.1 million reduction in loss on foreign exchange and the receipt of a \$0.2 million stipend for market research regarding the industry in which we operate that we provided to a market research firm.

### Liquidity and capital resources

As of September 30, 2012, we had cash and cash equivalents and short-term investments of \$121.0 million and no debt borrowings.

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On April 2, 2012, we completed our initial public offering in which we and existing stockholders sold 6,727,500 shares of common stock at \$16.00 per share, before underwriting discounts and commissions. We sold 5,000,000 shares and existing stockholders sold an aggregate of 1,727,500 shares, including 877,500 shares as a result of the underwriters' exercise of their over-allotment option. The Company recorded net proceeds of \$70.5 million for the IPO, after subtraction of underwriters' discounts and commissions, and offering expenses incurred in both 2011 and 2012. We did not receive any proceeds from the sale of shares by existing stockholders in our initial public offering. On September 12, 2012, we completed a secondary public offering in which we and existing shareholders sold 5,548,750 shares of common stock at \$28.75 per share, before underwriting discounts and commissions. We sold 1,337,500 shares and existing stockholders sold an aggregate of 4,211,250 shares, including an aggregate of 723,750 shares as a result of the underwriters' exercise of their over-allotment option. We received net proceeds of approximately \$36.0 million, after deducting underwriting discounts and commissions and other expenses of the offering. We did not receive any proceeds from the sale of shares by existing stockholders in our secondary public offering.

On April 3, 2012, we paid in full the outstanding amount under the revolving line of credit. We allowed the line of credit to expire in April 2012.

We believe that our existing sources of liquidity will satisfy our working capital and capital requirements for at least the next twelve months.

(in thousands)	Nine months ended September 30,	
	2012	2011
Consolidated Statements of Cash Flow Data:		
Net cash provided by (used in) operating activities	\$5,814	\$(1,565 )
Net cash used in investing activities	(74,776 )	(1,841 )
Net cash provided by financing activities	101,750	3,899
Net increase in cash and cash equivalents	\$32,788	\$493
Operating activities		

Cash provided by operating activities was \$5.8 million for the nine months ended September 30, 2012, due to net income of \$2.1 million, increased by exclusion of non-cash items such as the mark-to-market valuation of preferred stock warrants of \$1.6 million prior to our initial public offering, depreciation and amortization of \$1.3 million, amortization of intangible assets of \$0.7 million and stock-based compensation of \$2.6 million. These items counteract the decreased cash flow from growth in receivables of \$4.9 million, the decrease of \$1.2 million from paydown of accounts payable and the decrease of \$0.9 million from higher prepaids and other current assets. These were partly offset by a \$3.0 million increase in deferred revenues and a \$1.5 million increase from accrued liabilities. Cash used in operating activities was \$1.6 million for the nine months ended September 30, 2011, due to the net loss of \$2.2 million, which was offset by non-cash items, such as changes in the valuation of our preferred warrant and option liabilities of \$1.3 million, stock-based compensation expense of \$1.0 million, depreciation and amortization of \$0.5 million and amortization of intangible assets of \$0.8 million offset. The net changes in operating assets and liabilities required an additional \$3.0 million of cash during the nine months ended September 30, 2011. Our accounts receivable increased \$7.5 million due to the increase in volume and the timing of product shipments during the nine months ended September 30, 2011. We expect accounts receivable balances will fluctuate over time depending on the timing of product shipments within the given period. The largest offset against the receivables growth was in deferred revenues, which provided \$4.4 million in operating cash.

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## Investing activities

Cash used in investing activities was \$74.8 million for the nine months ended September 30, 2012, due to the purchase of short-term investments of \$87.4 million, partly offset by \$14.0 million of maturities. The purchase of property and equipment and leasehold improvements used another \$1.4 million cash.

Cash used in investing activities of \$1.8 million for the nine months ended September 30, 2011 was due to the purchase of property and equipment and leasehold improvements.

## Financing activities

Cash provided by financing activities was \$101.8 million for the nine months ended September 30, 2012, which was primarily attributable to the net proceeds received from our initial public offering of \$72.2 million and our secondary offering of \$36.0 million, partly offset by the \$8.3 million repayment of our credit facility and term loan.

Cash provided by financing activities was \$3.9 million for the nine months ended September 30, 2011, which was primarily attributable to a \$3.4 million net increase in debt. In June 2011, we drew \$4.5 million on the revolving line of credit for general corporate purposes as we added headcount and continued to invest in our operations for future growth. On April 3, 2012, we paid in full the outstanding amount under the revolving line of credit. The line of credit expired in April 2012. During the nine months ended September 30, 2011, an additional \$1.9 million in proceeds were provided from the exercise of stock options and preferred stock warrants, partly offset by \$1.4 million in common stock issuance costs in preparation for our 2012 initial public offering.

## Contractual obligations

The following table summarizes our contractual obligations as of September 30, 2012:

(in thousands)	Totals	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating leases (1)	\$5,214	\$1,410	\$2,962	\$842	\$—
Non-cancelable purchase commitments (2)	4,247	4,247	—	—	—
Total	\$9,461	\$5,657	\$2,962	\$842	\$—

(1) Consists of contractual obligations from non-cancelable office space under operating leases.

(2) Consists of minimum purchase commitments with our independent contract manufacturer and other vendors.

## Off-Balance Sheet Arrangements

During the nine months ended September 30, 2012, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities, that would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, historically we have invested in money market funds. To minimize the exposure due to an adverse shift in interest rates, we invest in cash and cash equivalents.

Historically our operations have consisted of research and development and sales activities in the United States. As a result, our financial results have not been materially affected by factors such as changes in foreign currency exchange rates or economic conditions in foreign markets. We expect to generate future revenue and incur future expenses associated with operating our





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Canadian subsidiary that was acquired in late 2010. We are developing plans to expand our international presence. Accordingly, we expect that our exposure to changes in foreign currency exchange rates and economic conditions will increase in future periods.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in reports filed under the Exchange Act is accumulated and communicated to management, including principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

As of September 30, 2012, we have carried out an evaluation under the supervision of, and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based on our evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of September 30, 2012 due to the material weakness in our internal control over financial reporting as described below.

Prior Material Weakness in Internal Control over Financial Reporting

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our financial statements will not be prevented or detected and corrected on a timely basis.

In connection with our preparation of the financial statements for six months ended June 30, 2012, adjustments to our financial statements were identified which resulted from a control deficiency that we considered to constitute a material weakness. This control deficiency related to the design and operation of controls for the preparation of the statement of cash flows as we did not maintain effective controls to ensure the accuracy and appropriate presentation and disclosure of the statement of cash flows. Specifically, the controls were not designed to consider non-cash activity related to issuance costs from the completion of our initial public offering. The material weakness resulted in material errors and adjustments to cash flows from operating and financing activities included within the condensed consolidated financial statements for the period ended June 30, 2012. Additionally, this material weakness could result in a misstatement of our financial information or disclosures that could result in a material misstatement of our interim condensed consolidated financial statements and/or year-end consolidated financial statements that may not be prevented or detected.

Remediation Plan and Status

In response to the identified material weakness in the Statement of Cash Flows, our management, with oversight from our Audit Committee, is executing the implementation of the following remediation steps. These efforts are focused on (i) redesigning the statement of cash flow spreadsheet, specifically related to non-cash items; completing a second more detailed review of the statement of cash flows at the end of each period; (ii) adopting an enhanced secondary review of the statement of cash flows, by agreeing each movement to supporting schedule and recalculating the amounts in the worksheet; and (iii) employing the services of external consultants to assist with the completion of the review.

We believe these steps, when they are fully implemented, will address the material weakness previously identified and will enhance our internal control over financial reporting, as well as our disclosure controls and procedures. However, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become

inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Changes in Internal Control over Financial Reporting

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As described above, other than the remediation plan for the existing material weakness, there was no change in our internal control over financial reporting which occurred during the period covered by this Quarterly Report on Form 10-Q which has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II: OTHER INFORMATION

### Item 1. Legal Proceedings

From time to time, we may be involved in lawsuits, claims, investigations and proceedings, consisting of intellectual property, commercial, employment and other matters which arise in the ordinary course of business. We are not currently involved in any material legal proceedings.

### Item 1A. Risk Factors

Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below, together with all of the other information set forth in this Quarterly Report on Form 10-Q. Our business, financial condition, results of operations or future prospects could be materially and adversely harmed if any of the following risks, or other risks or uncertainties that are not yet identified or that we currently believe are immaterial, actually occur. The trading price of our common stock could decline due to any of these risks or uncertainties, and, as a result, you may lose all or part of your investment.

#### Risks related to our business and industry

Although we reported net income for the nine months ended September 30, 2012, we have incurred significant losses in the past. If we cannot maintain profitability, our business will be harmed and our stock price could decline.

We have incurred significant losses in the past and may incur losses in the future as we continue to grow our business. As of September 30, 2012, we had an accumulated deficit of \$54.8 million. We expect our expenses to increase due to the hiring of additional personnel and the additional operational and reporting costs associated with being a public company. We reported net income for the nine months ended September 30, 2012. However, if we cannot maintain profitability, our business will be harmed and our stock price could decline.

Our ability to be profitable in the future depends upon continued demand for our communication solutions from existing and new customers. Further market adoption of our solutions, including increased penetration within our existing customers, depends upon our ability to improve patient safety and satisfaction and increase hospital efficiency and productivity. In addition, our profitability will be affected by, among other things, our ability to execute on our business strategy, the timing and size of orders, the pricing and costs of our solutions, and the extent to which we invest in sales and marketing, research and development and general and administrative resources.

We depend on sales of our Voice Communication solution in the healthcare market for substantially all of our revenue, and any decrease in its sales would harm our business.

To date, substantially all of our revenue has been derived from sales of our Voice Communication solution to the healthcare market and, in particular, hospitals. Any decrease in revenue from sales of our Voice Communication solution would harm our business. For 2011 and the nine months ended September 30, 2012, sales of our Voice Communication solution to the healthcare market accounted for over 91% and 94% of our revenue, respectively. In addition, we obtained a significant portion of these sales from existing hospital customers. We anticipate that sales of our Voice Communication solution will represent a significant portion of our revenue for the foreseeable future. While we are evaluating new solutions for non-healthcare markets, we may not be successful in applying our technology to these markets. In any event, we do not anticipate that sales of our Voice Communication solution in non-healthcare markets will represent a significant portion of our revenue for the foreseeable future.

Our success depends in part upon the deployment of our Voice Communication solution by new hospital customers, the expansion and upgrade of our solution at existing customers, and our ability to continue to provide on a timely basis cost-effective solutions that meet the requirements of our hospital customers. Our Voice Communication solution requires a substantial upfront investment by customers. Typically, our hospital customers initially deploy our solution for specific users in specific departments before expanding our solution into other departments or for other users. The cost of the initial deployment depends on the number of users and departments involved, the size and age of the hospital and the condition of the existing wireless infrastructure, if any, within the hospital.

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Even if hospital personnel determine that our Voice Communication solution provides compelling benefits over their existing communications methods, their hospitals may not have, or may not be willing to spend, the resources necessary to install and maintain wireless infrastructure to initially deploy and support our solution or expand our solution to other departments or users. Hospitals are currently facing significant budget constraints, ever increasing demands from a growing number of patients, and impediments to obtaining reimbursements for their services. We believe hospitals are currently allocating funds for capital and infrastructure improvements to benefit from recently enacted electronic medical records incentives, which may impact their ability to purchase and deploy our solution. We might not be able to sustain or increase our revenue from sales of our Voice Communication solution, or achieve the growth rates that we envision, if hospitals continue to face significant budgetary constraints and reduce their spending on communications systems.

Our sales cycle can be lengthy and unpredictable, which may cause our revenue and operating results to fluctuate significantly.

Our sales cycles can be lengthy and unpredictable. Our sales efforts involve educating our customers about the use and benefits of our solutions, including the technical capabilities of our solutions and the potential cost savings and productivity gains achievable by deploying them. Customers typically undertake a significant evaluation process, which frequently involves not only our solutions but also their existing communications methods and those of our competitors, and can result in a lengthy sales cycle of nine to twelve months or more. We spend substantial time, effort and money in our sales efforts without any assurance that our efforts will produce any sales. In addition, purchases of our solutions are frequently subject to budget constraints, multiple approvals, and unplanned administrative, processing and other delays. As a result, our revenue and operating results may vary significantly from quarter to quarter.

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

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

If we fail to offer high-quality services and support for any of our solutions, our ability to sell those solutions will be harmed.

Our ability to sell our Voice Communication, Secure Messaging or Care Transitions solutions is dependent upon our professional services and technical support teams providing high-quality services and support. Our professional services team assists our customers with their wireless infrastructure assessment, clinical workflow design, communication solution configuration, training and project management during the pre-deployment and deployment stages. Once our solutions are deployed within a customer's facility, the customer typically depends on our technical support team to help resolve technical issues, assist in optimizing the use of our solutions and facilitate adoption of new functionality. If we do not effectively assist our customers in deploying our solutions, succeed in helping our customers quickly resolve technical and other post-deployment issues, or provide effective ongoing support services, our ability to expand the use of our solutions with existing customers and to sell our solutions to new customers will

be harmed. If deployment of our solutions is unsatisfactory, as has been the case with certain third-party deployments in the past, we may incur significant costs to attain and sustain customer satisfaction. As we rapidly hire new services and support personnel, we may inadvertently hire underperforming people who will have to be replaced, or fail to effectively train such employees, leading in some instances to slower growth, additional costs and poor customer relations. In addition, the failure of channel partners to provide high-quality services and support in markets outside the United States could also harm sales of our solutions.

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

We depend on sole and limited source suppliers for several hardware components of our Voice Communication solution, including our batteries and integrated circuits. We purchase inventory generally through individual purchase orders. Any of these suppliers could cease production of our components, experience capacity constraints, material shortages, work stoppages,

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financial difficulties, cost increases or other reductions or disruptions in output, cease operations or be acquired by, or enter into exclusive arrangements with, a competitor. These suppliers typically rely on purchase orders rather than long-term contracts with their suppliers, and as a result, even if available, the supplier may not be able to secure sufficient materials at reasonable prices or of acceptable quality to build our components in a timely manner. Any of these circumstances could cause interruptions or delays in the delivery of our solutions to our customers, and this may force us to seek components from alternative sources, which may not have the required specifications, or be available in time to meet demand or on commercially reasonable terms, if at all. Any of these circumstances may also force us to redesign our solutions if a component becomes unavailable in order to incorporate a component from an alternative source.

Our solutions incorporate multiple software components obtained from licensors on a non-exclusive basis, such as voice recognition software, software supporting the runtime execution of our software platform, and database and reporting software. Our license agreements can be terminated for cause. In many cases, these license agreements specify a limited term and are only renewable beyond that term with the consent of the licensor. If a licensor terminates a license agreement for cause, objects to its renewal, or conditions renewal on modified terms and conditions, we may be unable to obtain licenses for equivalent software components on reasonable terms and conditions, including licensing fees, warranties or protection from infringement claims. Some licensors may discontinue licensing their software to us or support of the software version used in our solutions. In such circumstances, we may need to redesign our solutions at substantial cost to incorporate alternative software components or be subject to higher royalty costs. Any of these circumstances could adversely affect the cost and availability of our solutions.

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

Because we depend upon a contract manufacturer, our operations could be harmed and we could lose sales if we encounter problems with this manufacturer.

We do not have internal manufacturing capabilities and rely upon a contract manufacturer, SMTC Corporation, to produce the primary hardware component of our Voice Communication solution. We have entered into a manufacturing agreement with SMTC that is terminable by either party with advance notice and that may also be terminated for a material uncured breach. We also rely on original design manufacturers, or ODMs, to produce accessories, including batteries, chargers and attachments. If SMTC or an ODM is unable or unwilling to continue manufacturing components of our solutions in the volumes that we require, fails to meet our quality specifications or significantly increases its prices, we may not be able to deliver our solutions to our customers with the quantities, quality and performance that they expect in a timely manner. As a result, we could lose sales and our operating results could be harmed.

SMTC or ODMs may experience problems that could impact the quantity and quality of components of our Voice Communication solution, including disruptions in their manufacturing operations due to equipment breakdowns, labor strikes or shortages, component or material shortages and cost increases. SMTC and these ODMs generally rely on purchase orders rather than long-term contracts with their suppliers, and as a result, may not be able to secure sufficient components or other materials at reasonable prices or of acceptable quality to build components of our solutions in a timely manner. The majority of the components of our Voice Communication solution are manufactured in Asia or Mexico and adverse changes in political or economic circumstances in those locations could also disrupt our supply and quality of components of our solutions. In October 2011, we introduced the B3000 badge. Initial



production of this product commenced with SMTC in the United States, and new production fully transitioned to Mexico in May 2012. Companies occasionally encounter unexpected difficulties in ramping up production of new products, and we may experience such difficulties with future generations of our products. SMTC and our ODMs also manufacture products for other companies. Generally, our orders represent a relatively small percentage of the overall orders received by SMTC and these ODMs from their customers; therefore, fulfilling our orders may not be a priority in the event SMTC or an ODM is constrained in its ability to fulfill all of its customer obligations. In addition, if SMTC or an ODM is unable or unwilling to continue manufacturing components of our solutions, we may have to identify one or more alternative manufacturers. The process of identifying and qualifying a new contract manufacturer or ODM can be time consuming, and we may not be able to substitute suitable alternative manufacturers in a timely manner or at an acceptable cost. Additionally, transitioning to a new manufacturer may cause us to incur additional costs and delays if the new manufacturer has difficulty manufacturing components of our solutions to our specifications or quality standards.

If we fail to forecast our manufacturing requirements accurately, or fail to properly manage our inventory with our contract

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manufacturer, we could incur additional costs and experience manufacturing delays, which can adversely affect our operating results.

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

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

The effectiveness of our Voice Communication solution depends upon the quality and compatibility of the communications environment of our healthcare customers. Our solutions require voice-grade wireless, or Wi-Fi, installed through large enterprise environments, which can vary from hospital to hospital and from department to department within a hospital. Many hospitals have not installed a voice-grade wireless infrastructure. If potential customers do not have a wireless network that can properly and fully interoperate with our Voice Communication solution, then such a network must be installed, or an existing Wi-Fi network must be upgraded or modified, for example, by adding access points in stairwells, for our Voice Communication solution to be fully functional. The additional cost of installing or upgrading a Wi-Fi network may dissuade potential customers from installing our solution. Furthermore, if changes to a customer's physical or information technology environment cause integration issues or degrade the effectiveness of our solution, or if the customer fails to upgrade its environment as may be required for software releases or updates, the customer may not be able to fully utilize our solution or may experience technical problems, or these changes may impact the performance of other wireless equipment being used. If such circumstances arise, prospective customers may not purchase or existing customers may not expand their use of or deploy upgraded versions of our Voice Communication solution, thereby harming our business and operating results.

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

We believe that a significant opportunity exists to sell our products to healthcare facilities in the Veterans Administration and Department of Defense, or DoD. These customers require independent certification of compliance with particular requirements relating to encryption, security, interoperability and scalability. These requirements include compliance with Federal Information Processing Standard, or FIPS, 140-2 and, as to DoD facilities, certification by the Joint Interoperability and Test Command, or JITC, of DoD and under the DoD Information Assurance Certification and Accreditation Process, or DIACAP. We have received certification under certain of these standards for a military-specific configuration of the Vocera communication solution incorporating the B2000 badge. We are carrying out activities intended to achieve additional certifications, including certifications applicable to the

B3000 badge and future products as well. A failure on our part to comply in a timely manner with these requirements, or to maintain certification, both as to current products and as to new product versions, could adversely impact our revenue.

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Our Mobility Business Unit may not be successful in selling our communications solutions in non-healthcare markets.

Our primary focus has been on selling our communications solutions to the healthcare market, with other markets addressed only opportunistically. We have very recently created our Mobility Business Unit for sales efforts to customers outside the healthcare market, and it will initially focus on customers in selected industries. We may not be successful in further penetrating the non-healthcare markets upon which we are initially focusing, or other new markets. Our Voice Communication solution has been deployed in over 100 customers in non-healthcare markets, including hospitality, retail and libraries. For both 2011 and the nine months ended September 30, 2012, total revenue from non-healthcare customers accounted for 3% of our revenue. If we cannot maintain these customers by providing communications solutions that meet their requirements, if we cannot successfully expand our communications solutions in non-healthcare markets, or if our solutions are adopted more slowly than we anticipate, we may not obtain significant revenue from these markets. We may experience challenges as we expand in non-healthcare markets, including pricing pressure on our solutions and technical issues as we adapt our solutions for the requirements of new markets. Our communications solutions also may not contain the functionality required by these non-healthcare markets or may not sufficiently differentiate us from competing solutions such that customers can justify deploying our solutions.

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

Our success depends, in part, upon our ability to develop and introduce new solutions and features to existing solutions that meet existing and new customer requirements. We may not be able to develop and introduce new solutions or features on a timely basis or in response to customers' changing requirements, or that sufficiently differentiate us from competing solutions such that customers can justify deploying our solutions. We may experience technical problems and additional costs as we introduce new features to our software platform, deploy future models of our wireless badges and integrate new solutions with existing customer clinical systems and workflows. In addition, we may face technical difficulties as we expand into non-English speaking countries and incorporate non-English speech recognition capabilities into our Voice Communication solution. Our recently introduced B3000 badge has reduced demand for our existing B2000 badges, and we must therefore successfully manage the transition from existing badges, avoid excessive inventory levels and ensure that sufficient supplies of new badges can be delivered to meet customer demand. We also may incur substantial costs or delays in the manufacture of the B3000 badge and any additional new products or models as we seek to optimize production methods and processes at our contract manufacturer. In addition, we expect that we will at least initially achieve lower gross margins on new models, while endeavoring to reduce manufacturing costs over time. If any of these problems were to arise, our revenue, operating results and reputation could suffer.

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

We have acquired, and in the future may acquire, complementary businesses, technologies or assets that we believe to be strategic, such as our four acquisitions completed in 2010. We may not achieve the anticipated strategic or financial benefits, or be successful in integrating any acquired businesses, technologies or assets. If we cannot effectively integrate our Voice Communication solution with our Secure Messaging and Care Transition solutions and successfully market and sell these solutions, we may not achieve market acceptance for, or significant revenue from, these new solutions.

Integrating newly acquired businesses, technologies and assets could strain our resources, could be expensive and time consuming, and might not be successful. Our recent acquisitions expose us, and if we acquire or invest in additional businesses, technologies or assets, we will be further exposed, to a number of risks, including that we may:

- experience technical issues as we integrate acquired businesses, technologies or assets into our existing communications solutions
- encounter difficulties leveraging our existing sales and marketing organizations, and direct sales channels, to increase our revenue from acquired businesses, technologies or assets
- find that the acquisition does not further our business strategy, we overpaid for the acquisition or the economic conditions underlying our acquisition decision have changed
- have difficulty retaining the key personnel of acquired businesses
- suffer disruption to our ongoing business and diversion of our management's attention as a result of transition or integration issues and the challenges of managing geographically or culturally diverse enterprises
- experience unforeseen and significant problems or liabilities associated with quality, technology and legal contingencies relating to the acquisition, such as intellectual property or employment matters

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In addition, from time to time we may enter into negotiations for acquisitions that are not ultimately consummated. These negotiations could result in significant diversion of management time, as well as substantial out-of-pocket costs. If we were to proceed with one or more significant acquisitions in which the consideration included cash, we could be required to use a substantial portion of our available cash. To the extent we issue shares of capital stock or other rights to purchase capital stock, including options and warrants, the ownership of existing stockholders would be diluted. In addition, acquisitions may result in the incurrence of debt, contingent liabilities, large write-offs, or other unanticipated costs, events or circumstances, any of which could harm our operating results.

If we are not able to manage our growth effectively, or if our business does not grow as we expect, our operating results will suffer.

We have experienced significant revenue growth in a short period of time. For example, our revenue increased from \$30.3 million for the nine months ended September 30, 2009 to \$74.0 million for the nine months ended September 30, 2012, and during these periods, we significantly expanded our operations and more than doubled the number of our employees from 129 as of January 1, 2009 to 326 as of September 30, 2012. Our rapid growth has placed, and will continue to place, a significant strain on our management systems, infrastructure and other resources. We plan to hire additional direct sales and marketing personnel domestically and internationally, acquire complementary businesses, technologies or assets, and increase our investment in research and development. Our future operating results depend to a large extent on our ability to successfully implement these plans and manage our anticipated expansion. To do so successfully we must, among other things:

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

We expect to incur costs associated with the investments made to support our growth before the anticipated benefits or the returns are realized, if at all. If we are unable to manage our growth effectively, we may not be able to take advantage of market opportunities or develop new solutions or enhancements to existing solutions. We may also fail to satisfy customer requirements, maintain quality, execute our business plan or respond to competitive pressures, which could result in lower revenue and a decline in the share price of our common stock.

The implementation of our new enterprise resource planning system could disrupt our business and adversely affect our financial results.

In 2012, we undertook the planning process for a new enterprise resource planning application, or ERP, with implementation of our solution beginning in the fourth quarter of 2012 and extending into 2013. We may experience difficulties in implementing the ERP, and we may fail to obtain the risk mitigation benefits that the implementation is designed to produce. The implementation could also be disruptive to our operations, including the ability to timely ship and track product orders to our customers, project inventory requirements, manage our supply chain and otherwise adequately service our customers.

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

We generally recognize revenue from our customer maintenance and support contracts ratably over the contract term, which is typically 12 months, in some cases subject to an early termination right. For 2011 and the nine months ended September 30, 2012, revenue from our maintenance and support contracts accounted for 27.0% and 25.9% of our revenue, respectively. A portion of the revenue we report in each quarter is derived from the recognition of deferred

revenue relating to maintenance and support contracts entered into during previous quarters. Consequently, a decline in new or renewed maintenance and support by our customers in any one quarter may not be immediately reflected in our revenue for that quarter. Such a decline, however, will negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our services and potential changes in our rate of renewals may not be fully reflected in our operating results until future periods.

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

We recently began offering our badges and related hardware accessories to our customers through multi-year equipment lease agreements. For a sale, we recognize product-related revenue at the net present value of the lease payment stream once our

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obligations related to such sale have been met. We plan to sell these leases, including the related accounts receivables, to third party lease finance companies on a non-recourse basis. We, however, may not be able to sell all of these leases to third party lease finance companies. In such event, we will have to retain such leases in-house, which would expose us to the creditworthiness of such equipment lease customers over the lease term. For the leases that we retain in-house, our ability to collect payments from a customer or to recognize revenue for the sale could be impaired if the customer fails to meet its obligations to us such as in the case of its bankruptcy filing or deterioration in its financial position, or has other creditworthiness issues, any of which could harm our revenue and operating results.

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

Our operating results may be difficult to predict, even in the near term, and are likely to fluctuate as a result of a variety of factors, many of which are outside of our control. We have historically obtained substantially all of our revenue from the sale of our Voice Communication solution, which we anticipate will represent the most significant portion of our revenue for the foreseeable future, as we only began offering our Secure Messaging and Care Transition solutions in the last two years.

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

- the financial health of our healthcare customers and budgetary constraints on their ability to upgrade their communications
- changes in the regulatory environment affecting our healthcare customers, including impediments to their ability to obtain reimbursement for their services
- our ability to expand our sales and marketing operations
- the procurement and deployment cycles of our healthcare customers and the length of our sales cycles
- variations in the amount of orders booked in a prior quarter but not delivered until later quarters
- our mix of solutions and pricing, including discounts by us or our competitors
- our ability to forecast demand and manage lead times for the manufacture of our solutions
- our ability to develop and introduce new solutions and features to existing solutions that achieve market acceptance

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

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

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



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

We believe that at this time the primary competition for our Voice Communication solution consists of traditional methods using wired phones, pagers and overhead intercoms. While we believe that our system is superior to these legacy methods, our solution requires a significant infrastructure investment by a hospital and many hospitals may not recognize the value of implementing our solution.

Manufacturers and distributors of product categories such as cellular phones, pagers, mobile radios, and in-building wireless telephones attempt to sell their products to hospitals as components of an overall communication system. Of these product categories, in-building wireless telephones represent the most significant competition for the sale of our solution. The market

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for in-building wireless phones is dominated by large horizontal communications companies such as Cisco Systems, Ascom and Polycom, which recently announced the sale of its Spectralink wireless phones business to a Sun Capital Partners' affiliate. In addition, while smartphones and tablets are not at present direct competitors, their proliferation may make them a de facto standard for hospital workflow, thereby making our solution less attractive to customers.

While we do not have a directly comparable competitor that provides a richly featured voice communication system for the healthcare market, we could face such competition in the future. Potential competitors in the healthcare or communications markets include large, multinational companies with significantly more resources to dedicate to product development and sales and marketing. These companies may have existing relationships within the hospital, which may enhance their ability to gain a foothold in our market. Customers may prefer to purchase a more highly integrated or bundled solution from a single provider or an existing supplier rather than a new supplier, regardless of performance or features. Accordingly, if we fail to effectively respond to competitive pressures, we could experience pricing pressure, reduced profit margins, higher sales and marketing expenses, lower revenue and the loss of market share, any of which would harm our business, operating results or financial condition.

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

Although we derive a relatively small portion of our revenue from customers outside the United States, we believe that non-U.S. customers could represent an increasing share of our revenue in the future. During 2011 and the nine months ended September 30, 2012, we obtained 7.3% and 11.4% of our revenue, respectively, from customers outside of the United States, including Canada, the United Kingdom, Australia, the Republic of Ireland and New Zealand. Accordingly, we are subject to risks and challenges that we would not otherwise face if we conducted our business solely in the United States, including:

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

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

Our Voice Communication solution is highly complex and may contain undetected software or hardware errors that could harm our reputation and operating results.

Our Voice Communication solution incorporates complex technology, is deployed in a variety of complex hospital environments and must interoperate with many different types of devices and hospital systems. While we test the components of our solutions for defects and errors prior to release, we or our customers may not discover a defect or

error until after we have deployed our solution, integrated it into the hospital environment and our customer has commenced general use of the solution. For example, in 2005, a prior model of our wireless badge, the B1000, was affected by chipset compatibility issues with certain wireless access points at customer facilities, resulting in our exchanging a large percentage of deployed badges for new badges. We did this exchange at no cost to our customers, thereby incurring substantial costs. In addition, our solutions in some cases are integrated with hardware and software offered by “middleware” vendors in order to interoperate with nurse call systems, device alarms and other hospital systems. If we cannot successfully integrate our solution with these vendors as needed or if any hardware or software of these vendors contains any defect or error, then our solution may not perform as designed, or may exhibit a defect or error.

Any defects or errors in, or which are attributed to, our solutions, could result in:  
• delayed market acceptance of our affected solutions

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- loss of revenue or delay in revenue recognition
- loss of customers or inability to attract new customers
- diversion of engineering or other resources for remedying the defect or error
- damage to our brand and reputation
- increased service and warranty costs
- legal actions by our customers and hospital patients, including product liability claims

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

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

In connection with our healthcare communications business, we may handle or have access to personal health information subject in the United States to the Health Insurance Portability and Accountability Act of 1996, or HIPAA, the Health Information Technology for Economic and Clinical Health Act of 2009, or HITECH, regulations issued pursuant to these statutes, state privacy and security laws and regulations, and associated contractual obligations as a “business associate” of healthcare providers. These statutes, regulations and contractual obligations impose numerous requirements regarding the use and disclosure of personal health information with which we must comply. Our failure to accurately anticipate the application or interpretation of these statutes, regulations and contractual obligations as we develop our solutions, a failure by us to comply with their requirements (e.g., evolving encryption and security requirements) or an allegation that defects in our products have resulted in noncompliance by our customers could create material civil and/or criminal liability for us, resulting in adverse publicity and negatively affecting our business. In addition, the use and disclosure of personal health information is subject to regulation in other jurisdictions in which we do business or expect to do business in the future. Those jurisdictions may attempt to apply such laws extraterritorially or through treaties or other arrangements with U.S. governmental entities. We might unintentionally violate such laws, such laws may be modified and new laws may be enacted in the future which may increase the chance that we violate them. Any such developments, or developments stemming from enactment or modification of other laws, or the failure by us to comply with their requirements or to accurately anticipate the application or interpretation of these laws could create material liability to us, result in adverse publicity and negatively affect our business. For example, the European Union, or EU, adopted the Data Protection Directive, or DPD, imposing strict regulations and establishing a series of requirements regarding the storage of personally identifiable information on computers or recorded on other electronic media. This has been implemented by all EU member states through national laws. DPD provides for specific regulations requiring all non-EU countries doing business with EU member states to provide adequate data privacy protection when receiving personal data from any of the EU member states. Similarly, Canada's Personal Information and Protection of Electronic Documents Act provides Canadian residents with privacy protections in regard to transactions with businesses and organizations in the private sector and sets out ground rules for how private sector organizations may collect, use and disclose personal information in the course of commercial activities. A finding that we have failed to comply with applicable laws and regulations regarding the collection, use and disclosure of personal information could create liability for us, result in adverse publicity and negatively affect our business.

Any legislation or regulation in the area of privacy and security of personal information could affect the way we operate our services and could harm our business. The costs of compliance with, and the other burdens imposed by, these and other laws or regulatory actions may prevent us from selling our solutions or increase the costs associated with selling our solutions, and may affect our ability to invest in or jointly develop solutions in the United States and in foreign jurisdictions. Further, we cannot assure you that our privacy and security policies and practices will be found sufficient to protect us from liability or adverse publicity relating to the privacy and security of personal information.

Developments in the healthcare industry and governing regulations could negatively affect our business.

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

In March 2010, the United States enacted comprehensive healthcare reform legislation through the Patient Protection and Affordable Health Care for America Act and the Health Care and Education Reconciliation Act. The new law is expected to

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increase the number of Americans with health insurance coverage by approximately 32 million through individual and employer mandates, subsidies offered to lower income individuals with smaller employers and broadening of Medicaid eligibility, and to affect healthcare reimbursement levels for healthcare providers. We cannot predict with certainty what the ultimate effect of federal healthcare reform or any future legislation or regulation, or healthcare initiatives, if any, implemented at the state level, will have on us or our customers. For example, the federal healthcare reform imposes a 2.3% excise tax on medical devices beginning January 2013, to which our company would be subject if any of our communications solutions are classified as medical devices. The impact of the tax, coupled with reform-associated payment reductions to Medicare and Medicaid reimbursement, could harm our business, operating results and cash flows.

In addition, our customers' expectations regarding pending or potential industry developments may also affect their budgeting processes and spending plans with respect to our communications solutions. The healthcare industry has changed significantly in recent years and we expect that significant changes will continue to occur. However, the timing and impact of developments in the healthcare industry are difficult to predict. We cannot assure you that the markets for our solutions will continue to exist at current levels or that we will have adequate technical, financial and marketing resources to react to changes in those markets.

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

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

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

Claims of intellectual property infringement could harm our business.

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

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

Many potential litigants have the capability to dedicate substantially greater resources to enforce their intellectual property rights and to defend claims that may be brought against them. Furthermore, a successful claimant could secure a judgment that requires us to pay substantial damages or prevents us from distributing certain solutions or performing certain services. We might also be required to seek a license and pay royalties for the use of such intellectual property, which may not be available

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on commercially acceptable terms or at all. Alternatively, we may be required to develop non-infringing technology, which could require significant effort and expense and may ultimately not be successful.

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

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

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

- current or future U.S. or foreign patent applications will be approved
- our issued patents will protect our intellectual property and not be held invalid or unenforceable if challenged by third parties
- we will succeed in protecting our technology adequately in all key jurisdictions in which we or our competitors operate
- others will not independently develop similar or competing products or methods or design around any patents that may be issued to us

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

Our solutions could be subject to regulation by the U.S. Food and Drug Administration or similar foreign agencies, which could increase our operating costs.

We provide devices that may be, or may become, subject to regulation by the U.S. Food and Drug Administration, or FDA, and similar agencies in other countries, or the jurisdiction of these agencies could be expanded in the future to include our solutions. The FDA regulates certain products, including software-based products, as “medical devices” based, in part, on the intended use of the product and the risk the device poses to the patient should the device fail to



perform properly. Although we have concluded that our wireless badge is a general-purpose communications device not subject to FDA regulation, the FDA could disagree with our conclusion, or changes in our solutions or the FDA's evolving regulation could lead to FDA regulation of our solutions. Many other countries in which we sell or may sell our solutions could also have similar regulations applicable to our solutions, some of which may be subject to change or interpretation. We may incur substantial operating costs if we are required to register our solutions or components of our solutions as regulated medical devices under U.S. or foreign regulations, obtain premarket approval from the FDA or foreign regulatory agencies, and satisfy the extensive reporting requirements. In addition, failure to comply with these regulations could result in enforcement actions and monetary penalties.

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

Our solutions are utilized by healthcare professionals and others in the course of providing patient care. It is possible that patients, family members, physicians, nurses or others may allege we are responsible for harm to patients or healthcare professionals due to defects in, the malfunction of, the characteristics of, or the operation of, our solutions. Any such allegations could harm our reputation and ability to sell our solutions.

Components of our solutions utilizing Wi-Fi also emit radio frequency, or RF, energy. RF emissions have been alleged, in connection with cellular phones, to have adverse health consequences. While these components of our solutions comply with guidelines applicable to such emissions, some may allege that these components of our solutions cause adverse health consequences or applicable guidelines may change making these components of our solutions non-compliant. Regulatory agencies in the United States and other countries in which we do or plan to do business may implement regulations concerning RF emissions standards. In addition, healthcare professionals have alleged and may allege in the future that magnets in our badges may emit electromagnetic radiation or otherwise interfere with implanted medical or other devices. Any such allegations or non-compliance, or any regulatory developments, including any changes affecting the transmission of radio signals, could negatively impact the sales of our solutions, require costly modifications to our solutions and harm our reputation.

Although our customer agreements contain terms and conditions, including disclaimers of liability, that are intended to reduce or eliminate our potential liability, we could be required to spend significant amounts of management time and resources to defend ourselves against product liability, tort, warranty or other claims. If any such claims were to prevail, we could be forced to pay damages, comply with injunctions or stop distributing our solutions. Even if potential claims do not result in liability to us, investigating and defending against these claims could be expensive and time consuming and could divert management's attention away from our business. We maintain general liability insurance coverage, including coverage for errors and omissions; however, this coverage may not be sufficient to cover large claims against us or otherwise continue to be available on acceptable terms. Further, the insurer could attempt to disclaim coverage as to any particular claim.

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

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

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

We intend to continue to make investments to support business growth and may require additional funds to respond to business challenges, which include the need to develop new solutions or enhance existing solutions, enhance our

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

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As an “emerging growth company” under the JOBS Act, we are permitted to, and may, rely on exemptions from certain disclosure and governance requirements.

As an “emerging growth company” under the recently-enacted Jumpstart Our Business Startups Act, or JOBS Act, we are permitted to, and may, rely on exemptions from certain disclosure and governance requirements. For example, for so long as we are an emerging growth company, which can last, at most, until the first fiscal year following the fifth anniversary of our initial public offering, we will not be required to:

- have an auditor report on our internal control over financial reporting pursuant to Section 404(b) of the Sarbanes-Oxley Act
- comply with any requirement that may be adopted by the Public Company Accounting Oversight Board regarding mandatory audit firm rotation or a supplement to the auditor's report providing additional information about the audit and the financial statements
- provide the “compensation discussion and analysis” and certain compensation tables for our named executive officers in our Form 10-K or annual proxy statement
- submit certain executive compensation matters to stockholder advisory votes, such as “say on pay” and “say on frequency”

Although we may rely on the exemptions provided in the JOBS Act, the exact implications of the JOBS Act for us are still subject to interpretations and guidance by the Securities and Exchange Commission and other regulatory agencies. Also, as our business grows, we may no longer satisfy the conditions of an emerging growth company.

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

As a public company, we will continue to incur substantial legal, accounting and other expenses that we did not incur as a private company. We will continue to incur substantial expenses even though we as an “emerging growth company” may rely upon the disclosure and governance exemptions under the JOBS Act. The Sarbanes-Oxley Act of 2002, as well as rules subsequently implemented by the Securities and Exchange Commission and our stock exchange, have imposed various requirements on public companies, including requiring changes in corporate governance practices. Our management and other personnel will need to devote a substantial amount of time to these compliance requirements and any new requirements that the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 may impose on public companies. Moreover, these rules and regulations, along with compliance with accounting principles and regulatory interpretations of such principles, as amended by the JOBS Act, have increased and will continue to increase our legal, accounting and financial compliance costs and have made and will continue to make some activities more time-consuming and costly. For example, we expect these rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantial costs to maintain the same or similar coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors or our board committees, or as executive officers. We will evaluate the need to hire additional accounting and financial staff with appropriate public company experience and technical accounting and financial knowledge.

If we do not remediate a material weakness in our internal control over financial reporting or are unable to implement and maintain effective internal control over financial reporting or disclosure controls and procedures in the future, the accuracy and timeliness of our financial reporting may be adversely affected.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our financial statements will not be prevented or detected and corrected on a timely basis.

In connection with our preparation of the financial statements for six months ended June 30, 2012, adjustments to our financial statements were identified which resulted from a control deficiency that we considered to constitute a

material weakness. This control deficiency related to the design and operation of controls for the preparation of the statement of cash flows as we did not maintain effective controls to ensure the accuracy and appropriate presentation and disclosure of the statement of cash flows. Specifically, the controls were not designed to consider non-cash activity related to issuance costs from the completion of our initial public offering. The material weakness resulted in material errors and adjustments to cash flows from operating and financing activities included within the condensed consolidated financial information for the period ended June 30, 2012. Additionally, this material weakness could result in a misstatement of our financial statements or disclosures that could result in a material misstatement of our interim condensed consolidated financial statements and/or year-end consolidated financial statements that may not be prevented or detected.

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In response to the identified material weakness in the Statement of Cash Flows, our management, with oversight from our Audit Committee, is executing the following remediation steps, beginning with the three months ended September 30, 2012. These ongoing efforts are focused on (i) redesigning the statement of cash flow spreadsheet, specifically related to non-cash items; (ii) adopting an enhanced secondary review of the statement of cash flows, by agreeing each movement to supporting schedule and recalculating the amounts in the worksheet; and (iii) employing the services of external consultants to assist with the completion of the review.

We believe these steps, when they are fully implemented will address the material weakness previously identified and will enhance our internal control over financial reporting, as well as our disclosure controls and procedures; however, there can be no absolute assurance that these efforts will permanently remediate this material weakness. As efforts continue to evaluate and enhance internal control over financial reporting, we may determine that additional measures must be taken to address this control deficiency or may determine that we need to modify or otherwise adjust the remediation measures described above.

The Sarbanes-Oxley Act requires, among other things, that we assess the effectiveness of our internal control over financial reporting annually and disclosure controls and procedures quarterly. In particular, beginning with the year ending on December 31, 2013, we must perform system and process evaluation and testing of our internal control over financial reporting to allow management to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act (the "Act"). If other material weaknesses are identified in the future or we are not able to comply with the requirements of Section 404 in a timely manner, our reported financial results could be materially misstated or could be restated, we could receive an adverse opinion regarding our controls from our accounting firm (once such opinion is required under the Act) and we could be subject to investigations or sanctions by regulatory authorities, which would require additional financial and management resources, and the market price of our stock could decline.

Risks related to our common stock

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

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

- actual or anticipated variation in anticipated operating results of us or our competitors
- the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections
- announcements by us or our competitors of new solutions, new or terminated significant contracts, commercial relationships or capital commitments
- failure of securities analysts to maintain coverage of us, changes in financial estimates by any securities analysts who follow our company, or our failure to meet these estimates or the expectations of investors
- developments or disputes concerning our intellectual property or other proprietary rights
- commencement of, or our involvement in, litigation
- announced or completed acquisitions of businesses, technologies or assets by us or our competitor
- changes in operating performance and stock market valuations of other technology companies generally, or those in our industry in particular
- price and volume fluctuations attributable to inconsistent trading volume levels of our common stock
- our public float relative to the total number of shares of our common stock that are issued and outstanding
- price and volume fluctuations in the overall stock market, including as a result of trends in the economy as a whole
- rumors and market speculation involving us or other companies in our industry
- any major change in our management
- unfavorable economic conditions and slow or negative growth of our markets

Other events or factors, including those resulting from war or incidents of terrorism

In addition, in the past, following periods of volatility in the overall market and the market price of a particular company's securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management's attention and resources.

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

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

The concentration of our capital stock ownership with insiders will likely limit your ability to influence corporate matters.

Our executive officers, directors, current 5% or greater stockholders and entities affiliated with any of them together beneficially own approximately 46% of our common stock outstanding as of September 30, 2012. These stockholders, if they act together, will have significant influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, and may take actions that may not be in the best interests of our other stockholders. This concentration of ownership could also limit stockholders' ability to influence corporate matters. Accordingly, corporate actions might be taken even if other stockholders, including you, oppose them, or may not be taken even if other stockholders view them as in the best interests of our stockholders. This concentration of ownership may have the effect of delaying or preventing a change of control of our company, may make the approval of certain transactions difficult or impossible without the support of these stockholders and might adversely affect the market price of our common stock.

Our management has broad discretion over the use of proceeds from our public offerings and might not apply the proceeds of our public offerings in ways that increase the value of your investment in our company.

Our management has broad discretion to use the net proceeds to us from our initial public offering and our secondary public offering, and you are relying on the judgment of our management regarding the application of these proceeds, without the opportunity to assess whether the proceeds are being used appropriately. The failure of our management to apply the \$70.5 million net proceeds of our initial public offering and the \$36.0 million net proceeds from our secondary public offering effectively could harm our business, financial condition and operating results, and may not increase the value of your investment in our company. Largely as a result of these public offerings, we had \$121.0 million invested in cash, cash equivalents, and short-term investments at September 30, 2012.

We have not allocated these net proceeds for specific purposes other than allocating a portion of the proceeds from our initial public offering to the repayment in full of outstanding borrowings under our credit facility, which we repaid in April 2012. We intend to use the net proceeds from our public offerings for general corporate and working capital purposes. We may also use a portion of the net proceeds to acquire or invest in complementary businesses, technologies or assets, but at this time, we have no current understandings, agreements or commitments to do so. Our management might not be able to yield a significant return or any return on any investment of these net proceeds. Our stock price could decline due to the substantial number of outstanding shares of our common stock eligible for future sale.

As of September 30, 2012, a substantial number of our issued and outstanding shares were restricted by securities laws, lock-up agreements and other contractual restrictions that restrict sales and other transfers. The 180-day lock-up period related to our initial public offering terminated on September 23, 2012 and the 60-day lock-up period related to our secondary offering terminated on November 5, 2012. If the holders of the shares that were previously subject to these restrictions sell, or indicate an intention to sell, substantial amounts of our common stock could be available for sale for the first time in the public market, and the trading price of our common stock could decline. Shares held by directors, executive officers and other affiliates are subject to volume limitations under Rule 144 of the Securities Act



and various vesting agreements. Shares subject to outstanding warrants and shares subject to outstanding options and reserved for future issuance under our stock option and purchase plans will also become eligible for sale in the public market to the extent permitted by the provisions of various vesting agreements and Rules 144 and 701 under the Securities Act.

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

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

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

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

- authorize the issuance of “blank check” preferred stock that our board of directors could issue to increase the number of outstanding shares and to discourage a takeover attempt
- prohibit stockholder action by written consent, requiring all stockholder actions to be taken at a meeting of stockholders
- establish advance notice procedures for nominating candidates to our board of directors or proposing matters that can be acted upon by stockholders at stockholder meetings
- limit the ability of our stockholders to call special meetings of stockholders
- prohibit stockholders from cumulating their votes for the election of directors
- permit newly created directorships resulting from an increase in the authorized number of directors or vacancies on our board of directors to be filled only by majority vote of our remaining directors, even if less than a quorum is then in office
- provide that our board of directors is expressly authorized to make, alter or repeal our bylaws
- establish a classified board of directors so that not all members of our board are elected at one time
- provide that our directors may be removed only for “cause” and only with the approval of the holders of at least 66 2/3rds percent of our outstanding stock
- require super-majority voting to amend certain provisions in our certificate of incorporation and bylaws

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

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

Use of Proceeds from Public Offering of Common Stock

Our initial public offering of common stock was effected through a Registration Statement on Form S-1 (File No. 333-175932) that was declared effective by the Securities and Exchange Commission on March 27, 2012, and a Registration Statement on Form S-1 (File No. 333-180389) under Rule 462(b) of the Securities Act that became effective upon its filing. The securities registered were 6,727,500 shares of common stock, of which 5,000,000 shares were sold by us and 850,000 shares were sold by selling stockholders, plus 877,500 additional shares to cover the underwriters’ over-allotment option, all of which were sold by selling stockholders. On April 2, 2012, we closed the initial public offering, in which all shares of common stock that were registered were sold and, on April 2, 2012, we closed the underwriters’ over-allotment option, which the underwriters exercised in full. These sales were at the initial public offering price of \$16.00 per share, for an aggregate gross offering price of \$80.0 million for the shares sold by our company, and \$27.6 million for the shares sold by selling stockholders. We did not receive any proceeds from the sale of securities by selling stockholders. J.P. Morgan Securities LLC, Piper Jaffray & Co., Robert W. Baird & Co. Incorporated, William Blair & Company, L.L.C., Wells Fargo Securities, LLC and Leerink Swann LLC were the underwriters for the offering. Following the sale of the shares in connection with the closing of the initial public offering, the offering terminated.

We paid to the underwriters underwriting discounts and commissions totaling approximately \$5.6 million, and we incurred additional costs of approximately \$3.9 million, in connection with the offering, which amounted to total fees and costs of approximately \$9.5 million. Thus, the net offering proceeds to us, after deducting underwriting discounts and commissions and offering costs, were approximately \$70.5 million. No offering costs were paid directly or indirectly to any of our directors or officers (or their associates) or persons owning ten percent or more of any class of our equity securities or to any other affiliates, other than reimbursement of legal expenses for selling stockholders.

There has been no material change in the planned use of proceeds from our initial public offering as described in our final prospectus filed with the Securities and Exchange Commission on March 28, 2012 pursuant to Rule 424(b). On April 3, 2012, we paid off the remaining debt and revolving line of credit.

Issuer Purchases of Equity Securities

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The table below provides information with respect to repurchases of unvested shares of our common stock made pursuant to our 2000 Stock Option Plan, as amended, and our 2006 Stock Option Plan, as amended. All shares in the table below were shares repurchased as a result of us exercising our right of repurchase for unvested shares under our stock option plans and not pursuant to a publicly announced plan or program.

Period	Total Number of Shares Purchased(1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
July 1 - July 31, 2012	—	—	—	—
August 1 - August 31, 2012	—	—	—	—
September 1 - September 30, 2012	139	1.08	—	—
Total	139	\$ 1.08	—	—

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

None.

## Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit

Number

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

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

†† In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

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SIGNATURES

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

Date: November 13, 2012

By: /S/ Robert J. Zollars  
Robert J. Zollars  
Chief Executive Officer  
(Principal Executive Officer)

Date: November 13, 2012

By: /S/ William R. Zerella  
William R. Zerella  
Chief Financial Officer  
(Principal Financial Officer)

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EXHIBIT INDEX

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