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

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2013
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from to
Commission File Number: 001-35469

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

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

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer | ¨ | Accelerated filer | ¨ |
| Non-accelerated filer | x | Smaller reporting company | ¨ |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding at May 2, 2013 |
|---|---|

| | |
|---|---|
| Common Stock, $0.0003 par value per share | 24,501,724 shares |

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VOCERA COMMUNICATIONS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2013
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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)
Vocera Communications, Inc.
Condensed Consolidated Balance Sheets
(In Thousands, Except Share and Par Amounts)
(Unaudited)

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | $116,407 | $92,521 |
| Short-term investments | 10,000 | 34,989 |
| Accounts receivable, net of allowance of $23 and $0 at March 31, 2013 and December 31, 2012, respectively | 14,886 | 21,697 |
| Other receivables | 333 | 550 |
| Inventories | 4,565 | 2,772 |
| Prepaid expenses and other current assets | 3,719 | 2,808 |
| Total current assets | 149,910 | 155,337 |
| Property and equipment, net | 4,713 | 3,631 |
| Intangible assets, net | 2,087 | 2,267 |
| Goodwill | 5,575 | 5,575 |
| Other long-term assets | 515 | 495 |
| Total assets | $162,800 | $167,305 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities | | |
| Accounts payable | $3,021 | $2,854 |
| Accrued payroll and other liabilities | 7,572 | 11,754 |
| Deferred revenue, current | 21,748 | 22,451 |
| Total current liabilities | 32,341 | 37,059 |
| Deferred revenue, long-term | 5,410 | 5,882 |
| Other long-term liabilities | 1,269 | 1,239 |
| Total liabilities | 39,020 | 44,180 |
| Commitments and contingencies (Note 7) | | |
| Stockholders' equity | | |
| Preferred stock, $0.0003 par value - 5,000,000 shares authorized as of March 31, 2013 and December 31, 2012; zero shares issued and outstanding | — | — |
| Common stock, $0.0003 par value - 100,000,000 shares authorized as of March 31, 2013 and December 31, 2012; 24,481,612 and 24,229,356 shares issued and outstanding as of March 31, 2013 and December 31, 2012, respectively | 7 | 7 |
| Additional paid-in capital | 181,239 | 177,081 |
| Accumulated other comprehensive income | 1 | 5 |
| Accumulated deficit | (57,467) | (53,968) |
| Total stockholders’ equity | 123,780 | 123,125 |
| Total liabilities and stockholders’ equity | $162,800 | $167,305 |

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

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

| | Three months ended March 31, 2013 | 2012 |
|---|---|---|
| Revenue | | |
| Product | $12,960 | $14,637 |
| Service | 9,453 | 8,482 |
| Total revenue | 22,413 | 23,119 |
| Cost of revenue | | |
| Product | 4,610 | 5,429 |
| Service | 4,084 | 3,569 |
| Total cost of revenue | 8,694 | 8,998 |
| Gross profit | 13,719 | 14,121 |
| Operating expenses | | |
| Research and development | 3,614 | 2,511 |
| Sales and marketing | 10,232 | 7,530 |
| General and administrative | 3,298 | 3,087 |
| Total operating expenses | 17,144 | 13,128 |
| (Loss) income from operations | (3,425) | 993 |
| Interest income | 24 | 12 |
| Interest expense and other finance charges | — | (71) |
| Other expense, net | (47) | (1,597) |
| Loss before income taxes | (3,448) | (663) |
| Provision for income taxes | (51) | (173) |
| Net loss | $(3,499) | $(836) |
| Net loss per share attributable to common stockholders | | |
| Basic and diluted | $(0.14) | $(0.23) |
| Weighted average shares used to compute net loss per share attributable to common stockholders | | |
| Basic and diluted | 24,282 | 3,661 |

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

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Vocera Communications, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(In Thousands)
(Unaudited)

| | Three months ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Net loss | $(3,499) | $(836) |
| Other comprehensive loss, net: | | |
| Decrease in unrealized gain on investments, net | (4) | — |
| Comprehensive loss | $(3,503) | $(836) |

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)

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | | 2012 | |
| Cash flows from operating activities | | | | |
| Net loss | $(3,499 | ) | $(836 | ) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | | | |
| Depreciation and amortization | 536 | | 553 | |
| Change in non-cash interest | 14 | | — | |
| Loss on disposal of property and equipment | — | | 3 | |
| Allowance for doubtful accounts | 23 | | — | |
| Inventory write-down | 26 | | 4 | |
| Stock-based compensation expense | 1,704 | | 317 | |
| Non-employee stock-based compensation expense | — | | 29 | |
| Excess tax benefits from employee stock plans - operating | (257 | ) | — | |
| Change in fair value of warrant liability | — | | 1,706 | |
| Changes in operating assets and liabilities: | | | | |
| Accounts receivable | 6,789 | | (45 | ) |
| Other receivables | 115 | | (161 | ) |
| Inventories | (1,819 | ) | 264 | |
| Prepaid expenses and other assets | (932 | ) | (747 | ) |
| Accounts payable | 133 | | (1,942 | ) |
| Accrued and other liabilities | (3,844 | ) | 94 | |
| Deferred revenue | (1,175 | ) | 1,029 | |
| Net cash (used in) provided by operating activities | (2,186 | ) | 268 | |
| Cash flows from investing activities | | | | |
| Purchase of property and equipment | (1,502 | ) | (545 | ) |
| Maturities of short-term investments | 24,971 | | — | |
| Net cash provided by (used in) investing activities | 23,469 | | (545 | ) |
| Cash flows from financing activities | | | | |
| Cash from lease-related performance obligations | 106 | | — | |
| Principal payments on long-term borrowings | — | | (500 | ) |
| Payment for repurchase of early exercised options | (3 | ) | (6 | ) |
| Excess tax benefits from employee stock plans - financing | 257 | | — | |
| Proceeds from issuance of common stock from the employee stock purchase plan | 1,596 | | — | |
| Proceeds from exercise of stock options | 421 | | 288 | |
| Proceeds from exercise of common stock warrants | 226 | | — | |
| Common stock issuance costs | — | | (250 | ) |
| Net cash provided by (used in) financing activities | 2,603 | | (468 | ) |
| Net increase (decrease) in cash and cash equivalents | 23,886 | | (745 | ) |
| Cash and cash equivalents at beginning of period | 92,521 | | 14,898 | |
| Cash and cash equivalents at end of period | $116,407 | | $14,153 | |
| | | | | |
| Supplemental disclosure of non-cash investing and financing activities: | | | | |
| | $— | | $1,988 | |

| | | |
|---|---|---|
| Costs related to the initial public offering in accounts payable and accrued liabilities | | |
| Property and equipment in accounts payable and accrued liabilities | 257 | 116 |

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 was incorporated in Delaware on February 16, 2000. The Company formed wholly-owned subsidiaries Vocera Communications UK Ltd and Vocera Communications Australia Pty Ltd. in 2005, and Vocera Hand-Off, Inc., Vocera Canada, Ltd. and ExperiaHealth, Inc. in 2010.

The Company completed its initial public offering (“IPO”) of common stock on April 2, 2012 in accordance with the Securities Act of 1933, as amended ("Securities Act"). The Company sold 5,000,000 shares and certain of its stockholders sold 1,727,500 shares, including 877,500 shares for the underwriters' over-allotment option, through a firm commitment underwritten, public offering. The shares were sold at the initial public offering price of $16.00 per share, before underwriting discounts and commissions and offering costs. The Company recorded proceeds of $70.5 million for the IPO, net of offering expenses and underwriters' discounts and commissions.

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

Basis of presentation

The Company’s unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the U.S. Securities and Exchange Commission, and include the accounts of Vocera and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated. Certain information and note disclosures normally included in the financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these unaudited interim condensed consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company’s interim consolidated financial information. The results for the quarter presented are not necessarily indicative of the results to be expected for the year ending December 31, 2013 or for any other interim period or any other future year. Certain prior period amounts have been reclassified to be consistent with current period presentation.

Use of Estimates

The preparation of the accompanying unaudited condensed consolidated financial statements in conformity with U.S. GAAP requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting periods. The estimates include, but are not limited to, revenue recognition, useful lives assigned to long-lived assets, warranty reserves, stock-based compensation expense, provisions for income taxes and contingencies. Actual results could differ from these estimates, and such differences could be material to the Company’s financial position and results of operations.

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Fair Value of Financial Instruments

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

Cash Equivalents and Short-term Investments

The Company’s cash equivalents and short-term investments consist of money market funds, commercial paper 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. Investments with an original purchase maturity of less than three months are classified as cash equivalents, those with longer maturities are classified as short-term investments. As of March 31, 2013 and December 31, 2012, all of the Company's available-for-sale securities had maturities of less than one year.

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. The Company's revenue recognition policy has not changed from that described in its Annual Report on Form 10-K for the year ended December 31, 2012.

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

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

For the three months ended March 31, 2013, the Company transferred $0.3 million of lease receivables and recorded $0.1 million of financing liabilities for future performance of executory service obligations. For lease receivables retained as of March 31, 2013, 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 Financial Accounting Standards Board ("FASB") issued new disclosure guidance related to the presentation of the statement of comprehensive income. This guidance eliminated the previous option to report other comprehensive income, or OCI, and its components in the consolidated statement of stockholders' equity. The Company adopted this accounting standard effective January 1, 2012; the adoption had no material impact on the financial position or results of operations of the Company. In February 2013, the FASB resolved the deferred guidance on OCI reclassifications with a new rule effective in the first quarter of 2013, which was adopted but did not have any material impact.

2. Fair value of financial instruments

The Company’s cash and cash equivalents and short-term investments are carried at their fair values, usually with immaterial differences from their amortized cost, 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 three months ended March 31, 2013 there have been no transfers between Level 1 and Level 2 fair value instruments and no transfers in or out of Level 3.

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The Company's money market funds are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. The Company's other cash equivalents and short-term investments are classified within Level 2 of the fair value hierarchy because they are valued by professional pricing services using market-corroborated inputs from similar instruments, rather than direct observation of quoted prices in active markets. Each security is compared to a benchmark yield at the balance sheet date, with adjustment for its specific characteristics.

The Company’s assets that are measured at fair value on a recurring basis, by level, within the fair value hierarchy as of March 31, 2013 and December 31, 2012, are summarized as follows (in thousands):

| | March 31, 2013 | | | | December 31, 2012 | | | |
|---|---|---|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | | | | | |
| Money market funds | $77,542 | $— | $— | $77,542 | $45,040 | $— | $— | $45,040 |
| Commercial paper | — | — | — | — | — | 32,487 | — | 32,487 |
| U.S. government and agency securities | — | 10,000 | — | 10,000 | — | 10,001 | — | 10,001 |
| Total assets measured at fair value | $77,542 | $10,000 | $— | $87,542 | $45,040 | $42,488 | $— | $87,528 |

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

3. Cash, Cash Equivalents and Short-Term Investments

The following tables present current and prior-year-end balances for cash, cash equivalents and short-term investments (in thousands):

| | As of March 31, 2013 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair value |
| Cash and cash equivalents: | | | | |
| Demand deposits and other cash | $38,865 | $— | $— | $38,865 |
| Money market funds | 77,542 | — | — | 77,542 |
| Total cash and cash equivalents | 116,407 | — | — | 116,407 |
| | | | | |
| Short-Term Investments: | | | | |
| U.S. government and agency securities | 9,999 | 1 | — | 10,000 |
| Total short-term investments | 9,999 | 1 | — | 10,000 |
| Total cash, cash equivalents and short-term investments | $126,406 | $1 | $— | $126,407 |

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

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

4. Income (loss) per share

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

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

| | Three months ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Numerator: | | |
| Net loss | $(3,499) | $(836) |
| Denominator: | | |
| Weighted-average shares used to compute net loss per common share- basic and diluted | 24,282 | 3,661 |
| Net loss per share | | |
| Net loss per common share - basic and diluted | $(0.14) | $(0.23) |

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

| | Three months ended March 31, | |
|---|---|---|
| (in thousands) | 2013 | 2012 |
| Convertible preferred stock (on an if converted basis) | — | 12,938 |
| Options to purchase common stock | 3,180 | 3,682 |
| Common stock subject to repurchase | 36 | 195 |
| Warrants to purchase convertible preferred stock | — | 187 |
| Warrants to purchase common stock | 44 | — |

| | | |
|---|---|---|
| Restricted stock units | 441 | — |
| Restricted stock awards | 12 | — |

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## 5. Goodwill and intangible assets

### Goodwill

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

### Intangible assets

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

| | | March 31, 2013 | | | December 31, 2012 | | |
|---|---|---|---|---|---|---|---|
| (in thousands) | Weighted Average Useful Life (years) | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Customer relationships | 9 | $2,350 | $1,201 | $1,149 | $2,350 | $1,117 | $1,233 |
| Developed technology | 6 | 1,880 | 988 | 892 | 1,880 | 896 | 984 |
| Trademarks | 7 | 70 | 33 | 37 | 70 | 30 | 40 |
| Non-compete agreements | 2 | 70 | 61 | 9 | 70 | 60 | 10 |
| Intangible assets | | $4,370 | $2,283 | $2,087 | $4,370 | $2,103 | $2,267 |

Amortization expense was $0.2 million and $0.2 million for the three months ended March 31, 2013 and March 31, 2012, respectively.

Amortization of acquired intangible assets is reflected in cost of revenue and operating expenses. The estimated future amortization of existing acquired intangible assets as of March 31, 2013 was as follows (in thousands):

| (in thousands) | Future amortization |
|---|---|
| 2013 (remaining nine months) | $547 |
| 2014 | 567 |
| 2015 | 389 |
| 2016 | 258 |
| 2017 | 156 |
| Thereafter | 170 |
| Future amortization expense | $2,087 |

## 6. Balance Sheet Components

### Inventories

| (in thousands) | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Raw materials | $815 | $23 |
| Finished goods | 3,750 | 2,749 |
| Total inventories | $4,565 | $2,772 |

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Property and Equipment

| (in thousands) | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Computer equipment and software | $4,281 | $4,127 |
| Furniture, fixtures and equipment | 886 | 886 |
| Leasehold improvements | 1,663 | 1,654 |
| Manufacturing tools and equipment | 2,784 | 2,710 |
| Construction in process | 2,301 | 1,100 |
| Property and equipment, at cost | 11,915 | 10,477 |
| Less: Accumulated depreciation | (7,202) | (6,846) |
| Property and equipment, net | $4,713 | $3,631 |

Depreciation and amortization expense was $0.4 million and $0.3 million for the three months ended March 31, 2013 and March 31, 2012, respectively.

Accrued payroll and other liabilities

| (in thousands) | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Payroll and related expenses | $3,925 | $7,845 |
| Accrued payables | 1,551 | 1,823 |
| Deferred rent, current portion | 610 | 591 |
| Lease financing, current portion | 302 | 213 |
| Product warranty | 207 | 297 |
| Exercise of unvested stock options | 160 | 198 |
| Customer prepayments | 188 | 115 |
| Sales and use tax payable | 348 | 323 |
| Other | 281 | 349 |
| Total accrued payroll and other liabilities | $7,572 | $11,754 |

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

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

| | Three months ended March 31, | |
|---|---|---|
| (in thousands) | 2013 | 2012 |
| Balance at the beginning of the period | $297 | $983 |
| Warranty expense accrued for shipments in period | 74 | 354 |
| Changes in liability related to pre-existing warranties | 49 | 149 |
| Warranty settlements made | (213) | (257) |
| Balance at the end of the period | $207 | $1,229 |

7. Commitments and contingencies

The Company undertakes, in the ordinary course of business, to (i) defend customers and other parties from certain third-party claims associated with allegations of trade secret misappropriation, infringement of copyright, patent or other intellectual property right, or tortious damage to persons or property and (ii) indemnify and hold harmless such parties from certain resulting damages, costs and other liabilities. The term of these undertakings may be perpetual and the maximum potential liability of the Company under certain of these undertakings is not determinable. 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 March 31, 2013 and December 31, 2012, approximately $4.1 million and $4.1 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 April 2014 and April 2017. The Company recognizes rent expense on a straight-line basis over the lease period, and has accrued for rent expense incurred but not paid.

Future minimum lease payments at March 31, 2013 under non-cancelable operating leases are as follows (in thousands):

| (in thousands) | Operating leases |
|---|---|
| 2013 (remaining nine months) | $1,194 |
| 2014 | 1,545 |
| 2015 | 1,480 |
| 2016 | 440 |
| 2017 and thereafter | 30 |
| Total minimum lease payments | $4,689 |

8. Stock-based Compensation and Awards

Equity Incentive Plans

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

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 March 31, 2013 and December 31, 2012, 35,585 and 48,260 shares held by employees were subject to repurchase at an aggregate price of $0.2 million and $0.2 million, respectively.

Cash exercise of common stock warrants

During the three months ended March 31, 2013 holders of common stock warrants exercised 34,142 shares for cash proceeds of $0.2 million. There were no cash exercises in the prior year period.

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Stock Option Activity

A summary of the stock option activity for the three months ended March 31, 2013 is presented below:

| | Options outstanding | | | | |
|---|---|---|---|---|---|
| | Shares Available for Grant | Number of Options | Weighted Average Exercise Price | Weighted average remaining contractual term (in years) | Aggregate intrinsic value (in thousands) |
| Outstanding at December 31, 2012 | 460,579 | 3,187,559 | $7.51 | 6.8 | $56,362 |
| Shares added to the plan | 1,211,487 | | | | |
| Options granted | (108,145) | 108,145 | 25.98 | | |
| Options exercised | — | (103,822) | 3.07 | | |
| Options canceled | 11,529 | (11,529) | 11.94 | | |
| Options expired | 229 | (229) | 11.10 | | |
| Early exercised options repurchased and added back to the pool | 1,492 | — | | | |
| Outstanding at March 31, 2013 | 1,577,171 | 3,180,124 | $8.26 | 6.7 | $48,104 |

The cash received for exercises of stock options during the three months ended March 31, 2013 includes the collection of approximately $0.1 million classified in other receivables at December 31, 2012.

At March 31, 2013, there was $7.7 million of unrecognized net compensation cost related to options which is expected to be recognized over a weighted-average period of 2.6 years. The Company did not grant non-employee options in either of the three months ended March 31, 2013 or 2012.

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

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

| | Three months ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Expected Term (in years) | 5.43 | 5.60 |
| Volatility | 48.1% | 47.9% |
| Risk-free interest rate | 0.81% | 1.03% |
| Dividend yield | 0% | 0% |

Employee Stock Purchase Plan

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

At the end of each offering period, employees are able to purchase shares at 85% of the lower of the fair market value of the Company's common stock on the first trading day of the offering period or on the last day of the offering period. On the initial purchase date during the three months ended March 31, 2013, employees purchased 115,784 shares of common stock at an average exercise price of $13.79. As of March 31, 2013, there were 293,175 shares which remained available for future issuance under the ESPP.

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

| | Three months ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Expected Term (in years) | 0.50 | 0.88 |
| Volatility | 33.3% | 50.8% |
| Risk-free interest rate | 0.13% | 0.18% |
| Dividend yield | 0% | 0% |

Restricted Stock Awards and Restricted Stock Units

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

A summary of restricted stock activity for the three months ended March 31, 2013 is presented below:

| | Restricted Stock Awards | | Restricted Stock Units | |
|---|---|---|---|---|
| | Number of shares | Weighted Average Grant Date Fair Value per Share | Number of shares | Weighted Average Grant Date Fair Value per Share |
| Outstanding at December 31, 2012 | 24,152 | $12.42 | 373,908 | $25.34 |
| Granted | — | — | 78,149 | 25.99 |
| Vested | (12,076) | 12.42 | — | — |
| Forfeited | — | — | (10,939) | 25.37 |
| Outstanding at March 31, 2013 | 12,076 | $12.42 | | |