VOCERA COMMUNICATIONS, INC.
Form 10-Q
November 01, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

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

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

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

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

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

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

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

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

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

Class	Outstanding as of October 30, 2017
Common Stock, $0.0003 par value per share	29,216,913

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FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2017
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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, 2017	December 31, 2016
Assets		
Current assets		
Cash and cash equivalents	$ 14,840	$ 35,033
Short-term investments	52,652	39,033
Accounts receivable, net of allowance	35,453	24,142
Other receivables	1,115	1,211
Inventories	3,115	4,556
Prepaid expenses and other current assets	4,758	3,364
Total current assets	111,933	107,339
Property and equipment, net	6,073	5,894
Intangible assets, net	14,658	18,200
Goodwill	49,246	49,246
Other long-term assets	1,537	1,394
Total assets	$ 183,447	$ 182,073
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	$ 2,790	$ 3,231
Accrued payroll and other current liabilities	16,050	15,896
Deferred revenue, current	41,559	43,845
Total current liabilities	60,399	62,972
Deferred revenue, long-term	17,577	11,155
Other long-term liabilities	5,084	4,505
Total liabilities	83,060	78,632
Commitments and contingencies (Note 7)		
Stockholders' equity		
Preferred stock, $0.0003 par value - 5,000,000 shares authorized as of September 30, 2017 and December 31, 2016; zero shares issued and outstanding	—	—
Common stock, $0.0003 par value - 100,000,000 shares authorized as of September 30, 2017 and December 31, 2016; 29,208,322 and 27,568,103 shares issued and outstanding as of September 30, 2017 and December 31, 2016, respectively	9	8
Additional paid-in capital	244,827	230,605
Accumulated other comprehensive loss	(93)	(69)
Accumulated deficit	(144,356)	(127,103)
Total stockholders’ equity	100,387	103,441
Total liabilities and stockholders’ equity	$ 183,447	$ 182,073

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Revenue				
Product	$23,249	$19,303	$63,940	$50,807
Service	19,051	14,452	53,105	40,877
Total revenue	42,300	33,755	117,045	91,684
Cost of revenue				
Product	7,208	6,042	20,424	16,435
Service	9,241	6,253	28,358	18,037
Total cost of revenue	16,449	12,295	48,782	34,472
Gross profit	25,851	21,460	68,263	57,212
Operating expenses				
Research and development	6,644	4,286	20,944	12,686
Sales and marketing	15,831	13,305	45,789	38,078
General and administrative	6,088	5,138	17,767	14,099
Total operating expenses	28,563	22,729	84,500	64,863
Loss from operations	(2,712)	(1,269)	(16,237)	(7,651)
Interest income	177	196	410	573
Other income (expense), net	(41)	(75)	1	(226)
Loss before income taxes	(2,576)	(1,148)	(15,826)	(7,304)
Provision for income taxes	(309)	(49)	(1,050)	(183)
Net loss	$(2,885)	$(1,197)	$(16,876)	$(7,487)
Net loss per share				
Basic and diluted	$(0.10)	$(0.04)	$(0.59)	$(0.28)
Weighted average shares used to compute net loss per share				
Basic and diluted	29,130	27,024	28,439	26,675

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 September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net loss	$(2,885)	$(1,197)	$(16,876)	$(7,487)
Other comprehensive loss, net:				
Change in unrealized gain (loss) on investments, net of tax	(15)	(106)	(24)	104
Comprehensive loss	$(2,900)	$(1,303)	$(16,900)	$(7,383)

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,	
	2017	2016
Cash flows from operating activities		
Net loss	$(16,876)	$(7,487)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,755	2,271
Inventory provision	179	125
Change in lease-related performance obligations	(598)	(631)
Stock-based compensation expense	13,204	8,591
Other	28	(57)
Changes in operating assets and liabilities:		
Accounts receivable	(11,310)	4,833
Other receivables	96	140
Inventories	1,262	(1,496)
Prepaid expenses and other assets	(1,539)	(690)
Accounts payable	(436)	(414)
Accrued payroll and other liabilities	925	239
Deferred revenue	4,137	2,225
Net cash provided by (used in) operating activities	(5,173)	7,649
Cash flows from investing activities		
Purchase of property and equipment	(2,420)	(3,888)
Purchase of short-term investments	(59,608)	(82,941)
Maturities of short-term investments	45,963	93,925
Sales of short-term investments	—	4,876
Net cash provided by (used in) investing activities	(16,065)	11,972
Cash flows from financing activities		
Cash from lease-related performance obligations	347	1,457
Proceeds from issuance of common stock from the employee stock purchase plan	1,246	786
Proceeds from exercise of stock options	7,145	1,117
Tax withholdings paid on behalf of employees for net share settlement	(7,693)	(2,453)
Net cash provided by financing activities	1,045	907
Net increase (decrease) in cash and cash equivalents	(20,193)	20,528
Cash and cash equivalents at beginning of period	35,033	20,572
Cash and cash equivalents at end of period	$14,840	$41,100
Supplemental disclosure of non-cash investing and financing activities:		
Property and equipment in accounts payable and accrued liabilities	$40	$390

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

Notes to Unaudited Condensed Consolidated Financial Statements

1. The Company and Summary of Significant Accounting Policies

Organization and Business

Vocera Communications, Inc. and its subsidiaries (the "Company" or "Vocera") is a provider of secure, integrated, intelligent communication and clinical workflow solutions, focused on empowering mobile workers in healthcare, hospitality, energy and other mission-critical mobile work environments, in the United States and internationally. The significant majority of the Company's business is generated from sales of its solutions in the healthcare market to help its customers improve quality of care, patient and staff experience and increase operational efficiency.

The Vocera Communication System, which includes an intelligent enterprise software platform, a lightweight, wearable, voice-controlled communication badge and smartphone applications, enables users to connect instantly with other staff simply by saying the name, function or group name of the desired recipient. It also securely delivers text messages and alerts directly to and from smartphones, replacing legacy pagers. The Company's new Engage software is an event-driven, communication and workflow collaboration solution for the hospital environment. It features an advanced clinical rules engine and interoperates with data from multiple clinical systems. This enables the prioritization of notifications, including patient context, and sends messages to the right care team members on their mobile devices. The Company's software applications help improve care coordination, patient safety and patient satisfaction.

Basis of Presentation

The Company's unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the U.S. Securities and Exchange Commission, and include the accounts of Vocera and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated. Certain information and disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these unaudited interim condensed consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2016. The year-end condensed balance sheet data was derived from the Company's audited financial statements, but does not include all disclosures required by GAAP.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company's interim consolidated financial information. The results for the quarter presented are not necessarily indicative of the results to be expected for the year ending December 31, 2017 or for any other interim period or any other future year.

The accounting policies followed in the preparation of these financial statements are consistent in all material respects with those presented in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Use of Estimates

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

Revenue Recognition

The Company derives revenue from the sales of communication badges, perpetual software licenses for software that is essential to the functionality of the communication badges, smartphones, software maintenance, extended product warranty and professional services. The Company also derives revenue from the sale of licenses for software that is not essential to the functionality of the communication badges, which may include Clinical Integration and Vocera smartphone applications as well as certain subscription-based revenues including Vocera Care Experience. The Company’s revenue recognition policy has not changed from that described in its Annual Report on Form 10-K for the year ended December 31, 2016.

Transfer of sales-type leases to third-parties

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

For the nine months ended September 30, 2017 and 2016, the Company transferred $0.6 million and $3.3 million, respectively, of lease receivables in non-recourse sales to third-party financial companies, with immaterial net losses. For the nine months ended September 30, 2017 and 2016, the Company recorded $0.5 million and $1.5 million, respectively, of financing liabilities for future performance of executory service obligations. For lease receivables retained as of September 30, 2017 and December 31, 2016, the Company recorded $1.5 million and $1.9 million of net investment in sales-type leases, respectively, equivalent to the minimum lease payments less the unearned interest portion.

Recently Adopted Accounting Pronouncement

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

Recent Accounting Pronouncements

In May 2014, the FASB together with the International Accounting Standards Board issued converged guidance for revenue recognition that will replace most existing guidance, eliminate industry-specific guidance and provide a unified model for determining how and when revenue from contracts with customers should be recognized. Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The new guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method). The Company currently plans to adopt using the full retrospective method, however, such determination could change depending on a number of factors including system readiness, the magnitude of the potential impact on the financial results, and its ability to gather sufficient data to assess the impact on prior period financial statements timely.

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

The Company anticipates the new guidance to have a material impact on its consolidated financial statements. While the Company is continuing to assess all potential impacts of the standard, the Company currently believes the most significant impact relates to the timing of revenue recognition for software licenses sold with professional services as it did not have vendor specific objective evidence (“VSOE”) for professional services under current guidance. Under the new standard, the requirement to have VSOE for undelivered elements is eliminated and the Company will recognize revenue for software licenses upon transfer of control to its customers. Additionally, the new standard requires the capitalization and amortization of costs related to obtaining a contract which are currently expensed at the time of sale. The Company is continuing to assess the impact of this guidance on its consolidated financial statements, as well as the determination of the method of adoption.

In February 2016, the FASB amended lease accounting requirements to begin recording assets and liabilities arising from leases on the balance sheet. The new guidance will also require significant additional disclosures about the amount, timing and uncertainty of cash flows from leases. This new guidance will be effective beginning on January 1, 2019 using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. The Company has not yet determined the future effect of the standard on its financial position or results of operations.

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In June 2016, the FASB issued new guidance related to the accounting for credit losses on instruments for both financial services and non-financial services entities. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. The guidance will be effective beginning January 1, 2020. Early adoption is permitted. The Company is currently evaluating the impact of this new guidance on its consolidated financial statements.

In October 2016, the FASB issued amended guidance on the accounting for income taxes. The new guidance requires the recognition of the income tax consequences of an intercompany asset transfer, other than transfers of inventory, when the transfer occurs. The guidance will be effective for reporting periods beginning after December 15, 2017, with early adoption permitted. The Company is currently evaluating the impact of this new guidance on its consolidated financial statements, but does not expect that it will have a material impact on its consolidated financial statements.

In January 2017, the FASB issued new guidance which clarifies the definition of a business to assist companies with evaluating whether transactions should be accounted for as acquisitions of assets or businesses. The new guidance requires a company to evaluate if substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets; if so, the set of assets and activities is not a business. The guidance also requires a business to include at least one substantive process and narrows the definition of outputs by more closely aligning it with how outputs are described in the guidance for revenue from contracts with customers. The new guidance will be effective for the Company in the first quarter of 2018. Early adoption is permitted. The guidance should be applied prospectively to any transactions occurring within the period of adoption. The adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements.

In January 2017, the FASB issued new guidance to simplify the accounting for goodwill impairment. The guidance simplifies the measurement of goodwill impairment by removing step 2 of the goodwill impairment test, which requires the determination of the fair value of individual assets and liabilities of a reporting unit. The new guidance requires goodwill impairment to be measured as the amount by which a reporting unit’s carrying value exceeds its fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amendments should be applied on a prospective basis. The new standard is effective for fiscal years beginning after December 15, 2019 with early adoption permitted for interim or annual goodwill impairment tests performed after January 1, 2017. The Company is evaluating the impact of this new accounting guidance on its consolidated financial statements.

In May 2017, the FASB amended the scope of modification accounting for share-based payment arrangements. The guidance clarifies the type of changes to terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting. Specifically, under this guidance, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The new standard is effective for the Company in the first quarter of 2018. Early adoption is permitted. The guidance will be applied prospectively to awards modified on or after the adoption date. The Company does not expect the guidance to have a material impact on the Company's consolidated financial statements.

2. Fair Value of Financial Instruments

The Company’s cash, cash equivalents and short-term investments are carried at their fair values with any differences from their amortized cost recorded in equity as unrealized gains (losses) on marketable securities. As a basis for determining the fair value of its assets and liabilities, the Company follows a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. For the nine months ended September 30, 2017, there have been no transfers between Level 1 and Level 2 fair value instruments and no transfers in or out of Level 3.

The Company’s money market funds are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. The fair value of the Company’s Level 2 fixed income securities are obtained from independent pricing services, which may use quoted market prices for identical or comparable instruments or model-driven valuations using observable market data or other inputs corroborated by observable market data. The Company does not have any financial instruments which are valued using Level 3 inputs.

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The Company’s assets that are measured at fair value on a recurring basis, by level, within the fair value hierarchy as of September 30, 2017 and December 31, 2016, are summarized as follows (in thousands):

	September 30, 2017			December 31, 2016		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Assets						
Money market funds	$1,685	$—	$1,685	$4,996	$—	$4,996
Commercial paper	—	962	962	—	1,322	1,322
U.S. government agency securities	—	9,948	9,948	—	4,177	4,177
U.S. Treasury securities	—	4,481	4,481	—	2,045	2,045
Corporate debt securities	—	39,003	39,003	—	33,166	33,166
Total assets measured at fair value	$1,685	$54,394	$56,079	$4,996	$40,710	$45,706

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

3. Cash, Cash Equivalents and Short-Term Investments

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

	As of September 30, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair value
Cash and cash equivalents:				
Demand deposits and other cash	$11,413	$ —	$ —	$11,413
Money market funds	1,685	—	—	1,685
Commercial paper	400	—	—	400
U.S. government agency securities	1,040	—	—	1,040
Corporate debt securities	302	—		302
Total cash and cash equivalents	14,840	—	—	14,840
Short-Term Investments:				
Commercial paper	562	—	—	562
U.S. government agency securities	8,916	1	(9)	8,908
U.S. Treasury securities	4,487	—	(6)	4,481
Corporate debt securities	38,724	3	(26)	38,701
Total short-term investments	52,689	4	(41)	52,652
Total cash, cash equivalents and short-term investments	$67,529	$ 4	$ (41)	$67,492

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

The Company has determined that the unrealized losses on its short-term investments as of September 30, 2017 and December 31, 2016 do not constitute an “other than temporary impairment.” The unrealized losses for the short-term investments have all been in a continuous unrealized loss position for less than twelve months. The Company’s conclusion of no “other than temporary impairment” is based on the high credit quality of the securities, their short remaining maturity and the Company’s intent and ability to hold such loss securities until maturity.

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

(in thousands)	One year or shorter	Between 1 and 2 years	Total
Balances as of September 30, 2017			
Cash and cash equivalents (1)	$14,840	$—	$14,840
Short-term investments	32,577	20,075	52,652
Cash, cash equivalents and short-term investments	$47,417	$20,075	