VOCERA COMMUNICATIONS, INC.
Form 10-Q
May 09, 2014

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, 2014
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	x
Non-accelerated filer	¨	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No 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 5, 2014

Common Stock, $0.0003 par value per share	25,163,358

Table of Contents

VOCERA COMMUNICATIONS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2014
INDEX

PART I: FINANCIAL INFORMATION

Table of Contents

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, 2014	December 31, 2013
Assets		
Current assets		
Cash and cash equivalents	$25,912	$39,652
Short-term investments	95,847	88,024
Accounts receivable, net of allowance	20,151	23,543
Other receivables	801	882
Inventories	5,340	5,665
Prepaid expenses and other current assets	2,593	1,892
Total current assets	150,644	159,658
Property and equipment, net	4,957	5,365
Intangible assets, net	2,664	1,544
Goodwill	7,678	5,575
Other long-term assets	1,014	965
Total assets	$166,957	$173,107
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	$2,656	$3,531
Accrued payroll and other current liabilities	8,901	9,841
Deferred revenue, current	25,177	26,133
Total current liabilities	36,734	39,505
Deferred revenue, long-term	6,470	6,398
Other long-term liabilities	1,736	1,641
Total liabilities	44,940	47,544
Commitments and contingencies (Note 7)		
Stockholders' equity		
Preferred stock, $0.0003 par value - 5,000,000 shares authorized as of March 31, 2014 and December 31, 2013; zero shares issued and outstanding	—	—
Common stock, $0.0003 par value - 100,000,000 shares authorized as of March 31, 2014 and December 31, 2013; 25,128,149 and 24,967,140 shares issued and outstanding as of March 31, 2014 and December 31, 2013, respectively	8	7
Additional paid-in capital	192,832	189,966
Accumulated other comprehensive income	—	23
Accumulated deficit	(70,823)	(64,433)
Total stockholders’ equity	122,017	125,563
Total liabilities and stockholders’ equity	$166,957	$173,107

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

Table of Contents

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

	Three months ended March 31, 2014	2013
Revenue		
Product	$14,189	$12,960
Service	10,487	9,453
Total revenue	24,676	22,413
Cost of revenue		
Product	4,990	4,610
Service	4,814	4,084
Total cost of revenue	9,804	8,694
Gross profit	14,872	13,719
Operating expenses		
Research and development	4,066	3,614
Sales and marketing	12,743	10,232
General and administrative	4,397	3,298
Total operating expenses	21,206	17,144
Loss from operations	(6,334)	(3,425)
Interest income	87	24
Other expense, net	(65)	(47)
Loss before income taxes	(6,312)	(3,448)
Provision for income taxes	(77)	(51)
Net loss	$(6,389)	$(3,499)
Net loss per share		
Basic and diluted	$(0.26)	$(0.14)
Weighted average shares used to compute net loss per share		
Basic and diluted	25,047	24,282

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

Table of Contents

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

	Three months ended March 31,	
	2014	2013
Net loss	$(6,389)	$(3,499)
Other comprehensive loss, net:		
Change in unrealized loss on investments, net	(23)	(4)
Comprehensive loss	$(6,412)	$(3,503)

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

Table of Contents

Vocera Communications, Inc.
Condensed Consolidated Statements of Cash Flows
(In Thousands)
(Unaudited)

	Three months ended March 31, 2014	2013
Cash flows from operating activities		
Net loss	$(6,389)	$(3,499)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	734	536
Change in non-cash interest income, net	23	14
Loss on disposal of property and equipment	76	—
Allowance for doubtful accounts	7	23
Inventory write-down	15	26
Change in lease-related performance liabilities	(106)	—
Stock-based compensation expense	2,598	1,704
Excess tax benefits from employee stock plans	—	(257)
Changes in operating assets and liabilities:		
Accounts receivable	3,571	6,789
Other receivables	81	115
Inventories	311	(1,819)
Prepaid expenses and other assets	(750)	(932)
Accounts payable	(881)	133
Accrued payroll and other liabilities	(987)	(3,844)
Deferred revenue	(974)	(1,175)
Net cash used in operating activities	(2,671)	(2,186)
Cash flows from investing activities		
Purchase of property and equipment	(264)	(1,502)
Business acquisitions, net of cash acquired	(3,500)	—
Purchase of short-term investments	(41,318)	—
Maturities of short-term investments	33,005	24,971
Sales of short-term investments	446	—
Net cash (used in) provided by investing activities	(11,631)	23,469
Cash flows from financing activities		
Cash from lease-related performance obligations	307	106
Payment for repurchase of early exercised options	(11)	(3)
Excess tax benefits from employee stock plans	—	257
Proceeds from issuance of common stock from the employee stock purchase plan	—	1,596
Proceeds from exercise of stock options	433	421
Tax withholdings paid on behalf of employees for net share settlement	(167)	—
Proceeds from exercise of common stock warrants	—	226
Net cash provided by financing activities	562	2,603
Net (decrease) increase in cash and cash equivalents	(13,740)	23,886
Cash and cash equivalents at beginning of period	39,652	92,521
Cash and cash equivalents at end of period	$25,912	$116,407
Supplemental disclosure of non-cash investing and financing activities:		
Property and equipment in accounts payable and accrued liabilities	$63	$257

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

Table of Contents

Notes to Unaudited Condensed Consolidated Financial Statements

1. The Company and Summary of Significant Accounting Policies

Organization and Business

Vocera Communications, Inc. (the "Company") is a provider of secure, integrated, intelligent communication solutions, focused on empowering mobile workers in healthcare, hospitality, energy, and other mission-critical mobile work environments, in the United States and internationally. The majority of the Company's business is currently generated from sales of its solutions in the healthcare market, but the Company is expanding its sales and marketing efforts to enter and grow in other markets. Vocera helps its healthcare customers improve patient safety and satisfaction, and increase hospital efficiency and productivity through its Communication and Care Experience solutions. These have been installed in more than 1,200 healthcare and non-healthcare organizations worldwide.

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 Vocera Care Experience is a hosted, software solution suite that coordinates and streamlines patient-to-provider and provider-to-provider communication across the continuum of care. The solution is used to provide personalized patient instructions and education, alert and notify physicians and caregivers of patients' changing care plans, and track patient satisfaction pre, during, and post-hospitalization. Vocera Care Experience is complemented by the Company's Experience Innovation Network, a membership-based program to spread the adoption of leading strategies to improve patient and staff experience.

The Company was incorporated in Delaware on February 16, 2000. The Company formed wholly-owned subsidiaries Vocera Communications UK Ltd and Vocera Communications Australia Pty Ltd. in 2005, Vocera Hand-Off Communications, Inc., Vocera Canada, Ltd. and ExperiaHealth, Inc. in 2010 and Vocera Communications India Private Ltd. in 2013.

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 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, 2013. The year-end condensed balance sheet data was derived from the Company's 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, 2014 or for any other interim period or any other future year.

Use of Estimates

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

Revenue Recognition

The Company derives revenue from the sales of communication badges, smartphone application software, perpetual software licenses for enterprise software that is essential to the functionality of the communication badges, software maintenance, extended warranty and professional services. The Company also derives revenue from the sale of licenses for software that is not essential to the functionality of the communication badges. The Company's revenue recognition policy has not changed from that described in its Annual Report on Form 10-K for the year ended December 31, 2013.

Table of Contents

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, 2014 and 2013, the Company transferred $0.5 million and $0.2 million, respectively of lease receivables in non-recourse sales to third-party financial companies, with immaterial net gains. For the three months ended March 31, 2014 and 2013, the Company recorded $0.3 million and $0.1 million, respectively, of financing liabilities for future performance of executory service obligations. For lease receivables retained as of March 31, 2014 and December 31, 2013, the Company recorded $1.3 million and $1.4 million of net investment in sales-type leases, respectively, equivalent to the minimum lease payments less the unearned interest portion.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (“FASB”) issued new guidance for the gross versus net presentation of unrecognized tax benefits. The FASB concluded that an unrecognized tax benefit should be presented as a reduction of a deferred tax asset for a net operating loss (“NOL”) or other tax credit carryforward when settlement in this manner is available under the tax law. The new guidance was effective for the Company's first quarter of 2014, applied prospectively. Adoption of this standard was not significant to the Company's financial position or results of operations.

In April 2014, the FASB issued revised guidance for reporting discontinued operations and disclosures of disposals of components of an entity. Under the new guidance, only disposals representing a strategic shift in the entity’s operations and financial results will be presented as discontinued operations. In addition, the new guidance requires certain expanded disclosures about discontinued operations and limited disclosures for a disposal not qualifying for such reporting. The Company’s effective date for these amendments will be the first quarter of 2015, with early adoption permitted. The adoption of this guidance is not expected to have a significant impact on the Company’s financial position or results of operations.

2. Fair Value of Financial Instruments

The Company’s cash and cash equivalents and short-term investments are carried at their fair values with any differences from their amortized cost recorded in equity as unrealized gains (losses) on marketable securities. As a basis for determining the fair value of its assets and liabilities, the Company established a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. For the three months ended March 31, 2014, 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.

8

Table of Contents

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, 2014 and December 31, 2013, are summarized as follows (in thousands):

	March 31, 2014			December 31, 2013		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Assets						
Money market funds	$5,507	$—	$5,507	$22,991	$—	$22,991
Certificates of deposits	—	246	246	—	—	—
Commercial paper	—	3,599	3,599	—	900	900
U.S. government agency securities	—	11,596	11,596	—	11,279	11,279
U.S. Treasury securities	—	5,207	5,207	—	5,235	5,235
Municipal debt securities	—	4,723	4,723	—	4,765	4,765
Corporate debt securities	—	81,403	81,403	—	67,055	67,055
Total assets measured at fair value	$5,507	$106,774	$112,281	$22,991	$89,234	$112,225

The Company had no liabilities as of March 31, 2014 and December 31, 2013 that were measured at fair value on a recurring basis.

Table of Contents

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, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair value
Cash and cash equivalents:				
Demand deposits and other cash	$9,478	$—	$—	$9,478
Money market funds	5,507	—	—	5,507
Commercial paper	1,000	—	—	1,000
Certificates of deposit	246	—	—	246
Corporate debt securities	9,682	—	(1)	9,681
Total cash and cash equivalents	25,913	—	(1)	25,912
Short-Term Investments:				
Commercial paper	2,599	—	—	2,599
U.S. government agency securities	11,591	6	(1)	11,596
U.S. Treasury securities	5,203	4	—	5,207
Municipal debt securities	4,715	8	—	4,723
Corporate debt securities	71,735	17	(30)	71,722
Total short-term investments	95,843	35	(31)	95,847
Total cash, cash equivalents and short-term investments	$121,756	$35	$(32)	$121,759

	As of December 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair value
Cash and cash equivalents:				
Demand deposits and other cash	$15,451	$—	$—	$15,451
Money market funds	22,991	—	—	22,991
Commercial paper	150	—	—	150
Corporate debt securities	1,060	—	—	1,060
Total cash and cash equivalents	39,652	—	—	39,652
Short-Term Investments:				
Commercial paper	750	—	—	750
U.S. government agency securities	11,275	5	(1)	11,279
U.S. Treasury securities	5,233	2	—	5,235
Municipal debt securities	4,758	7	—	4,765
Corporate debt securities	65,982	20	(7)	65,995
Total short-term investments	87,998	34	(8)	88,024
Total cash, cash equivalents and short-term investments	$127,650	$34	$(8)	$127,676

The Company has determined that the unrealized losses on its short-term investments as of March 31, 2014 and December 31, 2013 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 (less than five months, weighted average) and the Company’s intent and ability to hold such loss securities until maturity.

Table of Contents

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 March 31, 2014			
Cash and cash equivalents (1)	$25,912	$—	$25,912
Short-term investments	87,798	8,049	95,847
Cash, cash equivalents and short-term investments	$113,710	$8,049	$121,759
Balances as of December 31, 2013			
Cash and cash equivalents (1)	$39,652	$—	$39,652
Short-term investments	71,464	16,560	88,024
Cash, cash equivalents and short-term investments	$111,116	$16,560	$127,676

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

All the above tables exclude restricted cash, primarily held in certificates of deposit, of $0.3 million as of March 31, 2014 and December 31, 2013, which is classified within prepaid expenses and other current assets on the balance sheet.

4. Net Loss Per Share

For fiscal years preceding 2013, basic and diluted net (loss) income per common share were presented in conformity with the two-class method required for participating securities.

For the three months ended March 31, 2014 and 2013, the two-class method is not applicable due to the net losses, which must be attributed entirely to the common shareholders. Additionally, as of March 31, 2014 and December 31, 2013, there were only 6,821 and 26,463 shares of participating securities, respectively, consisting of repurchasable shares issued from early exercise of options and unvested restricted shares; thus the future effect of participating securities would generally be immaterial, even in years with net income.

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, 2014	2013
Numerator:		
Net loss	$(6,389)	$(3,499)
Denominator:		
Weighted-average shares used to compute net loss per common share -basic and diluted	25,047	24,282
Net loss per share		
Basic and diluted	$(0.26)	$(0.14)

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

(in thousands)	Three months ended March 31, 2014	2013
Options to purchase common stock	3,305	3,180
Common stock subject to repurchase	7	36
Warrants to purchase common stock	44	44
Restricted stock units	802	441
Restricted stock awards	—	12

Table of Contents

5. Goodwill and Intangible Assets

Goodwill

As of March 31, 2014 and December 31, 2013, the Company had $7.7 million and $5.6 million of goodwill acquired. During the three months ended March 31, 2014, the Company recorded additional goodwill of $2.1 million for the mVisum acquisition (see Note 11, "Business acquisition"). As of March 31, 2014, there were no changes in circumstances indicating that the carrying values of goodwill or acquired intangibles may not be recoverable.

Intangible Assets

Acquisition-related intangible assets are amortized either straight-line, or over the life of the assets on a basis that resembles the economic benefit of the assets. This yields amortization in the latter case that is higher in earlier periods of the useful life.

The gross carrying amounts of intangible assets which have been fully amortized are removed annually in the subsequent first quarter balance sheet presentation. In the three months ended March 31, 2014, a fully amortized non-compete agreement intangible with $70,000 original cost (and accumulated amortization) was removed from the table of intangibles carrying cost, offset by increases in intangibles related to the mVisum acquisition, as described in Note 11.

The estimated useful lives and carrying value of acquired intangible assets are as follows:

		March 31, 2014			December 31, 2013		
(in thousands)	Range of Useful Life (years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	4 to 7	$2,710	$1,363	$1,347	$1,880	$1,264	$616
Customer relationships	7 to 9	2,520	1,516	1,004	2,350	1,449	901
Non-compete agreements	2 to 4	260	10	250	70	70	—
Trademarks and trade names	4 to 7	110	47	63	70	43	27
Intangible assets		$5,600	$2,936	$2,664	$4,370	$2,826	$1,544

Amortization expense was $0.2 million and $0.2 million for the three months ended March 31, 2014 and March 31, 2013, respectively.

Amortization of acquired intangible assets is reflected in the cost of revenue or operating expenses, depending on the nature of the intangible. The estimated future amortization of existing acquired intangible assets as of March 31, 2014 was as follows:

(in thousands)	Future amortization
2014 (remaining nine months)	$605
2015	626
2016	495
2017	394
2018	275
2019	229
Thereafter	40
Future amortization expense	$2,664

6. Balance Sheet Components

Inventories

(in thousands)	March 31, 2014	December 31, 2013
Raw materials	$806	$806
Finished goods	4,534	4,859
Total inventories	$5,340	$5,665

12

Table of Contents

Property and equipment, net

(in thousands)	March 31, 2014	December 31, 2013
Computer equipment and software	$7,681	$7,345
Furniture, fixtures and equipment	923	924
Leasehold improvements	2,131	2,125
Manufacturing tools and equipment	3,083	3,081
Construction in process	357	555
Property and equipment, at cost	14,175	14,030
Less: Accumulated depreciation	(9,218)	(8,665)
Property and equipment, net	$4,957	$5,365

Depreciation and amortization expense was $0.5 million and $0.4 million for the three months ended March 31, 2014 and March 31, 2013, respectively.

Net investment in sales-type leases

The Company has sales-type leases with terms of 1.25 to 4 years. Sales-type lease receivables are collateralized by the underlying equipment. The components of our net investment in sales-type leases are as follows:

(in thousands)	March 31, 2014	December 31, 2013
Minimum payments to be received on sales-type leases	$2,365	$2,597
Less: Unearned interest income and executory costs	(1,101)	(1,167)
Net investment in sales-type leases	1,264	1,430
Less: Current portion	(593)	(620)
Non-current net investment in sales-type leases	$671	$810

There were no allowances for doubtful accounts on these leases as of March 31, 2014 and December 31, 2013. There is no guaranteed or unguaranteed residual value on the leased equipment. The current and non-current net investments in sales-types leases as of March 31, 2014 are reported as components of the consolidated balance sheet captions "other receivables" and "other long-term assets," respectively.

The minimum payments expected to be received for future years under sales-type leases as of March 31, 2014 were as follows:

(in thousands)	Future lease payments
2014 (nine months remaining)	$697
2015	806
2016	633
2017	229
Total	$2,365

Accrued payroll and other current liabilities

Table of Contents

(in thousands)	March 31, 2014	December 31, 2013
Payroll and related expenses	$4,721	$5,065
Accrued payables	1,607	2,259
Deferred rent, current portion	450	490
Lease financing, current portion	655	528
Product warranty	722	840
Sales and use tax payable	252	259
Other	494	400
Total accrued payroll and other current liabilities	$8,901	$9,841

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

	Three months ended March 31,	
(in thousands)	2014	2013
Warranty balance at the beginning of the period	$840	$297
Warranty expense accrued for shipments in period	298	74
Changes in estimate related to pre-existing warranties	51	49
Warranty settlements made	(467)	(213)
Warranty balance at the end of the period	$722	$207

7. Commitments and Contingencies

Non-cancelable Purchase Commitments

The Company enters into non-cancelable purchase commitments with its third-party manufacturer whereby the Company is required to purchase any inventory held by the third party manufacturer that have been purchased by them based on confirmed orders from the Company. As of March 31, 2014 and December 31, 2013, approximately $3.2 million and $3.1 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 December 2014 and April 2017. The San Jose, California headquarters lease expires on March 31, 2016, with a single three-year extension option at rates approximating the then-fair market value. The Company recognizes rent expense on a straight-line basis over the lease period, and has accrued for rent expense incurred but not paid. Facilities rent expense was $0.5 million and $0.5 million for the three months ended March 31, 2014 and March 31, 2013, respectively.