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CERN - Q1 2019 Cerner Corp Earnings Call

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OVERVIEW:

Co. reported 1Q19 revenue of $1.390b, GAAP net earnings of $166m and GAAP diluted EPS of $0.51. Expects 2019 revenue to be $5.65-5.85b and adjusted diluted EPS to be $2.64-2.72. Expects 2Q19 revenue to be $1.410-1.460b and adjusted diluted EPS to be $0.63-0.65.

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PRESENTATION

Operator

Welcome to Cerner Corporation's First Quarter 2019 Conference Call. Today's date is April 25, 2019, and this call is being recorded.

The company has asked me to remind you that various remarks made here today constitute forward-looking statements, including, without limitation, those regarding projections of future revenues or earnings; operating margins; operating and capital expenses; bookings; new solution, services and offering development; capital allocation plans; and future business outlook, including new market or prospects for the company's solutions and services. Actual results may differ materially from those indicated by forward-looking statements. Please see Cerner's earnings release, which was furnished to the SEC today and posted on the Investors section of cerner.com and other filings with the SEC for information on the most significant factors that could cause actual results to differ materially from those in the forward-looking statements.

Additionally, a reconciliation of non-GAAP financial measures discussed in this earnings call can also be found in the company's earnings release available on cerner.com. Cerner assumes no obligation to update any forward-looking statements or information except as required by law.

At this time, I'd like to turn the call over to Brent Shafer, Chairman and Chief Executive Officer, Cerner Corporation.

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

Thank you, Brian. Good afternoon, everyone, and welcome to the call. I'll spend the first few minutes providing some context on the quarter, and then I'll ask our CFO, Marc Naughton, to walk through the results; and then our Chief Client Officer, John Peterzalek, to provide additional highlights and marketplace observations.

Since our last earnings call, you've likely seen that Starboard acquired a position in Cerner, and we announced the cooperation agreement with them. From the outset, we approached the conversation with Starboard in an open-minded fashion just like we do any shareholder. Starboard's focus on operational improvements and Board refreshment was consistent with our objectives and plans, and we had existing efforts underway in both areas. The cooperation agreement builds on and accelerates the work we've been doing and formalizes our commitment to improve operating performance, including specific targets that are aggressive but attainable.

In addition, we added 4 outstanding new Board members, which we believe strengthens our governance. We strongly believe these operational and governance improvements are in the best interest of Cerner's clients, plants, associates and shareholders.

Since assuming the role of CEO in 2018, the entire Cerner leadership team and I have been reviewing all facets of our operations to improve financial performance and unlock the company's significant potential. As we discussed in our last earnings call and at HIMSS, we rolled out a new operating model to streamline operations, become more client-centric and to enable improved focus on growth. We believe this work is foundational to our operational improvement commitments.

As the next step toward driving improvements in Cerner's operations and cost structure, we engaged AlixPartners, a leading outside consulting firm. Our goal is to uncover efficiencies without impacting important growth investments and commitments to Cerner clients. Key areas we expressed -- that we expect to address include: to assess top management spend and layers; to continue the portfolio management we work -- we started in 2018; rationalize company facilities; review nonpersonnel expenses; and drive additional process improvements. The work is off to a good start, and I have direct experience working with AlixPartners, and I'm confident in their ability to help us become more efficient while we become more focused and better position ourselves for profitable growth. Marc will discuss our targets in more detail, but I want to make it clear they have balanced -- they have been balanced against Cerner's growth investments and client commitments.

One of the other elements we evaluated last year was Cerner's capital allocation strategy. Based on the strength of our balance sheet, we wanted to enhance the return of capital to shareholders, which led to our announced quarterly dividend program and commitment to continued share repurchases. Given our expectation that we will create value as we deliver on our operational initiatives, we increased our share buyback authorization as part of our agreement with Starboard, resulting in a $1.5 billion currently available for repurchase.

With respect to governance, we welcome John Greisch, Melinda Mount, George Riedel, Halsey Wise, to Cerner's Board. These new members, along with our existing directors, bring invaluable counsel and insight. Our Board supports management view that the actions we are taking can create shareholder value without putting the business at risk. To monitor the operational improvement efforts, a Finance & Strategy Committee has been established that will work closely with management to ensure execution against our operating targets.

Cerner operates in a highly competitive space, and we will be measured in our approach with respect to client commitments, investments and considerations for our associate base. We believe the actions outlined will help us become a much stronger and more focused company, well positioned for long-term, profitable growth.

Now I'll turn it over to Marc.

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Thanks, Brent. Good afternoon, everyone. I'm going to cover our Q1 results and future guidance.

I'll start with bookings, which were $1.242 billion in Q1. This is $42 million above the midpoint of our guidance range and, as anticipated, down from Q1 '18 booking of $1.398 billion, which included much higher-than-normal levels of large, long-term bookings. As John will discuss, bookings, excluding long-term contracts, grew slightly over the year-ago period.

We ended the quarter with a revenue backlog of $14.87 billion, which is up 2% over a year ago. Recall that our backlog calculation under the new revenue standard excludes revenue from contracts with termination clauses even though such clauses are rarely exercised. When you combine the expected revenue from our backlog and the additional revenue expected from contracts not included in backlog, our revenue visibility remains at approximately 85% over the next 12 months. Revenue in the quarter was $1.390 billion, up 8% over Q1 of '18 and at the midpoint of our guidance range.

I'll now go through the business model detail and year-over-year growth compared to Q1 of '18. Licensed software revenue in Q1 was $154 million, up 15% over Q1 of '18 with good growth in both traditional software and SaaS offerings. The growth in traditional software benefited from a low comparable level in Q1 '18, which was the lowest software quarter of the year.

Technology resell decreased 12% in Q1 to $56 million, but was up sequentially as we expected. Subscriptions revenue grew 10% to $84 million in Q1, in line with our expectations that the subscriptions business model would return to solid growth after being impacted in 2018 by the adoption of Topic 606.

Professional services revenue in Q1 grew 11% to $490 million driven by solid growth in both implementation services and our works businesses. Managed services increased 13% to $304 million in Q1 primarily driven by robust bookings in 2018. Support and maintenance was down 3% compared to Q1 of '18 with solid growth in Cerner Millennium support not quite offsetting declines in legacy support and hardware maintenance. Note that support and maintenance was flat sequentially and has easier comparable periods going forward. But we expect year-over-year growth to be flat to low single-digit for the remainder of the year.

And finally, reimbursed travel in the first quarter was flat to both Q1 of '18 and last quarter at $24 million.

Looking at revenue by geographic segment. Domestic revenue was up 8% from the year ago quarter at $1.231 billion, and international revenue of $159 million was up $1 million from the year ago quarter. Note that our non-U. S. revenue growth was impacted by foreign currency rates and would have been mid-single-digit on a constant currency basis.

Moving to gross margin. Our gross margin for Q1 was 81.8%, down from 82.6% in Q4 of '18 and 82.1% year-over-year due to slightly higher mix of third-party services.

Now I'll discuss spending, operating margin and net earnings. For these items, we provide both GAAP and adjusted or non-GAAP results. The adjusted results exclude share-based compensation expense, share-based compensation permanent tax items, acquisition-related adjustments, organizational restructuring expenses and other adjustments, all detailed and reconciled to GAAP in our earnings release.

Looking at operating spending. Our first quarter GAAP operating expenses of $939 million were up 8% compared to $866 million in the year ago quarter. Our adjusted operating expenses were up 9% compared to Q1 of '18.

Looking at the line items for Q1. Sales in client service expense increased 9% year-over-year primarily driven by an increase in personnel expense related to our services businesses. Software development expense increased 12% over Q1 of '18 driven by a 7% increase in gross R&D, 12% increase in amortization and flat capitalized software. G&A expense is up 5%, and amortization of acquisition-related intangibles decreased slightly year-over-year.

Moving to operating margins. Our GAAP operating margin in Q1 was 14.2% compared to 15.1% in the year-ago period. Our adjusted operating margin for the quarter was 17.5%, down from 18.8% in Q1 of '18 and 18.7% last quarter.

As Brent discussed, we are taking steps to improve our operating performance with a focus on cost optimization, process improvement and portfolio management. We expect these efforts to begin positively impacting our results in the second half of the year. We are working with AlixPartners to refine our list of optimization and process improvement opportunities and build a more detailed timeline. We expect to be done with this work by the time we report our second quarter. And based on our preliminary work, we remain confident in our ability to meet previously announced targets for Q4 of '19 and Q4 of '20 adjusted operating margins of 20% and 22.5%, respectively.

This will be hard work, particularly with the backdrop of a challenging core market environment, but it is necessary to make these changes to enhance efficiency and focus as we position ourselves for ongoing profitable growth. I want to be clear that we still believe we have good, long-term growth opportunities driven by our federal business, opportunities within our large health system base and our strategic growth initiatives that address adjacent markets. As we work through our operational improvement efforts, we'll look to protect the investments necessary to drive this growth. The changes we expect to make revolve around focus. We are doing too many things, and we believe we can do better if we target our attention on areas that represent the largest and most profitable growth opportunities and drive client satisfaction and retention.

Moving to net earnings and EPS. Our GAAP net earnings in Q1 were $166 million or $0.51 per diluted share, which is up 6% compared to GAAP EPS in Q1 of '18. Adjusted net earnings in Q1 were $199 million, and adjusted diluted EPS was $0.61 compared to $0.58 in Q1 of '18. Our GAAP tax rate was 19.5% for the quarter. Our non-GAAP tax rate was 21%. We expect our non-GAAP tax rate to be closer to 22% for the remainder of 2019.

Moving to our balance sheet. We ended Q1 with $904 million of cash and short-term investments, which is up from $775 million in Q4 of '18. Our total debt was down $5 million from last quarter to $439 million. Total receivables at the end of the quarter are $1.159 billion, down from $1.183 billion in Q4 of '18. Our Q1 DSO was 76 days, which is down from 79 days in Q4 '18 and up from 73 days in the year-ago period. Operating cash flow for the quarter was $317 million. Q1 capital expenditures were $119 million, and capitalized software was $75 million.

Free cash flow, defined as operating cash flow less capital purchases and capitalized software development cost, was $123 million for the quarter. For 2019, we continue to expect our operating cash flow to be impacted by higher cash outflows for taxes, our voluntary separation plan payouts and other expenses related to our organizational restructuring.

On the capital side, we expect an increase in capital expenditures primarily driven by work on the phase of construction at our Innovations Campus, which should be completed in the first half of 2020. Due to a combination of these 2 factors, we expect free cash flow to decline in 2019. In 2020, we expect to return to normal operating cash flow growth, a meaningful decline in capital expenditures to lead to strong free cash flow. In addition, note that our capital spending is included in our operational review, and we expect to identify opportunities to reduce capital spending going forward.

Moving to capital allocation. As we recently announced, we increased our share buyback authorization to $1.5 billion. We expect to execute the majority of the repurchase authorization in the next 12 months subject to market conditions and other factors. We intend to fund this with cash from operations and debt, with the amount of debt depending on the timing of our repurchases and whether we use cash for other purposes such as M&A.

Regarding the dividend program we announced in February, we still expect to initiate a $0.15 per share quarterly cash dividend with the first payment expected early in the third quarter. We expect the Board to officially declare the dividend at our May shareholder meeting.

Our expected initiation of a dividend combined with our significantly increased repurchase authorization reflects our commitment to returning capital to shareholders and our belief in Cerner's long-term potential.

Now I'll go through the guidance. We expect revenue in Q2 to be between $1.410 billion and $1.460 billion. The midpoint of this range reflects growth of 5% over Q2 of '18. For the full year, we continue to expect revenue between $5.65 billion and $5.85 billion with a $5.75 billion midpoint reflecting 7% growth over 2018.

We expect Q2 adjusted diluted EPS to be $0.63 to $0.65 per share. The midpoint of this range is 3% higher than Q2 of '18. For full year adjusted diluted earnings per share, we expect to benefit from the recently announced operational improvement initiatives and expanded share repurchase program. The amount of the benefit will depend on the timing of operational improvements and share buybacks. But based on preliminary estimates, we now expect adjusted diluted EPS to be between $2.64 and $2.72, which reflects 9% growth at the midpoint and is above our previous guidance range of $2.57 to $2.67.

Moving to bookings guidance. We expect bookings revenue in Q2 of $1.25 billion to $1.45 billion. The midpoint of this range reflects a 24% decrease compared to the second quarter of 2018, which included the initial task order for the VA. As John will discuss, the primary reason for the projected year-over-year decline is we expect lower levels of long-term bookings.

In summary, we are pleased with our solid results in the first quarter, and we remain focused on delivering improved operating performance and creating shareholder value, as we position Cerner for long-term, profitable growth.

With that, I'll turn the call over to John.

John T. Peterzalek - *Cerner Corporation - Executive VP & Chief Client Officer*

Thanks, Marc. Good afternoon, everyone. Today, I'll cover our top line results and discuss the marketplace.

I'll start with our bookings, which are in line with our projections, with growth in non-long-term bookings being offset by a decline in long-term bookings, which we previewed last quarter. The percent of bookings coming from long-term contracts in the quarter was 30% compared to 40% in Q1 of last year. When you exclude the long-term component, bookings grew 3% compared to the year ago quarter.

As Marc mentioned, the dynamic is expected to continue in Q2 with another expected decline in long-term bookings, and the impact is amplified by the fact that Q2 of last year represents a tough comparable as it was near an all-time high and included our initial VA bookings.

The lower level of long-term bookings in our forecast is in part driven by our decision to be more selective as we consider certain low-margin, long-term contract opportunities, given the current operational review and our focus on higher-margin growth. This is not expected to have a material impact on near-term revenue or earnings, but we do expect the mix of long-term bookings to be lower for the year.

Our pipeline remains strong, and we are well-positioned to deliver good, long-term growth, but willing to make sure we pursue high-quality business that aligns with our focus on profitable growth.

Moving to new business mix. We had a solid quarter with 32% of bookings coming from outside our core Millennium installed base. In the federal space, our projects with DoD and VA are both progressing as planned. For DoD, we are continuing our work on the second wave of sites with go-lives on track for this fall. Similarly, our work with the VA has continued as planned, and we remain on track to steadily ramp our work on the project as we go through the year and into next year, with the initial sites still expected to go-live in 2020.

Q1 was also a solid quarter for other key growth areas such as revenue cycle and population health. We also see material growth opportunities beyond the hospital as we shift -- as the shift continues towards at-risk, value-based pay arrangements, providers will need better data and analytics to improve their economics. Cerner expects to help provider clients increase their top line revenue and win their ZIP code, providing the Big Data and predictive tools to support better health care experiences and outcomes.

A few weeks ago, we announced an expanded partnership with naviHealth, a pioneer in post-acute patient management. We have worked with naviHealth for the past 5 years to streamline workflows for the post-acute discharge. We are expanding the relationship to create a new EHR-agnostic offering that drives improved clinical outcomes and financial results with a focus on addressing the latest bundled payments model for the CMS, known as the bundled payments for care improvement advance.

As we build our health care network strategy, we will selectively add at-risk capabilities with key partners. NaviHealth, for example, will leverage Cerner's HealtheIntent platform and allows us to drive higher-dollar, higher-margin economics around the provider health network. Because health systems leverage a portfolio of value-based risk models, the naviHealth relationship is highly complementary to our work with Lumeris, an important strategy for advancing our post-acute line of business.

Now I'll provide brief observations on the marketplace. While our core EHR market is mature, opportunities remain to replace legacy suppliers and cross-sell additional solutions such as revenue cycle and ambulatory into our existing client base. We believe we are well positioned to act as a partner to our clients because we have the capabilities beyond EHR that align with their imperatives, which generally include optimizing revenue in both fee-for-service and value-based models, improve the health of population, enhancing quality and outcomes and creating operational efficiencies.

In summary, we believe we are aligned with our clients' needs and well positioned to enable them to pursue their growth strategies and deliver against their imperatives.

With that, I'll turn the call back to over to Brent for closing comments.

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

Thanks, John. Well, as you've heard from us today, we're undergoing a lot of change. We have embraced the cooperation agreement as an opportunity to build on the work we've done over the past year and move at a fast pace to make the needed improvements in our operating performance.

We are very committed to delivering against the targets we have established, and we're confident in our ability to execute.

One thing that will not change is our commitment to clients and innovation. We're focused on supporting our clients by aligning around the following priorities: intelligent innovation, which means delivering on our commitment to leverage the power of data to create contextual, intelligent experiences, new evidence-based insights and workflow interventions; better experiences and outcomes, which includes intelligent health networks and relentlessly advancing client successes; open and connected health care, which reflects our commitment to investing in rapid technology advancements to deliver tangible value to every patient, clinician, technologist and administrator. We believe open platforms that allow clients, partners and developers to innovate with us will allow us to solve health care's most complex challenges.

In summary, we believe we are making Cerner a stronger, more focused company, positioned to have a positive impact on health care.

I'll now turn the call back to the moderator and open up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And our first question will come from the line of Robert Jones with Goldman Sachs.

Robert Patrick Jones - *Goldman Sachs Group Inc., Research Division - VP*

Brent, you shared several areas that you highlighted as being evaluated to help you guys reach the operating margin targets shared in the cooperation agreement. But I was hoping maybe you could just give us a little bit more of a sense of order of magnitude. And I'm thinking, if you take a step back, R&D versus more of the traditional operating expenses, because I know you've highlighted things that kind of on both sides of the fence there. And then, within that, if you could just share the kind of line of sight you feel like you have today into those cost savings as we think about getting the operating profit level from what we saw in 1Q to that 20% exit rate that you guys had shared.

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

Yes, okay. Good question. Well it's early days, right? So we're a couple of weeks into the engagement with Alix. So we're in the data-sharing process and starting to really build out where to look. The analogy I've been using is (inaudible) a health care perspective is, we're doing a full-body CT scan of everything, all aspects of the organization to look for opportunities. And it's a little early to identify exactly where we go. But we do -- we, certainly we see opportunities, as mentioned, around how we're -- it's fundamental structured, around management span and layers. And we feel like we did some really good work last year on the portfolio, established a good baseline of understanding for us, quantified where the opportunities are and where some of the best opportunities are.

So it's kind of, in many cases, going to the next step here of seeing that through, making strong decisions around those that maximize our growth opportunity and help us find efficiencies.

And we know just, as we discussed last year, based on our scale and size, that the operating model was intended to help set up some fundamental alignment about accountability and clarity throughout the organization. But we know there's opportunity for process improvement that comes with that. And given that in Q1 we just rolled out the model, kind of the next obvious step is to then really look for clear processes to work those for efficiencies through the whole organization.

So I hope that at it least gives you some directional sense of where we're going, and there'll be more as we get into it, for sure.

Robert Patrick Jones - *Goldman Sachs Group Inc., Research Division - VP*

Yes. No, Brent, that helps. I guess just a quick follow-up. I thought it was interesting comments on the bookings guidance. It seems more conscious that you're not pursuing certain, as you described, lower-margin, long-term contracts. Is it safe to assume that that's on the work side of things? And if that's true, maybe just an update on where you stand on the billing center. I know that was a big focus, a big buildout last year.

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Yes, this is Marc. I think that certainly, every transaction and agreement we look at is going to be reviewed in light of our focus. But relative to bookings, keep in mind that long-term bookings, which is the primary difference we're seeing in Q1 and Q2, relative to the year ago quarters, those tend to be lumpy. And actually coming in the year, we indicated when we talked to you about Q1 as we're doing in Q2, the funnel for those types of transactions just wasn't as big as it was a year ago. And that -- the funnel varies or opportunities in front of us that are fairly large that can certainly bring us back to a more normalized number, relative to that. But I think that for us, the point we're making is, we're certainly going to look at all of our businesses and decide which ones we want to focus our attention on, and those are the ones that are going to be that we think help our clients, retain our clients and drive profitable growth. So right now, it's a little early to decide exactly what that's going to entail. But when you think about bookings, I think that probably the more meaningful impact in the first half of this year is just a lower pipeline.

Operator

Our next question will come from Rivka Goldwasser with Morgan Stanley.

Rivka Regina Goldwasser - *Morgan Stanley, Research Division - MD*

When we think about 2019 and kind of at the top line growth, what percent of revenue do you expect to come from the federal contracts, where you're not changing your spend versus customer areas where you are planning on spending less on? And then second a follow-up question on that is, if you had a chance to speak with them, to your hospital customers after your announcement? And what feedback are you hearing back from them?

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

Yes. John, do you want to take the (inaudible)?

John T. Peterzalek - *Cerner Corporation - Executive VP & Chief Client Officer*

I'll go first with the feedback from the client. This is John. I had the opportunity obviously to speak with many clients post announcements. And almost without exception, it's viewed as a positive catalyst for us. As we look at our new Board members and the focus on both technology and operational improvements, that's very positive from our clients' perspective. We're accelerating some of the things that we are already doing around our operating model to become more efficient. Our efficiencies, it reflects well with our clients as well. It's easier for them to do business with us. We get solutions to market quicker, all those types of things. So pretty much without exception, it was viewed as a good catalyst for us to move forward and accelerate our plans that we already have.

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Yes. This is Marc. Working on your question kind of relative to revenue that has costs or doesn't have costs, or obviously, we're early in determining where the opportunities are here. But I think a key element when you're thinking about revenue and the impact of our efforts on revenue is that, as we went into the year and we continue to see, based on the 12-month view out of backlog and those contracts that are not in backlog, but are going to roll out in the next 12 months, that 85% of our revenue is still visible to us. So that is going to be rolling through. Most of the activities from our services, which a lot of the VA revenue comes from, those people are generating revenue, and clearly, you're not going to go cut costs for people that are generating revenue. So I think from a revenue perspective, the efforts we're taking from a efficiency standpoint aren't going to make a material dent relative to 2019.

Operator

And our next question will come from the line of Lisa Gill with JPMorgan.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

I just wanted to follow up on the cadence of the margin improvement. Marc, if I look at -- I know you don't give specific margin guidance, but if I look at the implied margin for the second quarter, it looks like it'll be down again year-over-year. So can you maybe just talk about how quickly this will ramp to get to that, as Brent said, aggressive but attainable target of 20% by the fourth quarter? Is that -- does that mean that all of these efficiencies will really come in the third quarter and fourth quarter?

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Yes. Lisa, this is Marc. I mean, clearly, the efforts we're undertaking are fairly recent. We got a lot of analysis to do. And we then have to go take the steps that are going to start driving those. So I think it's certainly in our view, in the plan we have, is a material amount of that happens in Q4 for this year because it's going to take us time to get those projects underway and start realizing the benefits. So your synopsis that, is most of that going to be happening certainly in the last half of the year and much in Q4, I think is a realistic one. I think, certainly, all the work we're going to be doing in '19 is then going to set us up well as we roll into 2020 and put us on a good path for the 22.5% we expect to see in Q4 of that year. But certainly, from -- exiting Q4, you will see a pretty steep ramp from a quarterly operating margin percentage as more and more of these initiatives start hitting the P&L as we get toward the end of the year.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

And then, just so I understand. In the Updated guidance around the share repurchase, how much specifically do you have in the updated guidance for share repo?

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

We haven't given any specific number. It clearly depends on the timing of the repurchases, which will be subject to market conditions, et cetera. So we haven't really defined when we plan to do all of those repurchases. We just indicated that over -- certainly over the next 12 months, we expect to do the majority of that authorization. We're serious about bringing those shares and getting that repurchase done. But we haven't set a timing as far as when that's going occur and therefore relative to how it will impact EPS over that time.

Operator

And our next question will come from the line of Jeff Garro with William Blair & Company.

Jeffrey Robert Garro - *William Blair & Company L.L.C., Research Division - Research Analyst*

I want to ask more about bookings and the idea that you guys are getting more selective in some of these long-term opportunities. Maybe the way to ask it might be what types of long-term opportunities are you still really interested in pursuing? Is it with some of the market leaders? Is it with some of your tightest partnerships? Or is it more strictly based on margin potential?

John T. Peterzalek - *Cerner Corporation - Executive VP & Chief Client Officer*

Yes. This is John. We're going to continue to look at all of our opportunities. It's just going to be a path of which ones we believe are going to benefit the client the most and get them -- move them forward as well as with our added scrutiny around making sure that the margins are right long-term for us as you expect it comes in the big mix. But it doesn't mean you're only going to focus on the largest ones. It'll be throughout our client base where we'll have great opportunities to align both where we deliver tremendous value for the client and provide higher margins for Cerner. So it's not one specific area that we'll be looking at all of them with sort of just a revised look at them. But it should be brought throughout our entire client base.

Jeffrey Robert Garro - *William Blair & Company L.L.C., Research Division - Research Analyst*

Got it. That helps. And then as a follow-up, thinking about the 4% year-over-year bookings growth in the kind of near-term bookings category, and wanted to ask, what you see the pipeline supporting for the rest of the year, given a bit of change in philosophy of those longer, around those longer opportunities. Can you set some level of expectation around how kind of near-term bookings are going to unfold for the rest of the year?

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Yes. This is Marc. This -- once again, bookings is a number that we'd like to have gone through our rigorous forecast process and have a view on before we share a lot of color around that. So at this point I think it's a little premature to give guidance as far as what we see the non-long term versus the long-term in the second half of the year. Certainly, we'll be able to serve more of that as we get to our next call. But at this point, consistent with what we've always done, we're not going to provide a whole lot of more color based on those breakdowns.

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

I think it's fair to say that the pipeline is robust.

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Yes. As we look at the market, the market's strong.

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

I would add to that, and I'd mentioned that in my comments as well, there isn't a material change in our pipeline at all. We still have a very strong pipeline, top to bottom both, in solutions, services and other things. So I am highly optimistic about the pipeline itself. It continues to grow, and it continues to be very broad throughout our solution mix and services mix.

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

And this is Marc. Just as a reminder, that when you look at the bookings, you do have to keep in mind a little bit of a context in that in '17, we grew 16%. And in the last year, we grew pretty significantly in bookings as well. The prior year, actually, we grew 0. So I think there is some lumpiness to this, but the reality is based on our backlog, it's grown significantly from those 2 years of strong bookings. The revenue line is in pretty good shape relative to visibility. And the good news is that the pipeline is strong. In a market that is seeming -- deemed mature, we have a lot of opportunities within both our existing client base and new clients to go after market share. So we will continue to do that.

Operator

And our next question will come from the line of Eric Percher with Nephron Research.

Eric R. Percher - *Nephron Research LLC - Research Analyst*

Brent, can you speak to your hope for how the Board's Finance & Strategy Committee will interact with management, and Alix goes a little bit off the functional -- how that will function?

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

Yes. One: I think if you look at the bios of the 4 new Board members we're adding, they're all operators with a lot of diverse experience, who've been through multiple business cycles, different stages in business. So I think having their insights and as part of this will be a real benefit to us, to have these new folks. And then combined with our folks from our traditional Board who -- especially a couple who have very deep insights to the market and operations that we're in, I feel good about that. So I think it's mostly a question of perspective and experience, interacting with management as we work through these changes and helping us to avoid pitfalls and mistakes as we work our way through it. It's a lot -- as you know, this kind of work is a heavy lift, and we need to make sure we do it well and keep our priorities straight. So I expect it to be very helpful for us as we move forward.

Eric R. Percher - *Nephron Research LLC - Research Analyst*

And sounds like you see them working with the management team broadly more than just advising you and the Board.

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

Well, no. I mean, they're Board members. So I expect them to advise, absolutely. It's an advising role, right, as Board members. But the breadth of experience that they bring, I think, is a benefit as we work through this. So yes, but it's an advisory role.

Operator

And our next question will come from the line of Ross Muken with Evercore ISI.

Elizabeth Hammell Anderson - *Evercore ISI Institutional Equities, Research Division - Associate*

This is Elizabeth Anderson in for Ross. Can you discuss your openness to improve efficiencies in your R&D organization? So for example, how do you arrive at the proper level of investment or measure it, given the lack of revenue acceleration in certain of your end markets?

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

Yes. This is Brent. So maybe let me (inaudible) and maybe you can add some, Marc, as we go. But I think the steps we started last year, around just a disciplined approach to portfolio review was really fundamental. Marc mentioned, I think we've mentioned this a couple of times, we felt like we were trying to do too many things simultaneously. So the first piece is having a robust process around setting priorities and that, I feel like we've got a good start there. There's a lot more work that we can do. But I think that's a good start. And then within the R&D and in how assets are deployed and how we work through a cycle, I think the business model we put in place should help us, because we found that we were developing some great, new functionality and then really never getting it to market and scaling it through our client base because the way it was developed, we weren't seeing it all the way through. So there's opportunity there. And then I think, when you come back to the topic now about really process improvement, I think that's kind of new ground for us. We've got the model in place. We've got a portfolio process in place. Now really looking for how can we find efficiencies throughout that development processes is work ahead for us. So I think all of those are ongoing opportunities for us at this point. Hopefully that gives you a little color on it. Is there anything you want to add, Marc?

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Yes. I think that's exactly right. Certainly, every -- there is nothing off the table as we go through and do this work. Certainly, the focus is delivering for our clients and innovating. So R&D has been a key part of that spend. But certainly, everything we do as a company is going to be reviewed to make sure that the process is right and the level of resourcing is appropriate and the focus of those resources is appropriate. So...

Elizabeth Hammell Anderson - *Evercore ISI Institutional Equities, Research Division - Associate*

Perfect, that's very helpful. My final question is, how are you going to message your clients your intent regarding margins? And how do you counteract how competition is likely to position that?

John T. Peterzalek - *Cerner Corporation - Executive VP & Chief Client Officer*

Well, this is John. We know that there's going to be some competitive messaging around this, whether it's accurate or inaccurate on the competitive side. But our clients look at our margin, in my opinion, is more how efficient we are. And I've stated before, I think that our clients need us to be more efficient because we need to bring our solutions to market more quickly, and efficiency drives to that, though they will welcome the fact that we'll be more focused and not spend as much time around the periphery of some things. And they'll welcome the fact that some of the great ideas and innovations we have will make it all the way through, being deeply embedded in our clients. So I think messaging the reality to our clients will be very positive, and then we'll see some very positive things come out of it in terms of how effectively we work with them. And we'll just have to deal with the competitive messaging. We'll be proactive about it, but communication is the best thing we can do with our clients and let them know what we're doing, what to expect. And Brent has been very clear, and we all have been very clear, this process will not impact our client. The commitments we have to our clients will not impact the innovation they expect from us and will not impact what we deliver.

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

I think I'd just add to that, John. I appreciate the points. I think in the clients that we serve, these are generally very long-term partnerships. And so they depend on us to be a strong partner, a healthy partner and to continue to innovate and help them move forward. And so a strong Cerner is something that they want, all right? They want to know how we're positioned well for the future and can continue to deliver on our commitments. And so I think that's -- I think there is a pretty good understanding of that in our client base. But thanks for the question. I appreciate it.

Operator

And our next question will come from David Larsen with Leerink.

David M. Larsen - *SVB Leerink LLC, Research Division - MD, Healthcare Information Technology and Distribution*

Can you talk a little bit about your revenue works efforts? I think you brought on about 600 rev cycle FTEs in 2018. That obviously put some pressure on the margin there. But now what I'm hearing is the level of large service engagement wins has kind of slowed. Just any thoughts on your RevWorks efforts, Marc? I think at one point, you mentioned you wanted to make sure that Adventist was up and running and perfect before bringing on large, new ones. Is that still your thought process?

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Sure. I think, yes, we basically opened up our billing center in Kansas City, and that is fully staffed. It is beginning to take over roles that are opening up from attrition from some of our signed clients. So it is actually operating as it was intended to operate at this point. And I think we still look at that business and want to make sure that we are really good at it before we take it a whole lot broader. That's one of the activities we're doing relative to this -- to the work we're doing around efficiencies and profitability. But certainly, I think the (inaudible), that business office in Kansas City has turned out as we'd expected. We're getting the leverage from it. And I think we're going to have to continue to be able to leverage that office for new opportunities as they come up. Once again, those are probably even lumpier in the case of opportunities from a long-term bookings perspective. But currently, right now, that business is operating out of that service center and meeting our expectations.

David M. Larsen - *SVB Leerink LLC, Research Division - MD, Healthcare Information Technology and Distribution*

Okay. And then just one more quick one for me. In terms of like the VA and sort of the rolling on of the VA, can you remind me how many waves are there? I thought there were like more than 40 waves, and I think waves 1 and 2 are scheduled to go-live in like 2020. So my impression is that a lot of the VA revenue and bookings are still ahead of Cerner. Is that correct or not?

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Yes. A little more color would be that -- absolutely correct.

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

You're exactly right. There are a bunch of waves. And once we get further into the project, there will be multiple ways progressing at the same time. Right now, they are, they're set to be kind of single waves as you get to proof-of-concept and those other elements. But as we roll forward, and particularly, as you start looking at kind of the bookings, future view of bookings, you do have to keep in mind that really kind of VA, we had some initial bookings from them. This year, we'll have some additional bookings. But there's -- the real increase in VA bookings comes when they really start rolling out multiple waves, they start contracting for those projects. And our statement has been we expect that revenue stream to grow, kind of in $250 million increments until we get to around $1 billion a year. To get to a $1 billion year, you're going to have to have a significant amount of bookings come through to be able to support that revenue level. So you will see the revenue continuing to grow from VA. And therefore, the bookings growth from VA as we move forward, kind of on that 4-year timeline we discussed.

Operator

And our next question will come from the line of Richard Close with Canaccord Genuity.

Richard Collamer Close - *Canaccord Genuity Limited, Research Division - MD & Senior Analyst*

So on this profitable growth commentary, it sounds like you're deemphasizing some products or services. Maybe RevWorks is one of those. Does that change your long-term thoughts on revenue growth by maybe deemphasizing some of these things? And then if not, what are the areas that you see the most growth potential in, over maybe the next 5 years?

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Yes. This is Marc. I think at HIMSS, we kind of laid out some of the opportunities for growth that we were looking at. Certainly, the government growth area is a huge area for us to grow. You talked -- we talked about naviHealth today. There are opportunities in the top health space that we continue to look at opportunities to grow from a top line perspective. The reality -- the focus on profitable growth, that can be across almost any business. I mean, some of the work that Brent referenced from a portfolio management perspective is that we're spending a bunch of money on something that's never going to grow to be a sizable contributor to revenue. But it's taking cycles of intention, and it's taking people. So there's a lot of those types of things that are not just in categories but are individual areas that we need to go adjust and either decide we're not going to do those anymore, spin that off, whatever the approach is going to be. But I think from an overall standpoint, we have elements of growth that are out there, that will continue to be able to provide avenues. So today, if you look at RevWorks, if that was your kind of your focus question, that might be a couple of hundred million dollars of revenue to us today. So that's -- well, that's sizable. There hasn't been huge growth in that from a bookings perspective or more recently, from a revenue perspective. So I think, while that's an avenue of potential growth, we have lots of other avenues of potential growth. This process will help us define which of those we actively pursue and invest in, which of those we decide not to.

John T. Peterzalek - *Cerner Corporation - Executive VP & Chief Client Officer*

And I think we're jumping to specific business lines, which I wouldn't do right now. And I would not use the word deemphasize. I would use what we said in our comments, which is selective, that some of these long-term growth areas are still very important to us. We're just going to make sure that they add to the product. We're very selective in terms of profitable growth, the comments we made before. There are lots of opportunities out there, we can make sure they align both with our clients' needs, the value we drive and profitable growth for Cerner. So I would be hesitant to use the word deemphasize, and I would continue with what we're going to be selective in where we go.

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Yes. Keep in mind, one of the key elements of these works business is more tightly align the client to Cerner. And that tight alignment brings with it a lot more software sales, a lot more high-level services sales. So that is -- the overall contribution from those efforts is what we're looking at. We are not going to go pigeonhole just a piece of that business and say, this doesn't make sense. It's got to be in the overall profitability, relative to a client. And that's always been the focus we've had. But we want to be selective in which ones of those we pursue, making sure it does deliver on that promise.

Operator

And our next question will come from Stephanie Demko with Citi.

Stephanie July Demko - *Citigroup Inc, Research Division - VP & Senior Analyst*

First one, just what drove your view of a nonlinear margin path at the recent Analyst Day? Or I guess put another way, how much of that was a conscious decision to avoid any impact on top line or bookings growth versus something else?

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Yes, I don't, I mean, I don't think there was any intent to avoid an impact on the top line. We, at our HIMSS meeting, said our goal was to be over 20%, 20% plus. We clearly, as Brent says, spend a lot of time working on structures, and we're getting to a point where we were prepared to start doing the deeper work to go drive those efficiencies. Clearly, our agreement with Starboard accelerates that process. We're now adding detail. We're doing it at a faster pace. So I don't know that it's inconsistent with what we were talking about relative to getting over 20% margins. The good news is 22.5% is over 20%, and we're getting there probably more quickly than many people would have expected us to get there. And that's absolutely ourselves and Starboard, which is actually aligned with many of our investors and shareholders. We're all in alignment on that goal.

Stephanie July Demko - *Citigroup Inc, Research Division - VP & Senior Analyst*

Understood. So with that in mind, are there any near-term opportunities that you are looking at, they're just being offset by mix over the next quarter or 2? Or you're more staying on the sidelines until the consulting analyst finishes? Just to take a more fulsome approach there.

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

We are -- once again, we've been doing work on this, in this space for a while. Where certainly, love the work we're doing with AlixPartners, the collaboration, and it's actually been very -- they've been well received within our organization so that's going very well. But there are things that we already had in process and in thinking through, that we are going to be able to start the action in on. Depending on what those are, it may have a nearer-term impact, but many of these are going to be something that even if you're getting something kicked off immediately, real impact is going to be toward the last part of the year. And that's the reality of the situation at this point.

Operator

And our next question will come from the line of Matthew Gillmor with Robert Baird.

Matthew Dale Gillmor - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I just had one last one. On the buyback program and just if you can update us on your sort of future outlook there. And I guess the perspective would be that once you complete this repurchase authorization, do you intend to keep repurchasing stock at a similar pace? Or should we think of the $1.5 billion more as a onetime large repurchase and then you go back to the prior cadence? And I know M&A, if you execute there, that would obviously be influenced. But just trying to understand the philosophy at this point.

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Sure. This is Marc. I mean our capital allocation approach is something that we review all the time. I think the working -- we will certainly work through this authorization by the Board and get that done. We've always had the position that we are going to, at minimum, do repurchases that offset any dilution. And for the most -- a lot of the view of, on the stock repurchase is how attractive are market conditions and what's the share price look like, relative to what we think the value is. So I think you'll see us complete this large purchase. And keep in mind, we've bought a lot of stock back over the last 5 or 6 years. So this isn't inconsistent with that. It's a little larger than our prior authorizations. But we'll certainly look at it once we get this done and determine based on our capital allocation at that time. If we do another sizable one, we just continue doing offsets of dilution, do we have other investments. So a little early for us to tell that this is going to be a plan of attack, I think it's -- I think capital allocation is something you've got to do on a kind of, more of a temporal nature than a long-term plan nature.

Operator

And our next question will come from the line of Michael Cherny with Bank of America Merrill Lynch.

Michael Aaron Cherny - *BofA Merrill Lynch, Research Division - Director*

The thing about the cost cuts in the investment cycle from a little bit of a different angle. I think you've outlined at least the beginning pieces of what you plan to attack in terms of margin expansion. How do you think about positioning the company? And when you think about not just protecting revenue but also looking to expand revenue in a world where hiring talent in the tech land becomes so much more challenging, so much more competitive, how do you think about the culture that you want to bring to the organization against the backdrop of driving through some of these cost cuts, to make sure that you're staying at the forefront, given your competition, not just the dynamics of what's in the competition in terms of selling against you, but what's the competition in terms of developing new products and new platforms against you?

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

Maybe I'll -- a couple of comments here. You're asking about culture, and I think that's a great one to emphasize, because I think we -- that is amazing. As a relative new comer to Cerner, there's an amazing culture here and a real emphasis and a real desire to innovate and contribute and improve health care. And I think, as far as attracting global talent to be part of that, I think that is a very strong asset for us and something we need to continue to build and reinforce, and we want to do that. And if you look at some of the facilities that we have in place, our innovation center, I don't know if you've had a chance to tour, but it is world-class. It is a world-class environment for innovation and to attract talent. So I understand the nature of your question is, do we scare away talent? I think, honestly, we want to reinforce that this is a great place to be and a great culture to be in. And we're here to contribute to improvement in health care. And what better mission is there than that? So we'll be careful about balancing the need for efficiency while attracting talent and driving that culture that we want to maintain. .

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Yes. This is Marc. I think, in some cases, there are areas in the company that we -- because of how we've grown up and some of the silos we've created before we changed the operating model, it was harder to get things done inside Cerner. So I think the culture will evolve to one where it is easier to get things done. And I think that's important. I think the, clearly, one of the pillars of our organization is strategic growth. So we are focusing an entire organization just on finding new areas to go grow the company. So I think, rather than that being dispersed throughout the organization, having a single focus of that group on it makes it more likely that we're going to be successful in innovating. And just as one final comment, I would point out that the Innovation Campus that Brent referenced as being world-class, is being completely paid for by tax incentives from the State of Missouri and the city of Kansas City.

Operator

Our last question will come from the line of Steven Valiquette with Barclays.

Steven James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

And also, let me just say congrats on reaching the Starboard agreement. It's definitely a positive, no matter how you slice it. I think the additional good news really is that the majority of the investment community believes that the opportunity to get to 22.5% margin by the end of 2020 definitely exists within the company. Nobody's really doubting that. But I think similar to an earlier question, though, I think some investors are still really just trying to process the evolution of Cerner, targeting 30 to 60 bps of margin expansion not that long ago, then just kind of backing off that a little bit, but now you're obviously targeting a much larger 400 basis points in a pretty short time period. And I mean this in a good way, but in some ways, the 22.5% margin target is really almost higher than it needs to be to satisfy investors. I think investors are really just looking for more color on how you arrive at that 22.5% as the right margin target for 4Q of 2020 during this whole process.

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Sure. No, this is Marc. I mean we spent time early on with AlixPartners actually, to go through at a high level before they started doing their deep dives, give us a view of what they thought the opportunities were from an efficiency perspective. And we incorporated that into our thinking. We incorporated the thinking that we have relative to the business and opportunities. And yes, no, we think 22.5% is a strong, stretch target. So we have a high level of confidence in our ability to deliver on that target. I think the efficiencies are available. I think we'll be a healthy organization. And you keep in mind, when you look at the -- really the percent of cost that represents from -- as a percent of your total revenue, it's not that high of a percentage. So relative to the size of the company, we're not doing anything that we expect to be draconian here.

So I think where folks seeing certainly in the space of that 22.5% on cost reduction, things we can control. We're not expecting revenue growth to somehow add some basis points to our operating margin. So I think all in that context, we did the work to say, this feels strong. This is what we believe we can do, and this is what we're willing to commit to, and I think it's a good target. I think it's something that investors should hold us to and focus on. But I don't -- perhaps a smaller target would've been something that people would've been okay with. But I think this sends a message to both investors and our associates that we need to increase the health, financially, of this company. And so we're very comfortable with the 22.5% target, and I think that is our target. And we will continue to be marching towards that. We love the start we have on it, and I think we will continue to do the work that we need to get there. It's not -- it's something that the business can handle. We just have to be doing business more efficiently and better.

David Brent Shafer - *Cerner Corporation - Chairman & CEO*

And I would add, as we have taken a number of steps to set ourselves up for this work, from the work that was done last year and rolled out in first quarter, so the timing's good. We know we had more to do, and it's an ambitious but achievable set of goals. And I think the team's ready to take it on and go after it, and that's what we intend to do.

With that, we thank you all for attending, and we hope you have a good afternoon. Take care.

Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Thank you.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude today's program, and we may all disconnect. Everyone, have a wonderful day.
