Welcome to Cerner Corporation’s second quarter 2021 conference call. Today’s date is July 30, 2021, and this call is being recorded. I'd now like to turn the call over to your host, Allan Kells, SVP, Investor Relations.

Good morning everyone and thank you for joining us. On the call with me today are Brent Shafer, Chairman and CEO; Mark Erceg, our Chief Financial Officer; Don Trigg, our President; and Travis Dalton, our Chief Client and Services Officer. Brent will begin the call with observations on our business and the marketplace, then hand it over to Mark to provide more detail on our results and outlook. We’ll then transition to Q&A and be joined by Don and Travis.

Before we start, I’d like to remind you that our comments will contain forward-looking statements, including projections for our business and other statements about future events. These comments are based on our current expectations and assumptions and are subject to risks and uncertainties. Our actual results could differ materially from those indicated by our forward-looking statements due to those factors identified in our earnings release, which is posted to the investor section of cerner.com and other filings with the SEC. Cerner assumes no obligation to update forward-looking statements or information except as required by law.

We will also be referring to Adjusted, or non-GAAP, financial measures on this call for our discussion of Operating Margin, Earnings Per Share, and Free Cash Flow. A reconciliation of non-GAAP financial measures to GAAP financial measures can be found in our earnings release. These non-GAAP financial measures are not meant to be a substitute for, or superior to, financial measures prepared in accordance with GAAP.

With that, I’ll turn the call over to Brent.
Brent Shafer

Thank you, Allan. Good morning everyone and thanks for joining us.

On our last call, we talked about our sharpened focus and increased sense of urgency to deliver value to our clients and shareholders. As Mark will discuss, this increased focus and urgency helped us deliver very solid results in the second quarter. All key metrics reflected good progress on our transformation initiatives and a strengthening market presence. Based on this progress, we have increased our earnings outlook for the year (again).

What pleases me most is that as we undergo our transformation, we are maintaining an unwavering focus on client success, which is our North Star. Our key initiatives—which include product rationalization, driving operating efficiencies, and continuing to refine our operating structure—all revolve around creating client value through accelerated innovation. We expect these same efforts to also drive sustainable and profitable growth that should create value for shareholders.

I’d like to share examples of progress we are making.

• Through improved focus and structure in our client organization, Travis and his team have:
  o Grown our sales funnel and improved sales and client relationship management, resulting in 24 new client footprints so far this year while reducing client attrition;
  o Improved our overall Net Promoter score by 5 points; and
  o Delivered 49 major client go-lives.

• Don and his team have made meaningful progress on several fronts as well, including:
  o Advancing our product rationalization work, which is creating better focus and freeing investment dollars for products that create the most value for clients; and
  o Driving good sales and go-live activity in key areas, such as Real-Time Health, Behavioral Health, Consumer, Heath Network, and Data, with the progress in the Data space including a successful onboarding of Kantar Health during the second quarter.
• In our technology organization, Jerome Labat, our Chief Technology Officer, has:
  o Made good progress on solution and platform modernization, including being ahead of schedule on migrating CareAware® to the cloud, improving our ambulatory solution, and increasing the scale of CommunityWorks—all while maintaining 99.99%, or ‘four 9’s’, of incident free time for our clients.
  o He has also advanced our Digital Factory, which is a set of capabilities and services that power the product lifecycle from initial requirements to building, delivering, and running our products. This important work should drive R&D efficiencies, improve quality, increase innovation velocity and speed to market, and lower costs of running and supporting our products.

These leaders have made this progress while also delivering cost savings through restructuring and flattening their organizations, centralizing functions, and implementing tools to increase efficiency and improve the way we are running our business. Further, Tracy Platt, our Chief Human Resources Officer, has helped us navigate these changes while staying focused on culture and ensuring Cerner remains a great place to work. This is reflected in our being named one of the World’s Best Employers by Forbes. We have also received recent recognition by Forbes as a top 60 Best Employer for Diversity and for being among the Best Employers for Women.

In summary, we continue to make very good progress both inside Cerner and in the marketplace. Our products and services are well aligned with our clients’ needs as they face pressure to control operating costs, address provider burnout, meet increasing consumer demands, expand service lines, and build networks to improve performance in the evolving reimbursement environment.

Federal Business
Now I’d like to provide an update on our Federal business. The Department of Defense continues to move full speed ahead with deploying MHS GENESIS, their Cerner-powered EHR. In late April, DOD went live with Wave Carson which included 25 military treatment commands, 148 physical locations across 11 states and two time zones. In total, DOD is now live at 42 commands, in 663 locations, with more than 41,000 activated users; demonstrating that the system can be deployed at scale and on schedule. Later this year, DOD plans to go-live at facilities in Hawaii, and the U.S. Coast Guard has planned go-lives for both their Pacific and Atlantic waves, which will complete the Coast Guard deployment as planned.
Moving to the Department of Veterans Affairs. The VA recently completed their strategic review (which we supported) and issued a comprehensive report. Importantly, the findings were generally not technology related. Instead, they were more focused on governance, training and site readiness, and were consistent with the findings of our own internal assessment conducted earlier this year.

We are working closely with the VA on the project plan and ensuring we properly address all identified issues—so we can deliver a lifetime of seamless care for our Veterans. Secretary of Veterans Affairs Denis McDonough has reiterated his commitment to the program and to Cerner and (in return) Cerner has reiterated our commitment to the VA and our nation’s Veterans. While the VA finalizes their new governance and management structure, we will continue our pre-deployment efforts including technical development and enhancements, solution readiness and site preparation, but no further go-lives are expected until 2022. As a result, we now expect another half point of impact on our 2021 revenue growth, which is reflected in our updated guidance for the year.

**CEO Transition**

Before turning the call over to Mark, I’d like to quickly comment on the status of my transition and the search for a new CEO. The search process has been very active since we announced it last quarter. It is difficult to provide a timeline given the sensitivity and importance of the search, but I believe the Board is making good progress. I remain actively engaged and believe the team has been executing very well, so I am confident we will continue to advance our key initiatives as the search continues. As a result, I believe my successor will step into the role with Cerner well positioned for success.

In summary, I am very pleased with Cerner’s progress so far this year. We have demonstrated the ability to execute on near-term deliverables while also driving meaningful organizational change that is positioning Cerner to realize our potential to have a much bigger impact on healthcare.

With that, I’ll turn the call over to Mark.
Thanks Brent and good morning everyone. Today I will cover our second quarter results and provide a guidance update.

**Second Quarter P&L**

Overall, we are pleased with our second quarter results. Bookings were up 2 percent versus year ago to $1.36 billion, which brings year-to-date bookings growth to 7 percent. Importantly, we believe this represents a (positive) inflection point since total bookings were down during Fiscal 2019 and Fiscal 2020. The higher rate of bookings added to our revenue backlog which ended the second quarter at $13.2 billion, which is up 1 percent sequentially and down slightly versus year ago due primarily to divestitures.

Revenue of $1.46 billion was up 10 percent over the year-ago quarter, which was (admittedly) heavily impacted by COVID. The increase in revenue was driven in large part due to strong growth in Federal services. In addition, it is worth noting that virtually all of the growth we experienced during the second quarter was organic with $45 million of incremental revenue from the Kantar Health acquisition being largely offset by $39 million of divested revenue.

Gross margin was down 200 basis points from a year ago at 82.1 percent primarily due to the mix of revenue in the quarter. Specifically, higher levels of lower-margin technology resale, third-party services, and reimbursed travel. Adjusted Operating Margin, however, **expanded** 220 basis points—from 18.4 percent to 20.6 percent, driven primarily by tight expense control and a negatively impacted year-ago margin (due to COVID).

To build on this progress, we took bold actions (across our largest spend pools) during the second quarter.

- For example, we incurred $54 million of employee separation costs due to a sizable reduction in force related to productivity improvements we recently implemented.
• We also incurred a charge of $68 million to reduce the properties line on our balance sheet to fair value in connection with the sale of one property and the designation of two other properties as held for sale. Since the start of the year, we have sold 260 thousand square feet of office space and have earmarked an additional 750 thousand square feet of space for future sale.

• Lastly, we recorded a charge of $48 million to reduce the carrying amount of certain capitalized software development costs to estimated net realizable value as part of our comprehensive product portfolio rationalization work—which is designed to improve (over time) the return on our nearly $800 million annual R&D investment.

Each of these actions (and their related charges) are captured in our reconciliation of GAAP to Non-GAAP results. These actions are also consistent with our previously communicated efforts to operate more efficiently, drive more value for clients and better position Cerner for sustainable long-term profitable growth.

Wrapping up the P&L, Adjusted Diluted EPS was $0.80 per share, which is up 27 percent over last year due to stronger Adjusted Operating Earnings, a lower non-GAAP tax rate and a lower share count.

**Balance Sheet / Cash Flow / Capital Allocation**

Moving to our balance sheet, we ended Q2 with $885 million of cash and short-term investments, which is down from $1.47 billion last quarter. There are two things that account for the change. First, we used $350 million to close on the Kantar Health acquisition. Second, we spent $400 million on share repurchases during the quarter (which brings our purchases through the end of the second quarter up to $750 million). We have been using a large portion of our excess cash and short-term investments throughout the year to repurchase shares because we continue to believe that Cerner stock, at current trading levels, represents a good return on investment for our shareholders.

Sequentially, our quarter ending debt position was unchanged versus Q1 at $1.84 billion.
Operating cash flow for the quarter was $369 million. After $123 million of capital expenditures and $84 million of capitalized software, free cash flow came in at $162 million. This brings year-to-date free cash flow to $453 million (which is more than double the amount we generated during the same period last year). The significant increase in year-to-date free cash flow was driven by strong operating cash flow growth against a COVID-impacted first half of 2020.

**Guidance**

Moving to guidance.

- We expect revenue in Q3 to grow approximately 6 percent compared to Q3 of 2020. This includes just over $40 million of revenue from Kantar Health (slightly offset by a partial quarter of impact from a 2020 divestiture) bringing third quarter organic growth to the low- to mid-single digit range.

- For the full year, we continue to expect mid-single digit revenue growth. This range is consistent with our prior guidance, but we do now expect to be approximately a half point lower (within that range) due to the impact of the VA assessment that Brent discussed during his prepared remarks. Despite our slightly lower revenue expectations, we are confident in our ability to (more than) offset this topline impact with ongoing expense control—as reflected in our enhanced EPS outlook.

- That outlook calls for third quarter Adjusted Diluted EPS growth of 12 to 15 percent over Q3 of 2020.

- And, for the full year, we now expect Adjusted Diluted EPS to be approximately $3.25, reflecting growth of about 14 percent over last year and up from our prior guidance of more than $3.20 per share.

- For the third and fourth quarters we expect our tax rate to be approximately 19 to 20 percent...

- And we expect to generate approximately $900 million of free cash flow for the full year—up from $857 million last year.
• Finally, we remain on track to repurchase up to $1.5 billion of stock this year, which we believe will make better use of our strong balance sheet and free cash flow while still maintaining ample access to capital to fund high return organic growth opportunities and potential future acquisitions (provided, of course, that those acquisitions are attractive both strategically and financially).

In summary, I am pleased with our second quarter results and believe the work we have done (and are continuing to do) will position us for success in the second half of 2021 and beyond. We are making good progress against our strategic focus areas behind disciplined operational execution during a time of significant change.

Personally, I am very proud (and genuinely appreciative of) the dedication and professionalism we are seeing each and every day from Cerner associates all around the world—and I want to take a moment to thank all of them on behalf of Cerner’s entire executive leadership team.

With that, I will turn the call over to the operator for questions.