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EDITED TRANSCRIPT

CERN - Q4 2019 Cerner Corp Earnings Call

EVENT DATE/TIME: FEBRUARY 04, 2020 / 9:30PM GMT

OVERVIEW:

Co. reported 4Q19 revenue of $1.442b, GAAP net earnings of $154m and GAAP diluted EPS of $0.49. Expects 2020 revenue to be $5.725-5.975b and adjusted diluted EPS of $3.09-3.19. Expects 1Q20 revenue to be $1.415-1.465b and adjusted diluted EPS of $0.69-71.

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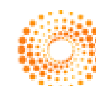

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PRESENTATION

Operator

Welcome to the Cerner Corporation Fourth Quarter 2019 Conference Call. Today's date is February 4, 2020, 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 solutions, services and offering development and capital allocation plans, cost optimization and operational improvement initiatives, future business outlook including new markets or prospects for the company's solutions and services and the expected benefits of certain of our acquisition or other collaborations. Actual results may differ materially from those indicated by the forward-looking statements. Please see Cerner earnings release, which was filed with the SEC today and posted to the Investors section of cerner.com and other filings with the SEC for additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements. A reconciliation of non-GAAP financial measures discussed in the earnings call can also be found in the company's earnings release. 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 CEO of Cerner Corporation.

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

Thank you, Duluem, and good afternoon, everyone, and welcome to the call. I'm joining the call from a client event, so I'll start the call with a few comments, then hand it over to the team in Kansas City, including our CFO, Marc Naughton; Chief Client Officer, John Peterzalek; and EVP of Strategic Growth, Don Trigg.

2019 was an important and productive year for Cerner. We began the year by introducing a new operating model to refine our operational organizational alignment to enhance our client focus and to accelerate scalable innovation to make Cerner easier to do business with. We also

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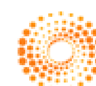

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initiated a company-wide transformation focused on operating efficiencies, business simplification, portfolio management and refining our growth strategy to position Cerner for long-term profitable growth. Further, we enhanced our governance through the addition of 4 strong Board members, who along with our existing members have been invaluable as we work through our transformation.

Our 2019 progress is reflected in our fourth quarter results, which included good performance across all key metrics including exceeding our adjusted operating margin target and delivering record free cash flow. We also returned $1.4 billion of capital to shareholders in 2019 through our share buyback program and our first 2 dividend payments, all reflecting our commitment to delivering value to shareholders.

Also significant in 2019 was the announcement of a multifaceted collaboration with AWS and Amazon. We view this relationship as an enabler to many of the growth strategies we've discussed on previous calls including Cerner's development of a cognitive platform and our evolution to become the Software-as-a-Service health care IT partner. Leveraging the powerful combination of Cerner technology, the AWS infrastructure, their artificial intelligence and machine learning capabilities, we expect to create next-generation user experiences and innovations to deliver more predictive patient-centric care.

Now before turning the call over to Marc, I'd like to discuss Cerner's position on the topic of interoperability, data security and privacy. For several decades, Cerner has been a trusted steward of health information and a leader in the pursuit of data interoperability. We have been a vocal proponent of the 21st Century Cures Act and look forward to continuing our work with the ONC, with clients and with other key stakeholders to ensure a secure flow of information across disparate systems and health care entities. We do this because it's the right thing to do, and I'm reminded of it today, I started my career at Intermountain Healthcare, and this is where I spent the day today talking with other leaders about the future of health and care. And we talked a lot about the fact that health care is too important to stay the same. And I love the chance to get together and collaborate with other organizations like Intermountain, who are working to help people live the healthiest lives possible.

We fundamentally believe it's wrong to ask patients striving to get better to manage a collection of faxes, PDFs and paper-filled shopping bags. It's wrong to ask providers to leave their workflows to review and leverage relevant patient information. It's wrong to waste hundreds of billions of dollars on the highest administrative costs in the world when we're in the middle of an affordability crisis in the United States health care.

So we're going to continue to be a positive voice for change in the industry. Access to the right information at the right time in the right place continues to drive our advocacy in Washington and the global markets we serve.

In summary, I'm very pleased with everything we accomplished in 2019. We consistently delivered against expectations we set while driving a significant amount of change throughout Cerner. So it's hard work. And I specifically appreciate all the Cerner associates' hard work throughout the year and their contributions to this progress. We have a lot more to do in 2020. We're off to a good start, and I'm optimistic we'll continue to advance our transformation. And more importantly, I believe the work we are doing will position us to create meaningful value in health care while also driving good long-term growth for Cerner.

And now I'll turn the call over to Marc.

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

Thanks, Brent. Good afternoon, everyone. Before I begin, I did want to cover the most important numbers from the weekend, which are 31 and 20, reflecting the 11 point win for the Super Bowl Champion, Kansas City Chiefs. Go Chiefs!

Now I'll cover our Q4 results and future period guidance. This quarter, we delivered all key metrics at or above our guidance.

I'll start with bookings, which were $1.665 billion in Q4, exceeding the high end of our guidance. This is down from Q4 '18, which was the second highest bookings quarter in our history. Full year bookings were $5.99 billion, which is down from $6.721 billion in 2018. The decline in Q4 and for the year was primarily due to a decline in long-term bookings related to us being more selective on our outsourcing contracts, as we've discussed throughout the year.

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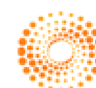

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We ended the quarter with a revenue backlog of $13.71 billion, which is down 10% from a year ago, primarily due to the termination of a RevWorks agreement that I discussed on our Q3 call. Also recall that our backlog calculation of the new revenue 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 our backlog, our revenue visibility remains at nearly 85% over the next 12 months.

Revenue in the quarter was $1.442 billion, up 6% over Q4 of '18 and in line with our expectations. Total revenue for the year was $5.693 billion, reflecting growth of 6% over 2018.

Now I'll go through the business model detail and year-over-year growth compared to Q4 '18 and full year 2018.

Licensed software revenue in Q4 grew 5% over Q4 of $18 to $174 million, and full year licensed software revenue grew 11% over 2018 to $681 million, both primarily due to strong growth in our SaaS offerings.

Technology resale of $60 million in Q4 increased 31% compared to a weak Q4 of '18. Full year technology resale revenue was up 1% to $247 million.

Subscription revenue grew 7% in Q4 to $93 million. Full year subscription revenue was $359 million, up 10% from $326 million in 2018.

Professional services revenue grew 9% in Q4 to $509 million, primarily driven by solid growth in implementation services and partially offset by approximately $23 million less revenue due to termination of the RevWorks agreement we previously discussed. Full year professional services revenue grew 10% to $1.992 billion.

Managed services was up 3% in Q4 to $309 million. Full year managed services revenue was $1.214 billion, an increase of 5% over 2018.

Support and maintenance was down 1% to $274 million for the quarter, which is our expectation range and reflects the impact of some past attrition that we discussed last quarter. Full year support and maintenance revenue was also down 1% for 2018 at $1.105 billion.

And finally, reimbursed travel of $22 million was down 9% in Q4 and down 2% for the full year at $95 million.

Looking at revenue by geographic segment. Domestic revenue was up 6% from the year-ago quarter at $1.276 billion, and non-U.S. revenue of $166 million was up 3% from the year-ago quarter. For the full year, domestic revenue grew 7%, and non-U.S. revenue grew 3%.

Moving to gross margin. Our gross margin for Q4 was 80.8%, down from 81% in Q3 of '19 and 82.6% year-over-year. Full year gross margin of 81.2% is down from 82.5% in 2018. The declines in our quarterly and full year gross margin are both driven by higher third-party services largely related to our federal business and a lower margin mix within technology resale.

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, acquisition-related adjustments, organizational restructuring and other expenses and other adjustments that are detailed and reconciled to GAAP in our earnings release.

Looking at our operating spending, our fourth quarter GAAP operating expenses of $982 million were up 2% compared to $965 million in the year-ago period. Full year GAAP operating expenses were $4.021 billion, up 10% from $3.654 billion in 2018.

Our adjusted operating expenses were up 4% for the full year with the fourth quarter essentially flat compared to Q4 of '18, reflecting good progress on our cost optimization efforts. Looking at the line items for Q4. Sales and client service expense increased 1% in Q4. Software development expense increased 4% over Q4 of '18, driven by a 1% increase in gross R&D, a 7% increase in amortization and a 3% decrease in capitalized software. G&A expense is 15%, driven by a decline in both personnel and non-personnel expenses. Amortization of acquisition-related intangibles decreased slightly year-over-year.

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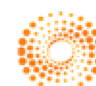

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Moving to operating margins. Our GAAP operating margin in Q4 was 12.7% compared to 12.0% in the year-ago period. Our adjusted operating margin for the quarter was 20.3%, up from 18.7% in Q4 of '18 and 18.1% last quarter. Our Q4 adjusted operating margin is in line with our expectations and above the 20% adjusted operating margin target for Q4 of '19 that we committed to last April. Our GAAP operating margin for full year 2019 was 10.6% compared to 14.4% in 2018. And our full year adjusted operating margin was 18.5%, which is down slightly from 18.8% last year.

We believe our ongoing business optimization efforts keep us on track for delivering our targeted Q4 '20 adjusted operating margin of 22.5%. I'd note that some of the margin expansion is expected to be back-end-loaded like last year due to the timing of our initiatives and some seasonality. However, our guidance, which I'll discuss in a minute, does reflect a full year adjusted operating margin of approximately 21%, which is about 250 basis points higher than 2019 and reflects the cumulative impact of all the optimization work we have done and expect to do this year. We also believe we can continue improving profitability beyond 2020 through ongoing optimization efforts and a longer-term opportunity to benefit from platform modernization.

As we discussed, the benefits from platform modernization will be a multiyear process, particularly for Millennium. And most near-term benefits are largely offset by modernization investments. However, we expect the lower operating costs associated with this move, along with efficiencies and improvements we're driving in our development process, to meaningfully contribute to our profitability while also helping us deliver a differentiated solution to our clients at a lower total cost of ownership.

Moving to net earnings and EPS. Our GAAP net earnings in Q4 were $154 million or $0.49 per diluted share. It is up from $0.40 in Q4 of '18. For the full year, GAAP net earnings were $529 million or $1.65 per diluted share. Adjusted net earnings in Q4 were $237 million, and adjusted diluted EPS was $0.75 compared to $0.63 in Q4 of '18. For the full year, adjusted net earnings were $862 million, and adjusted diluted EPS was $2.68, up 9% from 2018.

Our GAAP tax rate was 19% for the quarter and year. Our non-GAAP tax rate was 20% for the quarter and year. For 2020, we expect our GAAP and non-GAAP tax rates to be between 20% and 22%.

Moving to our balance sheet. We ended Q4 with $542 million of cash and short-term investments, which is down from $633 million last quarter, with our free cash flow being offset by our $75 million acquisition of AbleVets and $300 million of share repurchases in Q4. For the year, we repurchased 18.8 million shares for $1.3 billion at an average price of $69.06, keeping us on track against our plan to repurchase $1.5 billion by the end of Q1 of '20.

Moving to debt. Our total debt remained flat to last quarter at $1.038 billion. Total receivables ended the quarter at $1.14 billion, down from $1.155 billion in Q3 of '19. Our Q4 DSO was 72 days, which is down from 74 days in Q3 of '19 and 79 days in the year-ago period. Operating cash flow for the quarter was $438 million. Q4 capital expenditures were $83 million, and capitalized software was $63 million. Free cash flow defined as operating cash flow less capital purchases and capitalized software development costs was $292 million for the quarter. For the full year, operating cash flow was $1.313 billion. Capital expenditures were $472 million, and capitalized software was $274 million. Full year free cash flow was $568 million, which is down $166 million from 2018, driven by higher capital expenditures and restructuring costs. For 2020, we expect some level of restructuring costs to continue, but we still expect higher operating cash flow and lower CapEx to drive strong free cash flow growth.

Moving to capital allocation. As I indicated, we repurchased $1.3 billion shares of stock in 2019 and remain on track to meet our targeted level of $1.5 billion by the end of Q1. In December, we announced that our Board authorized the repurchase of an additional $1.5 billion of stock, bringing the total authorized amount available for repurchase up to $1.7 billion. We intend to continue funding these repurchases with a combination of cash from operations and debt, and the timing and amount of repurchases will depend on how much funding is used for other purposes such as acquisitions or investments.

Moving to our dividend program. We paid our first 3 quarterly dividends of $0.18 per share on July 26, October 9, January 9. Our quarterly dividend payments and the increased authorization in our share repurchase plan reflect our continued commitment to return capital to shareholders and the belief in Cerner's long-term potential.

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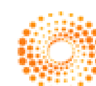

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I'd also note that we completed our acquisition of AbleVets in Q4 and have begun to integrate their service offerings into our portfolio to accelerate our success in the federal space. As we've discussed, we expect to be more active in M&A, as we believe there are opportunities that could be foundational to our growth in several of the markets our strategic growth organization is pursuing. I'd also note that our portfolio management efforts are expected to lead to some divestiture activity as we look to create more focus in areas most aligned with our refined growth strategy.

Now I'll go through guidance. We expect revenue in Q1 to be between $1.415 billion and $1.465 billion. The midpoint of this range reflects growth of 4% over Q1 of '19. For the full year, we expect revenue between $5.725 billion and $5.975 billion with a $5.85 billion midpoint, reflecting 3% growth over 2019. The midpoint of this range is slightly below consensus growth of 4%. We expect this could be due to estimates not fully factoring in the impact of reduced levels of outsourcing bookings in 2019 and our continued approach of being more selective with those types of contracts.

Also, I'd like to walk you through an organic growth view of 2020. If you adjust for exit from the Adventist Health contract by taking that revenue out of 2019, our 2020 growth would be over 5%. Adjusting our AbleVets revenue would bring pure organic growth back to 4%. But we don't view all of the revenue for AbleVets as inorganic because we expect to leverage their associates and performing on the VA contract as it ramps up. This normally would have been done through organic hiring, but we believe there is value in leveraging their highly qualified workforce. As we've discussed, there will likely be additional actions we take this year that could result in revenue reductions. There is also the potential that we do M&A, which could serve as an offset to divestiture activity. Overall, we do expect there to be several moving parts on the top line in 2020, but we believe the actions we take will set us up for solid and profitable growth.

Moving to EPS. We expect Q1 adjusted diluted EPS to be $0.69 to $0.71 per share. The midpoint of this range is 15% higher than Q1 of '19. Our adjusted diluted EPS guidance reflects a ramp-up throughout the year that is similar to last year, with the biggest sequential increase in Q4. This reflects the expected timing of ongoing efficiency and operation efforts. For the full year, we expect adjusted diluted EPS to be $3.09 to $3.19, with a $3.14 midpoint reflecting 17% growth over 2019. As I mentioned, we also expect our adjusted operating margin to ramp during the year, with Q4 expected to be slightly higher than our 22.5% target, due primarily to a lower mix of outsourcing revenue.

I'd also note our expected full year non-GAAP tax rate of approximately 21% is 1% higher than 2019, impacting EPS by about $0.04.

Moving to bookings guidance. We expect bookings revenue in Q1 of $1.1 billion to $1.3 billion. The midpoint of this range reflects a 3% decrease compared to the first quarter of 2019, driven by an expected decline in long-term bookings.

In summary, we are pleased with our strong results in the fourth quarter and believe we've made a lot of progress this year. There's a lot of hard work left to meet our profitability and growth targets, but we have a good plan in place and expect to execute it in 2020 and beyond.

Before I wrap up, I'd like to remind you that we will host our Annual Investment Community Meeting at HIMSS on Tuesday, March 10. If you plan to attend and have not registered, please do so through the link at the top of the Investors section of cerner.com. If you are unable to attend in person, there will be a webcast available.

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 will provide results, highlights and an update on our federal business. I'll start with our bookings.

As Marc mentioned, we delivered bookings ahead of our guidance range for the quarter, driven by strong contributions across multiple segments such as investor owned, academic and IDNs. We also had good contributions from revenue cycle solutions and across our strategic growth businesses, which Don will discuss.

Consistent with recent quarters, we had a lower level of long-term bookings compared to last year, which drove the decline in overall bookings. For the quarter, the percent of bookings coming from long-term contracts was 29% compared to 38% in Q4 of last year. Long-term bookings for

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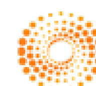

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the year represented 28% of total bookings compared to 36% last year, with this decline in long-term bookings driving total bookings down for the year. Bookings excluding long-term contracts increased slightly for the full year.

Looking at the broader marketplace, many of the same trends continued to play out during 2019, with health care cost growth outpacing the economy; elevated levels of industry consolidation; rising consumer expectations around cost, convenience and service; and the continual gradual evolution of reimbursement models adding to pressure on providers to lower costs and advance their risk-based strategies. These forces are contributing to an overall challenging macro environment. Providers are simultaneously seeking to grow key service lines, drive operational efficiencies to make money at Medicare rates and build out the competencies required to take and effectively manage risk and participation in value-based reimbursement models. Information technology is seen as an enabler of these efforts, which represents an opportunity for Cerner. At the same time, the lower-margin nature of provider businesses can make it difficult to fund required investment, make it important for solutions and services to have a clear return on investment.

As we look at 2020, we see solid opportunity both in our installed base as well as continuing to gain new clients. This opportunity is reflected in our pipeline, which is up year-over-year for both new business and opportunities for sales back into our base. In our base, we are focused on getting our clients current while also filling out their Cerner solutions suite with a focus on increasing penetration of revenue cycle solutions and solutions supported by our CareAware and HealtheIntent platforms. Our CommunityWorks pipeline remains strong, and we have opportunities outside of our traditional provider base in areas such as state government, employer and long-term post-acute care.

We also have opportunities to continue growing the presence of our EHR-agnostic CareAware and HealtheIntent solutions beyond our EHR base.

Moving to our federal business. We continue to advance both our VA and DoD projects. On the VA project, Cerner, along with the VA and our partners, remain focused on initial operating capability, or IOC go-live. We have completed initial integration validation and are doing a significant amount of training and site preparation activities ahead of the scheduled go-live in March. Looking beyond the initial go-live, we also expect to go live at additional IOC sites in 2020 and continue to steadily scale our work to provide additional value and capabilities to the VA in the upcoming quarters. As Marc mentioned, we expect to leverage the AbleVets team as these activities ramp throughout the year.

We're also making good progress on DoD. We successfully completed the code upgrade during the quarter and kicked off the Coast Guard project and 2 additional deployment waves. Go-lives for these waves are slated for late 2020.

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

Donald D. Trigg - *Cerner Corporation - EVP of Strategic Growth*

Thanks, John. Good afternoon, everyone. Our strategic growth organization launched in 2019. Our ambition was a simple one: scale a set of focused business units that position Cerner beyond the hospital, beyond our Cerner Millennium EMR and beyond the traditional fee-for-service payment model.

The 6 business units that make up strategic growth, each target large addressable markets in excess of $3 billion, with a path to meaningful share in each market. They gain leverage from existing Cerner assets ranging from the industry-leading data processing and aggregation capabilities of HealtheIntent, to our subject matter expertise around the last-mile EMR workflow. Regulatory requirements are understood, surmountable and offer opportunities for differentiation. All 6 businesses are overweight on recurring revenue and high gross margin potential. And finally, strategic growth leaders focus squarely on speed to revenue as they pursue larger category-leading positions.

For full year 2019, our strategic growth businesses generated $520 million in revenue, representing 22% growth year-over-year. We believe we can deliver similar growth in 2020 and look forward to our Investor Day at HIMSS in Orlando, which will afford us the opportunity to review the long-term targets for each business.

As we look at areas of particular strength in 2019, cybersecurity frames our strategic approach. U.S. health care has seen data breaches at a rate of 1 per day. Our technologies are core to how CIOs and CSIOs are building out their enterprise strategies. Cyber is an area of growing internal

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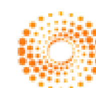

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competency, driven in part by our critical work to support our armed services and veterans. As a result, our security revenue from health systems grew nearly 40% in 2019.

Our provider communications business, leveraging our EMR-agnostic CareAware platform, also benefited from strong market tailwinds and delivered record bookings in 2019. CareAware Connect solution adoption was strong with an over 100% year-over-year increase in utilization to almost 75,000 monthly users.

We also were pleased with the full year progress in the long-term and post-acute care market with 23% year-over-year growth. Our behavioral health solution within our LT pack suite was a particular bright spot. It delivered almost 40 new footprints, with 80% of total bookings revenue coming from outside our Millennium base. Our unified behavioral health solution is not only strongly differentiated in the market, it also was announced Friday as the 2019 Best-in-KLAS category leader. For individuals and families that seek help, our unified Cerner solutions strives to make it easier for providers to deliver the integrated care that successful treatment demands.

While LTPAC is an area we sell at the point solution level, it also fits solidly into our larger strategic push to build out our health network strategies in every MSA in the United States and all 5 of our focused global regions.

At the technical platform level, our HealtheIntent platform is a strategic lynchpin of our health network efforts. Our market-facing push to drive adoption of HealtheIntent continued to progress in 2019, bringing us to 175 HealtheIntent plants worldwide, including the addition of leading providers like Prospect Health and DaVita Health.

As Brent noted in describing our AWS partnership, HealtheIntent was built as a native cloud platform, is EMR-agnostic and has been recognized by industry analysts like Chillmark as having the best product capabilities in the category. It also has been at the heart of our work with AWS.

As we move nearly all of our non-federal HealtheIntent clients to the AWS public cloud in the first half of 2020, it will establish the clear value proposition of cloud technology approach for provider health care. We also see it as a key enabler of our health network strategy and focused global markets such as England, as the NHS accelerates its push to advance Integrated Care Systems.

Finally, with the content of health care digitized, we also are advancing a set of strategies around data services. Art Glasgow and team launched a learning health network concept in 2019 to make it easier for patients to be identified and participate in clinical trials. The new clinical research institute partnership announced in 2019 played a central role in generating research opportunities for Cerner clients. And top health systems, such as MedStar announced yesterday, are helping us to activate a network we believe can make it less expensive to create the next-generation of life-saving therapeutics.

Across all 6 business units, our efforts to drive strategic growth fit into an emerging enterprise discipline around portfolio management across Cerner. In 2019, we were as intentional about the things we decided not to do as the things we decided to do.

Several important strategic growth partnerships helped tell that story. Our partnership with ResMed offers new revenue-generating opportunities in post-acute care and advanced analytics around sleep & respiratory. It also featured a decision to make ResMed's Brightree home health offering our preferred go-to-market solution. Similarly, our partnership with GetWellNetwork embedded their HealthLoop asset into our consumer application framework. It also came with a portfolio decision to not invest further in our MyStation patient engagement solution in favor of GetWell's industry-leading offering.

We believe a combination of thoughtful build, buy, partner assessment will bring us closer to our long-standing vision to build a system of health and care with the individual at the center. It's a system where consumers not only have a right to their data but also have the ability to mobilize it in pursuit of better health.

We believe the entrepreneurial opportunities at the intersection of health care and IT have never been greater. We're excited about what 2020 and the 2020s hold for setting an emerging area of strategic growth for Cerner.

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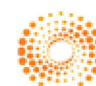

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2019 performance, for its part, laid a solid foundation for moving further, faster in the quarters to come.

And with that, let me turn the call over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Robert Jones from Goldman Sachs.

Robert Jones

I guess, Marc, just to go back to some of your comments, you highlighted 4% growth ex AbleVets addition and less the revenue cycle service contract that you guys exited. I guess, just out of curiosity, as we frame the year and understanding that 2020 has been put aside as kind of a transition year, how much of that remaining growth came from federal? And then, clearly more importantly, and I know we'll hear more in March, maybe just some of the major building blocks that as you think about returning to profitable growth in the future? What are the pieces we should be at least starting to frame out as we think about growth beyond 2020?

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

Yes. No, this is Marc. I think from a -- certainly, as we look at the year and trying to get apples-to-apples will be a little bit challenging in 2020. We're going to do our best job to do that. It's a little bit why we try to talk a little bit about organic growth. I think if we get back to the overall view of top line growth, we've talked last year about kind of that being the 6% to 9% range. Clearly, the outsourcing selectivity and certainly the Adventist contract could impact that. And I think as we look through that, that's probably 100 basis point potential impact, which would put you some place in a 5% to 8% top line growth level, I think that's certainly something that we would expect to be doable for us.

I think from the things that are going to continue driving, certainly, federal will be part of that growth as that contract, the VA contracts ramps its way up to $1 billion a year of annual revenue. That's $250 million or so of additional annual growth in revenue that's just coming out of the VA contract, depending on the time period. So that's certainly a good driver.

And then strategic growth is obviously another area that we're expecting to see growth out of, that will take the -- to $500 million to $600 million business it is today and continue to grow that at strong growth rates. We also look at the opportunity that we have just within our existing base business. So our core business, the opportunity to sell revenue cycle solutions back into that base, the ability to go attack the white space, all of those are things that we think, overall, are elements that contribute to us having overall top line growth. And that really, all of those things I've talked about are primarily organic. We've talked in the past that we also expect there to be a level of inorganic growth for us and some M&A that will support primarily the opportunities in strategic growth. And depending on the size of those opportunities and the size -- the revenue impact they bring, that certainly could be accretive to those -- to the top line growth that we've talked about. But certainly, as we go -- get to HIMSS and can have a little bit more time with everyone, we'll try to take you through a more detailed view of strategic growth and the elements of those businesses and how we've got the opportunities for growing the top line, kind of just in the range that we've traditionally discussed. But I think to your point, we have talked about 2020 being a reset year. We are looking at opportunities to divest certain things as we do our portfolio management. That's going to negatively impact revenue. The M&A will positively impact revenue. And what we'll try to do on a quarterly basis is kind of give you an update as to where we're going. Obviously, we'll be giving you quarterly guidance if there's any adjustments. But right now, we think the guidance we provided for the year is really solid.

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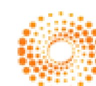

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Robert Jones

No, Marc, I appreciate all that. I guess just a quick follow-up on your comments then would be around those potential further divestitures and potential M&A. Are those contemplated in the 2020 guidance? Or is this kind of best case of what we know today is just where the business stands?

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

Yes. The way we did our guidance was basically kind of on a same-store basis, so it does not contemplate any of the divestitures. It does not contemplate any of the M&A potential activity because that's still, as of today, something to be determined. We think it's going to be more effective as those items occur that we can talk about them at that point. Keep in mind that the AH, if you will, divestiture or that RevWorks business going away is by far the largest item that was on the list. Those items after that would be smaller items. So whether they even impact the overall guidance, to a great extent, will be something we determine at the point they occur. But right now, the guidance is based on current course and speed, and then we will adjust as we -- as anything comes up in that space, one way or the other.

Operator

Our next question comes from Kevin Caliendo from UBS.

Kevin Caliendo - *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare IT and Distribution*

I know you don't guide for bookings for the full year, but given the shift away from LT service bookings, when do you think it's reasonable for you to assume you can return to year-over-year bookings growth? And when I look at the ones you guide, is there any additional content waiting for the shift? Or do you view the year-over-year long-term bookings compares already normalize entering the year?

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

Yes. I mean, I think, clearly, we don't guide beyond the Q1 because we do want to be pretty accurate relative to our guidance. I think as you -- the solid results that we delivered in Q4, actually delivering above our guidance range, with the opportunity based on some opportunities to pull things in to the quarter based on some of the timing of our clients and their year ends, that is going to impact Q1 a little bit because those things would have normally been landing in Q1. But I think we're still normalizing for some of the outsourcing elements in the bookings.

So I think for 2020, while it's kind of a year for resetting the top line from a growth perspective, I think it's fair to say that the bookings, we'll get through the full year of 2020, and then we should get some pretty comparable bookings to be able to do apples-to-apples growth thereafter. But Q1 is still being impacted by the more focused view of anything that we're going to do on the services side that might be in the outsourcing space.

Kevin Caliendo - *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare IT and Distribution*

And one quick follow-up, if I might. So we were reading that a VA Deputy Secretary was let go yesterday, and I guess he was the one who was technically in charge of VA implementations. I was wondering if you had been in contact with them, with leadership over there since that decision was made. Is there any concern or any issues about timing or potential bottlenecks for the implementation of the VA contract?

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

Yes, this is John. I won't comment specifically on that activity, but what I would say is that both the veterans, VA, the modernization project, they have significant bipartisan support. And the fact that there are changes in political activity, it's not a surprise or unexpected. And from the beginning of this project, we took great effort in making sure that we had broad support throughout The Hill, the VA, veterans groups and other constituents

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and supporters to ensure when things like this do happen, or political activity occurs, it doesn't impact where we're going. So we don't anticipate any impact from that, and we think that our broad base of support is incredibly solid, and we're just going to continue on.

Operator

Our next question comes from Charles Rhyee from Cowen.

Charles Rhyee - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Maybe you want to touch on -- I think, at the beginning, you guys talked about the interoperability rules, the final rule is right expected soon. Any thoughts on sort of the -- I know there were some concerns, particularly on providers around compressed timelines or perceived compressed timelines for implementation. How do you view those challenges? And what is -- what would you talk -- I guess, say, about your preparedness to help clients to work through that? And any thoughts on maybe seeing a phased implementation schedule put in place instead?

Donald D. Trigg - *Cerner Corporation - EVP of Strategic Growth*

Yes. So this is Don. I think, first and foremost, just to echo Brent's comments. This is a space that we've been very vocal on and pushed aggressively on for a number of years. So we have a lot of, I think, personal passion around interoperability, semantic interoperability and what this space needs to look like for patients and providers and payers. So that's first and foremost.

I think, secondly, we feel like we're very well positioned to meet the implementation time lines that are being discussed, both from a technical and a nontechnical business perspective. We'll obviously finalize those strategies as the final rule comes out and they're completely understood, but we think they're manageable and that we're well positioned to do that.

And I think, finally, just to reiterate some of the framing on the call, we think there's going to be a ton of business opportunities associated with these elevated rates of data liquidity. So when I think about the types of things that we're doing to enable our strategies around Medicare Advantage, alternative payment models like bundled payments and BPCIA, the opportunity to think through the technical strategies required to help provide our organizations make those business models work, we think create tons of opportunity for Cerner, and frankly for the industry as a whole.

Charles Rhyee - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Great. And maybe if I could just follow on, in terms of sort of the strategic -- the new model that you're working on. I'm not sure if I might have missed it, but I didn't hear any mention of Lumeris. Just curious on an update on how that partnership's working.

Donald D. Trigg - *Cerner Corporation - EVP of Strategic Growth*

Yes. No, I appreciate it. We think we're making a ton of progress there, and I'll tether back to the comments I just made. So first and foremost, really, the thing that was -- one of the things that was super exciting to us was to take the methodology, sort of the best-in-class methodology of Lumeris for Medicare Advantage, our technical capabilities and their service expertise and use it to bring a total solution offering to the market.

In terms of progress made around that, we were very excited to use HealtheIntent as a foundational platform for running a provider-sponsored plan, focused on MA, and we over-attained against those IP milestones over the course of 2019, and now we're deploying the solution as part of the go-to-market strategy for Lumeris and Cerner.

And again, just to come back to the topic around information sharing, if you think about the 4-star MA plan that Lumeris runs in the St. Louis market, 14 different practices, high degrees of technology, heterogeneity and how do you think about elevated rates of data liquidity, both to drive through your strategies for activating that network as well as integrating their best practice capabilities into the last-mile workflow of the physician, it's

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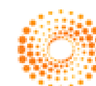

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nicely complementary to the regulatory trends that are playing out. And we think it represents one of several very big business model opportunities for us going forward.

Operator

Our next question comes from Ricky Goldwasser from Morgan Stanley.

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

Going back to the revenue growth guidance and some of the comments, Marc, that you made. So first of all, just to clarify because I might have missed it. I think at some point, you said 5% to 8% is doable for longer-term revenue growth, and I'm just trying to understand the building block there. That's one.

Second of all, I think you highlighted that the VA is a long-term revenue opportunity, so I just want to make sure that we heard it right that you expect it to grow, that $250 million that you mentioned, beyond the term of the initial contract.

And then lastly, as we think about the potential divestitures that are not included in this guidance range that you provided us today, who's making the decision? Is this a decision that you are making based on the margin mix? Or is this something that the client, when the contract is up for renewal, decides to not renew? I just -- just if you can just clarify why is this taking such a long time to make the decision of what contracts are being divested or not?

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

Sure. First of all, the 5% to 8% was really just discussing the long-term growth we kind of provided last year at HIMSS of 6% to 9%, with a little bit of 100 bps haircut based on the lower amount of outsourcing activity that's going to happen. So we're going to be -- as I indicated, a little bit earlier, at HIMSS we'll be taking you through that long-term growth rate, what that looks like, where it's coming relative to our core businesses, our strategic growth businesses, our federal businesses, so you'll be able to see how it lays out. And then we'll give you some more details as to the strategic growth businesses that underpin all of those growth assumptions. So our goal is to lay out a very clear path that kind of falls within that range, with the opportunity to over-attain depending on what we do from an M&A perspective.

Relative to the VA contract, when we first talked about it being a $10 billion contract and it's a 10-year contract, the math would say that's $1 billion a year. Obviously, there's a ramp-up period. And when we talk about it -- and when we talked about it, we said it ramps up over a 4-year period, growing about $250 million a year until it gets to the $1 billion. So my reference to that $250 million increase was basically the revenue we're going to be ramping up to in that contract that gets us to the $1 billion run rate. We have talked about the opportunities to certainly sell more of our solutions and services to the VA, which could increase the $1 billion to a bigger number. But certainly, the $250 million I reference is just kind of current course and speed, ramping up the projects, doing more and more in implementations and how that drives that revenue stream forward. So nothing new there. That's just really reiterating what we've talked about. It's another piece of the growth puzzle that is -- we talked about and does drive a good amount of growth.

And finally, on the divestitures, AH was a little bit of an anomaly in that space. That was really a business we're looking to kind of decide whether we want to be in or not. They were our largest client in that outsourcing. So that was more of a client contractual agreement. Going forward, it will be much more of us reviewing relative to our portfolio management, relative to our growth options for the business, where do we want to focus our attention. In those areas that we don't want to -- don't think are the growth areas for the company we want to focus on, we're going to consider divesting as one of the options. We'll consider divesting. We'll consider partnering. There are a variety of things that we'll consider. But those divestitures will be, in many cases, of an existing business. It won't be a specific client relationship that will be unwound in some way. It will be an existing business that we will basically go out to market and look for opportunities to say, here's this asset. It's something we're willing to let go. And some of these assets have significant value. So I think -- and from a why-is-it-taking-so-long standpoint, there is a lot of work we've done in our portfolio management to decide what are the key things we want to drive as we talked, that work really was a lot of the 2019 work and really

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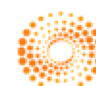

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was kind of finalizing as we ended the year. And certainly, some of these activities on divestitures are already underway, and ideally will be things that we can share with you in the very near future.

Operator

Our next question comes from Jeff Garro from William Blair.

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

I want to ask a little bit more about the AWS partnership and maybe putting aside the very important work around migration and those long-term benefits of efficiency and lowered TCO for our clients, more curious on the consumer experience innovation side and what type of milestones, either IP milestones or bookings-related milestones that we can look for in 2020 from that partnership.

Donald D. Trigg - *Cerner Corporation - EVP of Strategic Growth*

Yes. It's a great question, Jeff. Thanks. So let me talk to kind of multiple pieces of it. Just in terms of one, the framework for the relationship, I think, one of the things that we were excited about from an AWS and Amazon perspective was not just the opportunity to think through technical migration to the public cloud but to really think about broader opportunities around the Amazon relationship and what it would look like, in particular, to leverage their deep competencies around the consumer. Coupled with their strong interest in being part of the health care ecosystem. So that was a, I think, a design feature of the relationship. And I think we've been very happy with our opportunity to kind of engage with them and to look at key strategies around approach, whether those are publicly disclosed activities around how they think about their employee population and some of the things that they're doing in concert with JPM and with Berkshire portfolio of companies or acquisitions that they've made around capabilities like PillPack. So we've had good visibility to that. We think it's an exciting piece -- potential piece of the relationship and an important part of how we want to think about making the partnership work going forward.

Secondly, from a technical perspective, I talked a little bit about the fact that HealtheIntent has really been a tip of the spear, if you will, relative to the migration to the public cloud. Most of that work will be completed in the first half of the year. CareAware, similarly, is part of that early strategy and path. And I think we've been very transparent in terms of saying that the time frames around Millennium will be more elongated.

Finally, in terms of what this is going to look like in terms of targeted bookings or revenue impact I think there's businesses within strategic growth that are very excited about the potential pull-through impact relative to revenue. I would say our consumer and employer businesses in particular have a lot of energy here and have been real drivers around the strategic collaboration, but we're probably not at a point in the life cycle of the dialogue where I can put out a revenue target or a bookings target that we would feel confident we could hit or over-attain.

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

Great. That's very helpful. One quick follow-up, maybe on the technical side on HealtheIntent and CareAware in this first half migration. Maybe just some more specifics around where the benefits are for Cerner with those migrations and where the benefits are for clients.

Donald D. Trigg - *Cerner Corporation - EVP of Strategic Growth*

Yes. Well, first of all, I think just the ability to be able to stage and think through the migration to the public cloud has had a real value proposition for us as we try to think really comprehensively about not only the technical components but also how we have this conversation with our clients, how we think about innovation potentials in concert with our provider clients as part of the dialogue and the approach.

In terms of benefits, I think there are clear and demonstrable benefits that our clients are going to see. There's a performance -- system performance benefit that's very real. There is a benefit around latency and how we think about the path to near-real time data assets that I think could be very

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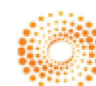

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important around strategies like hospital operations. And I think this is also relevant as we start thinking about growth opportunities like cybersecurity where clients need our competency and expertise around how they manage hybrid environments with on-prem and cloud. So I think real benefits that we're deriving from a performance perspective, from a data and utilization of the data against business strategy and some really interesting, from my perspective, conversations around capability that we have that create white space opportunities for growth.

Operator

Our next question comes from Sean Wieland from Piper Sandler.

Sean William Wieland - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

So on the restructuring costs that you're talking about Marc, you said 2020, your restructuring costs are going to continue. Can you quantify the impact that these costs are to the operating margin that you're forecasting, both in 2019 and 2020?

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

Well, the operating -- the restructuring costs that we're incurring that are the restructuring costs currently are being adjusted out of earnings, so our adjusted earnings, there is 0 impact on that, and that is the number on which we have based our operating margin targets.

Sean William Wieland - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Okay. And then -- that's helpful. And then a quick clarifying question. You said you're going to move almost all your hosting clients to AWS, first half of '20. That's consistent with what you've said, but does that impact the revenue or profitability cadence throughout the year? Or are you going to be backfilling that with government tenants?

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

Well, for the most part, the -- moving to AWS, the primary impact is freeing up hardware and space in our data center, and that will absolutely be used to support our federal clients as well as other clients we have that are hosted by us and on a Millennium platform. All of these devices are basically interchangeable relative to the various architectures we use. So that will be the savings is the impact on capital.

Operator

Our next question comes from Sean Dodge from RBC Capital Markets.

Sean Wilfred Dodge - *RBC Capital Markets, Research Division - Analyst*

Maybe staying with the platform modernization for a moment. Understanding that the entire project's going to be a multiyear effort, and ultimately long-term positive for margins, can you give us a little more insight into the impact it will have on margins in the interim? The investments you're going to have to make as part of this, can you put some bookends around how big, how much? Are they going to be consistent or chunky? And are there efficiencies you're going to be able to garner in the meantime that'll help offset some of it? Or is this something where the margin lift really doesn't come until the entire project is done?

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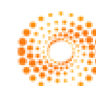

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Marc G. Naughton - *Cerner Corporation - Executive VP & CFO*

Yes, this is Marc. As John kind of went through the -- each time we move an element to AWS, there is some savings garnered. So certainly, from a -- as we move HealtheIntent, being able to manage that in the AWS environment, it has a savings on the people it takes for us to run those environments in our data center. So there are -- they are incremental. They aren't significant, but they are incremental. The investment we're going to make relative to our cloud investment on the other platform, primarily Millennium, that's part of our R&D expense, right? Part of our portfolio management goal is to free up dollars that we're spending on things that we don't see as long-term growth opportunities, and put that into some of the things that are going to be growth opportunities such as the cloud environment. We are still actually going through the exercise and the process of deciding exactly what the path to modernization is going to entail, exactly what's going to move in exactly the timing, so it's a little bit hard for me right now to give you an idea of what those dollars are. But our expectation is that much of that work is going to get funded out of our normal R&D spend, that will be focused on those efforts as opposed to potentially some other efforts on things that we're going to not be moving forward with. So there is -- that's -- it's going to be a refocus of it, so we're not going to garner some of the savings that we might have from some of those divestitures, although we will get -- gather some. But we shouldn't have a large influx of costs relative to this effort. And it will, as Don said, be a period of time before that gets there. Now once we get there, the benefits are significant. We've got well over $100 million of annualized costs for hosting our clients in our data center just from software that we run them on in our data center that we won't need to use when they go to the cloud. There will -- the advantages of running a single version of the software in the cloud is a significant decrease in the costs we have for supporting our clients. They will get a much better experience, so your clients' stack goes higher, so the appetite for more solutions goes higher.

So those are harder to quantify at this point other than the actual cost savings from sublicensed software. But I think for the most part, that's the goal. Those benefits aren't going to happen in the next 2 or 3 years. That's -- we have to get through a lot of work, and we'll be able to give you more of an update on that as we do our work to make -- to identify the path forward. But it isn't something I think is going to be a big expense impact. But the benefits will be a little bit longer-term relative to margin improvement. And that's one of the things we've kind of talked about is, we've got our path, we delivered '19. We have our path to 2020. How do you keep delivering thereafter? You continue on the optimization. And then the next iteration is going to be basically platform-based that you bring these other additions and other opportunities to increase operating margins.

Sean Wilfred Dodge - *RBC Capital Markets, Research Division - Analyst*

Okay. That's great. And then maybe on margins more broadly, you're still expecting to exit 2020 around the 22.5% level. You said maybe even a little bit better. I think you touched on it briefly in the prepared remarks, but could you just walk us kind of quickly through what you see being the primary levers or buckets of opportunities you can take out to get you from the 20% you just printed to something north of 22.5% in the next 4 quarters?

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

Yes. I think the key to remember is, a lot of what we did in '19 really started impacting us late in the year, right? It really -- there's margin improvement from Q3 to Q4 was significant. So -- but we have in place over 50% of the actions we need to go drive the margin uplift for 2020. The next set of things that are going to happen are going to happen toward the end of 2020 as we do things based on location of associates and things like that, that will drive kind of some of those next year benefits for us. So the reason that Q4 and 2020 will be a little bit of a, back-end-loaded once again is because those are the next tranches, and it takes time and effort to go get those in place.

But I would point out that, basically after Q1, we'll be delivering about 250 basis points of margin improvement each quarter year-over-year, Q2, Q3 and Q4 and basically for the full year. So that level -- those margin improvements are the continuation of what we put in place in '19, then delivering on the next phases that occur in 2020.

Just to clarify, before we get to the next question. My comments around 5% to 8%, it seemed like there's a little bit of confusion on people that talk about that comment. I'm just trying to -- the indication that I was trying to portray is that if you took our previous 6% to 9% target and lowered it for the impact of outsourcing, it would reduce the range by 100 basis points. So I was just doing math, and subtraction is one of the skills I do have, and we basically were taking those down to the 5% or 8%, just based on what our prior view was and kind of what the impact of the outsourcing

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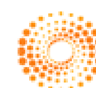

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that we've talked to you about is. But certainly, at HIMSS, we'll give you a more detailed view of what we think the right answer is and how do we get to that right answer. So I just want to clarify that because there's a little bit of confusion.

Operator

Our next question comes from George Hill from Deutsche Bank.

George Robert Hill - *Deutsche Bank AG, Research Division - MD & Equity Research Analyst*

This might be one for Don. I know Don, historically -- this is an interoperability question. Historically, interface management has been an attractive part of the business with pretty good margins. And as we think about kind of changing interoperability regulations, that will probably create some opportunities, but can you talk about how much business risk there might be to parts of the legacy business?

Donald D. Trigg - *Cerner Corporation - EVP of Strategic Growth*

Yes. It's a good question, George. I think -- I think we're pretty comfortable that, that business -- I mean, you're right, it's relatively small, and it does have a good margin profile. I think we're relatively comfortable that the things that we've been doing on SMART on FHIR enablement and our code program, mean that the net impact is de minimis.

And I think more to my earlier point, we think it's actually enabling to some of the bigger swing business strategies that we're advancing inside strategic growth. So while I can't perfectly net that out for you, I think we look at it and say it inures to our advantage into the upside relative to where we want to go from a top line perspective.

George Robert Hill - *Deutsche Bank AG, Research Division - MD & Equity Research Analyst*

Okay. That's super helpful. And then, Marc, maybe just 2 quick number follow-ups. Can you talk about -- can you give maybe any color around the CapEx guidance for 2020? You talked about the number coming down from the $471 million in number in 2019, maybe just something about that. And is any share repo assumed in the 2020 EPS guidance?

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

Yes. I think that from a CapEx perspective, you could take $100 million out of that number. It would be kind of the range that we would expect as we look at 2020 for CapEx based on our buildings being slowed down or basically being completed. And I think the repurchase, we obviously have $200 million scheduled for Q1 to complete our 12-month. And I think going forward, certainly, our capital allocation, we'll look at investment M&A opportunities and other things relative to the use of capital. But I would think at least $200 million a quarter of repurchases would seem to be kind of a base amount that we would then adjust relative to what our M&A is.

Why don't we take one last question?

Operator

Our last question comes from Eric Percher from Nephron Research.

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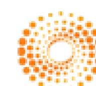

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Eric R. Percher - *Nephron Research LLC - Research Analyst*

A question on federal contracts. And I know that early in the uptake, you've had third party service. That appears to be weighing on the margin. As we think about 2020 versus 2019, does that level of third-party support remain about stable? Or is there any increase or decrease?

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

Yes, this is Marc. For 2020, it will be about the same. We continue to leverage our partners in that space. Clearly, AbleVets was one example of us working to bring a larger workforce quickly inside Cerner that we can then move to focus on the VA. As some of the -- as we work through their existing projects, which are relatively short-term and get them on the VA. That will allow us to bring that down, but that's probably more of a 2021 event at this point.

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

That's helpful. And then last, on the ex U.S. 3% growth last year, as you look to 2020, I don't think that was part of the items you ticked off on growth opportunity. But what is your perspective on growth ex U.S.?

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

This is John. I said I think it will be consistent with previous years. There's still a lot of opportunity outside the U.S. in the form of new business, new regions, countries and those type of things, which we will look at, pursuing each one of those opportunities that make a decision. But similar to the U.S., we're also doing portfolio analysis on non-U.S. as well. So we're going to look to be -- follow the same process and become much more focused and outside the U.S. as well. So we may see both ups and downs outside the U.S. as well.

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

Hey, this is Marc. I want to thank everybody for participating. One last comment, there still might be a little confusion about our long-term top line growth target. The 5% to 8% I mentioned is absolutely something I think we can deliver. Absolutely. And in fact, I think there's upside to that. So I think the number -- something closer to the 7% range is probably more reasonable. But once again my point is, we really want to take you through it in detail, show you what the building blocks are, so you're not just blindly putting a number in, but the 5% to 8% level is a level that I have a great deal of confidence in.

So with that, I want to thank you for attending this afternoon and look forward to getting together with you at HIMSS on March 10. Until then, have a good evening.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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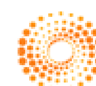

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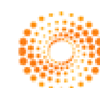

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