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# EDITED TRANSCRIPT

CERN - Q1 2015 Cerner Corp Earnings Call

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## OVERVIEW:

Co. reported 1Q15 revenue of \$996m and GAAP net earnings of \$111m or \$0.32 per diluted share. Expects 2015 revenue to be \$4.65-4.80b and adjusted EPS before share-based compensation expense and acquisition-related adjustments to be \$2.07-2.15. Expects 2Q15 revenue to be \$1.175-1.225b and 2Q15 adjusted EPS, before share-based compensation expense and acquisition-related adjustments to be \$0.51-0.52.



## CORPORATE PARTICIPANTS

**Marc Naughton** *Cerner Corporation - EVP and CFO*

**Zane Burke** *Cerner Corporation - President*

**Mike Nill** *Cerner Corporation - EVP and COO*

## CONFERENCE CALL PARTICIPANTS

**Michael Cherny** *Evercore ISI - Analyst*

**George Hill** *Deutsche Bank - Analyst*

**Ricky Goldwasser** *Morgan Stanley - Analyst*

**David Larsen** *Leerink Partners - Analyst*

**David Francis** *RBC Capital Markets - Analyst*

**Garen Sarafian** *Citi Research - Analyst*

**Steve Halper** *FBR - Analyst*

**Dave Windley** *Jefferies & Company - Analyst*

**Sean Wieland** *Piper Jaffray & Co. - Analyst*

## PRESENTATION

### Operator

Good day ladies, and gentlemen. Welcome to Cerner Corporation's first-quarter 2015 conference call. Today's date is May 7, 2015, 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 expenses, product development, new markets, or prospects for the Company's solutions and plans and expectations related to the acquisition and integration of the Siemens Health Services business. Actual results may differ materially from those indicated by THE forward-looking statements.

Additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements may be found UNDER Item 1A in Cerner Form 10-k, together with the Company's other filings. A reconciliation of non-GAAP financial measures discussed in this earnings call can be found in the Company's earnings release, which was furnished to the SEC today and posted on the investor section of Cerner.com.

At this time, I'd like to turn the call over to Marc Naughton, Chief Financial Officer, Cerner Corporation.

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### **Marc Naughton** - *Cerner Corporation - EVP and CFO*

Thank you, Steve. Good afternoon, everyone, and welcome to the call. I'll lead off today with a review of the numbers. Zane Burke, our President, will follow me with results, highlights, and marketplace observations. Mike Nill, Executive Vice President and Chief Operating Officer, will discuss operations. And Neal Patterson, our Chairman and CEO, will join us for Q&A. Now I will return to our results.

Overall, while revenue was below our expectations, we had a solid quarter highlighted by very strong bookings, and our outlook remains positive. Our bookings revenue in Q1 was \$1.2 billion, which is an all-time high and reflects 32% growth over Q1 of 2014, driven by strong growth in traditional Cerner bookings, with minimal bookings contributions from Health Services. Our revenue backlog ended the quarter at \$13 billion, which is up from \$9.2 billion a year ago and reflects the strong bookings in Q1 and the inclusion of backlog from Health Services.



Revenue in the quarter was \$996 million, which is up 27% over Q1 of 2014. Total revenue for Cerner was approximately \$820 million, with the remaining \$176 million attributable to Health Services. The total is approximately \$50 million below our guidance range, with the shortfall equally split between Cerner and Health Services. On the Cerner side, the higher percentage of the record bookings that came from long-term contracts and a lower percentage of items that generated in-quarter revenue.

Additionally, services and reimbursed travel was lower than expected. On the Health Services side, part of the shortfall was due to the \$12.5 million adjustment to earnings for deferred revenue not being reflected in revenue, as we had assumed in our guidance. However, since we decided not to report a non-GAAP revenue metric, our top-line guidance was off by that amount. This difference in Health Services will continue and is factored into our new four-year revenue guidance along with slightly lower run rate for the total revenue that reflects the Q1 shortfall.

It is important to note that our Q1 adjusted earnings results were not impacted by the lower revenue, and our annual guidance for adjusted earnings remains the same.

The revenue composition for Q1 was \$259 million in system sales, \$229 million in support and maintenance, \$490 million in services, and \$18 million in reimbursed travel. System sales revenues reflect a 26% increase over Q1 of 2014, with the growth mainly driven by an increase in subscriptions, which is where the addition of Health Services had the biggest impact. Q1 system sales margin dollars grew by 1% over the year-ago period. System sales margin percent of 64.7% is down from 68.5% in Q1 of 2014 and up from 63.6% in Q4 of 2014. The decline year over year reflects slower tech resale margins.

Moving to services, total services revenue, including professional and managed services, was up 28% compared to Q1 of 2014, with solid growth in Cerner Services augmented by the addition of Health Services. Support and maintenance revenue increased 31% over Q1 of 2014, reflecting solid growth in core support maintenance and the addition of Health Services.

Looking to revenue by geographic segment, domestic revenue increased 25% over the year-ago quarter to \$871 million, and global revenue grew 44% to \$126 million, with both those growth rates augmented by the addition of Health Services.

Health Services had a slightly higher mix of global revenue than Cerner's historical levels. So the addition of Health Services had a bigger impact on global revenue, but our existing global businesses also had a strong performance.

Moving to gross margin, our gross margin for Q1 was 83.1%, which is down slightly compared to 83.5% in Q1 of 2014, reflecting a lower technology resale margin and a slightly lower gross margin from Health Services.

Looking at operating spending, our first-quarter operating expenses before share-based compensation expense and acquisition related to adjustments were \$591 million, which is up 28% compared to adjusted Q1 2014 operating expenses.

Since we have already integrated many components of Health Services, we don't have an exact breakout of operating expense between Cerner and Health Services. But we estimate that Cerner operating expenses grew in the mid-single digit range, and the rest of the growth is the addition of Health Services.

Total year-over-year growth for each expense category was 23% for sales and client service, 41% for software development, and 33% for G&A.

Moving to operating margin, our operating margin before share-based compensation expense and acquisition related to adjustments was 23.7% in Q1. This is down 90 basis points compared to Q1 of 2014, reflecting the incorporation of Health Services.

Given we achieved our earnings on lower revenue this quarter, the operating margin percent with Health Services incorporated into our results is higher than we originally projected. This is largely due to lower core Cerner expense growth offsetting the lower core revenue growth. We expect higher core Cerner revenue growth for the rest of the year but still expect the full year to be below original projections. This is expected to continue being offset by a lower expense growth, so we will expect to drive the same level of earnings with a combination of lower revenue and unchanged earnings leading to a higher core operating margin percent.

In total, this means we expect our combined operating margin to only go down approximately 100 to 150 basis points for the year versus an original expectation it would go down over 200 basis points with the addition of Health Services.

Moving to net earnings and EPS, our GAAP net earnings in Q1 were \$111 million, or \$0.32 per diluted share. Adjusted net earnings were \$157 million, and adjusted EPS was \$0.45, which is up 22% compared to Q1 of 2014. Adjusted net earnings and diluted earnings per share exclude share-based compensation expense, which reduced first-quarter 2015 net earnings and diluted earnings per share by \$11 million and \$0.03 respectively.

Adjusted net earnings and diluted earnings per share also reflect adjustments related to the acquisition of Health Services, including amortization of intangibles, which reduced net earnings and diluted earnings per share by \$10 million and \$0.03 respectively, and deferred revenue adjustment, which reduced net earnings and diluted earnings per share by \$8 million and \$0.02 respectively, and other acquisition-related adjustments which reduced net earnings and diluted earnings per share by \$17 million and \$0.05 respectively.

The Q1 tax rate for adjusted net earnings was 33.6%, which is in line with our expected effective tax rate. For the remainder of 2015, we expect our effective tax rate to be in the 33% to 34% range.

Now I'd like to preview a non-recurring expense we expect to incur in Q2. We recently offered a voluntary separation plan, or VSP, to eligible associates. Generally, the VSP was made available to US associates who meet a minimum level of combined age and tenure. The VSP was offered to both Cerner and Health Services associates, and the percent accepting has been roughly equal across both groups. There were some positions such as executive officers and certain critical roles that were excluded from being eligible for business continuity purposes.

Associates who elected to participate in the VSP will achieve financial benefits commensurate with their tenure and position, along with vacation payout and medical benefits. The acceptance period for associates electing to participate in the VSP ends later this month. Based on levels of acceptance, we currently estimate a net of tax charge of approximately \$35 million in Q2 for the VSP and related costs.

This completely voluntary program will have a small impact on the total headcount, as the eligible associates that accepted the offer only represent about 2% of total associates. While a portion of these positions will be backfilled, we believe we will be able to fill many of the positions with existing associates, which should create efficiencies in the future, also creating career growth opportunities for our associates. Now I'll move to our balance sheet.

We ended Q1 with \$889 million of total cash and investments, which is down \$763 million from \$1.65 billion in Q4, mainly driven by a \$1.37 billion purchase of Siemens Health Services, and partially offset by \$500 million of debt that we issued earlier this year and added to cash and investments. Our total debt including capital lease obligations is \$626 million, up from \$130 million in Q4 due to the new debt.

Total receivables ended the quarter at \$941 million, which was up \$268 million from Q4, driven by strong sales in the quarter. Our DSO in Q1 was 79 days, which compares to DSO of 66 days in Q4 and 66 days in the year-ago quarter. The increase was driven by higher accounts receivable, which is largely due to adding Health Services and the lower revenue this quarter. We expect DSO to be closer to historical levels in future quarters.

Operating cash flow for the quarter was \$214 million. Q1 capital expenditures were \$82 million, and capitalized software was \$63 million. Free cash flow, defined as operating cash flow less capital expenditures and capitalized software, was \$69 million for the quarter.

Moving to capitalized software, the \$63 million of capitalized software in Q1 represents 39% of the \$161 million of total investment in development activities. Software amortization for the quarter was \$29 million, resulting in net capitalization of \$34 million, or 21% of our total R&D investment.

We still expect to continue generating solid free cash flow this year, with operating cash flow growth partially offsetting an expected increase in capital expenditures tied to beginning construction of a new campus and capital expenditures related to our Health Services business. Note that the cash flow that impacted the VSP will primarily impact Q2 and reduce overall free cash flow for the year.



Now I'll go to Q2 and full-year 2015 guidance. For Q2, we expect revenue between \$1.175 billion and \$1.225 billion, the midpoint reflecting growth of 41% over Q2 of 2014. For the full year, we expect revenue between \$4.65 billion and \$4.8 billion. This is lower than our prior guidance due to the lower revenue in Q1 and expectation of about \$1 billion of Health Services revenue for the year instead of our previous expectation of \$1.1 billion, which is largely due to the deferred revenue investment not impacting the revenue line. This is still 39% growth at the midpoint, reflecting expectation for higher growth in Q1 from core Cerner for the rest of the year.

The lower revenue is not expected to impact our earnings in Q2 or for the year. For Q2, we expect adjusted earnings before share-based compensation and acquisition-related adjustments, to \$0.51, \$0.52 per share, with the midpoint reflecting 29% growth over Q2 2014 adjusted EPS. For the full year, we expect adjusted EPS before share-based compensation and acquisition-related adjustments to be \$2.07 to \$2.15, which is up from a previous range of \$2.05 to \$2.15 and reflects 28% growth at the midpoint. Our estimate for the impact of share-based compensation expense is approximately \$0.03 to \$0.04 in Q2 and \$0.14 to \$0.15 for the full year.

Moving to bookings guidance, we expect bookings revenue in Q2 of \$1.2 billion to \$1.3 billion, with the midpoint reflecting 16% growth over Q2 of 2014. We expect our strong Q1 bookings and Q2 outlook to contribute to better core top-line growth as we move through the year. Keep in mind, Q4 has a tough comparable due to the extra week in Q4 2014.

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

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**Zane Burke** - Cerner Corporation - President

Thanks, Marc. Good afternoon, everyone. Today I'll provide color on our results and make some marketplace observations. I'll start with our results.

Our bookings revenue in Q1 of \$1.2 billion reflects very strong growth of 32% over Q1 2014. Bookings this quarter included a high level of large contracts, with 24 contracts over \$5 million, including 19 over \$10 million. We also had strong contribution from long-term bookings, with an ITWorks contract and an expansion of existing RevWorks relationship. This led to long-term bookings making up 37% of the total, which is approximately 5% higher than normal. Even adjusting out the higher-term, long-term bookings contribution, our bookings were very strong, and bookings would still be at the high end of our guidance.

As Marc discussed, our strong bookings didn't convert to high revenue this quarter, but it does position us for higher future growth.

The highlight of the quarter was strong competitiveness, which resulted in 34% of our bookings coming from outside our core Millennium install base. As I discussed during our investment community meeting at HIMMS, our pipeline is very strong and we are well positioned for new business this year and beyond.

I believe we still have a multi-year period ahead of us where there will be opportunities to win new footprints as organizations look to replace legacy systems and align with the strategic supplier. There is also a meaningful opportunity to expand our footprints within our client base, as many of our large clients still have several non-Cerner facilities and are looking to consolidate on a single system. The ongoing acquisition activity in the marketplace plays to our advantage as well because it is being led by our clients. We are already off to a good start with migrating Health Services clients to Millennium, and this activity is bringing along sales in other solutions such as Population Health and ambulatory.

My view of our opportunities was reinforced at HIMMS, where we interacted with more than \$5 billion of pipeline, including many new EMR replacement opportunities.

In addition to strong new business activity, the dominant themes at HIMMS align very well with Cerner's strengths. Our complete vision and strong capabilities in Population Health coupled with our commitment to interoperability and an open EMR were clearly on display and well received.

Regarding interoperability, we were pleased with the level of progress that was on display during the conference, most notably CommonWell member expansion to over 70% of the acute EMR market being represented.

Now I'll briefly discuss a few key areas of our business starting with Population Health. Our Population Health organization had a strong start to the year. We continue to have success with selling Population Health solutions to clients ranging from small hospitals to IDNs to counties and states. Population Health solutions are now part of most new EMR contracts and, as I have mentioned, have been added to migration contracts for Health Services clients converting to Millennium.

Overall, I believe our differentiation in Population Health is becoming clearer. We are quickly separating ourselves from other offerings with our ability to aggregate and normalize clinical, financial, and claims data across multiple systems and bring near real-time information into the workflow.

Another key differentiator is results. Our early adopter clients such as Advocate Healthcare are getting value out of the system and are vocal about the fact that they view Health Intent as a platform that improves their ability to operate in an environment in which they are taking on more risk.

Moving to our revenue cycle business, we had a good first quarter and have a strong outlook for the year. Revenue cycle continues to be an important component of EMR placement opportunities, and the strength of our integrated revenue cycle offering is contributing to our success at gaining new footprints.

We are also continuing to increase penetration of our revenue cycle solutions in our client base in both acute and ambulatory venues as our clients look to move to a single platform. We are still early in this opportunity and expect many more of our large clients to move to our revenue cycle solutions now that we have more proof points among our large clients.

On the RevWorks services side of our business, we expanded our relationship with an existing RevWorks client based on success we've had so far. I am pleased with how we have executed on our initial RevWorks relationships, and we are achieving results I believe will be compelling to other prospects. For example, Adventist Health Northern California region has achieved a \$27 million increase in revenue, a 21% decrease in AR days, and all their sites are over 100% of cash targets. These types of results reflect the strength of both our Revenue cycle solutions and our RevWorks services offerings and create compelling reasons for new prospects to consider our Revenue cycle solutions and services.

Moving to the ambulatory market, where we had a strong Q1. Noteworthy activity in Q1 included continued displacements of key competitors, including the displacement of the ambulatory solutions of our primary competitor at 29 ambulatory facilities. A strong start at selling ambulatory solutions into the Health Services space, including standalone sales and being included as part of acute care migrations to Millennium and continued strength in our ambulatory business office services.

Regarding business office services, I'd like to highlight that business because I think success there is not widely known. We currently have ambulatory business office services clients across 45 specialties in 39 states. Our clients range from single physician practices up to large IDNs where we have RevWorks relationships that include ambulatory business office services.

As we have gained traction in this space, we are identifying more opportunities to displace a cloud competitor's business office services by proving our offering is more effective. For example, we are able to show in many cases our business office services are more than 20% less than our competitors' cloud offering primarily because they require the client to maintain a staff of approximately 3 times what our offering requires.

In addition, many of these larger and more sophisticated clients are facing several challenges with our competitors' solutions, such as having 50% to 60% of the claims requiring manual intervention because they don't fit the cloud configuration. I believe that we will keep doing well in this business office services space as we continue to gain positive proof points with our clients and as awareness broadens about the true costs and challenges associated with our cloud competitor.

Outside the US, we had a strong Q1. Total revenue growth was 44%, consisting of strong organic growth and the addition of Health Services. Strong performance in the UK was a big driver of our organic growth as we continue to have success gaining new footprints and expanding relationships with clients as they transition out of a national program.

One of the reasons we continue to do well in the market is that our clients are getting value out of the solutions. A great example of this was documented when the Health and Social Care Information Centre did a benefits deep dive of the Cerner Millennium implementation at Barts Health



NHS Trust, which is the largest hospital trust in England. In this review, they concluded Barts is achieving significant clinical and operational benefits in areas where Cerner Millennium is installed. This and other proof points that we have in the UK market position us very well relative to our less established competitors.

Broadly, we remain optimistic about our ability to get good contributions from global for the rest of the decade. And this opportunity is enhanced by the complementary global business of Health Services.

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

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**Mike Nill** - Cerner Corporation - EVP and COO

Thanks, Zane. Good afternoon, everyone. Today I'm going to discuss ITWorks and provide some comments on our initial go-lives with Intermountain Healthcare. I'll start with ITWorks. In the first quarter, we established a new ITWorks relationship and also expanded an existing ITWorks relationship. Our new ITWorks client is a 410-bed community hospital with 29 ambulatory locations. Similar to many of our ITWorks clients, taking over IT operations is only part of the new contract. For example, as Zane discussed, we will be displacing our primary competitor in the ambulatory facilities. We will also be doing an optimization project for the clients' Millennium system at the hospital and implementing Population Health and revenue cycle solutions.

In a memo to all health system employees, the CEO of our client highlighted the strategic nature of the ITWorks' engagement by saying, "we believe it's the best approach to ensure we meet our long-term strategic objectives of our organization while continuing to provide the highest level of care to our patients in an era of incredibly fast-moving changes in healthcare, information technology, and increasing regulatory requirements."

As I indicated on our last call, our ITWorks pipeline is strong, as many provider organizations face pressure to control costs, improve quality, and keep up with regulatory requirements. In Q1, our results are a good start, and I expect continued success throughout the year. Now I'd like to make a few comments on our initial go-lives at two Intermountain Healthcare hospitals and 24 clinics.

The go-lives occurred just 15 months after we signed the contract, which is extremely fast when you consider the majority of projects of similar scope take more than twice as long. When fully deployed, Project iCentra will be at 22 hospitals and more than 180 clinics. It will include nearly 80 solutions across each of our practice management and revenue cycle, and the system will have over 320 role profiles, 354 clinical workflow models, and 372 financial workflow models. This is the first Cerner project to make use of our new agile development methodology, a model that represents a departure from the industry-standard waterfall implementation approach. In the agile model, physicians and other end users participate in the system-building design and never go more than six weeks without an opportunity to see, use, and get feedback on the system prior to go-live.

This approach has been a big success, and we believe there are benefits that will extend beyond the go-lives. It has the potential to support elements of a learning health system, something that has been elusive in healthcare.

Another key element of this project is incorporation of Intermountain's care process models and clinical process guidelines, which have helped its clinicians achieve high-quality care and lower overall cost for many years. Before iCentra, these were mostly paper documents. Now they are all part of the digital workflows that are used every day.

In summary, we believe our work with Intermountain, combined with the work we are doing with other strategic client partners, is resulting in a new generation of systems. We are leading the transition in the industry away from systems that are simply transactional or used for the purpose of meeting regulatory requirements. We are creating intelligent systems designed to meet the complex needs of providers across the spectrum of health care; coordinating care at any time, any place; use intelligence to inform decisions at the highest standards; and connecting all of the individuals they serve seamlessly into that process.

With that, I'd like to turn the call over to questions.

Steve, do we have any questions?





## QUESTIONS AND ANSWERS

### Operator

Michael Cherny, Evercore ISI.

### Michael Cherny - Evercore ISI - Analyst

Good afternoon, guys, and thanks for all the details. So Marc, I just want to dive in a little bit on the Cerner core a bit. You talked about the fact that you had a \$50 million shortfall versus your guidance -- about a 50-50 split between the core and the Cerner Health Services business. As I think about the core, how many of the -- how much of the shortfall was items that you've had historically like some of the third-party tech resale? Versus I know you had a really strong booking -- long-term bookings number. Was there anything else that surprised you in terms of why that number missed that you haven't seen in the past, I guess?

### Marc Naughton - Cerner Corporation - EVP and CFO

Well, I think the one-time revenue was slightly lower than we expected. Much of that was from tech resale, which obviously means you don't get a chunk of revenue, but it doesn't really impact earnings very much. The other piece was services and travel was lowered. Some of the services related to just contract signing time frames and project start dates that were a little bit later than we expected, but we didn't start turning that revenue spigot on as early in the quarter as we felt we would. And that also impacted the reimbursed travel. Usually, reimbursed travel is a number that I pay very little attention to other than managing it from an expense standpoint because it's zero revenue or zero margin. But that one was actually significantly lower than we would have projected as we came in the quarter.

I don't know -- there was no real surprises. And as we look out for the rest of the year, Q2 to Q4, we get back on track for the most part and, I think, delivering more according to what we are planning and forecasting.

### Michael Cherny - Evercore ISI - Analyst

And I know in the past you have given a software number. Did you give a software growth number in the quarter specifically on the software?

### Marc Naughton - Cerner Corporation - EVP and CFO

I don't think I did, and I don't know that I've got one in front of me. I apologize.

### Michael Cherny - Evercore ISI - Analyst

But nothing outside the norm in terms of -- software growth still was fairly solid. I assume that those (multiple speakers).

### Marc Naughton - Cerner Corporation - EVP and CFO

No, it was really kind of if you went through each -- all the line items there. It was primarily the services side of just getting stuff kicked off because once you get it kicked off, the revenue kind of streams across the quarters as you go forward. So you don't get a one-time bump. But if you don't kick it off early -- and that was just an environment where without specific dates driving clients to start those projects, some of those things fall a little bit later than we would have projected. The mix -- there was nothing major in the mix; still strong software, just a probably weaker tech resale and lower margins on the tech resale we did get.



**Michael Cherny** - *Evercore ISI - Analyst*

Thanks. That's helpful, Marc.

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**Operator**

George Hill, Deutsche Bank.

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**Unidentified Participant**

Hi, is actually Stephen on for George Hill. Calling to ask about -- our question is on the strong number of kind of the larger contracts in the quarter. I was wondering what was driving that.

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**Zane Burke** - *Cerner Corporation - President*

This is Zane. We had a number of very large new business opportunities as well as existing extensions in our core base. And so, very strong -- the new business was 34% of total bookings, as I mentioned in our prepared comments. Those come along with -- those tend to be larger contracts in the initial booking period. So that drove much of that, along with a couple of extension of the RevWorks business and the large ITWorks that we had in the quarter.

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**George Hill** - *Deutsche Bank - Analyst*

Okay. Thank you. That's helpful.

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**Operator**

Ricky Goldwasser, Morgan Stanley.

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**Ricky Goldwasser** - *Morgan Stanley - Analyst*

You know, we talk about contract at the Intermountain and it really kind of affecting your way of doing business. So when you think about those other health systems that are similar in size, can you just kind of share with us how that pipeline is booking? And do need to first implement all the 22 hospitals at Intermountain, or should we expect to see a deal kind of like it looks at that type of intelligence system before that?

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

This is Marc. Relative to Intermountain with our first go-live, I think that once we get the second set turned on, I think we'll have proof points for people that are interested in going and seeing what that model system, if you will, looks like. But I don't know that it is going to significantly impact the timing of opportunities that at their size. Interestingly enough, it directly impacts one of the bigger opportunities, which is DOD which is out there. And we are working with Intermountain on relative to the model systems that we are going to implement there. But the timing of those projects and the turn-on dates really are separate contact. A lot of what Intermountain helps us with when we talk is their concept and their approach and embedding the content to make the healthcare more effective and to actually help manage the health of the population.

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So a lot of what they are doing from kind of a sales perspective is just sharing that message. And then as we do go-lives, we will be able to show it live and up and running. But given the first one is going live, given the next set coming, given the project staying in good shape, the timing of those doesn't preclude us from pursuing those opportunities.

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**Ricky Goldwasser** - *Morgan Stanley - Analyst*

Okay. And on the DOD contract, can you just update us on the timing?

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**Zane Burke** - *Cerner Corporation - President*

Sure. This is Zane. Obviously it's in the government's hand in terms of where they are. Our understanding is that they are looking to make a decision for the first phase of that work at the end of the second quarter -- end of our second quarter at this point in time. They've held pretty true to their timelines for the most part, and this has been a pretty effective procurement process. And we anticipate that they will continue along that path of hitting their timeline and make the probably the end of the second quarter, but it could go into the early third quarter.

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**Ricky Goldwasser** - *Morgan Stanley - Analyst*

Okay. And then lastly on Population Health -- I'm not sure if you said that in the prepared remarks -- when we look at your new contract, what percent of your new contract have Population Health features to them? And how should we think about -- what is an average Population Health deal in terms of revenue contribution?

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**Zane Burke** - *Cerner Corporation - President*

This is Zane. I'll start and let Marc finish as it relates to the composition. Most all of our new EMR business has some Population Health as part of that. And we would include things like registries as part of the core solution set and as part of the key differentiators as we move forward because our ability to get the data back into the clinicians' workflow at the point of care in near real time is the key differentiator between us and all other competitors. So you see that as one of the core elements as what we do. So nearly all of the new business has that related to that.

I'll set Marc up for the second piece of that. It tends to be a smaller portion upfront, so it is not a significant portion of the contract bookings in that it typically is that what I call a starter set for Population Health around registries, and really sets up the footprint for pop health and the opportunity to go back and sell back into the base over time.

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

Yes. And that's exactly right, Zane. Most of the economics that we expect on a per-number, per-month basis are in the future for some of those -- we put in the platform some revenue related to that initial work. But for the most part -- and a lot of their initial projects are pilot in nature. So even when it goes live on a PMPM basis, you don't have quite so many of them.

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**Zane Burke** - *Cerner Corporation - President*

Yes. And traditionally, we've talked about Population Health as being about 14% of total revenue. And you can typically think about bookings being similar in that space.

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**Ricky Goldwasser** - *Morgan Stanley - Analyst*

Okay. Thank you. That's very helpful.

**Operator**

David Larsen, Leerink.

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**David Larsen** - *Leerink Partners - Analyst*

Congratulations on a good quarter. Zane, can you talk a little bit more about the different components within Population Health? So just what exactly is a patient registry? And then above and beyond patient registries, can you talk about some of the I guess more advanced features and components that might be reimbursed on a PMPM basis? And how relevant are those? How many clients you have in those types of solutions? Thanks.

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**Zane Burke** - *Cerner Corporation - President*

The patient registry really provides the ability for the clinician to understand what the disease state is of that person and run the protocols for that particular scenario. And that's a very normal part of a particularly ambulatory process. The PMPM portions will come up in the future -- kind of the next pieces you will see us around is in the enterprise data warehouse elements. And we are seeing client uptake on that side. That does have some PMPM elements to it. We have a number of offerings that will come out throughout the year as we move to programs and to some other areas, and those are all PMPM basis.

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**Mike Nill** - *Cerner Corporation - EVP and COO*

Probably the next big one coming out is care management. That's a key element. So once you identify through your registries the people that are high risk, then how the you go manage their care in an effective manner? So those are the two. Keep in mind, while each of the solutions that we put on this platform, which we expect them to be certainly in the double-digit range, all have a PMPM factor. That PMPM price may vary based on the importance of those solutions. And certainly doing the registries and the care management are two of the key components of that architecture.

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**David Larsen** - *Leerink Partners - Analyst*

Great. Thanks a lot.

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**Operator**

David Francis, RBC Capital Markets.

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**David Francis** - *RBC Capital Markets - Analyst*

Marc, can you talk a little bit about looking at the backlog? What are the dynamics of your backlog conversion capabilities? Specifically, what kind of levers do you guys have available to either throttle up or throttle down conversion of backlog into revenue?

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

For the most part, not having a big backlog gives you good visibility. But a lot of the visibility we have in our backlog doesn't -- isn't one that you are going to throttle up or down a whole lot. A lot of it is hours worked based on the project activity that is going on. So, a lot of services, a lot of backlog is a -- you are going to pay me X amount a month for a 10-year period.

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So a lot of it is less subject to going and changing relative to a revenue outlook. So when we go into a quarter and start looking at revenue in a quarter like this, you are really looking primarily at things that are more near-term revenue that can impact your level of revenue for that quarter. But you've got everything else is basically subscription supports -- all those elements are coming out of backlog, but there are not a lot of levers that we can go move. I can't take a six-month services project and take 6 times the number of people and go work for one month really fast to drive that revenue out.

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**David Francis** - *RBC Capital Markets - Analyst*

Right. And that makes sense. Let me ask it a different way. How much of the backlog would you say is related to projects or contracts that are currently in process versus those that are for future periods, then? Or is that just not the right way to look at it?

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

Well, you are kind of asking what is backlog going to contribute to the next period.

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**David Francis** - *RBC Capital Markets - Analyst*

Well, just trying to see how much visibility one has near term versus long term relative to the ten quarters or so of revenue that are represented at backlog today.

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

I think if you weight the backlog, certainly it weights toward current. If you look at an average life, it might be 3 1/2 years, but there's a higher percentage of that that occurs in the first 12 months relative to the overall 10 years plus potential of the backlog.

So I think when we go into a quarter, there is probably 85% to 90% of the revenue is visible coming out of that backlog. So maybe that's a good answer to you. If I look at the full year from today, kind of about 12 months, I have about probably 75% because there will be things that get in the backlog that help me feed those out-quarter P&Ls. But when I go into this next quarter, I'm about 85% to 90%, so pretty high correlation. So that's why we don't normally have a lower-revenue quarter.

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**David Francis** - *RBC Capital Markets - Analyst*

And that's helpful. Thank you. And then one follow-up -- as it relates to the \$100 million or so shortfall that you're looking for at Siemens, it looks like just doing the math about half of that is the deferred revenue shift out, and then the other half is just kind of what's coming out of the business. Is that the right way to look at it?

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

Yes, that's exactly right, David.

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**David Francis** - *RBC Capital Markets - Analyst*

Okay. Thank you.

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**Operator**

Garen Sarafian, Citi Research.

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**Garen Sarafian** - Citi Research - Analyst

Thanks for taking the questions. One is just a clarification. And I think you started to touch on it in the prior question. So the shortfall -- the 50-50 split, and it was from the Cerner side -- it came from tech resale; then services and travel, that got off to a slower start. So for the remaining three quarters, I'm just trying to figure out what is the assumption of the mix in terms of it coming from Health Services versus core legacy Cerner.

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**Marc Naughton** - Cerner Corporation - EVP and CFO

Well, I think when you talk about the -- from our perspective, we would have always indicated that we would expect to grow Cerner revenue at kind of basically low double-digit rates. So, say 10%. So based on our numbers, that's kind of what we would have expected. We were below that in Q1, but we expect to get closer to that as we go through Q2 to the end of the quarter, probably high single digits at the end of the year in total.

So if you are looking at that for Cerner, then kind of do the math and just subtract and come up with what the DHS is. We look at HS to deliver for this year right about \$1 billion of revenue. So that was the number that Dave was asking about relative to -- originally, we were looking at about \$1.1 billion, so there's \$100 million just on the HS side for the full year. Half of that is deferred revenue not being the revenue line, and then half of it is just tweaking the revenue projections for the rest of the year for them.

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**Garen Sarafian** - Citi Research - Analyst

Okay. That's useful. And then moving to the international side, you mentioned top-line growth of 44% all in. Could you break that out as to what portion was legacy Cerner? And specifically on UK, I think you mentioned momentum as clients move from government systems. So just trying to get a better idea of how to think about it. Where do you think you are in terms of building momentum in that area? How long will this outside opportunity last, do you think, just to help us out? Thanks.

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**Zane Burke** - Cerner Corporation - President

Well, I think from a bookings perspective, certainly UK, as trusts are transitioning out of the government program, we had a very strong performance. Part of the reason we had good performance in the larger contracts is we had three UK contracts that qualified as over \$10 million.

So those trusts coming out and purchasing -- globally, there is a focus on healthcare and on technology, and it's really trying to match up the available resources in spending in each country relative to being able to go procure it. Since 2008 and 2009, that's been fairly light. We are starting to see that rebound, starting to see more interest certainly in Continental Europe. I think certainly bringing Siemens into the fold has solidified us as a very credible and key choice in the European markets. And there are still countrywide procurements that are ongoing as we speak that we have a much better positioning for because of that acquisition.

But I think we still see a lot of opportunity globally. I think even if you go outside Europe and start looking at North America, I think Canada is probably as good an opportunity in the next 12 months that we've seen for quite some time. So it kind of -- we are starting to see a little bit of a mirror in our overall pipeline, which is the strongest we've never seen as we go into 2015, that we are starting to see some good strength in targeted areas globally.

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**Zane Burke** - Cerner Corporation - President

This is Zane. In fact, every piece of our pipeline picked up in terms of across our business, our install business, our core clientele in the US business, and our global marketplace. And as Marc described, we have a number of opportunities across elements outside the US as well as unprecedented activity that we see in the US in terms of number of decisions. We see approximately 50% more decisions in the US than we have seen -- than we saw all of last year in 2014. The level of activity of presentations and demos are at all-time highs and well over 50% increase year over year. So the activity levels across the business have picked up quite a bit. And so from a bookings perspective and looking forward, we are as optimistic as we've ever been about the growth of the business and health of that.

**Marc Naughton** - Cerner Corporation - EVP and CFO

To give you a sense on global, just our bookings growth is double digit year over year in our global markets, which is very good strength consistent with our strong growth in the US.

**Garen Sarafian** - Citi Research - Analyst

Great. Thank you, guys.

**Operator**

Steve Halper, FBR.

**Steve Halper** - FBR - Analyst

So just a couple of questions. First, you mentioned some project time frames slipping, which led to lower service revenues. Have those picked up yet in line with your expectation?

**Marc Naughton** - Cerner Corporation - EVP and CFO

It wasn't really slipping as much as just the start of those projects, Steve. Especially with a lot of new contracts getting signed. Depending on the projects, we can start some of those projects that are landing for projects. We'll start some of them even early in the process just to start the revenue stream going.

For this period, we didn't really have as much of that as we often do relative to getting that revenue stream started in the quarter. Once it gets started, which those are starting as we speak, then the revenue stream continues and delivers -- starts delivering a very predictable stream out of the backlog. But in the quarter sign, there is an element, especially when you have the level of bookings that we had and the level of new clients that we had, that the project starts did not align exactly with some of our modeling, which is somewhat of an art as opposed to a science. But that's primarily what we saw in Q1 and that's why we really don't see it in Q2 because now they are in the backlog, and we are covered for that.

**Steve Halper** - FBR - Analyst

Right. And then relative to the deferred revenue from Health Services, shouldn't that have been reflected in the original guidance?

**Marc Naughton** - Cerner Corporation - EVP and CFO

Well, that deferred revenue was a number that we included in our revenue guidance. We at that point thought we would be reflecting it as revenue in the income in an adjusted income statement. We decided it would be clearer to just have adjustments to a net earnings line, which means that

we didn't have an adjusted earning or a non-GAAP revenue number, while we do have a non-GAAP earnings number. Since it didn't go in that number, it's not reported as revenue, and it's the difference between what we would have had in our head when we provided guidance in the number that got delivered for Q1.

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**Steve Halper** - *FBR - Analyst*

Right. So it's a little apples-to-oranges comparison?

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

Yes, right. It's a number that we thought would be in there and isn't, but doesn't really impact the results.

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**Steve Halper** - *FBR - Analyst*

Right. And lastly as a follow-up on Health Services, you are past the HIMSS conference. We are a couple of months in. Can you characterize any conversations that you've had with the Health Service clients about conversion to Millennium? New sales into that base? Any sort of color you can give us around the progression there?

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**Zane Burke** - *Cerner Corporation - President*

Sure, Steve. This is Zane. We had three clients that actually made decisions in the first quarter to go from a Siemens legacy, Health Services legacy solution to a Cerner Millennium full EHR decision, which was very, very good uptick. We had a number of Health Services clients that added Cerner solutions to the mix. So, ambulatory, Population Health, surgery -- we saw a number of elements where those Health Services clients picked up and made some decisions to complete the portfolio. So I was very pleased with the performance in the first quarter and the start that we had in that space.

We are also working with those same clients. There are many of them that want to continue on the journey of the Soarian solutions or on a combined strategy of Cerner on the clinicals and Soarian or other legacy solutions on the financial side. And we are supportive of those, and the reception has been very good. We hosted a breakfast at HIMSS for a number of those clients, and it was very well received and well attended. And so I am very pleased with the clients' perspective of how we are performing and the receptivity to Cerner as the custodian of the legacy solutions as well as those that are moving forward with the Cerner Millennium and other solutions set. So it's been very, very positive.

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**Steve Halper** - *FBR - Analyst*

And just one follow-up. So obviously those discussions with those three clients were already underway. But since the acquisition was announced or closed, did that process speed up because of the acquisition?

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**Zane Burke** - *Cerner Corporation - President*

It did. They moved very quickly. So a couple of those actually moved very quickly to make a decision to move forward with us. And I think some of the -- we did not have a lot of bookings contribution from the Health Services business itself, which I think makes sense as you had some of that client base waiting to see how the transition would occur and what, in fact, happened. So then I would anticipate a better contribution from the pure Health Services clients themselves on the more legacy solutions as we move forward. But that contribution was very minimal in the first quarter.





**Marc Naughton** - *Cerner Corporation - EVP and CFO*

Steve, this is Marc. Just a couple of data points. I think actually when we look at bookings going forward and the guidance that we give, we are assuming pretty minimal contributions from HS bookings just because we think a lot -- we just don't think that they are -- as they are still ramping up and they are still working through the clients. A lot of the clients are going to make decisions; those are going to be buying Millennium solutions in some form or fashion, as Zane talked about.

So I think that we don't really -- we are not looking for a great -- much of an impact at all from HS bookings for this, actually, full year.

But the one thing that strikes me on HS is that we kind of have a strategy of running those two companies in parallel. We didn't want to distract those organizations -- either organization. We're coming together a lot faster than I would have expected and a smooth transition. The client side is almost -- we just had our Q2 forecast meeting a week ago. And it's pretty amazing how seamless it feels that we are talking as one Company, looking at all the opportunities across both sides. And I think that's one of the reasons that as we look out and try to track the numbers, we are really focusing on kind of the one big number rather than trying to come up with artificial breakdowns between HS and Cerner. Because we are getting together more quickly than I would have expected, which is actually great given that it is being done pretty seamlessly. Just thought I'd throw that in for color.

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**Steve Halper** - *FBR - Analyst*

Thank you so much.

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**Operator**

Dave Windley, Jefferies.

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**Dave Windley** - *Jefferies & Company - Analyst*

Marc, I thought I understood this, but now I'm confused. On the deferred revenue, your answer to Steve there talking about it not being in the revenue because you are -- it sounds like you are basically saying you are presenting it differently than you originally anticipated doing. But do I understand correctly that the absence of that revenue -- so treating it as deferred instead of running it through the revenue line -- does have a bottom-line impact? Does it not?

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

No, it doesn't. The difference was that I knew that there was a number for deferred revenue that under GAAP you wouldn't recognize. But as an adjusted item, given that it was in their run rate, our expectation was we would recognize it.

The difference is the number was always going to be in the earnings line. The difference really is presentation. When we have guided revenue prior to the quarter, I would've put that \$12.5 million in my revenue number that I guided to. The results that we presented don't have it in the revenue number; they have it as a separate line adjusting net earnings.

So it still has the same impact on earnings; there's no change. But from a presentation standpoint, revenue that we talk about today is \$12.5 million less than what I thought it would have been when we did our guidance, and that continues.



**Dave Windley** - *Jefferies & Company - Analyst*

In the paragraph on the front of the press release where it does say the deferred revenue which reduced net earnings and diluted earnings per share, is that something different?

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

Well, that is -- relative to GAAP, net earnings, not including that deferred revenue, resulted in a lower GAAP number. So our adjusted earnings statement basically takes the GAAP number as a starting point that was reduced by the deferred revenue and then add that deferred revenue item back to get to the adjusted earnings, which we think is a better indicator to investors of the performance of the Company.

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**Dave Windley** - *Jefferies & Company - Analyst*

Okay. Fine. Thanks. Sorry for that. So moving on to a more important question -- the expansions of I guess the longer-term contracts, which is a good number in the quarter, and the expansions of longer-term contracts -- I'm curious on those works situations where you get those expansions, what are the triggers for those? Are those situations where the client was piloting in part of their enterprise? Or where they have acquired something, and the acquired facility needs that expansion? What drives an existing client to expand rather than take it enterprise-wide to begin with?

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**Zane Burke** - *Cerner Corporation - President*

This is Zane. It's a number of considerations. Oftentimes, it's acquisition activity. So they have made an acquisition who had a competitor's EMR, and they have not yet gotten to that rollout. In some cases, there were decisions to pilot that EMR and get a certain set up and running. And you often see that in the investor-owned segment where they start with a subset of their hospitals and will decide based on success to continue to roll out. And we see that happening in a number of our investor-owned clients.

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

I think relative to some of the expansions on the works deals, some of those will be based on -- some clients do have a smaller starting point. Some clients start with a certain term and say, we like this, we like how this is going, so we are going to expand the term of our license. So it's adding years.

Keep in mind each of these works businesses can have different flavors. We can go anywhere from a full works business to maybe they only had AMS and some other support services that they signed up for, and then they sign up for the works.

So an expansion usually can either mean they have acquired more facilities and those are going to fall in under the original contract of support. It could be the length of the term, or it could be an expansion of the actual services that they wanted to have.

Keep in mind we've talked about this. This year, we are seeing a lot of ITWorks opportunities. So as you are thinking on a revenue growth perspective, those add \$7 million to \$10 million on an annual basis. And if we can get to the point where we are signing four or five of those in a year or more, then that's a good opportunity to expand the top line as well.

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**Dave Windley** - *Jefferies & Company - Analyst*

Okay. Thanks. And my last question, I think -- a quick one. But at the HIMSS analyst day, you talked about 5 Soarian clients making the decision to shift over to Millennium. And Zane, I think you just said 3 during the first quarter. So I just wanted to make sure I was understanding the two numbers correctly. And perhaps you could update -- has there been any subsequent decision to what we heard at the analyst day? Thanks.

**Zane Burke** - Cerner Corporation - President

Sorry about that. So there were -- one of those had 3 hospitals that were kind of 3 individual buying decisions that I in my head have rolled that into one. So the 5 is an accurate element of that, but principally driven by one. So that's still the same as you think about where we were from HIMSS previously.

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**Marc Naughton** - Cerner Corporation - EVP and CFO

Yes. For the most part, we expect there to be migrations as we go. It's not a metric that we are going to track every quarter. But I think from Dick's comments at HIMSS and our comments today, it is noteworthy that within 60 days of closing we still had 5 basically transactions with 3 basic clients that made the decision to go with Cerner and do the migration very quickly. So that was one of the data points. We expect once again there to be, over time, a very good chunk of their base will migrate to Cerner solutions in some form or another.

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**Dave Windley** - Jefferies & Company - Analyst

Got it.

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**Zane Burke** - Cerner Corporation - President

We are still getting very good activity in the transition space.

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**Dave Windley** - Jefferies & Company - Analyst

Excellent. Thank you.

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**Operator**

Sean Wieland, Piper Jaffray.

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**Dave Windley** - Jefferies & Company - Analyst

So this quarter and last quarter you talked about the expanded pipeline in the hospital market. Can you just talk a little bit about the close rate that you are seeing in that pipeline? And what if any is the sense of urgency that these customers have in making a decision?

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**Zane Burke** - Cerner Corporation - President

Great question. It is different than it was in a meaningful-use era where the timelines were really forced by the government related to the meaningful-use pieces. So we are seeing some variability in the close rates of those decisions and the ability to accurately forecast some of the timing of that. The level of activity is unprecedented, but the close rate does have some variability as we move forward.

There are compelling elements as people look to the future. They know that they have to have a contemporary solutions set. So the more at-risk dollars that they have around readmissions -- so the more that their revenue is at risk. So as they look forward, they have a number of mandates from the government and from the payer side around their risk elements.



So they need to go move forward. It's a matter of how much pain will they allow themselves to be inflicted upon before they move to a more contemporary system. So that really is the key driver of the close rate of that.

But we've got a very extensive forecast methodology that we continue to utilize and has really helped us take the variability out of the business. And that discipline is what we utilize to run and reforecast our business every quarter for the following four quarters.

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

This is Marc. The nice part is having a big pipeline and lots of activity, meaning we can apply risk to closure. And so if something moves out, there is usually something else is taking its place. So pipeline mix increases your forecast ability even in an environment where there isn't a special -- particular date that is driving closure to contract.

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**Sean Wieland** - *Piper Jaffray & Co. - Analyst*

Thank you. And then also another question, last quarter -- I think my notes say you had 11 competitive displacements in the ambulatory space. How many of those do you have live now?

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

I would have to go do the research to figure that out. Obviously if they are a PowerWorks client, very likely they are up and running. But I think for the most part those displacements are likely going to be the other solutions that will have a normal project standpoint.

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**Zane Burke** - *Cerner Corporation - President*

Typically in an integrated ambulatory model, which most of those displacements are around, you are looking at a 15-month cycle for most of those types of situations.

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**Sean Wieland** - *Piper Jaffray & Co. - Analyst*

Got it. Thanks so much.

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**Marc Naughton** - *Cerner Corporation - EVP and CFO*

Why don't we take one more question?

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**Operator**

Robert Jones, Goldman Sachs.

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**Unidentified Participant**

This is actually Stefan calling in for Bob. I just wanted to follow up on the comments around the strong pipeline more broadly. I was hoping you could share your thoughts around what you have seen with regard to overall client CapEx budgets or improving utilization. Is there an improving backdrop of ACF volume-driven improvements that's driving increased activity?



**Zane Burke** - Cerner Corporation - President

This is Zane. Obviously our business is impacted by the health of our clients. And many of our clients have seen a large amount of volume increase, and so that obviously is a positive element around that. And then those clients that have better reimbursement scenarios in certain states that have received some of the Medicaid additional dollars, their bottom lines have been positively impacted. I won't say that that's driving additional spending behavior because fundamentally what our clients are looking at is the future to both survive and then thrive. So these are core decisions that the client needs to make. So while their financial health will have an impact on our business overall, making the investments in these types of systems is actually crucial for their survival long term and ability to thrive.

So I don't think that it's going to have an immediate near-term impact so much as it has a -- it's good when our clients are doing well.

**Unidentified Participant**

Great. Thanks for the question.

**Marc Naughton** - Cerner Corporation - EVP and CFO

I want to thank everyone for joining the call. We appreciate the attention, especially given all the activity that was occurring at 3:30 today. So know that we appreciate your attention. And we are certainly pleased with the strong results we had this quarter, and we look forward to talking to you again very soon. Thank you.

**Operator**

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Have a very good day.

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