CERNER CORP /MO/
Form 10-Q
August 01, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended July 2, 2011

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to __________

Commission File Number 0-15386

CERNER CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	43-1196944
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

2800 Rockcreek Parkway
North Kansas City, Missouri 64117
(816) 201-1024

(Address of Principal Executive Offices, including zip code;
registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer [X]	Accelerated filer [ ]	Non-accelerated filer [ ] (Do not check if a smaller	Smaller reporting company [ ]

reporting
company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

There were 169,052,633 shares of Common Stock, $.01 par value, outstanding at July 28, 2011.

CERNER CORPORATION AND SUBSIDIARIES
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Part I. Financial Information
Item 1. Financial Statements
CERNER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
As of July 2, 2011 (unaudited) and January 1, 2011

(In thousands, except share data)		**2011**		**2010**
Assets				
Current assets:				
Cash and cash equivalents	$	214,056	$	214,511
Short-term investments		467,966		356,501
Receivables, net		504,290		476,905
Inventory		13,076		11,036
Prepaid expenses and other		105,197		83,272
Deferred income taxes		8,737		3,836
Total current assets		1,313,322		1,146,061
Property and equipment, net		497,770		498,829
Software development costs, net		247,709		244,848
Goodwill		189,194		161,374
Intangible assets, net		56,146		38,468
Long-term investments		329,990		264,467
Other assets		86,676		68,743
Total assets	$	2,720,807	$	2,422,790
Liabilities and Shareholders Equity				
Current liabilities:				
Accounts payable	$	72,571	$	65,035
Current installments of long-term debt		29,820		24,837
Deferred revenue		132,721		109,351
Accrued payroll and tax withholdings		90,908		86,921
Other accrued expenses		24,931		19,788
Total current liabilities		350,951		305,932
Long-term debt		84,871		67,923
Deferred income taxes and other liabilities		140,903		126,215
Deferred revenue		13,946		17,303
Total liabilities		590,671		517,373

Shareholders Equity:				
Cerner Corporation shareholders equity:				
Common stock, $.01 par value, 250,000,000 shares authorized, 168,931,933 shares issued at July 2, 2011 and 168,058,570 shares issued at January 1, 2011		1,689		1,681
Additional paid-in capital		689,190		616,972
Retained earnings		1,427,435		1,290,835
Accumulated other comprehensive income (loss), net		11,702		(4,191)
Total Cerner Corporation shareholders equity		2,130,016		1,905,297
Noncontrolling interest		120		120
Total shareholders equity		2,130,136		1,905,417
Total liabilities and shareholders equity	$	2,720,807	$	2,422,790

See notes to condensed consolidated financial statements (unaudited).

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CERNER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the three and six months ended July 2, 2011 and July 3, 2010
(unaudited)

	Three Months Ended		Six Months Ended	
(In thousands, except per share data)	**2011**	**2010**	**2011**	**2010**
Revenues:				
System sales	$ 157,145	$ 135,902	$ 297,524	$ 252,853
Support, maintenance and services	355,330	311,575	696,324	618,620
Reimbursed travel	11,748	8,524	22,039	15,865
Total revenues	524,223	456,001	1,015,887	887,338
Costs and expenses:				
Cost of system sales	61,887	52,863	119,986	97,691
Cost of support, maintenance and services	24,847	16,824	47,137	32,739
Cost of reimbursed travel	11,748	8,524	22,039	15,865
Sales and client service	210,213	190,030	411,561	377,623
Software development (Includes amortization of $19,910 and $38,968 for the three and six months ended July 2, 2011; and $16,421 and $32,259 for the three and six months ended July 3, 2010.)	69,790	67,988	140,934	134,767
General and administrative	37,765	33,420	72,558	66,645
Total costs and expenses	416,250	369,649	814,215	725,330
Operating earnings	107,973	86,352	201,672	162,008
Other income (expense):				
Interest income, net	2,875	421	4,851	2,204
Other income (expense), net	5	(495)	40	(571)
Total other income (expense), net	2,880	(74)	4,891	1,633
Earnings before income taxes	110,853	86,278	206,563	163,641
Income taxes	(38,809)	(30,801)	(69,963)	(57,878)

Net earnings	$ 72,044	$ 55,477	$ 136,600	$ 105,763
Basic earnings per share	$ 0.43	$ 0.34	$ 0.81	$ 0.64
Diluted earnings per share	$ 0.42	$ 0.33	$ 0.79	$ 0.62
Basic weighted average shares outstanding	168,299	164,669	167,706	164,291
Diluted weighted average shares outstanding	173,591	170,673	173,128	170,447

See notes to condensed consolidated financial statements (unaudited).

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CERNER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the six months ended July 2, 2011 and July 3, 2010
(unaudited)

(In thousands)	Six Months Ended 2011	Six Months Ended 2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	$ 136,600	$ 105,763
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	102,670	91,451
Share-based compensation expense	13,131	10,806
Provision for deferred income taxes	7,869	6,112
Changes in assets and liabilities (net of businesses acquired):		
Receivables, net	(35,718)	12,675
Inventory	(1,969)	2,024
Prepaid expenses and other	(11,185)	14,591
Accounts payable	2,913	14,900
Accrued income taxes	477	(12,117)
Deferred revenue	14,494	(19,656)
Other accrued liabilities	19,346	(10,808)
Net cash provided by operating activities	248,628	215,741
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital purchases	(51,677)	(56,011)
Capitalized software development costs	(41,055)	(41,248)
Purchases of investments	(628,686)	(319,056)
Maturities of investments	447,009	209,650
Purchase of other intangibles	(5,098)	(2,551)
Acquisition of businesses, net of cash acquired	(28,069)	(14,486)
Net cash used in investing activities	(307,576)	(223,702)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from sale of future receivables	-	1,516
Repayment of long-term debt	(454)	(1,686)
Proceeds from excess tax benefits from stock compensation	26,570	13,112
Proceeds from exercise of options	29,972	14,224
Contingent consideration payments for acquisition of businesses	(779)	-
Net cash provided by financing activities	55,309	27,166

Effect of exchange rate changes on cash		3,184		(5,133)
Net increase (decrease) in cash and cash equivalents		(455)		14,072
Cash and cash equivalents at beginning of period		214,511		241,723
Cash and cash equivalents at end of period	$	214,056	$	255,795
Supplemental disclosures of cash flow information:				
Cash paid during the year for:				
Interest	$	3,074	$	3,483
Income taxes, net of refund		40,061		63,415
Summary of acquisition transactions:				
Fair value of net tangible assets (liabilities) acquired	$	(8,053)	$	1,069
Fair value of intangible assets acquired		18,204		5,076
Fair value of goodwill		26,130		11,290
Less: Fair value of contingent liability payable		(5,235)		(1,725)
Less: Fair value of working capital settlement payable		(939)		-
Cash paid for acquisition		30,107		15,710
Cash acquired		(2,038)		(1,224)
Net cash used	$	28,069	$	14,486

See notes to condensed consolidated financial statements (unaudited).

CERNER CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(1) Interim Statement Presentation

The condensed consolidated financial statements included herein have been prepared by Cerner Corporation (the Company) without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in our latest annual report on Form 10-K.

In our opinion, the accompanying unaudited condensed consolidated financial statements include all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position and the results of operations and cash flows for the periods presented. Our interim results as presented in this Form 10-Q are not necessarily indicative of the operating results for the entire year.

The condensed consolidated financial statements were prepared using accounting principles generally accepted in the United States (GAAP). These principles require us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from those estimates.

Our second fiscal quarter ends on the Saturday closest to June 30. The 2011 and 2010 second quarters ended on July 2, 2011 and July 3, 2010, respectively. All references to years in these notes to condensed consolidated financial statements represent the three or six months ended of the second fiscal quarter, respectively, unless otherwise noted.

Stock Split

On May 27, 2011, the Board of Directors of the Company approved a two-for-one split of our common stock in the form of a one hundred percent (100%) stock dividend, which was distributed on June 24, 2011 to shareholders of record as of June 15, 2011. In connection with the stock split, 790,000 treasury shares previously reflected in the consolidated balance sheets were utilized to settle a portion of the distribution. All share and per share data have been retroactively adjusted for all periods presented to reflect the stock split including the use of treasury shares, as if the stock split had occurred at the beginning of the earliest period presented.

Under the terms of our outstanding equity awards, the stock split increased the number of shares of our common stock issuable upon exercise or vesting of such awards in proportion to the stock split ratio and caused a proportionate decrease in the exercise price of such awards to the extent they were stock options.

Recently Adopted Accounting Pronouncements

ASU 2009-13. In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2009-13 Multiple-Deliverable Revenue Arrangements (ASU 2009-13). ASU 2009-13 requires a vendor to allocate revenue to each unit of accounting in many arrangements involving multiple deliverables based on the relative selling price of each deliverable. It also changes the level of evidence of standalone selling price required to separate deliverables by allowing a vendor to make its best estimate of the standalone selling price of deliverables when more objective evidence of selling price is not available.

We adopted ASU 2009-13 for all new and materially modified arrangements on a prospective basis beginning January 2, 2011. We have reviewed the primary accounting literature related to the elements that typically get bundled into our arrangements and determined that the majority of the elements fall in to two different accounting units. One unit is comprised of software and software-related elements which include our licensed software, licensed software support, application services provider, subscriptions, professional services, remote hosting, sublicensed software and sublicensed software support. The second unit of accounting is non-software elements, which include hardware and hardware maintenance.

The majority of our multiple-element arrangements do not contain both software and non-software deliverables such as hardware and thus are not impacted by the new guidance. For our arrangements that are impacted by ASU 2009-

13, we determined fair value based upon vendor-specific objective evidence (VSOE), if it existed, and in instances where VSOE did not exist (primarily for our Licensed Software), we determined fair value based upon the estimated selling price concept. The application of this concept relies primarily on historical pricing and management guidance for similarly sized arrangements.

The adoption of ASU 2009-13 did not result in a material change in the timing of revenue recognition due to the small number of arrangements executed with both software and non-software deliverables and the existence of VSOE for most of our business models.

ASU 2009-14. In October 2009, the FASB issued ASU 2009-14 Certain Revenue Arrangements That Include Software Elements (ASU 2009-14). Under ASU 2009-14, tangible products containing software components and non-software components that function together to deliver the tangible product s essential functionality are no longer within the scope of the software revenue guidance in ASC 985-605. We adopted the amendment provisions of ASU 2009-14 on January 2, 2011; the adoption of this standard did not have material impact on the timing of revenue recognition.

Recently Issued Accounting Pronouncements

ASU 2011-05. In June 2011, the FASB issued ASU 2011-05 Presentation of Comprehensive Income (ASU 2011-05). ASU 2011-05 requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in equity. ASU 2011-05 is effective for us in our first quarter of 2012 and is required to be applied retrospectively. We are currently evaluating the impact of our pending adoption of ASU 2011-05 on our consolidated financial statements, but we do not expect its adoption will have a material effect on our consolidated financial statements.

(2) Acquisitions

On May 23, 2011, we completed the purchase of 100% of the outstanding common shares of Resource Systems, Inc., developer of the *CareTracker*® point-of-care electronic documentation system primarily used within skilled nursing and assisted living facilities. Cerner believes that there is significant market opportunity for information technology solutions in the long-term care market as the U.S. population ages and life expectancy continues to increase.

Consideration for the acquisition of Resource Systems is expected to total $36.3 million consisting of up-front cash plus additional contingent consideration, which is payable if we achieve certain revenue milestones through the quarters ending June 30, 2012 and December 29, 2012 and bookings milestones through the quarters ending June 30, 2012 and June 29, 2013 from the clients acquired from Resource Systems. We valued the contingent consideration at $5.2 million based on a probability-weighted assessment of potential contingent consideration payment scenarios. The allocation of the purchase price to the estimated fair values of the identified tangible and intangible assets acquired, net of liabilities assumed, is summarized below:

(In thousands)

	Allocation Amount
Tangible assets and liabilities	
Current assets	$ 5,249
Property and equipment	209
Current liabilities	(6,803)
Deferred tax liabilities	(6,708)
Total net tangible liabilities acquired	(8,053)
Intangible assets	
Customer relationships	11,204
Existing technologies	6,401
Non-compete agreements	599

Total intangible assets acquired		18,204
Goodwill		26,130
Total purchase price	$	36,281

The fair values of the acquired intangible assets and the contingent consideration were estimated by applying the income approach. Such estimations required the use of inputs that were unobservable in the market place (Level 3), including a discount rate that we estimated would be used by a market participant in valuing these assets, projections

of revenues and cash flows, probability weighting factors and client attrition rates. See Note 3 for further information about the fair value level hierarchy.

The goodwill of $26.1 million arising from the acquisition consists largely of the synergies and economies of scale, including the value of the assembled workforce, expected from combining the operations of Cerner and Resource Systems. All of the goodwill was allocated to our Domestic operating segment and is not expected to be deductible for tax purposes. The other identifiable intangible assets are being amortized over five years. The operating results of Resource Systems were combined with our operating results subsequent to the purchase date of May 23, 2011. Pro-forma results of operations, assuming this acquisition was made at the beginning of the earliest period presented, have not been presented because the effect of this acquisition was not material to our results.

(3) Fair Value Measurements

We determine fair value measurements used in our condensed consolidated financial statements based upon the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below:

Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that the entity has the ability to access.

Level 2 Valuations based on quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable data for substantially the full term of the assets or liabilities.

Level 3 Valuations based on inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table details our financial assets measured at fair value within the fair value hierarchy:

(In thousands)		July 2, 2011			January 1, 2011		
	Balance Sheet	Fair Value Measurements Using			Fair Value Measurements Using		
Description	Classification	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Money market funds	Cash equivalents	$ 48,060	$ -	$ -	$ 44,237	$ -	$ -
Time deposits	Cash equivalents	-	6,686	-	-	-	-
Time deposits	Short-term investments	-	56,591	-	-	41,764	-
Commercial paper	Short-term investments	-	44,800	-	-	44,500	-
Government and corporate bonds	Short-term investments	-	366,575	-	-	251,787	-
Auction rate securities	Short-term investments	-	-	-	-	18,450	-
Government and corporate bonds	Long-term investments	-	329,990	-	-	264,467	-

We classify our long-term, fixed rate debt as a long-term liability on the balance sheet and estimate the fair value using a Level 3 discounted cash flow analysis based on our current borrowing rates for debt with similar maturities. The fair value of our long-term debt, including current maturities, was approximately $101.8 million at July 2, 2011.

(4) Receivables

Receivables consist primarily of accounts receivable and contracts receivable. Accounts receivable represent recorded revenues that have been billed. Contracts receivable represent recorded revenues that are billable by us at future dates under the terms of a contract with a client. Billings and other consideration received on contracts in excess of related revenues recognized are recorded as deferred revenue. Substantially all receivables are derived from sales and related support and maintenance and professional services of our clinical, administrative and financial information systems and solutions to health care providers located throughout the United States and in certain non-U.S. countries.

We perform ongoing credit evaluations of our clients and generally do not require collateral from our clients. We provide an allowance for estimated uncollectible accounts based on specific identification, historical experience and our judgment. Provisions for losses on uncollectible accounts for the first six months of 2011 and 2010 totaled $4.0 million and $6.0 million, respectively. A summary of net receivables is as follows:

(In thousands)	July 2, 2011	January 1, 2011
Gross accounts receivable	$ 365,192	$ 352,554
Less: Allowance for doubtful accounts	18,751	15,550
Accounts receivable, net of allowance	346,441	337,004
Contracts receivable	157,849	139,901
Total receivables, net	$ 504,290	$ 476,905

During the second quarter of 2008, Fujitsu Services Limited s (Fujitsu) contract as the prime contractor in the National Health Service (NHS) initiative to automate clinical processes and digitize medical records in the Southern region of England was terminated by the NHS. This had the effect of automatically terminating our subcontract for the project. We are in dispute with Fujitsu regarding Fujitsu s obligation to pay the amounts comprised of accounts receivable and contracts receivable related to that subcontract, and we are working with Fujitsu to resolve these issues based on processes provided for in the contract. Part of that process requires resolution of disputes between Fujitsu and the NHS regarding the contract termination. As of July 2, 2011, it remains unlikely that the matter will be resolved in the next 12 months. Therefore these receivables have been classified as long-term and represent the significant majority of other long-term assets as of the second quarter ended July 2, 2011. While the ultimate collectability of the receivables pursuant to this process is uncertain, we believe that we have valid and equitable grounds for recovery of such amounts and that collection of recorded amounts is probable.

During the first six months of 2011 and 2010, we received total client cash collections of $1.0 billion and $930.7 million, respectively, of which $35.1 million and $25.3 million were received from third party arrangements with non-recourse payment assignments.

(5) Income Taxes

We determine the tax provision for interim periods using an estimate of our annual effective tax rate, adjusted for discrete items, if any, that are taken into account in the relevant period. Each quarter we update our estimate of the annual effective tax rate, and if our estimated tax rate changes we make a cumulative adjustment. We classify interest and penalties associated with unrecognized tax benefits as income tax expense in our Condensed Consolidated Statements of Operations.

Our effective tax rate was 33.9% and 35.4% for the first six months of 2011 and 2010, respectively. This decrease was primarily due to the research and development tax credit being in effect for the first six months of 2011 while it was not effective for the first six months of 2010 and a favorable foreign tax audit settlement during the first quarter of 2011.

During the first quarter of 2010, the Internal Revenue Service commenced its examination of the 2008 and 2009 income tax returns. We do not believe this examination will have a material effect on our financial position, results of operations or liquidity.

As of the end of the second quarter of 2011, we do not anticipate any settlements of the aforementioned matter or any of our remaining unrecognized tax benefits within the next 12 months.

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(6) Earnings Per Share

Basic earnings per share (EPS) excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in our earnings. A reconciliation of the numerators and the denominators of the basic and diluted per share computations are as follows:

	Three Months Ended					
	2011			2010		
(In thousands, except per share data)	Earnings (Numerator)	Shares (Denominator)	Per-Share Amount	Earnings (Numerator)	Shares (Denominator)	Per-Sl Amo
Basic earnings per share:						
Income available to common shareholders	$ 72,044	168,299	$ 0.43	$ 55,477	164,669	$
Effect of dilutive securities:						
Stock options and non-vested restricted stock	-	5,292		-	6,004	