

CERNER CORP /MO/  
Form 10-Q  
October 26, 2012  
Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 29, 2012

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  
(State or other jurisdiction of  
incorporation or organization)

43-1196944  
(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  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  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  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

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Yes [ ] No [X]

Indicate the number of shares outstanding of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 18, 2012
Common Stock, \$0.01 par value per share	171,564,145 shares

Table of Contents

CERNER CORPORATION AND SUBSIDIARIES

I N D E X

Part I. Financial Information:

Item 1. Financial Statements:

Condensed Consolidated Balance Sheets as of September 29, 2012 (unaudited) and December 31, 2011 1

Condensed Consolidated Statements of Operations for the three and nine months ended September 29, 2012 and October 1, 2011 (unaudited) 2

Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 29, 2012 and October 1, 2011 (unaudited) 3

Condensed Consolidated Statements of Cash Flows for the nine months ended September 29, 2012 and October 1, 2011 (unaudited) 4

Notes to Condensed Consolidated Financial Statements (unaudited) 5

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 15

Item 3. Quantitative and Qualitative Disclosures about Market Risk 25

Item 4. Controls and Procedures 25

Part II. Other Information: 26

Item 6. Exhibits 26

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Table of Contents

## Part I. Financial Information

## Item 1. Financial Statements

CERNER CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

As of September 29, 2012 (unaudited) and December 31, 2011

(In thousands, except share data)	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	\$288,101	\$243,146
Short-term investments	750,895	531,635
Receivables, net	542,415	563,209
Inventory	24,308	23,296
Prepaid expenses and other	128,541	94,232
Deferred income taxes, net	11,520	46,795
Total current assets	1,745,780	1,502,313
Property and equipment, net	551,663	488,996
Software development costs, net	260,876	248,750
Goodwill	211,793	211,826
Intangible assets, net	66,477	75,366
Long-term investments	462,999	359,324
Other assets	170,868	113,783
Total assets	\$3,470,456	\$3,000,358
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$134,775	\$85,545
Current installments of long-term debt	54,979	39,722
Deferred revenue	179,783	153,139
Accrued payroll and tax withholdings	108,842	109,227
Other accrued expenses	17,628	51,087
Total current liabilities	496,007	438,720
Long-term debt and other obligations	141,678	86,821
Deferred income taxes and other liabilities	122,153	150,229
Deferred revenue	13,941	13,787
Total liabilities	773,779	689,557
Shareholders' Equity:		
Cerner Corporation shareholders' equity:		
Common stock, \$.01 par value, 250,000,000 shares authorized, 171,536,679 shares issued at September 29, 2012 and 169,565,856 shares issued at December 31, 2011	1,715	1,696
Additional paid-in capital	818,130	723,490

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Retained earnings	1,882,886	1,597,462
Accumulated other comprehensive loss, net	(6,174 )	(11,967 )
Total Cerner Corporation shareholders' equity	2,696,557	2,310,681
Noncontrolling interest	120	120
Total shareholders' equity	2,696,677	2,310,801
Total liabilities and shareholders' equity	\$3,470,456	\$3,000,358

See notes to condensed consolidated financial statements (unaudited).

1

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Table of Contents

CERNER CORPORATION AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 For the three and nine months ended September 29, 2012 and October 1, 2011  
 (unaudited)

(In thousands, except per share data)	Three Months Ended		Nine Months Ended	
	2012	2011	2012	2011
Revenues:				
System sales	\$229,925	\$188,698	\$651,040	\$486,222
Support, maintenance and services	432,281	371,467	1,262,231	1,067,791
Reimbursed travel	14,276	11,475	41,781	33,514
Total revenues	676,482	571,640	1,955,052	1,587,527
Costs and expenses:				
Cost of system sales	100,668	84,268	318,193	204,254
Cost of support, maintenance and services	34,634	24,721	95,112	71,858
Cost of reimbursed travel	14,276	11,475	41,781	33,514
Sales and client service	259,141	220,177	746,090	631,738
Software development (Includes amortization of \$20,880 and \$60,353 for the three and nine months ended September 29, 2012; and \$20,919 and \$59,887 for the three and nine months ended October 1, 2011)	78,094	72,544	222,746	213,478
General and administrative	41,973	38,063	119,912	110,621
Total costs and expenses	528,786	451,248	1,543,834	1,265,463
Operating earnings	147,696	120,392	411,218	322,064
Other income, net	3,351	2,775	8,789	7,666
Earnings before income taxes	151,047	123,167	420,007	329,730
Income taxes	(52,160 )	(44,332 )	(134,583 )	(114,295 )
Net earnings	\$98,887	\$78,835	\$285,424	\$215,435
Basic earnings per share	\$0.58	\$0.47	\$1.67	\$1.28
Diluted earnings per share	\$0.56	\$0.45	\$1.63	\$1.24
Basic weighted average shares outstanding	171,251	169,140	170,643	168,343
Diluted weighted average shares outstanding	175,870	174,283	175,517	173,656
See notes to condensed consolidated financial statements (unaudited).				

Table of Contents

CERNER CORPORATION AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 For the three and nine months ended September 29, 2012 and October 1, 2011  
 (unaudited)

(In thousands)	Three Months Ended		Nine Months Ended	
	2012	2011	2012	2011
Net earnings	\$98,887	\$78,835	\$285,424	\$215,435
Foreign currency translation adjustment and other (net of taxes (benefit) of \$(843) and \$(1,478) for the three and nine months ended September 29, 2012; and \$2,245 and \$1,407 for the three and nine months ended October 1, 2011)	6,240	(23,358 )	5,247	(7,465 )
Change in net unrealized holding gain (loss) on available-for-sale investments (net of taxes (benefit) of \$321 and \$338 for the three and nine months ended September 29, 2012)	518	—	546	—
Comprehensive income	\$105,645	\$55,477	\$291,217	\$207,970

See notes to condensed consolidated financial statements (unaudited).

Table of Contents

CERNER CORPORATION AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 For the nine months ended September 29, 2012 and October 1, 2011  
 (unaudited)

(In thousands)	Nine Months Ended	
	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net earnings	\$285,424	\$215,435
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	162,336	156,841
Share-based compensation expense	26,304	20,363
Provision for deferred income taxes	20,679	9,246
Changes in assets and liabilities (net of businesses acquired):		
Receivables, net	(31,102 )	(103,829 )
Inventory	(907 )	(1,200 )
Prepaid expenses and other	(18,322 )	1,469
Accounts payable	30,596	8,026
Accrued income taxes	(36,983 )	4,662
Deferred revenue	26,333	18,932
Other accrued liabilities	63,402	47,860
Net cash provided by operating activities	527,760	377,805
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital purchases	(129,966 )	(75,602 )
Capitalized software development costs	(72,506 )	(61,827 )
Purchases of investments	(999,697 )	(870,960 )
Sales and maturities of investments	663,257	615,219
Purchase of other intangibles	(7,212 )	(8,395 )
Acquisition of businesses, net of cash acquired	—	(28,069 )
Net cash used in investing activities	(546,124 )	(429,634 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayment of long-term debt	(1,772 )	(715 )
Proceeds from excess tax benefits from stock compensation	36,431	34,009
Proceeds from exercise of options	31,102	36,463
Contingent consideration payments for acquisition of business	(3,400 )	(779 )
Net cash provided by financing activities	62,361	68,978
Effect of exchange rate changes on cash and cash equivalents	958	(466 )
Net increase in cash and cash equivalents	44,955	16,683
Cash and cash equivalents at beginning of period	243,146	214,511
Cash and cash equivalents at end of period	\$288,101	\$231,194



See notes to condensed consolidated financial statements (unaudited).

Table of Contents

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 (we or 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 (GAAP) 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 management's opinion, the accompanying unaudited condensed consolidated financial statements include all adjustments (consisting of only normal recurring adjustments) 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 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 third fiscal quarter ends on the Saturday closest to September 30. The 2012 and 2011 third quarters ended on September 29, 2012 and October 1, 2011, respectively. All references to years in these notes to condensed consolidated financial statements represent the respective three or nine months ended on such dates, unless otherwise noted.

Recently Adopted Accounting Pronouncements

**Comprehensive Income.** On January 1, 2012, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2011-05, Presentation of Comprehensive Income. 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. These condensed consolidated financial statements include separate Condensed Consolidated Statements of Comprehensive Income.

**Goodwill Impairment.** On January 1, 2012, we adopted FASB ASU 2011-08, Testing for Goodwill Impairment. ASU 2011-08 amends existing guidance by giving an entity the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than the carrying amount. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. If an entity determines that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then it is necessary to perform the two-step goodwill impairment test, as currently prescribed by FASB Accounting Standards Codification Topic 350. Otherwise, the two-step goodwill impairment test is not required. The adoption of this standard did not have a material effect on our condensed consolidated financial statements.

(2) 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.

Table of Contents

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 and recorded at fair value on a recurring basis at September 29, 2012:

(In thousands)		Fair Value Measurements Using		
Description	Balance Sheet Classification	Level 1	Level 2	Level 3
Money market funds	Cash equivalents	\$64,156	\$—	\$—
Time deposits	Cash equivalents	—	10,971	—
Time deposits	Short-term investments	—	86,381	—
Commercial paper	Short-term investments	—	63,978	—
Government and corporate bonds	Short-term investments	—	600,536	—
Time deposits	Long-term investments	—	5,693	—
Government and corporate bonds	Long-term investments	—	447,306	—

The following table details our financial assets measured, but not recorded, at fair value on a recurring basis at December 31, 2011:

(In thousands)		Fair Value Measurements Using		
Description	Balance Sheet Classification	Level 1	Level 2	Level 3
Money market funds	Cash equivalents	\$123,919	\$—	\$—
Time deposits	Cash equivalents	—	7,358	—
Time deposits	Short-term investments	—	67,632	—
Commercial paper	Short-term investments	—	23,250	—
Government and corporate bonds	Short-term investments	—	440,753	—
Time deposits	Long-term investments	—	19,579	—
Government and corporate bonds	Long-term investments	—	337,245	—

We estimate the fair value of our long-term, fixed rate debt using a Level 3 discounted cash flow analysis based on current borrowing rates for debt with similar maturities. The fair value of our long-term debt, including current maturities, at September 29, 2012 and December 31, 2011 was approximately \$75.6 million and \$72.6 million, respectively. The carrying amount of such fixed-rate debt at September 29, 2012 and December 31, 2011 was \$69.8 million and \$67.5 million, respectively.

### (3) Investments

Cash equivalents consist of short-term marketable securities with original maturities less than 90 days. Short-term investments primarily consist of time deposits, commercial paper, and government and corporate bonds with maturities of less than one year. Long-term investments primarily consist of government and corporate bonds with maturities of less than two years.

Effective April 1, 2012, we began reporting all securities in our investment portfolio as available-for-sale. The change resulted in the transfer of investments with an aggregate carrying amount of \$1.0 billion from held-to-maturity to available-for-sale, with gross unrealized gains of \$0.7 million and gross unrealized losses of \$0.7 million. The unrealized gains and losses, net of the related tax effects, were recorded to accumulated other comprehensive income. The decision to transfer the securities to available-for-sale is intended to provide us with financial flexibility in determining whether to hold our investment securities to maturity. Such change contemplates the possibility that securities may be liquidated prior to maturity as we manage through changing market conditions.

Available-for-sale securities are recorded at fair value with the unrealized gains and losses reflected in accumulated other comprehensive income until realized. Realized gains and losses from the sale of available-for-sale securities, if any, are determined on a specific identification basis.

We regularly review investment securities for impairment based on both quantitative and qualitative criteria that include the extent to which cost exceeds fair value, the duration of any market decline, and the financial health of and specific prospects for the issuer. Unrealized losses that are other than temporary are recognized in earnings.

6

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Table of Contents

Available-for-sale investments at September 29, 2012 were as follows:

(In thousands)	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash equivalents:				
Money market funds	\$64,156	\$ —	\$ —	\$64,156
Time deposits	10,971	—	—	10,971
Total cash equivalents	75,127	—	—	75,127
Short-term investments:				
Time deposits	86,339	44	(2 )	86,381
Commercial paper	64,000	18	(40 )	63,978
Government and corporate bonds	599,990	617	(71 )	600,536
Total short-term investments	750,329	679	(113 )	750,895
Long-term investments:				
Time deposits	5,700	2	(9 )	5,693
Government and corporate bonds	446,981	426	(101 )	447,306
Total long-term investments	452,681	428	(110 )	452,999
Total available-for-sale investments	\$1,278,137	\$ 1,107	\$ (223 )	\$1,279,021

At December 31, 2011, we held cash equivalents, short-term investments and long-term investments of \$131.3 million, \$531.6 million and \$359.3 million, respectively. Investments at December 31, 2011 were classified as held-to-maturity and stated at amortized cost.

We sold available-for-sale investments for proceeds of \$8.5 million during the nine months ended September 29, 2012, resulting in an insignificant gain.

**(4) Receivables**

A summary of net receivables is as follows:

(In thousands)	September 29, 2012	December 31, 2011
Gross accounts receivable	\$ 490,972	\$ 496,706
Less: Allowance for doubtful accounts	34,491	24,270
Accounts receivable, net of allowance	456,481	472,436
Contracts receivable	60,888	81,776
Current portion of lease receivables	25,046	8,997
Total receivables, net	\$ 542,415	\$ 563,209

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 September 29, 2012, 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 less than the majority of other long-term assets as of the quarter ended September 29, 2012. While the ultimate collectability of the receivables pursuant to this process is uncertain, we

7

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Table of Contents

believe that we have valid and equitable grounds for recovery of such amounts and that collection of recorded amounts is probable.

During the first nine months of 2012 and 2011, we received total client cash collections of \$2.0 billion and \$1.6 billion, respectively, of which \$56.2 million and \$53.4 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 32.0% and 34.7% for the first nine months of 2012 and 2011, respectively. This decrease was primarily due to an increase in net favorable discrete items recorded in 2012 relative to 2011, partially offset by the expiration of the research and development tax credit on December 31, 2011.

We recorded an adjustment to our unrecognized tax benefits during the first quarter of 2012, resulting from the settlement of an ongoing tax audit, which favorably impacted our income tax provision by \$12.0 million. In the first quarter of 2012, we also recognized \$5.6 million of tax expense as a discrete item in connection with the license of certain intellectual property rights to a wholly owned foreign subsidiary. During the second quarter of 2012, we increased our estimate of a tax deduction available for 2011 and recorded the related benefit as a favorable discrete item, which reduced our effective tax rate.

We do not anticipate recognition of any material unrecognized tax benefits in the next twelve months.

(6) Earnings Per Share

A reconciliation of the numerators and the denominators of the basic and diluted per share computations are as follows:

(In thousands, except per share data)	Three Months Ended			2011		
	2012 Earnings (Numerator)	Shares (Denominator)	Per-Share Amount	Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic earnings per share:						
Income available to common shareholders	\$98,887	171,251	\$ 0.58	\$78,835	169,140	\$0.47
Effect of dilutive securities:						
Stock options and non-vested shares	—	4,619		—	5,143	
Diluted earnings per share:						
Income available to common shareholders including assumed conversions	\$98,887	175,870	\$ 0.56	\$78,835	174,283	\$0.45

For the three months ended September 29, 2012 and October 1, 2011, options to purchase 2.8 million and 1.4 million shares, respectively, of common stock at per share prices ranging from \$55.24 to \$85.96 and \$42.84 to \$64.68, respectively, were not included in the computation of diluted earnings per share because the options were anti-dilutive.





Table of Contents

(In thousands, except per share data)	Nine Months Ended 2012			2011		
	Earnings (Numerator)	Shares (Denominator)	Per-Share Amount	Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic earnings per share:						
Income available to common shareholders	\$285,424	170,643	\$ 1.67	\$215,435	168,343	\$ 1.28
Effect of dilutive securities:						
Stock options and non-vested shares	—	4,874		—	5,313	
Diluted earnings per share:						
Income available to common shareholders including assumed conversions	\$285,424	175,517	\$ 1.63	\$215,435	173,656	\$ 1.24

For the nine months ended September 29, 2012 and October 1, 2011, options to purchase 2.1 million and 2.0 million shares, respectively, of common stock at per share prices ranging from \$55.24 to \$85.96 and \$38.99 to \$64.68, respectively, were not included in the computation of diluted earnings per share because the options were anti-dilutive.

## (7) Share-Based Compensation

## Stock Options

Options activity for the nine months ended September 29, 2012 was as follows:

(In thousands, except per share data)	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Contractual Term (Yrs)
Options				
Outstanding at beginning of year	12,909	\$ 23.78		
Granted	1,751	81.32		
Exercised	(1,911 )	16.68		
Forfeited and expired	(228 )	48.23		
Outstanding as of September 29, 2012	12,521	\$ 32.47	\$569,674	6.36
Exercisable as of September 29, 2012	7,613	\$ 16.86	\$460,814	5.10

We valued options granted in 2012 under the Cerner Corporation 2011 Omnibus Equity Incentive Plan using the following weighted average assumptions:

Expected volatility (%)	34.8
Expected term (yrs)	9.1
Risk-free rate (%)	2.1
Fair value per option	\$37.3

As of September 29, 2012, there was \$102.0 million of total unrecognized compensation cost related to stock options granted under all plans. That cost is expected to be recognized over a weighted-average period of 3.30 years.



Table of Contents

## Non-vested Shares

Non-vested share activity for the nine months ended September 29, 2012 was as follows:

(In thousands, except per share data)

Restricted Stock	Number of Shares	Weighted-Average Grant Date Fair Value
Outstanding at beginning of year	254	\$ 47.75
Granted	78	76.30
Vested	(48 )	50.85
Forfeited	—	—
Outstanding as of September 29, 2012	284	\$ 55.14

As of September 29, 2012, there was \$8.6 million of total unrecognized compensation cost related to non-vested share awards granted under all plans. That cost is expected to be recognized over a weighted-average period of 1.36 years. The following table presents the total compensation expense recognized in the Condensed Consolidated Statements of Operations with respect to stock options, non-vested shares and our Associate Stock Purchase Plan:

(In thousands)	Three Months Ended		Nine Months Ended	
	2012	2011	2012	2011
Stock option and non-vested share compensation expense	\$9,721	\$7,232	\$26,304	\$20,363
Associate stock purchase plan expense	719	458	2,064	1,506
Amounts capitalized in software development costs, net of amortization	(218 )	(175 )	(600 )	(425 )
Amounts charged against earnings, before income tax benefit	\$10,222	\$7,515	\$27,768	\$21,444
Amount of related income tax benefit recognized in earnings	\$3,910	\$2,875	\$10,621	\$8,182

## (8) Hedging Activities

The following table represents the fair value of our net investment hedge included within the Condensed Consolidated Balance Sheets:

(In thousands)	Balance Sheet Classification	Fair Value	
		September 29, 2012	December 31, 2011
Derivatives Designated			
Net investment hedge	Short-term liabilities	\$15,007	\$ 14,421
Net investment hedge	Long-term liabilities	45,020	43,262
Total net investment hedge		\$60,027	\$ 57,683

The following table represents the related unrealized gain or loss, net of related income tax effects, on the net investment hedge recognized in comprehensive income:

(In thousands)	Net Unrealized Gain (Loss) For the Three Months Ended		Net Unrealized Gain (Loss) For the Nine Months Ended	
	2012	2011	2012	2011
Net investment hedge - S/T	\$(262 )	\$281	\$(362 )	\$9

Net investment hedge - L/T	(786 )	(251 )	(1,085 )	(1,341 )
Total net investment hedge	\$(1,048 )	\$30	\$(1,447 )	\$(1,332 )

Table of Contents

## (9)Contingencies

The terms of our software license agreements with our clients generally provide for a limited indemnification of such clients against losses, expenses and liabilities arising from third party claims based on alleged infringement by our solutions of an intellectual property right of such third party. The terms of such indemnification often limit the scope of and remedies for such indemnification obligations and generally include a right to replace or modify an infringing solution. To date, we have not had to reimburse any of our clients for any losses related to these indemnification provisions pertaining to third party intellectual property infringement claims. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases under the terms of the corresponding agreements with our clients, we cannot determine the maximum amount of potential future payments, if any, related to such indemnification provisions.

## (10)Segment Reporting

We have two operating segments, Domestic and Global. Revenues are derived primarily from the sale of clinical, financial and administrative information systems and solutions. The cost of revenues includes the cost of third party consulting services, computer hardware, devices and sublicensed software purchased from manufacturers for delivery to clients. It also includes the cost of hardware maintenance and sublicensed software support subcontracted to the manufacturers. Operating expenses incurred by the geographic business segments consist of sales and client service expenses including salaries of sales and client service personnel, communications expenses and unreimbursed travel expenses. Performance of the segments is assessed at the operating earnings level and, therefore, the segment operations have been presented as such. "Other" includes expenses that have not been allocated to the operating segments, such as software development, marketing, general and administrative, share-based compensation expense and depreciation. We manage our operating segments to the operating earnings level. Items such as interest, income taxes, capital expenditures and total assets are managed at the consolidated level and thus are not included in our operating segment disclosures.

Accounting policies for each of the reportable segments are the same as those used on a consolidated basis. The following table presents a summary of our operating segments and other expense for the three and nine months ended September 29, 2012 and October 1, 2011:

(In thousands)	Domestic	Global	Other	Total
Three Months Ended 2012				
Revenues	\$591,327	\$85,155	\$—	\$676,482
Cost of revenues	131,663	17,915	—	149,578
Operating expenses	131,787	32,794	214,627	379,208
Total costs and expenses	263,450	50,709	214,627	528,786
Operating earnings (loss)	\$327,877	\$34,446	\$(214,627)	\$147,696
(In thousands)	Domestic	Global	Other	Total
Three Months Ended 2011				
Revenues	\$499,497	\$72,143	\$—	\$571,640
Cost of revenues	109,656	10,808	—	120,464
Operating expenses	110,775	33,412	186,597	330,784
Total costs and expenses	220,431	44,220	186,597	451,248
Operating earnings (loss)	\$279,066	\$27,923	\$(186,597)	\$120,392



Table of Contents

(In thousands)	Domestic	Global	Other	Total
Nine Months Ended 2012				
Revenues	\$1,707,259	\$247,793	\$—	\$1,955,052
Cost of revenues	403,618	51,468	—	455,086
Operating expenses	372,668	97,616	618,464	1,088,748
Total costs and expenses	776,286	149,084	618,464	1,543,834
Operating earnings (loss)	\$930,973	\$98,709	\$(618,464)	\$411,218
(In thousands)	Domestic	Global	Other	Total
Nine Months Ended 2011				
Revenues	\$1,370,741	\$216,786	\$—	\$1,587,527
Cost of revenues	274,994	34,632	—	309,626
Operating expenses	322,250	94,182	539,405	955,837
Total costs and expenses	597,244	128,814	539,405	1,265,463
Operating earnings (loss)	\$773,497	\$87,972	\$(539,405)	\$322,064



Table of Contents

(11) Related Party Transactions

During 2009, as part of our long-term space planning analysis, we determined that we would require additional office space for associates to accommodate our anticipated growth. We evaluated various sites in the Kansas City metropolitan area and negotiated with several different governmental entities regarding available incentives. Upon completion of this review, we decided to proceed with an office development in Wyandotte County, Kansas, which is part of the “Village West” development. In order to maximize available incentives, we agreed to pursue the Village West office development in conjunction with the development of an 18,000 seat, multi-sport stadium and related recreational athletic complex.

The Village West stadium complex was developed by Kansas Unified Development, LLC (the “Developer”), an entity controlled by Neal Patterson, Chairman of the Board of Directors, Chief Executive Officer and President of Cerner Corporation, and Clifford Illig, Vice Chairman of the Board of Directors of Cerner Corporation. Sporting Kansas City (“Sporting KC”) is the principal tenant of the stadium complex. OnGoal LLC (“OnGoal”), the owner of the Sporting KC professional soccer club, is also controlled by Messrs. Patterson and Illig.

The total construction and development cost of the office complex has initially been estimated to be approximately \$160.0 million. The Company currently believes it will receive incentives totaling approximately \$80.0 million from the Developer, the Unified Government of Wyandotte County/Kansas City, Kansas (the “Unified Government”) and the Kansas Department of Commerce. Incentives from the Kansas Department of Commerce will include cash grants, tax exemptions and tax credits. The value of some of these incentives may ultimately increase or decrease depending upon the final capital invested and the number of new jobs created. We currently expect our net investment in the Village West office complex, after applying expected government incentives and payments from the Developer, to be approximately \$80.0 million.

In connection with the Village West office complex development and the related incentives, we have entered into three agreements:

Land Transfer and Specific Venture Agreement (the “Land Transfer Agreement”) dated January 19, 2010 with the Unified Government and the Developer,  
Workforce Services Training Agreement (the “Workforce Agreement”) dated January 20, 2010 with the Kansas Department of Commerce, as amended by the First Amendment to Workforce Services Training Agreement dated June 7, 2011, and  
Interparty Agreement dated January 19, 2010 with OnGoal and the Developer.

Pursuant to the Land Transfer Agreement, we acquired the land from the Unified Government with certain contingencies upon which the office complex is being constructed. The purchase price, equal to the site’s fair market value, is being paid by the Developer. In the second quarter of 2012, vertical construction began on the Village West office development. In connection with the commencement of vertical construction, contingencies were resolved and we recorded land contributed to the Company from the Unified Government at its appraisal value.

Pursuant to the Workforce Agreement, as amended, we agreed to establish positions for 4,500 employees with an average annual wage of at least \$31.00 per hour. In consideration of this commitment, we have elected to receive up to \$48.5 million from the Kansas Department of Commerce for project investment costs and employee training (the “IMPACT Award”). We can specify the date when the IMPACT Award will be distributed by the Kansas Department of Commerce, which must be by December 31, 2015. The State of Kansas has issued bonds in order to fund these incentives to us and has incurred costs of issuance and debt service obligations. We may be obligated to repay the Kansas Department of Commerce under the following circumstances:

If we do not request distribution of all or part of the IMPACT Award, we must pay \$64.9 million (which represents the Impact Award amount plus the state's estimated issuance costs)(the "Gross Funded Amount") less an amount equal to any IMPACT Award amount not received,

If we fail to establish new jobs for at least 4,275 full time employees at the Village West office complex prior to December 31, 2017, we will repay an amount equal to \$48.0 million multiplied by the shortfall of total new jobs created by us, which is 4,500 less the number of jobs created as of December 31, 2017, divided by 4,500 (the "MPI Repayment Amount"), and

If we have not generated aggregate Kansas state tax withholdings from wages earned by new jobs at the Village West office complex of at least the Gross Funded Amount within 10 years after receiving the IMPACT Award, then

Table of Contents

we will repay the difference (the “Withholding Tax Repayment Amount”).

The MPI Repayment Amount is not due until 10 years after we first receive the IMPACT Award. Our total repayment obligations under the Workforce Agreement will not exceed the Gross Funded Amount less the aggregate Kansas state tax withholdings from wages earned by new jobs at the Village West complex during the 10-year period after the IMPACT Award is received.

The Interparty Agreement provides that the Developer and OnGoal will be responsible for the repayment of any issuance costs plus the MPI Repayment Amount owed by us under the Workforce Agreement. The Developer and OnGoal will also indemnify and hold us harmless from and against any and all losses, costs, expenses, penalties and damages arising as a result of: a) the Developer’s failure to pay any sum that it has agreed to pay, or b) the Developer’s breach of any agreement with us which creates an obligation on our part for which the Developer has agreed to be responsible.

The Interparty Agreement further provides that the Developer or OnGoal will pay us a success fee of \$4.0 million if the terms and conditions of the Workforce Agreement are satisfied so that no MPI Repayment Amounts or issuance costs are due by the Developer under the Workforce Agreement.

Pursuant to the Multi-Sport Stadium Specific Venture Agreement, the Developer, recognizing that the Unified Government relied on our jobs creation goals in its decision to provide incentives for the stadium complex, agreed to make ten annual “Office Payment Installments” to the Unified Government, each in the amount of approximately \$3.0 million, commencing in 2017. The Office Payment Installments are intended to supplement the purchase prices paid to the Unified Government by the Developer for the stadium site and the office site. The Office Payment Installments may be reduced if the Developer meets certain conditions and if we commence construction of the office complex and meet the job creation goals.

We believe that the amount of government incentives that the Developer and OnGoal received, as well as the government incentives received by us, were materially increased due to the fact that we agreed to build our office complex in close proximity to the stadium complex. The independent members of our Board of Directors, acting as a committee, reviewed and unanimously approved the decision to proceed with the development of the Village West office complex in 2009. The independent Directors received advice from outside legal counsel, retained a consultant with real estate expertise regarding the transaction and were briefed on the structure of the various expansion options by members of management (other than Messrs. Patterson and Illig) at six separate meetings.

We entered into a Construction Coordinator Agreement dated January 20, 2012, as amended by Amendment No. 1 to the Construction Coordinator Agreement dated May 31, 2012, with GRAND Construction, LLC (“Coordinator”), a limited liability company owned in part by an entity controlled by Messrs. Patterson and Illig, to coordinate, supervise, schedule and assist with managing the development, design and construction of the Cerner Kansas campus phase 1 and 2 buildings and site at the Village West development. Under the agreement, we will pay Coordinator 2% of the total cost of the project (as specified in the agreement). Based on management’s projected scope of services, it is anticipated that the fees will be approximately \$3.2 million, and paid over two years. The independent members of the Company’s Board of Directors, acting as a committee, reviewed and unanimously approved the Construction Coordinator Agreement dated January 20, 2012.

Additionally, in June 2012, the Company entered into an agreement with Coordinator for a separate project to make improvements to a parking facility for future use by one of our office campuses. The project is complete, and we paid Coordinator \$0.3 million.



Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management Discussion and Analysis (MD&A) is intended to help the reader understand the results of operations and financial condition of Cerner Corporation and subsidiaries (Cerner, the Company, we, us or our). This MD&A is provided as a supplement to, and should be read in conjunction with, our condensed consolidated financial statements and the accompanying notes to the financial statements (Notes) found above.

Our third fiscal quarter ends on the Saturday closest to September 30. The 2012 and 2011 third quarters ended on September 29, 2012 and October 1, 2011, respectively. All references to years in this MD&A represent the respective three or nine months ended on such dates, unless otherwise noted.

Except for the historical information and discussions contained herein, statements contained in this quarterly report on Form 10-Q may constitute "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended (the Exchange Act).

Forward-looking statements can often be identified by the use of forward-looking terminology, such as "could," "should," "will," "intended," "continue," "believe," "may," "expect," "hope," "anticipate," "goal," "forecast," "plan," "guidance" or "estimate" or the negative of these words, variations thereof or similar expressions. These statements involve a number of risks, uncertainties and other factors that could cause actual results to differ materially, including without limitation: the possibility of product-related liabilities; potential claims for system errors and warranties; the possibility of interruption at our data centers or client support facilities; our proprietary technology may be subject to claims for infringement or misappropriation of intellectual property rights of others, or may be infringed or misappropriated by others; risks associated with our non-U.S. operations; risks associated with our ability to effectively hedge exposure to fluctuations in foreign currency exchange rates; the potential for tax legislation initiatives that could adversely affect our tax position and/or challenges to our tax positions in the United States and non-U.S. countries; risks associated with our recruitment and retention of key personnel; risks related to our reliance on third party suppliers; risks inherent with business acquisitions; the potential for losses resulting from asset impairment charges; risks associated with the uncertainty in global economic conditions; changing political, economic, regulatory and judicial influences; government regulation; significant competition and market changes; variations in our quarterly operating results; potential inconsistencies in our sales forecasts compared to actual sales; volatility in the trading price of our common stock and the timing and volume of market activity; the authority of our Board of Directors to issue preferred stock and anti-takeover provisions contained in our corporate governance documents; material adverse resolution of legal proceedings; and, other risks, uncertainties and factors discussed elsewhere in this Form 10-Q, in our other filings with the Securities and Exchange Commission or in materials incorporated herein or therein by reference. Forward looking statements are not guarantees of future performance or results. The reader should not place undue reliance on forward-looking statements since the statements speak only as to the date they are made. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes in future operating results, financial condition or business over time.

Management Overview

Our revenues are primarily derived by selling, implementing and supporting software solutions, clinical content, hardware, health care devices and services that give health care providers secure access to clinical, administrative and financial data in real time, allowing them to improve quality, safety and efficiency in the delivery of health care. Our fundamental strategy centers on creating organic growth by investing in research and development (R&D) to create solutions and services for the health care industry. This strategy has driven strong growth over the long-term, as reflected in five- and ten-year compound annual revenue growth rates of 10% or more. This growth has also created an important strategic footprint in health care, with Cerner® solutions licensed by approximately 9,300 facilities around the world, including more than 2,650 hospitals; 3,750 physician practices; 40,000 physicians; 500 ambulatory facilities, such as laboratories, ambulatory centers, cardiac facilities, radiology clinics and surgery centers; 800 home health facilities; 40 employer sites and 1,600 retail pharmacies. Selling additional solutions back into this client base is an important element of our future revenue growth. We are also focused on driving growth through market share expansion by strategically aligning with health care providers that have not yet selected a supplier and by displacing competitors in health care settings that are planning to replace their current supplier.

We expect to drive growth through new initiatives and services that reflect our ongoing ability to innovate and expand our reach into health care. Examples of these include our CareAware<sup>®</sup> health care device architecture and devices, Cerner Health<sup>SM</sup> employer services, Cerner ITWorks<sup>SM</sup> services, Cerner RevWorks<sup>SM</sup> services, and solutions on our Health Intent<sup>SM</sup> platform. Finally, we believe there is significant opportunity for growth outside of the United States, with many non-U.S. markets focused on health care information technology (HCIT) as part of their strategy to improve the quality and lower the cost of health care. Beyond our strategy for driving revenue growth, we are also focused on earnings growth. Similar to

15

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Table of Contents

our history of growing revenue, our net earnings have increased at compound annual rates of more than 20% over the most recent five- and ten-year periods. We expect to drive continued earnings growth through ongoing revenue growth coupled with margin expansion, which we expect to achieve through efficiencies in our implementation and operational processes and by leveraging R&D investments and controlling general and administrative expenses. We are also focused on continuing to deliver strong levels of cash flow, which we expect to do by continuing to grow earnings and prudently managing capital expenditures.

Results Overview

The Company delivered strong levels of bookings, revenues, earnings and cash flows in the third quarter of 2012. New business bookings, which reflects the value of executed contracts for software, hardware, professional services and managed services, was \$769.9 million in the third quarter of 2012, which was an increase of 18% compared to \$650.3 million in the third quarter of 2011. Revenues for the third quarter of 2012 increased 18% to \$676.5 million compared to \$571.6 million in the year-ago quarter. The year-over-year increase in revenue reflects ongoing demand related to “meaningful use” incentives that we believe are increasing the focus of health care providers on improving the efficiency and quality of health care through the use of information technology and related services. In addition, demand for DeviceWorks and Cerner ITWorks solutions is contributing to growth.

Third quarter 2012 net earnings increased 25% to \$98.9 million compared to \$78.8 million in the third quarter of 2011. Diluted earnings per share increased 24% to \$0.56 compared to \$0.45 in the third quarter of 2011. Third quarter 2012 and 2011 net earnings and diluted earnings per share reflect the impact of stock-based compensation expense. The effect of these expenses reduced the third quarter 2012 net earnings and diluted earnings per share by \$6.3 million and \$0.04, respectively, and third quarter 2011 net earnings and diluted earnings per share by \$4.6 million and \$0.03, respectively.

The growth in net earnings and diluted earnings per share was driven primarily by strong revenue growth and continued progress with our margin expansion initiatives, including driving efficiencies in our services businesses, leveraging R&D investments and controlling selling, general and administrative expenses. Our third quarter 2012 operating margin was 21.8%, which is 70 basis points higher than the year-ago quarter.

We had strong cash collections of receivables of \$661.7 million in the third quarter of 2012 compared to \$532.8 million in the third quarter of 2011. Days sales outstanding was 73 days in the third quarter of 2012 compared to 71 days in the second quarter of 2012 and 87 days in the third quarter of 2011. Operating cash flows for the third quarter of 2012 were strong at \$182.2 million compared to \$129.2 million in the third quarter of 2011.

Table of Contents

## Results of Operations

Three Months Ended September 29, 2012 Compared to Three Months Ended October 1, 2011

The following table presents a summary of the operating information for the third quarters of 2012 and 2011:

(In thousands)	2012	% of Revenue	2011	% of Revenue	% Change
Revenues					
System sales	\$229,925	34 %	\$188,698	33 %	22 %
Support and maintenance	154,333	23 %	138,573	24 %	11 %
Services	277,948	41 %	232,894	41 %	19 %
Reimbursed travel	14,276	2 %	11,475	2 %	24 %
Total revenues	676,482	100 %	571,640	100 %	18 %
Costs of revenue					
Costs of revenue	149,578	22 %	120,464	21 %	24 %
Total margin	526,904	78 %	451,176	79 %	17 %
Operating expenses					
Sales and client service	259,141	38 %	220,177	38 %	18 %
Software development	78,094	12 %	72,544	13 %	8 %
General and administrative	41,973	6 %	38,063	7 %	10 %
Total operating expenses	379,208	56 %	330,784	58 %	15 %
Total costs and expenses	528,786	78 %	451,248	79 %	17 %
Operating earnings	147,696	22 %	120,392	21 %	23 %
Other income, net	3,351		2,775		
Income taxes	(52,160 )		(44,332 )		
Net earnings	\$98,887		\$78,835		25 %

## Revenues &amp; Backlog

Revenues increased 18% to \$676.5 million for the third quarter of 2012 from \$571.6 million for the same period in 2011.

System sales, which include revenues from the sale of licensed software, software as a service, technology resale (hardware, devices, and sublicensed software), deployment period licensed software upgrade rights, installation fees, transaction processing and subscriptions, increased 22% to \$229.9 million for the third quarter of 2012 from \$188.7 million for the same period in 2011. The increase in system sales was driven by strong growth in licensed software and solid growth in subscriptions and technology resale.

Support and maintenance revenues increased 11% to \$154.3 million during the third quarter of 2012 from \$138.6 million during the same period in 2011. This increase was attributable to continued success at selling Cerner Millennium® applications and implementing them at client sites. We expect that support and maintenance revenues will continue to grow as the base of installed Cerner Millennium systems grows.

Services revenue, which includes professional services, excluding installation, and managed services, increased 19% to \$277.9 million from \$232.9 million for the same period in 2011. This increase was driven by growth in



CernerWorks<sup>SM</sup> managed services as a result of continued demand for our hosting services and an increase in professional services due to increased implementation activities and growth in Cerner ITWorks services. Contract backlog, which reflects new business bookings that have not yet been recognized as revenue, at September 29, 2012 increased 22% when compared to October 1, 2011. This increase was driven by growth in new business bookings during the past four quarters, including continued strong levels of managed services and Cerner ITWorks services bookings that typically have longer contract terms. A summary of our total backlog follows:

17

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Table of Contents

(In thousands)	September 29, 2012	October 1, 2011
Contract backlog	\$ 6,061,500	\$4,964,942
Support and maintenance backlog	723,687	691,069
<b>Total backlog</b>	<b>\$ 6,785,187</b>	<b>\$5,656,011</b>

## Costs of Revenue

Cost of revenues was 22% of total revenues in the third quarter of 2012, compared to 21% in the same period of 2011. Cost of revenues includes the cost of reimbursed travel expense, sales commissions, third party consulting services and subscription content and computer hardware, devices and sublicensed software purchased from manufacturers for delivery to clients. It also includes the cost of hardware maintenance and sublicensed software support subcontracted to the manufacturers. Such costs, as a percent of revenues, typically have varied as the mix of revenue (software, hardware, devices, maintenance, support, services and reimbursed travel) carrying different margin rates changes from period to period. Cost of revenues does not include the costs of our client service personnel who are responsible for delivering our service offerings. Such costs are included in sales and client service expense.

## Operating Expenses

Total operating expenses increased 15% to \$379.2 million in the third quarter of 2012, compared with \$330.8 million for the same period in 2011.

Sales and client service expenses as a percent of total revenues were 38% in the third quarters of 2012 and 2011.

These expenses increased 18% to \$259.1 million in the third quarter of 2012 from \$220.2 million in the same period of 2011. Sales and client service expenses include salaries of sales and client service personnel, depreciation and other expenses associated with our CernerWorks managed service business, communications expenses, unreimbursed travel expenses, expense for share-based payments, sales and marketing salaries and trade show and advertising costs. The increase in sales and client service expense was primarily driven by an increase in personnel costs to support our overall revenue growth.

Software development expenses as a percent of revenue were 12% in the third quarter of 2012, compared to 13% in the same period of 2011. Expenditures for software development reflect ongoing development and enhancement of the Cerner Millennium platform, including investments in the next evolution of Cerner Millennium, Millennium+™, which leverages the cloud and enables greater mobility. The reduction as a percentage of revenue reflects our ongoing efforts to control spending relative to revenue growth. Because of the strong platform we have built, we are able to continue advancing our solutions and investing in new solutions without large increases in spending. A summary of our total software development expense in the third quarters of 2012 and 2011 is as follows:

(In thousands)	Three Months Ended 2012	2011
Software development costs	\$82,873	\$72,397
Capitalized software costs	(25,126 )	(20,368 )
Capitalized costs related to share-based payments	(533 )	(404 )
Amortization of capitalized software costs	20,880	20,919
<b>Total software development expense</b>	<b>\$78,094</b>	<b>\$72,544</b>

General and administrative expenses as a percent of total revenues were 6% in the third quarter of 2012, compared to 7% in the same period of 2011. These expenses increased 10% to \$42.0 million in the third quarter of 2012 from \$38.1 million for the same period in 2011. General and administrative expenses include salaries for corporate, financial and administrative staffs, utilities, communications expenses, professional fees, transaction gains or losses on foreign currency and expense for share-based payments. The increase in general and administrative expenses was

primarily driven by an increase in corporate personnel costs, as we have increased such personnel to support our overall revenue growth.

Table of Contents

## Non-Operating Items

Interest income increased to \$4.4 million in the third quarter of 2012 from \$4.1 million for the same period in 2011. Interest expense was \$1.0 million for the third quarter of 2012 compared to \$1.4 million for the same period in 2011. Our effective tax rate was 34.5% for the third quarter of 2012 and 36.0% for the third quarter of 2011. This decrease was primarily due to differences in the mix of earnings between U.S. and foreign operations, partially offset by the expiration of the research and development tax credit on December 31, 2011.

## Operations by Segment

We have two operating segments: Domestic and Global. The Domestic segment includes revenue contributions and expenditures associated with business activity in the United States. The Global segment includes revenue contributions and expenditures linked to business activity in Argentina, Aruba, Australia, Austria, Canada, Cayman Islands, Chile, China (Hong Kong), Egypt, England, France, Germany, Guam, India, Ireland, Italy, Japan, Malaysia, Mexico, Morocco, Puerto Rico, Qatar, Saudi Arabia, Singapore, Spain, Sweden, Switzerland and the United Arab Emirates.

The following table presents a summary of the operating information for the third quarters of 2012 and 2011:

(In thousands)	2012	% of Revenue	2011	% of Revenue	% Change
<b>Domestic Segment</b>					
Revenues	\$591,327	100%	\$499,497	100%	18%
Costs of revenue	131,663	22%	109,656	22%	20%
Operating expenses	131,787	22%	110,775	22%	19%
Total costs and expenses	263,450	45%	220,431	44%	20%
Domestic operating earnings	327,877	55%	279,066	56%	17%
<b>Global Segment</b>					
Revenues	85,155	100%	72,143	100%	18%
Costs of revenue	17,915	21%	10,808	15%	66%
Operating expenses	32,794	39%	33,412	46%	(2)%
Total costs and expenses	50,709	60%	44,220	61%	15%
Global operating earnings	34,446	40%	27,923	39%	23%
Other, net	(214,627 )		(186,597 )		15%
Consolidated operating earnings	\$147,696		\$120,392		23%

## Domestic Segment

Revenues increased 18% to \$591.3 million in the third quarter of 2012 from \$499.5 million in the same period in 2011. This increase was driven by growth in all business models, with strong growth in professional services and licensed software.

Cost of revenues was 22% of revenues in the third quarters of 2012 and 2011. The mix of sales in the third quarter of 2012 was consistent with the same period in 2011.

Operating expenses increased 19% to \$131.8 million in the third quarter of 2012 from \$110.8 million in the same period in 2011, due primarily to growth in managed services and professional services expenses.

## Global Segment

Revenues increased 18% to \$85.2 million in the third quarter of 2012 from \$72.1 million in the same period in 2011. This increase was primarily driven by growth in support and maintenance, licensed software and managed services, which was partially offset by a decrease in technology resale.

Cost of revenues was 21% of revenues in the third quarter of 2012, compared with 15% in the same period of 2011. The increase in cost of revenues as a percent of revenue was primarily driven by higher use of third party services.

Operating expenses were relatively flat at \$32.8 million for the third quarter of 2012, compared to \$33.4 million for

Table of Contents

the same period in 2011.

## Other, net

Operating results not attributed to an operating segment include expenses, such as centralized professional services costs, software development, marketing, general and administrative, stock-based compensation, depreciation and amortization. These expenses increased 15% to \$214.6 million in the third quarter of 2012 from \$186.6 million in the same period in 2011. This increase was primarily due to growth in corporate and development personnel costs.

## Nine Months Ended September 29, 2012 Compared to Nine Months Ended October 1, 2011

The following table presents a summary of the operating information for the first nine months of 2012 and 2011:

(In thousands)	2012	% of Revenue	2011	% of Revenue	% Change
Revenues					
System sales	\$651,040	33 %	\$486,222	31 %	34 %
Support and maintenance Services	450,584	23 %	408,580	26 %	10 %
Reimbursed travel	811,647	42 %	659,211	41 %	23 %
	41,781	2 %	33,514	2 %	25 %
Total revenues	1,955,052	100 %	1,587,527	100 %	23 %
Costs of revenue					
Costs of revenue	455,086	23 %	309,626	20 %	47 %
Total margin	1,499,966	77 %	1,277,901	80 %	17 %
Operating expenses					
Sales and client service	746,090	38 %	631,738	40 %	18 %
Software development	222,746	11 %	213,478	13 %	4 %
General and administrative	119,912	6 %	110,621	7 %	8 %
Total operating expenses	1,088,748	56 %	955,837	60 %	14 %
Total costs and expenses	1,543,834	79 %	1,265,463	80 %	22 %
Operating earnings	411,218	21 %	322,064	20 %	28 %
Other income, net	8,789		7,666		
Income taxes	(134,583 )		(114,295 )		
Net earnings	\$285,424		\$215,435		32 %

Revenues increased 23% to \$2.0 billion for the first nine months of 2012 from \$1.6 billion for the same period in 2011.

System sales increased 34% to \$651.0 million for the first nine months of 2012 from \$486.2 million for the same period in 2011. The increase in system sales was driven by very strong growth in technology resale and strong growth in licensed software and subscriptions.

Support and maintenance revenues increased 10% to \$450.6 million during the first nine months of 2012 from \$408.6 million during the same period in 2011. This increase was attributable to continued success at selling Cerner

Millennium applications and implementing them at client sites. We expect that support and maintenance revenues will continue to grow as the base of installed Cerner Millennium systems grows.

Services revenue increased 23% to \$811.6 million from \$659.2 million for the same period in 2011. This increase was driven by growth in CernerWorks managed services as a result of continued demand for our hosting services and an increase in professional services due to increased implementation activities and growth in Cerner ITWorks services.

Table of Contents

## Costs of Revenue

Cost of revenues was 23% of total revenues in the first nine months of 2012, compared to 20% in the same period of 2011. The higher cost of revenues as a percent of revenue was driven by a higher mix of technology resale, which carries a higher cost of revenue.

## Operating Expenses

Total operating expenses increased 14% to \$1.1 billion in the first nine months of 2012, compared with \$1.0 billion for the same period in 2011.

Sales and client service expenses as a percent of total revenues were 38% in the first nine months of 2012, compared to 40% in the same period of 2011. These expenses increased 18% to \$746.1 million in the first nine months of 2012 from \$631.7 million in the same period of 2011. The decrease as a percent of revenue reflects ongoing efficiencies in our implementation and operational processes.

Software development expenses as a percent of revenue were 11% in the first nine months of 2012, compared to 13% in the same period of 2011. Expenditures for software development reflect ongoing development and enhancement of the Cerner Millennium platform, including investments in Millennium+. The reduction as a percentage of revenue reflects our ongoing efforts to control spending relative to revenue growth. Because of the strong platform we have built, we are able to continue advancing our solutions and investing in new solutions without large increases in spending. A summary of our total software development expense in the first nine months of 2012 and 2011 is as follows:

(In thousands)	Nine Months Ended	
	2012	2011
Software development costs	\$234,899	\$215,418
Capitalized software costs	(70,960 )	(60,713 )
Capitalized costs related to share-based payments	(1,546 )	(1,114 )
Amortization of capitalized software costs	60,353	59,887
Total software development expense	\$222,746	\$213,478

General and administrative expenses as a percent of total revenues were 6% in the first nine months of 2012, compared to 7% in the same period of 2011. These expenses increased 8% to \$119.9 million in the first nine months of 2012 from \$110.6 million for the same period in 2011. The increase in general and administrative expenses was primarily driven by an increase in corporate personnel costs, as we have increased such personnel to support our overall revenue growth.

## Non-Operating Items

Interest income increased to \$12.7 million in the first nine months of 2012 from \$11.5 million for the same period in 2011, due primarily to growth in investments. Interest expense was \$3.9 million for the first nine months of 2012 and 2011.

Our effective tax rate was 32.0% for the first nine months of 2012 and 34.7% for the first nine months of 2011. This decrease was primarily due to an increase in net favorable discrete items recorded in 2012 relative to 2011, partially offset by the expiration of the research and development tax credit on December 31, 2011. Refer to Note (5) of the notes to the condensed consolidated financial statements for further information regarding our effective tax rate.





Table of Contents

## Operations by Segment

The following table presents a summary of the operating information for the first nine months of 2012 and 2011:

(In thousands)	2012	% of Revenue	2011	% of Revenue	% Change
<b>Domestic Segment</b>					
Revenues	\$1,707,259	100%	\$1,370,741	100%	25%
Costs of revenue	403,618	24%	274,994	20%	47%
Operating expenses	372,668	22%	322,250	24%	16%
Total costs and expenses	776,286	45%	597,244	44%	30%
Domestic operating earnings	930,973	55%	773,497	56%	20%
<b>Global Segment</b>					
Revenues	247,793	100%	216,786	100%	14%
Costs of revenue	51,468	21%	34,632	16%	49%
Operating expenses	97,616	39%	94,182	43%	4%
Total costs and expenses	149,084	60%	128,814	59%	16%
Global operating earnings	98,709	40%	87,972	41%	12%
Other, net	(618,464 )		(539,405 )		15%
Consolidated operating earnings	\$411,218		\$322,064		28%

**Domestic Segment**

Revenues increased 25% to \$1.7 billion in the first nine months of 2012 from \$1.4 billion in the same period in 2011.

This increase reflects growth across all business models, with particularly strong growth in technology resale and professional services.

Cost of revenues was 24% of revenues in the first nine months of 2012, compared to 20% of revenues in the same period in 2011. The higher cost of revenues as a percent of revenue was primarily driven by a higher mix of technology resale, which carries a higher cost of revenue.

Operating expenses increased 16% to \$372.7 million in the first nine months of 2012, from \$322.3 million in the same period in 2011, due primarily to growth in managed services and professional services expenses.

**Global Segment**

Revenues increased 14% to \$247.8 million in the first nine months of 2012 from \$216.8 million in the same period in 2011. This increase was primarily driven by strong growth in technology resale and managed services and a higher level of support services.

Cost of revenues was 21% of revenues in the first nine months of 2012, compared with 16% in the same period of 2011. The higher cost of revenues as a percent of revenue was primarily driven by a higher mix of technology resale, which carries a higher cost of revenue.

Operating expenses increased 4% to \$97.6 million for the first nine months of 2012 from \$94.2 million in the same period in 2011, primarily due to overall growth in our Global segment.

**Other, net**

These expenses increased 15% to \$618.5 million in the first nine months of 2012 from \$539.4 million in the same period in 2011. This increase was primarily due to growth in corporate and development personnel costs.



Table of Contents

## Liquidity and Capital Resources

Our liquidity is influenced by many factors, including the amount and timing of our revenues, our cash collections from our clients and the amount we invest in software development, acquisitions and capital expenditures.

Our principal sources of liquidity are our cash, cash equivalents, which consist of money market funds and time deposits with original maturities of less than 90 days, and short-term investments. At September 29, 2012, we had cash and cash equivalents of \$288.1 million and short-term investments of \$750.9 million, as compared to cash and cash equivalents of \$243.1 million and short-term investments of \$531.6 million at December 31, 2011.

Approximately 14% of our aggregate cash, cash equivalents and short-term investments at September 29, 2012, were held outside of the United States. As part of our business strategy, we plan to indefinitely reinvest the earnings of our foreign operations; however, should the earnings of our foreign operations be repatriated, we would accrue and pay tax on such earnings, which could be material.

Additionally, we maintain a \$100.0 million, multi-year revolving credit facility, which expires in February 2017. The facility provides an unsecured revolving line of credit for working capital purposes, along with a letter of credit facility. As of September 29, 2012, we had no outstanding borrowings under this credit facility; however, we have \$19.5 million of outstanding letters of credit, which reduced our available borrowing capacity to \$80.5 million.

We believe that our present cash position, together with cash generated from operations, short-term investments and, if necessary, our available line of credit, will be sufficient to meet anticipated cash requirements for the next twelve months.

The following table summarizes our cash flows in the first nine months of 2012 and 2011:

(In thousands)	Nine Months Ended	
	2012	2011
Cash flows from operating activities	\$527,760	\$377,805
Cash flows from investing activities	(546,124 )	(429,634 )
Cash flows from financing activities	62,361	68,978
Effect of exchange rate changes on cash	958	(466 )
Total change in cash and cash equivalents	44,955	16,683
Cash and cash equivalents at beginning of period	243,146	214,511
Cash and cash equivalents at end of period	\$288,101	\$231,194
Free cash flow (non-GAAP)	\$325,288	\$240,376

## Cash from Operating Activities

(In thousands)	Nine Months Ended	
	2012	2011
Cash collections from clients	\$2,024,529	\$1,572,917
Cash paid to employees and suppliers and other	(1,364,643 )	(1,129,703 )
Cash paid for interest	(3,790 )	(3,081 )
Cash paid for taxes, net of refund	(128,336 )	(62,328 )
Total cash from operations	\$527,760	\$377,805

Cash flow from operations increased in the first nine months of 2012 compared to the same period of 2011, due primarily to the increase in cash impacting earnings, along with cash provided by working capital changes. During the first nine months of 2012 and 2011, we received total client cash collections of \$2.0 billion and \$1.6 billion,

respectively, of which 3% and 3%, respectively, were received from third party client financing arrangements and non-recourse payment assignments. Days sales outstanding was 73 days in the third quarter of 2012, 71 days in the second quarter of 2012 and 87 days in the third quarter of 2011. Revenues provided under support and maintenance agreements represent recurring cash flows. Support and maintenance revenues increased 10% in the first nine months of 2012 compared to the same period of 2011. We expect these revenues to continue to grow as the base of installed Cerner Millennium systems grows.

Table of Contents

## Cash from Investing Activities

(In thousands)	Nine Months Ended	
	2012	2011
Capital purchases	\$(129,966)	\$(75,602 )
Capitalized software development costs	(72,506 )	(61,827 )
Purchases of investments, net of sales and maturities	(336,440 )	(255,741 )
Other, net	(7,212 )	(36,464 )
Total cash flows from investing activities	\$(546,124)	\$(429,634)

Cash flows from investing activities consist primarily of capital spending and our short-term investment activities.

Capital spending consists of capitalized equipment purchases primarily to support growth in our CernerWorks managed services business, building and improvement purchases to support our facilities requirements and capitalized spending to support our ongoing software development initiatives. Capital spending throughout the remainder of 2012, and in 2013, is expected to remain at higher than historical levels, primarily due to capital purchases associated with new office space; however, we still expect strong levels of free cash flow.

Short-term investment activity consists of the investment of cash generated by our business in excess of what is necessary to fund operations. We expect to continue such short-term investment activity throughout the remainder of 2012, as we expect strong levels of cash flow.

## Cash from Financing Activities

(In thousands)	Nine Months Ended	
	2012	2011
Repayment of long-term debt	\$(1,772 )	\$(715 )
Cash from option exercises (including excess tax benefits)	67,533	70,472
Other, net	(3,400 )	(779 )
Total cash flows from financing activities	\$62,361	\$68,978

Cash inflows from stock option exercises are dependent on a number of factors, including the price of our common stock, grant activity under our stock option and equity plans, and overall market volatility. We expect cash inflows from stock option exercises to continue throughout the remainder of 2012 based on the number of exercisable options at September 29, 2012 and our current stock price.

## Free Cash Flow

(In thousands)	Three Months Ended		Nine Months Ended	
	2012	2011	2012	2011
Cash flows from operating activities (GAAP)	\$182,213	\$129,177	\$527,760	\$377,805
Capital purchases	(51,802 )	(23,925 )	(129,966 )	(75,602 )
Capitalized software development costs	(25,659 )	(20,772 )	(72,506 )	(61,827 )
Free cash flow (non-GAAP)	\$104,752	\$84,480	\$325,288	\$240,376

Free cash flow increased \$84.9 million in the first nine months of 2012 compared to the same period in 2011, which we believe reflects continued strengthening of our earnings quality. Free cash flow is a non-GAAP financial measure used by management along with GAAP results to analyze our earnings quality and overall cash generation of the business. The presentation of free cash flow is not meant to be considered in isolation, nor as a substitute for, or superior to, GAAP results and investors should be aware that non-GAAP measures have inherent limitations and

should be read only in conjunction with our consolidated financial statements prepared in accordance with GAAP. Free cash flow may also be different from similar non-GAAP financial measures used by other companies and may not be comparable to similarly titled captions of other companies due to potential inconsistencies in the method of calculation. We believe free cash flow is important to enable investors to better understand and evaluate our ongoing operating results and allows for greater transparency in the review of our overall financial, operational and economic performance because free cash flow takes into account the capital expenditures necessary to operate our business.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk

No material changes.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures. The Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO) have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report on Form 10-Q (the Evaluation Date). They have concluded that, as of the Evaluation Date, these disclosure controls and procedures were effective to ensure that material information relating to the Company and its consolidated subsidiaries would be made known to them by others within those entities and would be disclosed on a timely basis. The CEO and CFO have concluded that the Company's disclosure controls and procedures are designed, and are effective, to give reasonable assurance that the information required to be disclosed by the Company in reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the rules and forms of the SEC. They have also concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that are filed or submitted under the Exchange Act are accumulated and communicated to the Company's management to allow timely decisions regarding required disclosure.

(b) There were no changes in the Company's internal controls over financial reporting during the nine months ended September 29, 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

The Company's management, including its CEO and CFO, has concluded that our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives and are effective at that reasonable assurance level. However, the Company's management can provide no assurance that our disclosure controls and procedures or our internal control over financial reporting can prevent all errors and all fraud under all circumstances. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of (c) controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been or will be detected. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.



Table of Contents

Part II. Other Information

Item 6. Exhibits

(a) Exhibits

- 31.1 Certification of Neal L. Patterson pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Marc G. Naughton pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Neal L. Patterson pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Marc G. Naughton pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.LAB XBRL Taxonomy Extension Labels Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CERNER CORPORATION  
Registrant

October 26, 2012  
Date

By: /s/ Marc G. Naughton  
Marc G. Naughton  
Executive Vice President and Chief Financial Officer  
(duly authorized officer and principal financial officer)

27