



COMPANY SPOTLIGHT:

Cerner Corp.

COMPANY DESCRIPTION

Headquartered in Kansas City, MO, Cerner is a supplier of health care information technology solutions and services. Cerner is a leader in electronic medical records solutions for hospitals and health clinics worldwide.

Brent Shafer took over as CEO on February 1, 2018 after the passing of Co-Founder and CEO Neal Patterson. Mr. Shafer joined Cerner after serving as CEO of Phillips North America.

COMPANY HIGHLIGHTS AND FINANCIALS

Founded in 1979, Cerner is a global leader in healthcare IT solutions. Cerner enjoys a strong competitive advantage due to the high costs for customers to change to a competitor and long lead times for sales and product implementation. They are the

number two provider of electronic medical records systems and services to hospitals, and the number one provider across the entire medical field. The company's customer base is well diversified across numerous private companies and public entities. Recently, Cerner has gained contracts with the U.S. government starting a multi-year transition to the Cerner platform for the Department of Defense. Cerner is also a strategic partner with Adventist Health (an OHSU partner), in charge of the company's day-to-day operation of their revenue management and clinical IT staff.

Cerner has been very conservative with their capital allocation strategy, choosing to reinvest most cash flows back into the business to remain competitive with software and solutions research and development. The company's operating performance has been very strong over time. The firm generates high operating margins, averaging 19% over the previous 5 years.

The firm also generates over \$700 million annually in free cash flow and has historically had a return on capital in the mid-teens. Their strong financial performance combined with their high quality balance sheet allows the company to fund operations internally, which we find attractive at this stage of the economic cycle.

KEY POINTS

- :: Industry leader in health care IT solutions and services
- :: High switching costs for customers gives the company a strong competitive advantage
- :: Above average financial health with low debt levels (Net Debt -\$279 million and Long-Term Debt/Capital of 11%) and high cash flow generation
- :: 14% average annual growth rate in sales and cash flows over the previous 5 years
- :: Compelling valuations based on historical operating metrics and future growth projections

VALUATION AND RISKS

Cerner is trading at attractive valuations compared to both historical operating performance and to free cash flow projections. Cerner is trading at 3.7 times sales and 11.9 times operating cash flows which is over a 20% discount compared to its ten year average. On a free cash flow basis, we expect the company to grow free cash flow on average at 9% annually, below its current growth rate of 20% over the previous 10 years, due to a more challenging health care spending and regulatory environment. If our conservative assumptions turn out to be overly optimistic, we feel there is a large margin of safety built into the current price based on the company's current valuation compared to its historical operating performance, and strong financial position.

Risks that we will monitor going forward surround market share strength and new client additions. Also, we would like to see the company continue to spend most of their excess cash on research and development to remain competitive. Weighing both potential rewards and risks, we are optimistic Cerner will be a good long-term investment.

—Patrick Mason, Investment Analyst, Cairn Investment Group



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