



Group 5: Charles Collier, Jonathan Cooley, Alex Fitzke

RECOMMENDATION: HOLD

FUNDAMENTALS			
Price (XX/XX/05) ¹	\$88.12	Gross Margin ⁴	77.8%
Target Price	\$85.55	ROE ¹	11.63%
Market Cap. ¹	3.29B	ROA ¹	7.99%
EV ¹	3.16 B	EPS ¹	2.08
Cash and Equiv. ⁴	134.2	% of Portfolio ³	0.00%
P/E Ratio ¹	33.13	Shares Outstanding ¹	37.39 M

Highlights:

- Over the last five years, Cerner's cash flow from operations and revenue have increase by a compound annual growth rate of 33% and 23%, respectively
- Cerner's revenue pours in from all areas of the country, reducing the company's dependence on any region of the United States.
- Cerner is a market leader in the growing healthcare information systems industry.
- Using a discount rate of 12%, our discounted cash flow analysis returned a target price of \$88.12,
- We currently feel that Cerner is fully priced, if not slightly over-priced, leading us to a hold recommendation.

Company Overview

Cerner Corporation was incorporated in 1980 and the company is listed on the NASDAQ market. Cerner is a leading supplier of healthcare information technology. The company currently has over 1500 clients worldwide and provides solutions that give end users secure access to clinical, administrative, and financial data in real time. These solutions can take the form of stand-alone, combined, or enterprise-wide systems, depending on the client's needs. Cerner uses its *Cerner Millennium* architecture to develop products. *Cerner Millennium* is an advanced technology infrastructure that combines clinical, financial and management information solutions. The technology is used to store patient information and make it available to doctors, nurses, pharmacists and lab technicians. Healthcare companies can use the technology to effectively and efficiently store information for their entire company.²

Third Quarter Results

Cerner has an excellent balance sheet as well as income statement. This is reflected in the company's recent third quarter earnings call that took place on October 20, 2005. Total revenue was \$294.6 million, which is a 28% increase from third quarter 2004. The table in the next column shows where revenues came from as well as the revenue growth compared to the same quarter in 2004. Net earnings for the third quarter 2005 are \$26.6 million. However, this includes a one-time tax benefit of \$4.8 million. Without the tax benefit, net earnings have increased by 29% compared to a year ago.

However, not all of Cerner's numbers are so excellent. The company's margins, for the most part, have been unimpressive. The gross margin for the third quarter 2005 was 77.8%, which is down 70 basis points from the last quarter. It is also down 270 basis points from a year ago. Cerner's management says that this is due to high level of hardware sales this quarter compared with low levels a year ago. The gross margin would have dropped lower, but management was able keep expense growth at a minimum. The company's operating margin for the third quarter 2005 was 12.6%. That is similar to last quarter and down 30 basis points from a year ago. However, the company has set 20% operating margins as a goal and is dedicated to achieving it.⁴

	Revenue (Mil\$)	Growth from 3 rd Qtr 2004 (%)
System Sales	110.2	33
Support & Maintenance	75.1	28
Services	100.1	21
Reimbursed Travel	9.2	12
Total	294.6	28

Industry

Cerner is part of the healthcare information systems industry. The growth prospects for this industry appear to be excellent. Healthcare has always been a large industry and it will continue to grow in the coming years as the Baby Boomers age. The information technology industry is also growing. Each day new technology is invented and companies are rushing to find uses for it. Cerner is well-positioned in the healthcare information systems industry and therefore has excellent growth potential. Analysts estimated growth to be around 20% for the rest of fiscal 2006.

Cerner is currently the industry leader in terms of market capitalization (\$3.2 billion). The company's largest competitor is Emdeon Corporation (HLTH) with a market capitalization of \$3.0 billion. However, Emdeon's business model is slightly different then Cerner's. Emdeon is best known for their WebMD website. The company also has a business segment that makes porous products plastic. Cerner focuses on IT solutions, while Emdeon is more diversified in

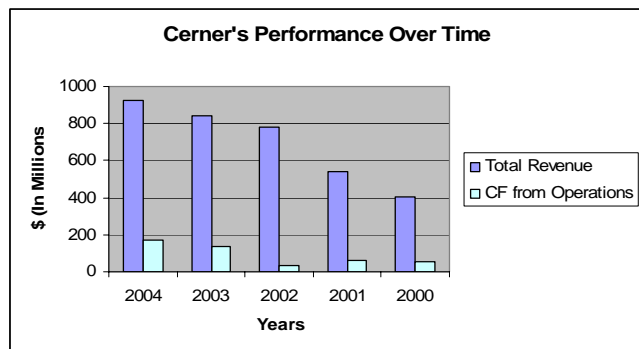
their product lines. This gives Cerner a competitive advantage because the company is able to focus on what it does best.

Cerner's second largest competitor is IDX Systems Corporation (IDXC), which has a market capitalization of \$1.4 billion. IDX Systems is Cerner's most direct competitor. IDX Systems provides software, services and technologies for healthcare organizations across the U.S. Cerner has a large advantage over IDX Systems because they are nearly three times as large. IDX Systems has significantly lower operating margins (9%) and has had negative quarterly earnings growth for the most recent quarter.¹

CERN vs. Competition in Last Fiscal Year			
(In Million)	HLTH ⁶	IDXC ⁷	CERN ²
Total Revenue	1160.35	520.67	926.36
Operating Earnings	44.24	43.73	111.46
Net Income	39.33	31.76	64.65
CF From Operations	90.04	51.36	168.3

As the chart above shows, Cerner's financial statements are strong when compared to the company's competition. Even though Emdeon generates more revenue, Cerner has a better bottom line. In fact, Cerner's net income is more than one and a half times that of Emdeon. The cash flow that Cerner generates is almost twice as much as Emdeon. IDX Systems' financial statements also leave something to be desired when compared to Cerner. Cerner's net income is more than twice as much, and the cash flow from operations is more than three times that of IDX Systems. When comparing Cerner to the company's competition, the financial statements of Cerner look very strong.

The Good Performance



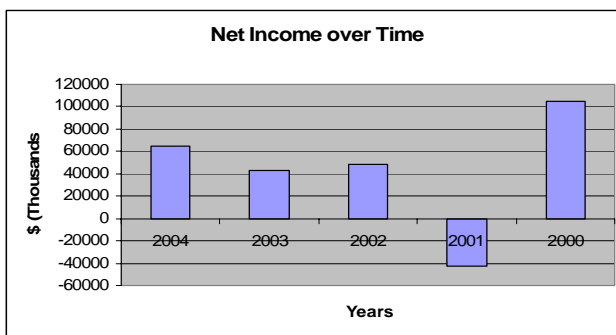
Values are from Cerner's 2001 and 2004 10-K Filing^{2,5}

For the past five years, Cerner's total revenue has consistently increased by an impressive compound annual growth rate of 23 percent. The cash flow provided by the company's operations has also increased over the past five

years. The last five years have had a compound annual growth rate of 33 percent. This includes 2002, when the cash flow from operations decreased due to the payment of tax on a gain from a sale that Cerner made. This tax payment was \$31.2 million.

The Not so Hot Performance

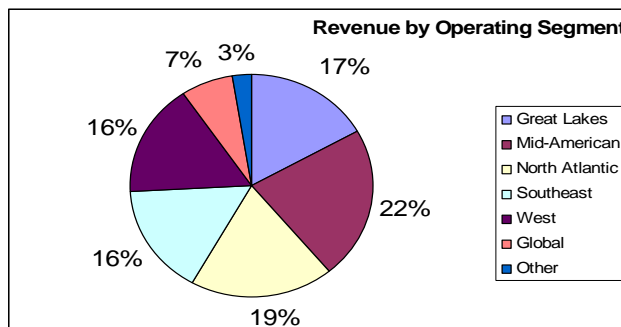
Even though the cash flow from operations and revenue have had an impressive performance over the last five years, not all aspects of the company have looked as good. Cerner's net income has experienced significant variability. In 2000, the company's net income was the highest during this five year period. However, during 2001, the net income was negative. From 2002 to 2004, the variability continued. Cerner's net income increased in 2002, but then decreased in 2003. This variability could be a place for concern, especially if the net income becomes negative again as it did in 2001.



Values are from Cerner's 2001 and 2004 10-K Filing^{2,5}

Revenue Diversification

Cerner's revenue originates from across the entire United States. This allows the company the luxury of being diversified in the fact that the company is not dependant on any region to survive. Cerner generated 7 percent of the company's 2004 revenue from global operations. This is a potential area for the company to expand the business in the future. Excluding the "other segment", 90 percent of the business originates in the United States. However, the revenue appears to be evenly split up across the country.



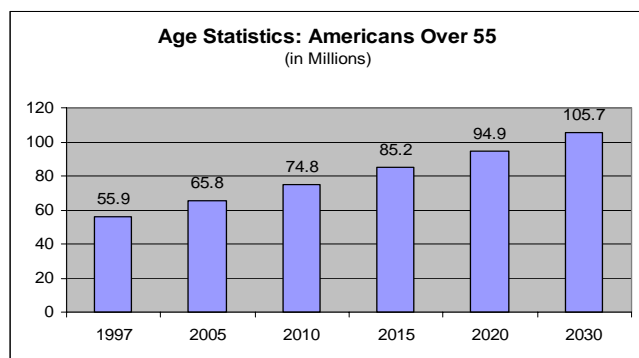
Values are from Cerner's 2004 10-K Filing²

Management

One of the most beneficial elements of the Cerner Corporation, we feel, is the company's 25 year history of solid and proficient ownership. Since the company's inception, Cerner has performed above market expectations and industry standards. Thus far in 2005, the Cerner Corporation has been recognized by: The Medical Records Institute, The Kansas City Star, Business 2.0 Magazine, and Computerworld Magazine as being a leading example of how information technology is used in medicine to benefit society. The current makeup of Cerner's Executive Officers have, on average, ten years of experience with the company. Neal Patterson, the current Chief Executive Officer and Chairman of the Board, has spearheaded operations for the last 20 years; he is widely recognized as the innovator who has brought Cerner to the company's current financial position as the world's largest stand-alone healthcare technology information company. With that, we are confident that Cerner's board and management are and will continue to perform above industry standards and act in the best interests of its shareholders.⁹

Growth and Risk

With approximately 350,000 Americans turning 50 every month, the need for better, more efficient access to a patient's healthcare information will be a necessity for the future. Cerner Corporation seems poised to capitalize on the potential growth of a graying America. As seen in the graph below, the Americans over the age of 55 will nearly double by 2030.



Graph from WGO Annual Report⁹

Although we feel that Cerner and the healthcare industry will see substantial growth in the foreseeable future, due to the hype of the industry, we feel that Cerner's stock price is currently fairly priced, if not overpriced. In regards to risks, withholding risks indicative of all healthcare technology companies, the Cerner Corporation's product and customer base is well diversified. Cerner has efficient distribution channels; losses of single customers or increased competition in a

few product markets should not cause a great deal of financial distress for the company.

Discounted Cash Flow Analysis

CERN – DCF Derived Fair Market Value Matrix
(in \$ Millions)

FCF Growth Rate	2%	3%	4%
PV of FCF (2004)	102.50	102.50	102.50
PV of FCF ('05E-'10E)	1,260.71	1,260.71	1,260.71
PV or Terminal Value	1,517.24	1,702.35	1,933.74
Aggregate Value	2,961.43	3,146.54	3,377.93
Aggregate value per share	80.52	85.55	91.84

For a more detailed view of our discounted cash flow analysis, please refer to the following page. We have set our discount rate at 12% which derived a target price of \$85.55. Despite our positive feelings toward future revenue and industry growth, partly due to the increased demand in correlation to a graying America, we feel that this growth in currently reflected in Cerner's stock price. We, therefore, believe the Cerner Corporation is currently priced correctly at \$88.12 (11/06/05)¹.

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Income Statement Projections	Years Ended June 30,									
	2003	2004	2005Q1	n=2005Q2	12005E	22006E	32007E	42008E	52009E	62010E
System Sales Revenues	332,349	351,861	105,200	99,942	410,284	518,734	648,418	842,943	1,053,679	1,053,679
Maintenance Revenues	476,795	542,414	164,251	156,001	640,504	739,196	923,995	1,201,194	1,501,492	1,501,492
Reimbursed Revenues	30,443	32,081	8,364	6,590	29,908	38,905	48,631	63,221	79,026	79,026
Total Revenues	839,587	926,356	277,815	262,533	1,080,696	1,296,835	1,621,044	2,107,357	2,634,197	2,634,197
COGS	194,290	196,348	59,601	55,408	230,018	272,335	324,209	379,324	395,129	395,129
Gross Profits	645,297	730,008	218,214	207,125	850,678	1,024,500	1,296,835	1,728,033	2,239,067	2,239,067
Sales and Client Service	352,728	383,628	114,291	110,840	450,262	544,671	680,838	842,943	1,053,679	1,053,679
Software Development	156,236	171,589	48,702	49,329	196,062	233,430	291,788	337,177	421,471	421,471
G&A	58,236	63,327	21,013	17,922	77,870	90,778	113,473	147,515	184,394	184,394
Total Operating Expenses	567,200	618,544	184,006	178,091	724,194	868,880	1,086,099	1,327,635	1,659,544	1,659,544
Operating Income	78,097	111,464	34,208	29,034	126,484	155,620	210,736	400,398	579,523	579,523
Depreciation & Amortization	69,330	90,802	30,870	31,711	125,162	100,000	100,000	100,000	100,000	100,000
Taxes	28,431	43,272	13,086	8,421	43,014	40,000	40,000	40,000	40,000	40,000
Capital Expenditures	83,583	56,490	13,094	29,764	85,716	60,000	60,000	60,000	60,000	60,000
Free Cash Flow	35,413	102,504	38,898	22,560	122,916	155,620	210,736	400,398	579,523	579,523
PV of Free Cash Flow					109,746	124,059	149,998	254,460	328,837	293,605
PV of Terminal Value										1,702,352

PV of FCFs	\$1,363,209
PV of Terminal Value	\$1,702,352
Total Value	\$3,065,561
Less:	
Total Debt	\$108,804
Plus:	
Cash	\$189,784
Total Fair Market Value	\$3,146,541
Diluted Shares Outstanding	36,781
Fair Market Value/Share	\$85.55

WACC	12.0%
Long Term Growth Rate	3.0%

DCF Derived Fair Market Value Matrix			
WACC v. LT Growth Rate			
	2%	3%	4%
10.5%	\$98.30	\$106.54	\$117.32
11.0%	\$91.61	\$98.55	\$107.48
11.5%	\$85.72	\$91.62	\$99.08
12.0%	\$80.52	\$85.55	\$91.84
12.5%	\$75.88	\$80.20	\$85.54
13.0%	\$71.73	\$75.47	\$80.03
13.5%	\$68.01	\$71.25	\$75.17

Operating Assumptions	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E
Revenues		10.3%	16.7%	20.0%	25.0%	30.0%	25.0%	0.0%
Gross Margins	76.9%	78.8%	78.7%	79.0%	80.0%	82.0%	85.0%	85.0%
Sales and Client Services as % of Rev.	42.0%	41.4%	41.7%	42.0%	42.0%	40.0%	40.0%	40.0%
Software Development as % of Rev.	18.6%	18.5%	18.1%	18.0%	18.0%	16.0%	16.0%	16.0%
G&A as % of Rev.	6.9%	6.8%	7.2%	7.0%	7.0%	7.0%	7.0%	7.0%