CERNER CORP /MO/
Form 10-Q
October 25, 2013
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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 28, 2013
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, MO	64117
(Address of principal executive offices)	(Zip Code)

(816) 201-1024
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [ ]
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes [X] No [ ]
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.
Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [ ]
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes [ ] No [X]
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, 2013
Common Stock, $0.01 par value per share	343,262,922 shares

CERNER CORPORATION

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Part I. Financial Information

Item 1. Financial Statements

CERNER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
As of September 28, 2013 (unaudited) and December 29, 2012

(In thousands, except share data)	2013	2012
Assets		
Current assets:		
Cash and cash equivalents	$287,520	$317,120
Short-term investments	634,308	719,665
Receivables, net	529,303	577,848
Inventory	28,234	23,681
Prepaid expenses and other	181,208	113,572
Deferred income taxes, net	40,521	38,620
Total current assets	1,701,094	1,790,506
Property and equipment, net	724,886	569,708
Software development costs, net	323,843	267,307
Goodwill	307,523	247,616
Intangible assets, net	140,245	132,045
Long-term investments	577,493	509,467
Other assets	191,286	187,819
Total assets	$3,966,370	$3,704,468
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$147,016	$141,212
Current installments of long-term debt and capital lease obligations	51,872	59,582
Deferred revenue	195,200	189,652
Accrued payroll and tax withholdings	127,531	125,253
Other accrued expenses	62,821	64,413
Total current liabilities	584,440	580,112
Long-term debt and capital lease obligations	131,030	136,557
Deferred income taxes and other liabilities	162,987	143,212
Deferred revenue	10,523	10,937
Total liabilities	888,980	870,818
Shareholders' Equity:		
Common stock, $.01 par value, 500,000,000 shares authorized, 343,727,041 shares issued at September 28, 2013 and 344,178,702 shares issued at December 29, 2012	3,437	3,442
Additional paid-in capital	782,143	840,769
Retained earnings	2,332,985	1,994,694
Treasury stock, 570,616 shares at September 28, 2013	(28,251)	—

Accumulated other comprehensive loss, net	(12,924)	(5,255)
Total shareholders' equity	3,077,390	2,833,650
Total liabilities and shareholders' equity	$3,966,370	$3,704,468

See notes to condensed consolidated financial statements (unaudited).

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CERNER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the three and nine months ended September 28, 2013 and September 29, 2012
(unaudited)

	Three Months Ended		Nine Months Ended	
(In thousands, except per share data)	2013	2012	2013	2012
Revenues:				
System sales	$202,632	$229,925	$602,037	$651,040
Support, maintenance and services	508,520	432,281	1,461,723	1,262,231
Reimbursed travel	16,678	14,276	51,660	41,781
Total revenues	727,830	676,482	2,115,420	1,955,052
Costs and expenses:				
Cost of system sales	64,389	100,668	217,580	318,193
Cost of support, maintenance and services	38,510	34,634	103,366	95,112
Cost of reimbursed travel	16,678	14,276	51,660	41,781
Sales and client service	304,665	259,141	853,213	746,090
Software development (Includes amortization of $24,056 and $69,366 for the three and nine months ended September 28, 2013; and $20,880 and $60,353 for the three and nine months ended September 29, 2012)	82,998	78,094	246,343	222,746
General and administrative	51,352	41,973	150,995	119,912
Total costs and expenses	558,592	528,786	1,623,157	1,543,834
Operating earnings	169,238	147,696	492,263	411,218
Other income, net	3,509	3,351	9,286	8,789
Earnings before income taxes	172,747	151,047	501,549	420,007
Income taxes	(57,403)	(52,160)	(163,258)	(134,583)
Net earnings	$115,344	$98,887	$338,291	$285,424
Basic earnings per share	$0.34	$0.29	$0.98	$0.84
Diluted earnings per share	$0.33	$0.28	$0.96	$0.81
Basic weighted average shares outstanding	342,992	342,502	343,681	341,287
Diluted weighted average shares outstanding	351,449	351,739	352,332	351,033

See notes to condensed consolidated financial statements (unaudited).

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CERNER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the three and nine months ended September 28, 2013 and September 29, 2012
(unaudited)

	Three Months Ended		Nine Months Ended	
(In thousands)	2013	2012	2013	2012
Net earnings	$115,344	$98,887	$338,291	$285,424
Foreign currency translation adjustment and other (net of taxes (benefit) of $(1,366) and $(1,984) for the three and nine months ended September 28, 2013; and $(843) and $(1,478) for the three and nine months ended September 29, 2012)	10,595	6,240	(7,610)	5,247
Unrealized holding gain (loss) on available-for-sale investments (net of taxes (benefit) of $509 and $(34) for the three and nine months ended September 28, 2013; and $321 and $338 for the three and nine months ended September 29, 2012)	801	518	(59)	546
Comprehensive income	$126,740	$105,645	$330,622	$291,217

See notes to condensed consolidated financial statements (unaudited).

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CERNER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the nine months ended September 28, 2013 and September 29, 2012
(unaudited)

(In thousands)	Nine Months Ended 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	$338,291	$285,424
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	189,460	162,336
Share-based compensation expense	33,650	26,304
Provision for deferred income taxes	19,573	20,679
Changes in assets and liabilities (net of businesses acquired):		
Receivables, net	41,281	(31,102)
Inventory	(3,887)	(907)
Prepaid expenses and other	(48,290)	(18,322)
Accounts payable	(19,309)	30,596
Accrued income taxes	(6,404)	(36,983)
Deferred revenue	5,440	26,333
Other accrued liabilities	4,580	63,402
Net cash provided by operating activities	554,385	527,760
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital purchases	(218,406)	(129,966)
Capitalized software development costs	(125,951)	(72,506)
Purchases of investments	(832,039)	(999,697)
Sales and maturities of investments	825,126	663,257
Purchase of other intangibles	(39,797)	(7,212)
Acquisition of businesses, net of cash acquired	(67,877)	—
Net cash used in investing activities	(458,944)	(546,124)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of long-term debt and capital lease obligations	(9,756)	(1,772)
Proceeds from excess tax benefits from share-based compensation	29,274	36,431
Proceeds from exercise of options	24,049	31,102
Treasury stock purchases	(170,042)	—
Contingent consideration payments for acquisition of businesses	(800)	(3,400)
Other	4,823	—
Net cash provided by (used in) financing activities	(122,452)	62,361
Effect of exchange rate changes on cash and cash equivalents	(2,589)	958
Net increase (decrease) in cash and cash equivalents	(29,600)	44,955
Cash and cash equivalents at beginning of period	317,120	243,146

Cash and cash equivalents at end of period	$287,520	$288,101
Summary of acquisition transactions:		
Fair value of net tangible assets acquired	$1,512	$—
Fair value of intangible assets acquired	25,489	—
Fair value of goodwill	60,511	—
Less: Fair value of contingent liability payable	(18,982)	—
Cash paid for acquisitions	68,530	—
Cash acquired	(653)	—
Net cash used	$67,877	$—

See notes to condensed consolidated financial statements (unaudited).

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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 2013 and 2012 third quarters ended on September 28, 2013 and September 29, 2012, 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.

Stock Split
On May 24, 2013, the Board of Directors of the Company approved a two-for-one split of our common stock in the form of a 100% stock dividend, which was distributed on or about June 28, 2013 to shareholders of record as of June 17, 2013. In connection with the stock split, 3.0 million treasury shares, which represented the amount held in treasury on June 28, 2013, were utilized to settle a portion of the distribution. All share and per share data have been retroactively adjusted for all periods presented to reflect the stock split including the use of treasury shares, as if the stock split had occurred at the beginning of the earliest period presented.

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

Recently Adopted Accounting Pronouncements
Comprehensive Income. In the first quarter of 2013, we adopted Financial Accounting Standards Board Accounting Standards Update (ASU) No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (AOCI). ASU 2013-02 requires an entity to disclose, either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of AOCI into net income and the income statement line items affected by the reclassification. If a component is not required to be reclassified to net income in its entirety, an entity would instead cross reference to the related footnote for additional information. The adoption of this standard did not impact disclosures in these condensed consolidated financial statements, as AOCI reclassification amounts are not material to the Company.

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(2) Business Acquisitions

PureWellness

On March 4, 2013, we purchased the net assets of Kaufman & Keen, LLC (doing business as PureWellness). PureWellness is a health and wellness company that develops solutions for the administration and management of wellness programs, and to enable plan member engagement strategies. Our acquisition of PureWellness will further expand what we believe to be a robust offering of solutions to manage and improve the health of populations.

Consideration for the acquisition of PureWellness is expected to total $69.2 million consisting of up-front cash plus contingent consideration, which is payable if we achieve certain revenue milestones from PureWellness solutions and services during the period commencing on August 1, 2013 and ending April 30, 2015. We valued the contingent consideration at $19.0 million based on a probability-weighted assessment of potential contingent consideration payment scenarios.

The acquisition of PureWellness is being treated as a purchase in accordance with ASC 805, Business Combinations, which requires allocation of the purchase price to the estimated fair values of assets and liabilities acquired in the transaction. The final allocation of purchase price is summarized below:

(In thousands)	Allocation Amount
Tangible assets and liabilities	
Current assets	$1,443
Property and equipment	240
Current liabilities	(1,315)
Total net tangible assets	368
Intangible assets	
Customer relationships	10,464
Existing technologies	9,805
Total intangible assets	20,269
Goodwill	48,555
Total purchase price	$69,192

The fair values of the acquired intangible assets were estimated by applying the income approach. Such estimations required the use of inputs that were unobservable in the market place (Level 3), including a discount rate that we estimated would be used by a market participant in valuing these assets, projections of revenues and cash flows, and client attrition rates, among others. See Note (3) for further information about the fair value level hierarchy.

The goodwill of $48.6 million arising from the acquisition consists largely of the synergies and economies of scale, including the value of the assembled workforce, expected from combining the operations of Cerner and PureWellness. All of the goodwill was allocated to our Domestic operating segment and is expected to be deductible for tax purposes. Identifiable intangible assets are being amortized over a weighted-average period of seven years. The operating results of PureWellness were combined with our operating results subsequent to the purchase date of March 4, 2013. Pro-forma results of operations, assuming this acquisition was made at the beginning of the earliest period presented, have not been presented because the effect of this acquisition was not material to our results.

Labotix

On March 18, 2013, we purchased 100% of the outstanding stock of Labotix Corporation (together with its wholly owned subsidiary Labotix Automation, Inc., Labotix). Labotix is a developer of laboratory automation solutions for clinical laboratories. We believe the combination of Cerner Millennium, Cerner Copath, and Labotix allows us to offer a comprehensive set of capabilities to support high volume laboratory testing.

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Consideration for the acquisition of Labotix was $18.0 million, which was paid in cash. The preliminary allocation of purchase price to the estimated fair value of the identified tangible and intangible assets acquired and liabilities assumed resulted in goodwill of $11.7 million and $5.2 million in intangible assets related to the value of existing technologies. The allocation of purchase price is subject to changes as a working capital adjustment is finalized and additional information becomes available; however, we do not expect material changes. The goodwill was allocated to our Domestic operating segment and is not expected to be deductible for tax purposes. Identifiable intangible assets are being amortized over a period of five years.

The operating results of Labotix were combined with our operating results subsequent to the purchase date of March 18, 2013. Pro-forma results of operations have not been presented because the effect of this acquisition was not material to our results.

(3) Fair Value Measurements

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

- Level 1 – Valuations based on quoted prices in active markets for identical assets or liabilities that the entity has the ability to access.
- Level 2 – Valuations based on quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable data for substantially the full term of the assets or liabilities.
- Level 3 – Valuations based on inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table details our financial assets measured and recorded at fair value on a recurring basis at September 28, 2013:
(In thousands)

		Fair Value Measurements Using		
Description	Balance Sheet Classification	Level 1	Level 2	Level 3
Money market funds	Cash equivalents	$66,400	$—	$—
Time deposits	Cash equivalents	—	9,785	—
Government and corporate bonds	Cash equivalents	—	6,210	—
Time deposits	Short-term investments	—	81,524	—
Commercial paper	Short-term investments	—	43,757	—
Government and corporate bonds	Short-term investments	—	509,027	—
Time deposits	Long-term investments	—	491	—
Government and corporate bonds	Long-term investments	—	569,840	—

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The following table details our financial assets measured and recorded at fair value on a recurring basis at December 29, 2012:
(In thousands)

		Fair Value Measurements Using		
Description	Balance Sheet Classification	Level 1	Level 2	Level 3
Money market funds	Cash equivalents	$68,267	$—	$—
Time deposits	Cash equivalents	—	24,068	—
Time deposits	Short-term investments	—	90,550	—
Commercial paper	Short-term investments	—	86,458	—
Government and corporate bonds	Short-term investments	—	542,657	—
Time deposits	Long-term investments	—	6,197	—
Government and corporate bonds	Long-term investments	—	496,770	—

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 28, 2013 and December 29, 2012 was approximately $48.1 million and $59.0 million, respectively. The carrying amount of such fixed-rate debt at September 28, 2013 and December 29, 2012 was $45.0 million and $54.8 million, respectively.

(4) Investments

Available-for-sale investments at September 28, 2013 were as follows:

(In thousands)	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash equivalents:				
Money market funds	$66,400	$—	$—	$66,400
Time deposits	9,785	—	—	9,785
Government and corporate bonds	6,210	—	—	6,210
Total cash equivalents	82,395	—	—	82,395
Short-term investments:				
Time deposits	81,515	12	(3)	81,524
Commercial paper	43,750	7	—	43,757
Government and corporate bonds	508,623	432	(28)	509,027
Total short-term investments	633,888	451	(31)	634,308
Long-term investments:				
Time deposits	490	1	—	491
Government and corporate bonds	570,028	208	(396)	569,840
Total long-term investments	570,518	209	(396)	570,331
Total available-for-sale investments	$1,286,801	$660	$(427)	$1,287,034

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

(In thousands)	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash equivalents:				
Money market funds	$68,267	$—	$—	$68,267
Time deposits	24,068	—	—	24,068
Total cash equivalents	92,335	—	—	92,335
Short-term investments:				
Time deposits	90,535	17	(2)	90,550
Commercial paper	86,500	15	(57)	86,458
Government and corporate bonds	542,236	497	(76)	542,657
Total short-term investments	719,271	529	(135)	719,665
Long-term investments:				
Time deposits	6,190	10	(3)	6,197
Government and corporate bonds	496,845	324	(399)	496,770
Total long-term investments	503,035	334	(402)	502,967
Total available-for-sale investments	$1,314,641	$863	$(537)	$1,314,967

Investments reported under the cost method of accounting as of September 28, 2013 and December 29, 2012 were $7.2 million and $6.5 million, respectively.

We sold available-for-sale investments for proceeds of $109.9 million and $8.5 million during the nine months ended September 28, 2013 and September 29, 2012, respectively, resulting in insignificant gains in each period.

(5) Receivables

A summary of net receivables is as follows:

(In thousands)	September 28, 2013	December 29, 2012
Gross accounts receivable	$ 532,857	$ 581,386
Less: Allowance for doubtful accounts	38,142	33,230
Accounts receivable, net of allowance	494,715	548,156
Current portion of lease receivables	34,588	29,692
Total receivables, net	$ 529,303	$ 577,848

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 28, 2013, it remains unlikely that our matter with Fujitsu 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 at September 28, 2013 and December 29, 2012. While the ultimate collectability of the receivables pursuant to this process is uncertain, we believe that we have valid and equitable grounds for recovery of such amounts and that collection of recorded amounts is probable.

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During the first nine months of 2013 and 2012, we received total client cash collections of $2.3 billion and $2.0 billion, respectively, of which $44.9 million and $56.2 million were received from third party arrangements with non-recourse payment assignments.

(6) 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.

Our effective tax rate was 32.6% and 32.0% for the first nine months of 2013 and 2012, respectively. This increase was primarily due to a decrease in net favorable discrete items recorded in 2013 relative to 2012, partially offset by reinstatement of the research and development credit in 2013.

In January 2013, the American Taxpayer Relief Act of 2012 (Act) became law. The Act reinstates the research and development tax credit retroactively from January 1, 2012 to December 31, 2013. In the first quarter of 2013, we recognized the research and development tax credit related to 2012 as a favorable discrete item. Research and development tax credits generated in 2013 are being recognized pro-rata as a component of the overall 2013 effective tax rate.

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(7) Earnings Per Share

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

	Three Months Ended					
	2013			2012		
(In thousands, except per share data)	Earnings (Numerator)	Shares (Denominator)	Per-Share Amount	Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic earnings per share:						
Income available to common shareholders	$115,344	342,992	$0.34	$98,887	342,502	$0.29
Effect of dilutive securities:						
Stock options and non-vested shares	—	8,457		—	9,237	
Diluted earnings per share:						
Income available to common shareholders including assumed conversions	$115,344	351,449	$0.33	$98,887	351,739	$0.28

For the three months ended September 28, 2013 and September 29, 2012, options to purchase 7.2 million and 5.6 million shares of common stock at per share prices ranging from $36.92 to $50.54 and $27.62 to $42.98, respectively, were outstanding but were not included in the computation of diluted earnings per share because they were anti-dilutive.

	Nine Months Ended					
	2013			2012		
(In thousands, except per share data)	Earnings (Numerator)	Shares (Denominator)	Per-Share Amount	Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic earnings per share:						
Income available to common shareholders	$338,291	343,681	$0.98	$285,424	341,287	$0.84
Effect of dilutive securities:						
Stock options and non-vested shares	—	8,651		—	9,746	
Diluted earnings per share:						
Income available to common shareholders including assumed conversions	$338,291	352,332	$0.96	$285,424	351,033	$0.81

For the nine months ended September 28, 2013 and September 29, 2012, options to purchase 5.8 million and 4.3 million shares of common stock at per share prices ranging from $32.92 to $50.54 and $27.62 to $42.98, respectively, were outstanding but were not included in the computation of diluted earnings per share because they were anti-dilutive.

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(8) Share-Based Compensation and Equity

Stock Options

Options activity for the nine months ended September 28, 2013 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)
Outstanding at beginning of year	24,072	$16.99		
Granted	3,596	47.66		
Exercised	(2,472)	10.11		
Forfeited and expired	(239)	37.77		
Outstanding as of September 28, 2013	24,957	21.89	$766,741	6.40
Exercisable as of September 28, 2013	14,255	$10.40	$601,743	4.92

The weighted-average assumptions used to estimate the fair value of stock options granted in 2013 were as follows:

Expected volatility (%)	30.4 %
Expected term (yrs)	9.1
Risk-free rate (%)	1.9 %
Fair value per option	$19.46

As of September 28, 2013, there was $130.2 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 3.37 years.

Non-vested Shares

Non-vested share activity for the nine months ended September 28, 2013 was as follows:

(In thousands, except per share data)	Number of Shares	Weighted-Average Grant Date Fair Value
Outstanding at beginning of year	602	$ 28.41
Granted	238	46.66
Vested	(276)	24.00
Forfeited	(10)	22.73
Outstanding as of September 28, 2013	554	$ 38.54

As of September 28, 2013, there was $13.6 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 1.74 years.

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The following table presents total compensation expense recognized with respect to stock options, non-vested shares and our associate stock purchase plan:

(In thousands)	Three Months Ended 2013	Three Months Ended 2012	Nine Months Ended 2013	Nine Months Ended 2012
Stock option and non-vested share compensation expense	$12,527	$9,721	$33,650	$26,304
Associate stock purchase plan expense	1,168	719	2,867	2,064
Amounts capitalized in software development costs, net of amortization	(237)	(218)	(900)	(600)
Amounts charged against earnings, before income tax benefit	$13,458	$10,222	$35,617	$27,768
Amount of related income tax benefit recognized in earnings	$5,221	$3,910	$13,819	$10,621

Treasury Stock

In December 2012, our Board of Directors authorized a stock repurchase program of up to $170.0 million, excluding transaction costs, of our common stock. The repurchases were to be effectuated in the open market, by block purchase, or possibly through other transactions managed by broker-dealers.

During the nine months ended September 28, 2013, we repurchased 3.6 million shares for total consideration of $170.0 million. These shares were recorded as treasury stock and accounted for under the cost method. Repurchased shares at the time of the stock split were utilized to settle a portion of the stock split distribution, as further described in Note 1 of these notes to condensed consolidated financial statements. As of September 28, 2013, the program is complete.

Authorized Shares

Effective May 24, 2013, we amended our Second Restated Certificate of Incorporation of Cerner Corporation to increase the number of authorized shares of our common stock from 250,000,000 to 500,000,000 shares.

(9) Hedging Activities

The following table represents the fair value of our net investment hedge included within the condensed consolidated balance sheets:

(In thousands)		Fair Value	
Derivatives Designated	Balance Sheet Classification	September 28, 2013	December 29, 2012
Net investment hedge	Short-term liabilities	$14,986	$15,015
Net investment hedge	Long-term liabilities	29,973	30,030
Total net investment hedge		$44,959	$45,045

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)	Net Unrealized Gain (Loss)

Derivatives Designated	Balance Sheet Classification	For the Three Months Ended 2013	For the Three Months Ended 2012	For the Nine Months Ended 2013	For the Nine Months Ended 2012
Net investment hedge	Short-term liabilities	$(523)	$(262)	$2	$(362)
Net investment hedge	Long-term liabilities	(1,058)	(786)	2	(1,085)
Total net investment hedge		$(1,581)	$(1,048)	$4	$(1,447)

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(10) 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.

(11) 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. “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. Performance of the segments is assessed at the operating earnings level and, therefore, the segment operations have been presented as such. 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 28, 2013 and September 29, 2012:

(In thousands)	Domestic	Global	Other	Total
Three Months Ended 2013				
Revenues	$641,541	$86,289	$—	$727,830
Cost of revenues	107,560	12,017	—	119,577
Operating expenses	148,478	34,078	256,459	439,015
Total costs and expenses	256,038	46,095	256,459	558,592
Operating earnings (loss)	$385,503	$40,194	$(256,459)	$169,238

(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
Nine Months Ended 2013				
Revenues	$1,837,171	$278,249	$—	$2,115,420
Cost of revenues	327,356	45,250	—	372,606
Operating expenses	439,345	84,685	726,521	1,250,551
Total costs and expenses	766,701	129,935	726,521	1,623,157
Operating earnings (loss)	$1,070,470			