August 22, 2007

Zacks Digest of Brokerage Research

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Cerner Corporation	(CERN-NYSE)	$53.64

Note: All changes since the last report are highlighted.

Reason for Report: Minor Changes and News Update; Final Version **Previous Edition:** July 30, 2007

Brokers' Target Price: $62.67 (↔ with last edition; 15 firms)

Brokers' Recommendations: Neutral: 60% (9 firms); Positive: 40.0% (6); Negative: 0% (0)

Recent Events

On July 24, 2007, CERN reported 2Q07 earnings. Highlights are as follows:

• 2Q07 total revenue was $387.0 million versus $330.6 million in 2Q06, up 17% y/y.
• 2Q07 GAAP EPS was $0.37, up 28% y/y.

Overview

Analysts have identified the following factors for evaluating the investment merits of CERN:

Key Positive Arguments	Key Negative Arguments
• CERN continues to be one of the best executed companies in the growing healthcare information technology (HIT) space. • Cerner continues to execute in both the domestic and international healthcare IT markets. • Cerner continues to be a winner in the market for hospital clinical information technology and also in building a significant presence in the rapidly growing ambulatory clinical IT market. • Cerner is one of the best positioned companies to benefit from the increased spending on inpatient and ambulatory clinical IT systems. • The acquisition of Etreby aims to expand its portfolio of solutions aimed at retail pharmacies, and is considered to be part of a strategy to connect the entire continuum of the healthcare community. • Cerner's proven execution and ability to deliver predictable results to its clients at a predictable cost continue to distinguish it in the marketplace.	• Any negative change to reimbursement rates from the government could dampen the outlook for capital spending and slow HIT spending. • Potential disputes may arise between the company and the British government regarding the UK/NHS contract. In addition, the company could face potential penalties if it experiences delays in implementation in the out-years of the contract. • Cerner could experience pricing pressure as the company's penetration with existing customers grows. Higher customer purchasing power could impair Cerner's ability to improve margins. • Cerner's industry is highly regulated by the government, and is currently undergoing a transition. Due to the fast evolution of product standards and requirements, any change in government regulation may have an adverse impact on Cerner's products.

Headquartered in North Kansas City, Missouri, Cerner Corporation (CERN) supplies healthcare information technology solutions worldwide. It designs, develops, markets, installs, hosts, and supports software information technology and content solutions for healthcare organizations and consumers. It offers software solutions and hardware that gives healthcare providers secure access to clinical, administrative, and financial data in a short time. It operates under three main segments, namely: System sales, Support, Maintenance and Services, and Reimbursements. The company provides access to an individual's electronic medical record from the point of care, and organizes information for the specific needs of physicians, nurses, laboratory technicians, pharmacists, and other care providers, as well as of front and back office professionals. Further information on the company can be found at its website: www.cerner.com.

Note: The Company's fiscal year coincides with the calendar year.

Revenue

CERN reported 2Q07 total revenue of $387.0 million versus $330.6 million in 2Q06, up 17% y/y. The Zacks Digest average total revenue was $386.6 million, up 17.2% y/y.

Bookings in 2Q07 were $486.8 million, up 56% y/y. 2Q07 bookings included a $97.8 million booking related to CERN's participation in the London and Southern regions of the National Health Service (NHS) initiative to automate clinical processes and digitize medical records in England. Excluding this booking, CERN bookings were $389.0 million, up 25% y/y. A healthy 15% of bookings were attributed to new customers. The company attributed the substantial upside to increased contract signings volume in professional services. From a geographical standpoint, global bookings represented an all-time record with strength from multiple regions. Management also noted that from a booking perspective software sales were lower than expected with the bookings upside driven by higher hardware sales, professional services, and managed services.

The overall backlog was $3.0 billion, up 32% y/y and up 4% sequentially. Total backlog is broken into contract revenue backlog of $2.50 billion and support backlog of $513.0 million. During 2Q07, the company turned on 349 Millenium units, for a total of 6,700 total Millenium applications running at 1,155 sites. CERN also added four new acute care sites for a total of 135 at the end of 2Q07. In total, CERN signed 383 contracts during the quarter, with twelve contracts greater than $5 million and six contracts greater than $10 million.

CERN has enjoyed the backlog benefits of its two monster National Health Services (NHS) contracts in the UK, as well as its Choose-and-Book contract with the UK government. Beyond these deals, Cerner has expanded its presence in Canada, Australia, France, and Spain. The company's Marseille contract is a good starting point in competing for more French opportunities.

Provided below is a summary of revenue details as compiled by Zacks Digest.

($ in million)	2Q06A	2006A	1Q07A	2Q07A	3Q07E	4Q07E	2007E	2008E
Zacks Consensus					$393.0	$425.0	$1,570.0	$1,771.0
Digest High	$330.6	$1,378.2	$365.9	$386.6	$398.7	$433.1	$1,583.8	$1,837.7
Digest Low	$320.6	$1,378.0	$365.9	$386.6	$389.4	$417.2	$1,561.9	$1,737.8
Digest Average	$330.0	$1,378.0	$365.9	$386.6	$393.1	$425.3	$1,570.8	$1,771.0
Digest Y/Y growth		18.7%	13.9%	17.2%	13.8%	11.7%	14.0%	12.8%
Digest Seq. Growth	2.7%		-3.9%	5.7%	1.7%	8.2%		

The company's revenue segments are:

System sales (33.7% of revenues): Revenue was $130.1 million in 2Q07, up 13.7% y/y, due to higher hardware sales during 2Q07.

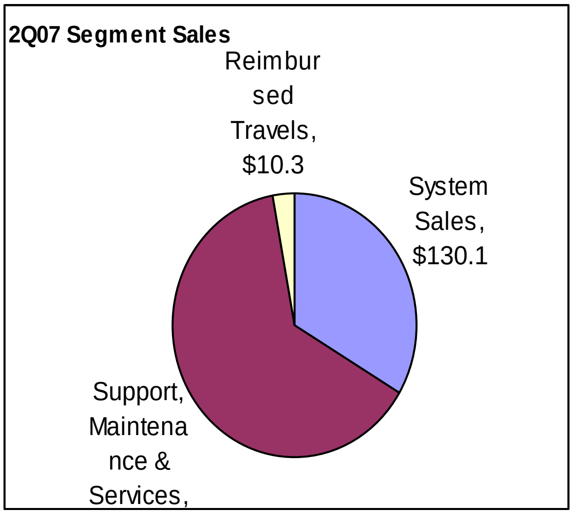
Support, Maintenance, and Services (63.7% of revenues): This segment also includes implementation and consulting revenues. Revenue was $246.2 million in the quarter, and increased about 19.4% y/y. Of this, $148.5 million were for Services and $97.7 million for Support and Maintenance. Services revenue was up 21.5% y/y, while support and maintenance revenues were up 16.3% y/y.

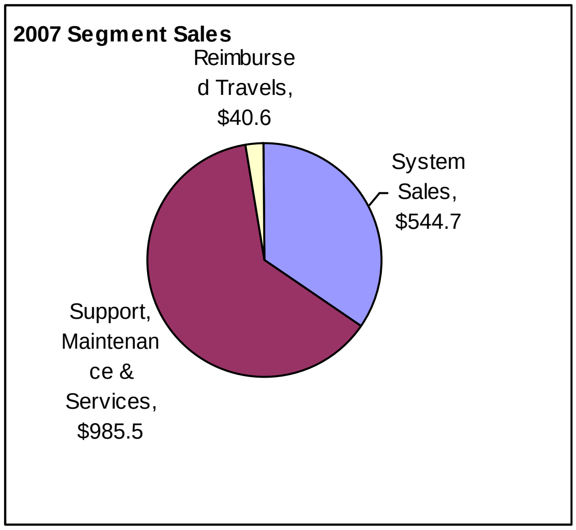
Reimbursed Travels (2.6% of revenues): Revenue in this segment was $10 million in 2Q07.

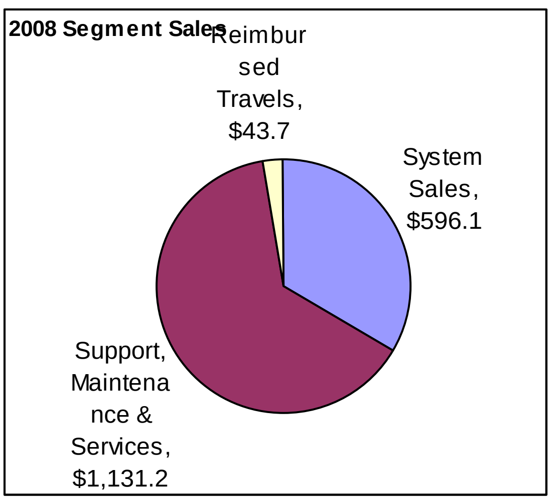
The details of the three revenue segments are as follows:

($ in million)	2Q06A	2006A	1Q07A	2Q07A	3Q07E	4Q07E	2007E	2008E
System Sales	$114.4	$505.7	$122.9	$130.1	$134.5	$157.2	$544.7	$596.1
Support, Maintenance & Services	$198.1	$833.2	$233.9	$246.2	$248.4	$257.0	$985.5	$1,131.2
Reimbursed Travels	$10.0	$39.1	$9.1	$10.3	$10.4	$10.0	$40.6	$43.7

Provided below is a pie chart analysis of segment revenue ($ million) as compiled by Zacks Digest







The company expects revenue in the third quarter of 2007 to be approximately between $385 million and $395 million. For the year 2007, Cerner increased its revenue guidance from $1.54 billion–$1.57 billion to $1.55 billion–$ 1.57 billion. This represents 14%–15% over 2006.

Cerner expects new business bookings in 3Q07 to be between $365 million and $380 million, with the midpoint of this range expected to reflect 7% growth over 3Q06 bookings and puts the company on-line to achieve greater than 20% annual bookings growth.

Margins

In 2Q07, the Zacks Digest average gross margin was 79.1%, down 150 bps sequentially, given an increased mix of hardware sales. In 2Q07, Systems gross margin was 57.3% while Services support and maintenance gross margin was 93.8%.

The Zacks Digest average operating margin was 13.2%, while net margin was 8.4%. The Zacks Digest average EBITDA margin was 21.3%, up 12.4% y/y.

In the quarter, the company reported operating margin of 13.8% (excluding options expense), an improvement of 20 bps y/y. Operating margin was impacted by approximately $26.0 million in zero-margin revenue from the outstanding projects with NHS's Southern and London clusters in England. Operating margin was 14.8%, excluding the negative margin impact of the UK contract accounting.

At the conference call, management indicated the inclusion of approximately $26 million zero-margin revenue associated with the UK contracts (Southern England and London) reduced the operating margin by 100 bps. Excluding revenue from the UK contracts, operating margin in the quarter reached 14.8%, up 50 bps y/y. The UK business is expected to continue generating zero-margin revenue until all of the software components related to this contract have been delivered (expected mid-2008). At that point, Cerner would recognize the profit for the entire contract over the remaining life of the contract. The company indicated it is continuing to strive toward its long-term goal of a 20% operating margin.

Provided below is a summary of margins as compiled by Zacks Digest:

Margin	2Q06A	2006A	1Q07A	2Q07A	3Q07E	4Q07E	2007E	2008E
Gross	80.7%	78.9%	80.2%	79.1%	79.9%	79.1%	79.5%	80.2%
Operating	13.0%	12.8%	12.4%	13.1%	14.1%	15.1%	13.7%	15.4%
Pre-Tax	12.8%	12.8%	12.3%	13.0%	14.0%	15.1%	13.6%	15.5%
Net	7.7%	8.0%	7.8%	8.4%	9.0%	9.6%	8.7%	9.9%

Earnings per Share

As per the company, 2Q07 GAAP net earnings were $31.1 million, and diluted earnings per share were $0.37. Adjusted 2Q07 net earnings were $33.8 million, which is 25% higher than the $27.0 million of adjusted net earnings in 2Q06. Adjusted diluted earnings per share were $0.41 in 2Q07 versus $0.33 in 2Q06. The Zacks Digest average pro forma EPS in 2Q07 was $0.40, up 28.1% y/y.

Adjusted 1Q07 net earnings and diluted earnings per share exclude the impact of adopting Statement of Financial Accounting Standards (SFAS) No. 123R, share-based payment, which requires the expensing of stock options. The adoption of SFAS 123R reduced the 2Q07 net earnings and diluted earnings per share by $2.7 million and $0.04, respectively.

Provided below is a summary of EPS estimates as compiled by Zacks Digest:

EPS	2Q06A	2006A	1Q07A	2Q07A	3Q07E	4Q07E	2007E	2008E
Zacks Consensus					$0.41	$0.47	$1.59	$2.00
Digest High	$0.33	$1.51	$0.36	$0.41	$0.45	$0.53	$1.74	$2.19
Digest Low	$0.29	$1.23	$0.33	$0.37	$0.40	$0.47	$1.58	$1.98
Digest Avg.	$0.32	$1.36	$0.36	$0.40	$0.44	$0.51	$1.71	$2.12
Digest Y/Y Growth		26.1%	27.0%	28.1%	26.3%	26.2%	25.5%	24.2%
Digest Sequential Growth	12.8%		-11.7%	13.7%	9.1%	15.3%		
Company Guidance before FAS 123				$0.40-$0.41			$1.58	
Company Guidance after FAS 123				$0.44-$0.45			$1.72-$1.73	

CERN expects adjusted diluted earnings per share before stock options expense in 3Q07 to be between $0.44 and $0.45. The company expects SFAS No. 123R share-based compensation expense to reduce diluted earnings per share in 3Q07 by approximately $0.04, leading to expected diluted earnings per share between $0.40 and $0.41.

For the full year 2007, CERN expects adjusted diluted earnings per share before stock options expense to grow in the mid-twenty percent range. This expectation is consistent with EPS before options expense in the range of $1.72–$1.73, with the high end of the range reflecting a $0.01 increase from the previous guidance. The company expects SFAS No. 123R share-based compensation expense to reduce diluted earnings per share for 2007 by approximately $0.15 to $0.16. The company increased its EPS guidance to mid-20% growth, up from low-to-mid 20%.

Target Price/Valuation

The average Zacks Digest price target quoted by firms is $62.67 (↔ with the previous report and 9.96% upside from the current price). The price targets range from $53 (7.0% down from the current level) to $70 (22.82% upside from the current level), with a median price target of $66.00 (↔ with the previous report).

Rating Distribution	
Positive	**40.0%**
Neutral	**60.0%**
Negative	**0.0%**
Avg. Target Price	**$62.67 ↔**

Metrics detailing current management effectiveness are as follows:

Metric (TTM)	Value
Return on Assets (ROA)	8.46%
Return on Equity (ROE)	13.45%
Return on Invested Capital (ROIC)	10.34%

ROE and ROIC are lower than the overall market averages (measured by the S&P 500) of 21.29% and 12.33%, respectively, but ROA is higher than the overall market average (measured by the S&P 500) of 8.33%.

Capital Structure/Solvency/Cash Flow/Governance/Other

Cash flow from operations was $63 million in the quarter. Free cash flow (FCF) was negative $4 million, which was negatively impacted by the large capital expenditure (capex) spend in the quarter and lower levels of third party financing. The company expects less capitalized spending to revitalize FCF in 2H07. Free cash flow generation has been a historic concern for investors, with relatively low results given the company's potential. Management expects FCF in 2007 to remain relatively in line with 2006 levels.

Capital expenditures were $51 million in the quarter, with $19 million of property expenditures primarily related to the company's new data center and office space in Kansas City.

Contract receivables in 2Q07 were $119 million, down $21 million sequentially. The company's R1 release in the U.S. was approved during 2Q07, which allowed the company to collect cash about $438 million during the reported quarter. Total R&D spending was $65.7 million with a capitalization rate of 4.3% versus 8.3% in 2Q06. Days sales outstanding (DSO) were 86 days in 2Q07 versus 89 days and 91 days in 1Q07 and 2Q06, respectively.

On July 13, 2007, CERN announced that Paul M. Black, Executive Vice President and Chief Operating Officer, will retire effective from August 31, 2007.

On June 28, 2007, CERN announced that Cerner Bridge Transfusion Administration and Specimen Collections software solution has received FDA clearance to market a new software system designed to prevent errors involved with blood transfusions and specimen collections. Cerner will immediately make this solution available to clients. This approval completes the point-of-care suite for Cerner Bridge Medical, which also includes Medication Administration.

Potentially Severe Problems

UK project delays appear to be a concern to government officials. While Cerner remains encouraged with the progress made in the UK with 24 sites and 99 solutions live, the high profile and expensive Connecting for Health program is facing a lot of criticism from members of Parliament and the press. With the program running nearly two years behind schedule, according to some commentators, there remain some concerns about the NHS contract's stability and terms.

Long-Term Growth

The average long-term growth rate quoted by analysts is 23.7%, ranging from 13.0% to 30.0%.

CERN has the ability to win big deals and pursue strategic opportunities, according to analysts. Most firms view CERN as a visionary in the healthcare IT market, with an overarching goal of using technology to connect all participants in the healthcare process to drive operational efficiencies and improve clinical research and care. Most firms also believe the company can sustain a 20%-plus growth rate over the next several years.

International Progress

CERN's deal with Mortara Instrument will optimize the Electrocardiogram ECG workflow and eliminate the need for ECG Management Systems. The use of the DICOM ECG standard allows EMR to receive and present raw ECG data seconds after they have been acquired. Combining the diagnostic ECG with EMR, greater EMR data can be properly utilized.

Healthcare Information Technology (HIT) industry backdrop looks strong heading into 2007, due to a number of developing changes in the U.S. Healthcare system. The Chairman and CEO of Trizetto Group (TZIX-NR) cited several ongoing changes to the U.S. Healthcare system that could result in increasing demand for IT solutions over the next several years. They are: (1) increasing consumer healthcare debt as they shoulder more of the cost of their healthcare services, which in turn could generate demand for realtime, point-of-care claims systems that generate accurate consumer payment amounts; and (2) the recent changes on Capitol Hill are not likely to alter the fundamental forces that are driving broad changes in the healthcare industry. Therefore, Congressional support is not likely to wane for HIT solutions since it provides the most likely path to improving care, driving waste out of the system, and reducing healthcare costs.

In the U.K. CERN continues its NHS work in Southern and London clusters. In 2Q07, this project contributed a $97.8 million booking, and at the end of 2Q07, CERN booked $467 million of the original estimated $800 million in contract value for the clusters. CERN continues to participate with Atos Origin, the national scheduling or referral program which passed 3 million bookings in 1Q07. CERN has enjoyed much recent success outside the UK as well, having contracts with the two largest states (encompassing over 60% of the population) in Australia, Victoria and New South Whales, to provide clinical IT system and was recently able to add two significant French clients, including the largest hospital system in Marseilles, thereby increasing their footprint in the country. The company has also been making inroads in Canada, Hong Kong, India, Malaysia, Spain, Taiwan, and the Middle East.

The **U.S. Healthcare IT** market is still a great opportunity for CERN. The company highlighted the opportunity in the U.S. HCIT market, thereby pointing out that fewer than 5% of U.S. hospitals have computerized physician order entry (CPOE) with integrated clinical decision support and protocols.

CERN is creating a new organization, DeviceWorks, which will focus on marketing CERN’s CareAware drug dispensing cabinet, as well as other IT/medical device integrated offerings down the line. CERN’s dispensing cabinets are not yet rolled out to their alpha customers, but expected to be so in 1H07, and management expects to have the product available for sale by the end of 2007.

CERN will also focus on an initiative called HealthE Employees, which will begin attempting to tap the third party administrator market for self-insured employers. Both the DeviceWorks and HealthE Employees efforts are nascent efforts, and are not expected to have any impact in either 2007 or 2008, but represent CERN’s continued efforts to utilize its capabilities to provide potentially meaningful additional services. Cerner did make progress in 2Q07 bringing the total number of live sites to 30 in 2Q07, up from 24 in the previous quarter. Again, Cerner expects no-margin revenue for its Southern cluster until late 2008.

CERN reported some progress in its newer strategic initiatives in 2Q07, signing 9 new clients to use its CareAware connectivity solution and one employer to use the Healthe health plan administration services.

Cerner acquired Etreby Computer Company, Inc., a leading software provider of retail pharmacy management systems. The acquisition expanded Cerner's pharmacy systems portfolio, adding innovative solutions and services to serve the independent, supermarket-associated and chain retail pharmacies. With the addition of the Etreby solutions, CERN clients, affiliated pharmacies and retail pharmacy chains will now have one company to connect and serve their IT needs, and improve patient safety and quality of care. Etreby provides information systems to more than 1,200 retail pharmacies.

Upcoming Events

On October17, 2007, CERN is expected to report its 3Q07 earnings.

Copy Editor: Pushpanjali B.