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Cerner Corporation (CERN) CEO Brent Shafer on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-24-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $0.66 beats by $0.00 | Revenue of $1.43B (6.67% Y/Y) beats by $2.69M

Earning Call Audio

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Cerner Corporation (NASDAQ:CERN) Q3 2019 Results Earnings Conference Call
October 24, 2019 4:30 PM ET

Company Participants

Brent Shafer - Chairman and Chief Executive Officer

Marc Naughton - Executive Vice President and Chief Financial Officer

Donald Trigg - Executive Vice President of Strategic Growth

John Peterzalek - Executive Vice President and Chief Client Officer

Conference Call Participants

David Windley - Jefferies LLC

Donald Hooker - KeyBanc Capital Markets

Stephanie Demko - Citigroup

George Hill - Deutsche Bank

Sandy Draper - SunTrust Robinson Humphrey

Matthew Gillmor - Robert W. Baird

Eric Percher - Nephron Research

Michael Cherny - Bank of America

Jamie Stockton - Wells Fargo

Operator

Welcome to the Cerner Corporation's Third Quarter 2019 Conference Call. Today's date is October 24, 2019, and this call is being recorded.

The company has asked me to remind you that various remarks made here today constitute forward-looking statements, including without limitation, those regarding projections of future revenues or earnings; operating margins; operating and capital expenses; bookings; new solution, services and offering development; capital allocation plans; cost optimization and operation improvement initiatives; future business outlook, including new markets or prospects for the company's solutions and services and expected benefits of certain of our collaborations.

Actual results may differ materially from those indicated by the forward-looking statements. Additional information concerning factors that could cause actual to differ materially from those in the forward-looking statements may be found under Item 1A in Cerner's Form 10-K, together with the company's other filings.

A reconciliation of non-GAAP financial measures discussed in this earnings call can be found in the company's earnings release which is furnished to the SEC today and posted on the Investors section of cerner.com. Cerner assumes no obligation to update any forward-looking statements or information except as required by law.

At this time, I'd like to turn the call over to Brent Shafer, Chairman and CEO of Cerner Corporation. You may begin.

Brent Shafer

Thank you, Toronto. Good afternoon, everyone. And welcome to the call. I'll spend the first few moments providing my thoughts on the business and then I'll ask our CFO, Marc Naughton, to take you through the financial results. When Marc concludes, our Chief Client Officer, John Peterzalek, will provide some marketplace commentary. And I have also asked Don Trigg, our EVP of Strategic Growth, to talk about Cerner's growth strategies.

It's been an eventful quarter at Cerner. At the end of July, we announced our collaboration agreement with AWS and Amazon and the company has made good progress around our transformation efforts.

And we recently concluded our annual healthcare conference, Cerner Healthcare Conference, and it was really another successful CHC where we hosted over 11,000 clients, partners, media and other healthcare affiliates from around the world.

The theme of this year's conference was "Now and Next." And during my keynote, I shared Cerner's improvements in addressing our clients need today and our innovation plans for the future.

Now, as we discussed last quarter, our strategic framework to deliver on this innovation and growth is focused on three key areas – software as a service, health networks and data as a service.

Our recently announced relationship with AWS and Amazon is foundational to these areas. Our work with AWS is expected to enable delivery of scalable and secure solutions in a faster, more agile way, with the power of advanced artificial intelligence and machine learning tools embedded in the workflow.

Our clients can expect to see advancement in the overall user experience for consumers and care teams, as well as their overall health system and financial operations.

We plan to modernize our platforms and software development approach, increase the pace of innovation and speed to market and lower the operational burdens for our clients.

This also represents an opportunity to reduce Cerner's costs over time and is part of our focus on long-term profitability improvements.

Further, the possibilities with the Cerner and Amazon collaboration are substantial given their vast consumer knowledge.

I'd also like to provide an update on other activity that's part of Cerner's broader transformation. We spent most of this year focused on identifying and addressing inefficiencies and cost optimization opportunities.

And while this work is ongoing, we are now putting additional focus on other improvements to drive long-term business transformation. This includes work on capability building, automation, product management and go-to-market strategy.

To help us deliver on the market and product management elements of our transformation, we recently created and filled the [Technical Difficulty] September. Now, Darrell Johnson is joining us from Cerner following his successful career at Medtronic and he has very deep expertise in healthcare data ecosystems and is a recognized leader in marketing innovations and global brand positioning for devices, software, services and data platforms.

I believe instituting this new CMO role and integrating strategic marketing into our organizational structure will strengthen Cerner's portfolio and product management processes and also improve our brand and go-to-market strategies.

As it relates to the financial results, I'm pleased with this quarter's numbers. Against the backdrop of advancing our transformation, the team executed and delivered against the expectations we set. Now, there's more work to do, but I'm confident that we have the right balance-of-focus on executing in the near-term and recalibrating the company for long-term and the profitable growth ahead.

And I'd like to hand the call over to Marc.

Marc Naughton

Thanks, Brent. Good afternoon, everyone. I am going to cover our Q3 results and future guidance.

In the quarter, we delivered solid bookings, revenue and earnings. I'll start with bookings, which were $1.651 billion in Q3, up 4% over Q3 of 2018 and at the high end of our guidance range.

We ended the quarter with a revenue backlog of $13.31 billion, which is down 9% from a year ago primarily due to the termination of a large outsourcing contract that I'll discuss in a minute.

Also recall that our backlog calculation under the new revenue standard excludes revenue from contracts with termination clauses, even though such clauses are rarely exercised, and we had a higher-than-usual amount of these types of contracts in Q3.

When you combine the expected revenue from our backlog and the additional revenue expected from contracts not included in backlog, our revenue visibility remains at approximately 85% over the next 12 months.

Revenue in the quarter was $1.429 billion, up 7% over Q3 of 2018 and in line with our expectations.

I'll now go through the business model detail and year-over-year growth compared to Q3 of 2018. Licensed software revenue in Q3 was $155 million, up 10% over Q3 of 2018 driven primarily by our strong growth in our SaaS offerings.

Technology resale of $70 million increased 16% compared to both Q3 of 2018 and last quarter. Subscriptions revenue grew 16% to $92 million. Professional services revenue grew 11% to $507 million, primarily driven by solid growth in implementation services.

Managed services was flat at $302 million, with the lack of growth primarily related to the phase out of revenue from Health Services clients that made the decision to leave in past years and are just now getting transitioned out of our data centers.

Note that our retention rate for Health Services clients is solid at about 80%, but there is still some impact from those that have left.

Overall, attrition remains very low and we expect managed services to return to modest growth in 2020.

Support and maintenance was also flat at $277 million, which is in line with our expectations and also reflects the impact of attrition.

And finally, reimbursed travel of $26 million was up 6%.

Looking at revenue by geographic segment, domestic revenue was up 6% from the year-ago quarter at $1.265 billion and international revenue of $164 million was up 8% year-over-year.

Moving to gross margin. Our gross margin for Q3 was 81.0%, down from 81.2% in Q2 of 2019 and 82.8% year-over-year driven by higher third-party services, largely related to our federal business and a lower margin mix within technology resale.

Now, I will discuss spending, operating margin and net earnings. For these items, we provide both GAAP and adjusted or non-GAAP, results. The adjusted results exclude share-based compensation expense, share-based compensation permanent tax items, acquisition-related adjustments, organizational restructuring and other expenses, and investment gains that are detailed and reconciled to GAAP in our earnings release.

Included in the organizational restructuring line this quarter is a $60 million charge related to the termination of our revenue cycle outsourcing contract with Adventist Health.

This was a joint decision based on what we agreed was best for both parties and is also related to our previously communicated portfolio management process. This will result in revenue cycle operations being assumed by Adventist and Huron beginning in early November, with nearly 1,700 Cerner associates transitioning back to Adventist Health and Huron at that time. This will reduce annual revenue by approximately $170 million, but have little impact on earnings.

Note that Adventist Health has re-committed to all clinical and revenue cycle solutions and ITWorks services. This only pertains to the revenue cycle outsourcing services.

One other item of note that is included in GAAP results but not our adjusted results is the $9 million non-operating unrealized gain on one of our equity investments.

Now, I'll walk through our operating expenses. Our third quarter GAAP operating expenses of $1.069 billion were up 18% compared to $903 million in the year-ago period, largely driven by the restructuring charges.

Our adjusted operating expenses were up 6% compared to Q3 of 2018. Looking at the line items for Q3, sales and client service expense increased 6% year-over-year, primarily driven by an increase in personnel expense related to the growth in professional services.

Software development expense increased 10% over Q3 of 2018, driven by a 7% increase in gross R&D, a 6% increase in amortization, and flat capitalized software.

G&A expense was down 8%, driven by a decline in both personnel and non-personnel expenses.

Amortization of acquisition-related intangibles decreased slightly year-over-year.

Moving to operating margins. Our GAAP operating margin in Q3 was 6.2% compared to 15.5% in the year-ago period. Our adjusted operating margin for the quarter was 18.1%, down from 19.2% in Q3 of 2018, but up from 18.0% last quarter and in-line with our expectations.

The adjusted operating margin implied by our revenue and earnings guidance that I'll discuss in a moment implies an expected adjusted operating margin slightly over our targeted 20% for Q4.

We also believe our ongoing business optimization efforts keep us on track for delivering our targeted Q4 2020 adjusted operating margin of 22.5%.

As I mentioned last quarter, we believe our ongoing cost optimization and business simplification efforts position us to continue improving our profitability beyond 2020.

Further, we believe our platform modernization and move to the cloud represents another driver of margin improvement longer term. This will be a multi-year process, particularly for Millennium, and most near-term benefit is largely offset by modernization investment.

However, we expect the lower operating costs associated with this move, along with efficiencies and improvements we are driving in our development process, to meaningfully contribute to our profitability, while also helping us deliver a differentiated solution to our clients at a lower total cost of ownership.

Moving to net earnings and EPS, our GAAP net earnings in Q3 were $82 million or $0.26 per diluted share, which is down from $0.51 in Q3 of 2018. Adjusted net earnings in Q3 were $212 million and adjusted diluted EPS was $0.66 compared to $0.63 in Q3 of 2018.

Our GAAP and non-GAAP tax rates were both approximately 20% in Q3.

Moving to our balance sheet, we ended Q3 with $633 million of cash and short-term investments, which is down from $954 million last quarter with our free cash flow being offset by $400 million of share repurchases.

For the year, we have repurchased 14.4 million shares for $1 billion at an average price of $69.53, and currently have $483 million of remaining authorization under our repurchase program.

Moving to debt, our total debt remained flat to last quarter at $1.039 billion.

Total receivables ended the quarter at $1.155 billion, down from $1.229 billion in Q2 of 2019. Our Q3 DSO was 74 days, which is down from 78 days in Q2 of 2019 and 82 days in the year-ago period.

Operating cash flow for the quarter was $351 million. Q3 capital expenditures were $111 million and capitalized software was $66 million.

Free cash flow, defined as operating cash flow less capital purchases and capitalized software development costs, was $174 million for the quarter. We expect free cash flow to remain solid in Q4 and solid growth in free cash flow in 2020.

Moving to capital allocation. As I indicated, we repurchased $1 billion of stock in Q2 and Q3, leaving $483 million remaining on our current authorization. We still expect to execute the majority of the repurchase authorization by the end of Q1 of next year, subject to market conditions and other factors.

We intend to continue funding this with a combination of cash from operations and debt, with the amount of debt depending on the timing of our repurchases and whether we use cash for M&A and other purposes.

Regarding M&A, we did just announce a definitive agreement to acquire AbleVets. The cash consideration for this acquisition is expected to total approximately $75 million and we expect it to close in Q4 of this year.

We expect this to contribute approximately $90 million of revenue in 2020. As John will discuss, AbleVets is a great fit given their experience and the importance of our federal business.

Moving to our dividend program, we paid our first two quarterly dividends of $0.18 per share on July 26th and October 9th.

Now I'll go through guidance. We expect revenue in Q4 to be between $1.41 and $1.46 billion. The midpoint of this range reflects growth of 5% over Q4 of 2018 and would bring full-year 2019 revenue to $5.685 billion, which reflects 6% growth over 2018 and is within our previously provided full-year guidance range.

Note that guidance includes approximately $25 million of impact from the termination of our Adventist RevWorks agreement, and our Q4 guided growth would be 7% without this change. Also note that our guidance reflects minimal impact from AbleVets given it has not closed.

We expect Q4 adjusted diluted EPS to be $0.73 to $0.75 per share. The midpoint of this range is 17% higher than Q4 of 2018 and would bring full-year 2019 adjusted diluted EPS to $2.67, which reflects 9% growth over 2018.

Moving to bookings guidance, we expect bookings revenue in Q4 of $1.45 billion to $1.65 billion. The midpoint of this range reflects a 21% decrease compared to the fourth quarter of 2018 and would bring full-year 2019 bookings to $5.876 billion, down 13% from 2018.

Year-over-year decrease in Q4 is primarily driven by a couple of different factors. Historically, Q4 bookings have included large RevWorks extensions from Adventist Health that will no longer occur given the transition of those services back to Adventist.

Additionally, as we've discussed throughout this year, we are taking a more selective approach to low-margin long-term contracts, and this has led to a decline in those types of bookings and that is expected to continue.

We expect to provide our outlook for 2020 on our Q4 call.

In summary, we are pleased with our solid results in the third quarter. We have made good progress this year, but there is still a lot of work to do and we expect to continue executing against our plan as we finish 2019 and move into 2020.

With that, I'll turn the call over to John.

John Peterzalek

Thanks, Marc. Good afternoon, everyone. Today, I will provide results, highlights and a quick update on our federal business.

I'll start with our bookings, which grew 4% over last year and were at the high-end of our guidance. Consistent with recent quarters, we had a lower level of long-term bookings compared to last year, with the percent of bookings coming from long-term contracts in the quarter at 29% compared to 34% in Q3 of last year. Excluding these long-term bookings, our bookings grew at a double-digit rate in Q3.

We had solid contributions this quarter from all key areas, including revenue cycle, federal, and our strategic growth businesses, which include population health, health networks, employer, consumer, data-as-a-service, and other adjacent markets.

Coming out of our health conference early this month, I had several positive takeaways. First, our clients are creating tremendous value with our solutions. Clients led over 200 presentations, education sessions and demonstrations where these accomplishments were shared with over 11,000 attendees.

They are committed to getting current and staying current, which is an important foundation for our longer-term shift to a single-instance cloud platform.

They are excited and enthusiastic about our collaboration with AWS and Amazon, our commitment to innovation and the vast opportunities that a cloud-enabled platform brings.

Finally, we heard positive feedback on our revenue cycle progress, and this sentiment is also reflected in our pipeline, which includes some large clients initiating the move to Cerner's revenue cycle.

I also wanted to share a noteworthy success story that demonstrates the benefits of changes we have made over the past 18 months to become more client centric.

This client is an academic system that had low satisfaction with their Cerner solutions just a couple of years ago. By turning our focus to getting them current on our latest software release and strong alignment with our model experience, they have become a top reference site with strong system performance and improved clinician productivity.

We are also in the process of converting 125 of their clinics from our primary competitor's system to Cerner. This demonstrates the value of our client-centric operating model with a focus on getting clients current, aligned with standards, and which helps make them successful and can drive broad levels of satisfaction and opportunities to expand our relationship.

Now, I'll provide an update on our federal business where we had a very busy quarter. We brought a wave of four sites live for DoD in September and expect the next wave of sites to go live in the fall of 2020.

We are also kicking off the Coast Guard project this quarter. For VA, we expect the initial operating capability go-live and the kick-off for additional waves to occur in the spring of 2020.

Before I close, I'd like to provide a little more color on the AbleVets acquisition that Marc mentioned. We believe bringing the AbleVets team on board will provide Cerner additional capacity and technical expertise that will be very valuable in the federal space.

As a trusted partner in our EHR modernization program with the VA, they are highly specialized in cybersecurity, agile engineering, analytics, technology enablement, with deep experience in delivering value to federal health clients.

As we prepare for the upcoming key milestones on our federal projects, integrating the AbleVets team into our business is a natural next step, as we expect their expertise will accelerate Cerner's success in providing integrated, seamless care for veterans, service members and their families.

With that, I'll turn the call back over to Don.

Donald Trigg

Thanks, John. Good afternoon, everyone.

We believe our vision to create a health network architecture for providers of care in every community will be realized in the coming decade. The addressable market is far larger than the integrated EMR category that Cerner helped to created and progress was made in the third quarter to lead it.

One of the strongest provider brands in healthcare is Pennsylvania-based Geisinger. They share our vision to architect a system of health and care. In Q3, Geisinger designated our EMR-agnostic HealtheIntent as their preferred health network platform for a 10-year term. They also will continue to leverage our Wellbeing application for member engagement within their health plan.

Market reaction has been quite favorable. Health systems are seeking solutions to help them scale growing health networks with high levels of technology heterogeneity and a shifting mix of employed and affiliated physicians. Cerner is well-positioned to meet that market need.

Beyond Geisinger, the emerging market reach of HealtheIntent can be seen in the recently released CMS data on Medicare shared savings ACO performance. CMS announced over $700 million in 2018 MSSP savings. After accounting for shared savings and losses, Cerner clients generating nearly more than $200 million of those savings via their MSSP ACOs. Advocate Physician Partners or APP, Hackensack Alliance and Memorial Hermann were among the top performers.

As long-term and post-acute care become an increasingly meaningful part of the health network, we also took steps in Q3 to strengthen our continuum of care strategy. We announced ResMed's Brightree home health product will be our go-forward market solution.

ResMed and Cerner also will use HealtheIntent as a health network platform for post-acute care assets. This strategy, coupled with condition and therapeutic-specific analytic opportunities in areas like sleep, give ResMed and Cerner the potential to build a category-leading presence in a post-acute market that we believe has significant momentum.

In the state government space, we extended a meaningful relationship in the third quarter with the Texas Department of Aging and Disability to bring a holistic care offering to Texas senior and disabled population.

It's a solid use case for how Cerner's extended care and behavioral health assets, our managed services, our proven history of innovation and our solid delivery record created a compelling win strategy.

We also announced an investment and partnership in the third quarter with i2i Systems. i2i commands 25% market share within the federally qualified health centers segment, covers nearly a third of all Medicaid patient data and has a strong payer business with 13 managed care clients.

The relationship already has delivered our first material win, a FQHC/community health network based in North Carolina. Cerner technology will help provide Medicaid recipients with care coordination and management across a state level network looking to tackle rising Medicaid costs.

Whether the financing model is Medicaid, Medicare Advantage or commercial insurance, we see the person at the center of any true health network architecture.

During Q3, we delivered a new version of our Wellbeing application. We also launched a consumer framework that delivers one seamless consumer experience for both our application as well as client-developed and 3rd party applications. As part of that overall strategy, we added consumer self-pay capabilities from Palo Alto-based Simplee and we also augmented our patient access and online scheduling capabilities through a partnership with Boston-based Kyruus.

Cerner's health network architecture vision has four core pillars: Automate the care process; connect the person; structure, store and study the data; and then close the loop by pushing those analytic insights back into the care process.

I believe our health network architecture vision is more relevant today than when it was first sketched for an MBA class in the 1990s. Our strategic urgency to advance it has never been greater, and the quarter just concluded was foundational for doing so.

With that, let me turn the call back to Brent.

Brent Shafer

Thanks a lot, Don. And thank you all for being on the call. As you heard from the team, we are continuing to execute against our targets and advance our strategies.

And just to summarize, our transformation work remains on track and is advancing beyond cost optimization to include broader structure and process changes and automation.

We are executing against opportunities in our core while also building pipeline and capabilities in our strategic growth areas.

And we are actively executing our portfolio management strategy and demonstrating increased willingness to partner when it accelerates opportunities and strengthens our capabilities.

In summary, I believe this represents solid progress on our pursuit of sustainable and profitable growth which I believe can be achieved while playing a key role in driving meaningful improvements in health care quality and efficiency.

Now, I'll turn the call over to the operator for questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions]. Our first question comes from the line of Steven Valiquette with Barclays. Your line is open.

Unidentified Participant

Hi. This is Jonathan Young on for Steve. I just had a question on the Adventist transition. I'm just curious if it has had any impact on future revenue opportunities. Or, I guess, what the client feedback that you're exiting al these Cerner relationships? And, I guess, to that extent, does it hurt future relationship opportunities where a client may want a one-stop shop type of vendor?

John Peterzalek

This is John Peterzalek. I don't think it hurts either our position or where we're trying to go because what we do is we try to align with the needs of our clients. And as those needs change and they result in something like we did with Adventist. So, as long as we have a good solid reason, explanation and the reason that that happened, it hasn't been an impact. So, we haven't got a tremendous amount of questions about it. And as this is one of the areas we're being more selective about, I think it's understood by our clients in terms of what we're doing. So, in the short term, it hasn't had any negative impact.

Marc Naughton

This is Marc. We talked about being selective, so that doesn't mean we're not going to do certain elements of that business, but we aren't going to do the full outsourcing. We're going to have all the bodies. We can still do tactical assistance to our clients often where they need help, but at margins that are attractive to us. So, when you still add that benefit to that client base without them saying, Cerner can't offer everything I need. So, I think – and we're seeing that in the marketplace.

Unidentified Participant

Okay. That makes sense. And then, I guess, as we kind of think about the top line revenue algorithm moving forward, how do you expect these exited businesses and future exits to change the top line dynamics? Will you guys end up leaning a bit more on acquisitions moving forward with respect to the 6% to 9% long-term revenue outlook?

Marc Naughton

Yeah, this is Marc. I think, clearly, as we're going through these optimization and restructuring efforts, there will be some level of resets at the top line as certainly we exit certain businesses and certain approaches to driving revenue. But I think if you look at the – M&A absolutely will be a component of how we look to grow the businesses. I think Don's comments really indicate that we have a lot of internal growth opportunities, some organic growth opportunities. By leveraging those with some M&A to make them go quicker and grow them more quickly, I think, is clearly one of our strategies. So, it's not going to be us just going out and acquiring revenue. It's going to be us investing in the business. And in some cases, that investment will be M&A and a business that can help us grow identified opportunity faster than if we do it organically.

Unidentified Participant

Okay, great. Thanks.

Operator

Thank you. Our next question comes from the line of David Lindley with Jefferies. Your line is open. Check to see if your phone is on mute.

David Windley

Thanks. Sorry about that. Thanks for taking my question. I wanted to follow-up on the portfolio review. Would it be possible to get a little bit more specific as you transition out of the Adventist relationship and revenue cycle, you have I think a remaining small revenue stream with some other revenue cycle services that you're providing. Does it still make sense to stay in that business? And then, I think at your recent – at THC and the analyst discussion, talked about kind of maybe the varying levels of scale and penetration that you might've achieved in some of your international markets. What are your thoughts about your persistency in international markets? Thanks.

Marc Naughton

Yeah. This is Marc. Clearly, the non-US market is still a huge opportunity and John can comment on that. I think, overall, we are still in the process and working through that portfolio review process. So, I don't want to talk a whole lot about the results of that until we're at a point where we've worked through it and can be more precise. Clearly, one of the things we've talked about for a while is being selective in some of these outsourcing opportunities. And the fact that we could work Adventist who is interested in taking back those associates, every Cerner associate that was working on Adventist now has a job with Adventist. So, all of those people are employed. So, that is a great result for them to take that over. It was consistent with the strategy they currently have, consistent with our strategies. But there are going to be a lot of opportunity. We're going to look at the remainder of that revenue cycle business. If it doesn't meet our selective criteria relative to margins, we're going to determine what needs to be done with that business. From a global perspective, we're going to look at the same lens. We're going to look at the operating margins, the opportunities we see and how we might address those markets in a more efficient method that can drive margins or we might not be driving them today. John, do you have additional comments on the global.

John Peterzalek

Yeah. I'm going to comment on the international market. I still remain incredibly optimistic and positive about the markets outside the US. In a couple of fronts, when we addressed a call or two ago, which there are large RFPs pending or about to be released for some statewide and municipalities and regional components out there that we're looking at pursuing, as well as our strategy of where we have embedded in a country the ability to expand beyond that first initial region or footprints and expand beyond. And both of those are playing out right now. Not to mention opportunities in countries where we've already embedded in, in Canada, UK, Europe, Middle East and Australia. So, outside US still remains a positive opportunity for us, so one we look at opportunities everyday there.

Brent Shafer

No, I was just going to say, just to go back to sort of the previous question on growth and the discussion around portfolio management, from a growth perspective, we're going to be looking at a combination of build by partner strategies, as Marc discussed. I think relevant to that, there's also a divest and partner component that's been a significant piece of how we've been thinking about the business. I think over the last 180 days, there's a good cadence there. Certainly, the decision we made last quarter to partner with GetWell from a myStation perspective which gives us a best-in-class offering there from an experience perspective and with their GetWell Loop asset and in this quarter with the decision around Home Health and the partnership with ResMed. So, I think we are running a process. We have selectively looked to make some decisions there and it's part of a framework that we see continuing into 2020 that will be part of how we position for growth long-term.

David Windley

Got it. Thank you. I'll cede the floor. Thanks.

Operator

Thank you. Our next question comes from the line of Donald Hooker with KeyBanc. Your line is open/

Donald Hooker

Okay, great. I'd love to hear maybe a little bit more elaboration on the ResMed partnership. Maybe kind of what they brought that you thought you could not do. And did you – I don't know if it's material, may not be, but roughly the size of the business that you had previously that you're, I guess, sunsetting. Can you talk about that and how that process will play out?

Brent Shafer

Sure. I'll do a little bit of high-level framing on how we thought about the relationship. So, I think first and foremost, we really like the macro trends playing out from an addressable market perspective in the postacute space. We think it's got interesting trend around it, particularly with large regional IDMs who are building out network strategies within their MSA. So, it's a space we like a lot and areas like behavioral health continue to be huge growth areas for us within the strategic growth business.

I think secondly, from a Home Health perspective, you'll recall that we acquired a solution in that space called BeyondNow. So, we we had an acquired solution in that area and we stepped back and looked at it and said, is this an area where we want to make significant investment? Or alternatively, is there a chance for us to partner? We like the Brightree solution offering. It's cloud-based. We think it's industry-leading. It has a very accelerated implementation timeline around it. And as I started the conversation with ResMed, we saw an opportunity for HealtheIntent to be a material network overlay around our postacute assets. And we also thought they brought some interesting sort of non-traditional assets from our perspective around areas like sleep and respiratory that could be very interesting for us as we play through our strategy on a five-year basis and start thinking about member and consumer strategies where that ends up being relevant around premium and first dollar risk strategies. So, that's how we thought about it at the decision tree level, if you will. And I can tell you, as John said, the reaction from Cerner Health Conference and from our early client conversations has been quite positive.

Marc Naughton

This is Marc. From an economic standpoint, it was not contributing a whole lot to revenue. We've not invested in the business significantly. The revenue was actually declining from that business. And by this agreement with ResMed, being able to get some additional dollar from HealtheIntent platforms and leveraging those elements, we actually expect that to turn and actually become a growth business for us, which it hadn't been. But today's contribution is very small. It's a blip on the radar today. And one of the reasons we want to take an action to turn that into something that would be a growth driver going forward.

Donald Hooker

Okay. And then, maybe with regard to the Amazon AWS relationship, how should we think about that juxtaposed against your hosting business over time? Like, how are you going to sort of balance kind of some of the overlap there?

Marc Naughton

Clearly, 80% of our clients are hosted today. First, AWS, there's a kind of strategy of when we're moving things there. HealtheIntent is going to be the first platform when we move there. It's a cloud developed solution that we host today. Very natural to move that over to AWS. And that's the first thing you're going to see move, and we'll have that primarily moved in the first half of next year.

The benefits of doing that are lower cost of operation from using a platform that I can buy on an as-needed basis, hour by hour as opposed to building out the maximum capacity I need at the height and having to provision for that in my data center.

It also allows me to take those data center components and space and rededicate them to projects such as the DoD and the VA, which is significant savings of capital as we roll forward.

So, relative to the hosting versus AWS, at a tactical level, it will drive efficiencies and drive up cost optimization as we move forward. We'll continue to move the platforms. CareAware will be the next platform we move over to AWS. And then, obviously, over time, then we start moving elements and components of Millennium over to that platform. But the first mover is going to be HealtheIntent, perfectly designed to go do that. We already have HealtheIntent running in AWS. All new clients we've had in the last two quarters have been brought up in AWS. So, it will be a very clean transition to go catch those benefits and the capital savings.

Donald Hooker

And real quick, could you say what the currency impact was for foreign revenues?

Brent Shafer

It was slightly negative.

Donald Hooker

Okay, thanks.

Operator

Thank you. Our next question comes from the line Stephanie Demko with Citi. Your line is open.

Stephanie Demko

Thank you. And thank you for taking my question, guys. So, I saw some improvement in free cash flow conversion in the quarter. And I was hoping you would kind of walk us through the puts and the takes there that will be impacting your go forward cash flow conversions, just given you have this move away from some of these lower margin outsourcing businesses, [indiscernible] project in AWS, all going online.

Marc Naughton

Yeah. I think as the business moves to more recurring nature – healthcare is really the challenging collection environment just because of the pace of play. Usually get paid, but it always takes longer to get paid than most businesses. That's why you're actually pretty happy when your DSO is 74 days. But I think as we continue to move and more toward these SaaS business models, toward the monthly payments, you start getting into a mode of where those checks will be more repetitive in nature, similar to our support checks that we get as we go through this business. Obviously, in our mind, as we move to those platforms, it is going to help our conversion, lower our DSO, lower the AR as we move forward. We are very happy with the free cash flow that we delivered this quarter. Very strong and want to replicate that again in Q4 to get us to a fairly good position for 2019. And then, just as a reminder, from overall free cash flow, we'll complete the work on our new campus in the first half of 2020, which will then start allowance for the loss, a lot of the expenditures that are being spent on that campus, adding potentially $100 million of free cash flow as we roll forward past that completion.

Stephanie Demko

Once all of these projects net out in second half of 2020 and beyond, how should we think about your long-term free cash flow conversion evolving?

Marc Naughton

Clearly, as we look forward to 2020 and 2021 and beyond, if you're looking kind of as a percent of adjusted net income, say, we're between 50% to 60% in 2019, we expect to be quickly aggregating that to – where you're getting to the – going from the 70s into certainly the mid-80s by the time you get into the kind of the end of the three or four year period. We're not going to be spending more money on buildings. That's clear. So, the cash flow, it's safe. And that will be part of our capital allocation analysis and certainly will help us, both as we look at opportunities to invest in M&A, to invest organically and to look at share repurchases.

Stephanie Demko

Right, thank you. Just one quick follow-up. What drove the backlog decline in the third quarter?

Marc Naughton

The backlog decline, obviously, the AAH contract that was is the backlog isn't in the backlog anymore. So, that was the biggest element.

Stephanie Demko

Got it. Thank you.

Operator

Thank you. Our next question comes from the line of George Hill with Deutsche Bank. Your line is open.

George Hill

Hey. Good afternoon, guys. And thanks for taking the question. I guess, Marc, are you able to – or will you quantify for us – you talked about the roll off of the Adventist business. I guess, can you quantify the total value if we think about it, like, on a 2019 basis of the works business that might roll off?

And then, I guess, as we think about the 2019 and the 2020 margin targets, how much should we think of as kind of the rolling off of the low-margin business versus the cost tackling initiatives the company is taking?

Marc Naughton

Yeah, George. We've been very clear that our focus on the margin expansion is focused on cost optimization and fit-for-growth efficiencies. But the top line impact may impact that one way or the other, but what we're focused on delivering is on the cost side. I think as you look at the AAH business, in Q4, it might be $25 million of revenue impact that's going away. So, that's a sense of what that number looks like. I think the – so, that will give you a kind of a sense for the total. But I think over the entire time, it's going to be someplace around $150 million, $100 million, someplace in that vicinity would be the annual impact. Once again, from an earnings impact, it's zero impact on the earnings side. And I think that's clearly one of the reasons or the reason we're looking to get out of that business. So, I think there will be some impact. Obviously, if you look at $25 million Q4, that might be 30 basis points of impact. But I think if you look at our guidance, we're kind of guiding to be in a 20-point-something, which kind of takes into account getting to 20 without the impact of that. But I think, once again, our focus is on driving the optimization cost. There will be some impact on top line relative to that, but our focus definitely is on the cost side of the business.

George Hill

That's helpful. And then, maybe just kind of as a follow-up, I think what a lot of investors are going to focus on is the Adventist is going to roll off to, call it, 150, 160. There's probably other business that rolls off. Thinking about the business that rolls off versus the M&A versus kind of what the company's longer-term top line targets which probably will need to be tweaked at the Investor Day, I guess stepping back, kind of – maybe just do you have a timeframe for when you'll wash through the businesses that you want to exit even if you don't want to quantify them. So, I guess, we can think of when the business re-bases and kind of construct your road back towards the company's long-term targets?

Marc Naughton

Good question. I think our goal through this portfolio management process is to make those decisions, identify those areas. And basically, as we exit 2020, we've got our base of revenue that we are expecting to deliver from and grow from going forward. And ideally, we'll be able to kind of keep investors in the loop as each of those decisions becomes public, what the impact of those is. Because, as you indicated, you have got an element of AAH is going away. But starting 2020, I've got an element of AbleVets that's coming in. Right now, there's going to be a lot of puts and takes. I can't give you with clarity when those are going to hit. But as we roll – get to the end, we start rolling into the 2020, we should be able to give you a better view of kind of the revenue that is in the bucket that we think is likely something that we're going to adjust out relative to portfolio management and the other things that we would expect to be able to bring in as we roll forward.

The point that you're getting to is really important is that 2020 will reset the base, our revenue number. And it's going to be at the – taking out low-margin revenue and bringing in big opportunities for growth and higher margin revenue. And once we get that kind of base reset, we absolutely will look to grow from that levels we've kind of consistently talked about in the past.

George Hill

Good stuff. All right, Marc. Thank you.

Marc Naughton

Sure.

Operator

Thank you. Our next question comes from the line of Sandy Draper with SunTrust. Your line is open.

Sandy Draper

Thanks very much. Maybe a follow-up on George's question. Marc, with the bulk of the revenue that you're – between AAH and other potential, is most of that going to show up in managed services or are there other revenue lines where that would show up? Just trying to make sure I'm thinking a little bit more near-term in terms of fine tuning the model.

Marc Naughton

Yeah, Sandy. As we go through the portfolio management process, some of those businesses impact all of the lines. And some of them aren't as high impact on the hosting side because there are some benefits. There are some businesses – if you look at our Home Health, that had nothing to do – small number, but it was more illustrative of solution sales and client revenue stream that we could turn into something that we saw as an opportunity. There will be other businesses that are more focused on shared services. And there will be other businesses that are just in areas that are kind of a full company complement of business models, but that we think they are in areas that we don't see the growth opportunity that we're going to go invest in them. So, I can't really give you today what business models are all going to fallout because there are a variety of business models that are going to be impacted. Ideally, as we get started working our way through 2020, we'll be able to give you something that lets get a little bit more of a sense of where those are going to hit.

George Hill

Okay, that's helpful. And then, a quick follow-up on support and maintenance. I missed what you said. I can't remember. Is there any 606, 605 issue that's impacting support and maintenance. Just remind me what it is that's caused support and maintenance to be flat to down this year. And do you think that starts to pick back up going forward? Thanks.

Marc Naughton

Yeah. Support and maintenance once again is really more tied to DHS [ph] clients that – basically, when we kind of did the acquisition were in flight or beginning to be inflight. We're starting to see those clients actually complete their contracts with Cerner and move on to a different platform. And that's offsetting the growth that you would see in the support stream normally. Once those kind of get fully embedded, which probably should be over the next 12 months or so, I think you're going to see going back to kind of low-single digit increases. But it's a very large number from a denominator perspective. But we should return to growth in that space, but there is going to be a near-term impact headwind to get through with some of those clients.

George Hill

Okay, thanks.

Operator

Thank you. Our next question comes from the line of Matthew Gillmor with Baird. Your line is open.

Matthew Gillmor

Thanks for the question. I wanted to ask about the federal bookings side. I was hoping to confirm that the VA or it's helped drive some of the upside to the 3Q bookings are towards the high end, I should say. Marc, can you give us a sense for what's embedded within the fourth quarter guidance with respect to VA bookings?

Marc Naughton

This is Marc. We don't talk about exactly what's in our guidance relative to a client specific characterization. I think from a bookings guidance perspective coming into this quarter, we certainly – there wasn't any large single transaction that we're looking to get from any one location. I think we had a good contribution from the federal business as is kind of expected given the end of the government fiscal year. So, I think that was a contribution. But given the percent of that business versus the total business, [indiscernible] that was the upside to our bookings. We had some other things that came into the larger number than we originally expected. So, I don't know that that was a source of us getting to the high end of the guidance range. It was pretty good performance across. John, I don't know if you have…

John Peterzalek

I'll start with – I was really happy with the Q3 results and I think the strong areas is where you would want to see them strong. So, revenue cycle, not RevWorks, but the actual revenue cycle solutions and those that surround it. We had a really solid quarter there, which also reflects the progress we've been making on revenue cycle. So, I think that's incredibly positive. Services were up, incredibly positive. And then, some of our strategic growth things that Don had mentioned in his components, whether they include population health, adjacencies and those type of things made a strong presence as well. I see that continuing. And I think it's where I want to see my bookings come from as well. It's because of what we've been focusing on. And then, we surround it with normal opportunities we have.

Matthew Gillmor

Got it. That's all I have. Thank you.

Operator

Thank you. Our next question comes from the line of Eric Percher with Nephron Research. Your line is open.

Eric Percher

Thank you. Marc, given what your – your commentary about growth and how much you need to work through in 2020, when we get to February, obviously, there will be a moment where we see what you've accomplished for 2019. As you think about the budget process for 2020 and what you'll be able to communicate for the year with all those moving parts, what does – what should we expect in terms of communication at that point?

Marc Naughton

Well, I think, obviously, in Q4 results, we'll talk to you about our guidance for 2020. As I indicated in my comments, the optimization work is going well. We are hitting our targets and that means that, for Q4, we feel good about delivering the 20% margin number that we talked about as Cerner's target. And as I did mention, based on the success that we're having and the fact that we're getting some of those benefits slightly earlier than we would've expected – had on the calendar to get to in 2020, it gives us a good feel for –

relative to the 22.5% that we laid out Q4 of 2020. So, I think from a cost optimization standpoint, we're right on track. As I indicated, on the revenue side, the business is – certainly, there are opportunities for us to look through the various elements of business and do the portfolio management work that we've talked about and look at M&A opportunities that can impact 2020. So, all that work is still to be done when we come out and are able to complete our 2020 plan and kind of share the highlights of that with you guys in the form of guidance as we do our Q4 call. I think that will be the next time we're able talk to you about that. But as I sit today, I feel pretty good about where we stand.

Eric Percher

Okay. And then, one follow-up question. As you get to phase two or three of getting to those margin targets, I think there's been some discussion of investment in tools that will help facilitate the process. Are those significant? Will they run through non-GAAP metrics? Will those weigh on you to some extent next year?

Marc Naughton

For the most part, next year would be primarily focused on implementation of those tools. For the most part, that implementation work will go through on the restructuring line. So, it won't impact our adjusted earnings.

Eric Percher

Okay, thank you.

Marc Naughton

Sure.

Operator

Thank you. Our next question comes from the line of Michael Cherny with Bank of America. Your line is open.

Michael Cherny

Good afternoon. Thanks for taking the questions. I guess, summarizing a lot of what you've said today, it seems to us, as you go through this portfolio rationalization, as you move towards the 2020 margin targets, I guess, how do you think about the balance of what should be contributed from somebody's potential exit? And if there are further exits of products or further wind down of some of this low-margin particularly services revenue, could we be viewing upside potential to that 4Q target? Or, I guess, what would drive the upside to the 4Q target if we were to see one? 4Q 2020.

Marc Naughton

Yeah. Once again in advance on 4Q 2020 other than expressing am I comfortable with the 22.5%, I would remind – restate that our focus is on the cost optimization to get to that 22.5%. So, depends on what the – the adjustments to revenue could change that number. Could impact that number. The AAH in Q4 could be a 30 basis point positive to it, but that's not – I'm not really taking that into consideration when I'm looking at my numbers, right? I'm looking at the cost optimization to drove to those margin targets. So, today, it's just too early for me to go tell you, hey, there's upside or there's downside. I'm focused on the 22.5% and focus on the cost drivers that I need to get to that number. So, I think at this point that's kind of all I can tell you. Hopefully, when we get to Q4 and can share our 2020 plan, guidance level, we'll be able to give you a little bit more specifics.

Brent Shafer

On the revenue cycle area, from a portfolio management perspective, as John said, the primary lens we have there is a significant whitespace opportunity in our client base and how we There is a significant whitespace opportunity and our client base and how we take advantage of a real growth opportunity for the business. So, that's our line of sight focus and how do we think about the total solution offering in terms of technologies and services required to go deliver that. And it's the best way to do that through an organic build, to partner or divest and partner strategy. So, I think that's the decision tree and the calculus and the process we're working through. But I think there's a big, big growth opportunity for us in the revenue cycle space. There's a lot for us to like about what's playing out there. It's got significant trend.

Marc Naughton

When you look at, clearly, at least in my mind, AAH, from a revenue divestiture standpoint, it is the largest by far. So, you're not see similar levels of businesses that we will be looking to get out of. Most of the others are going to be – they will be smaller than that and probably significantly smaller. So, relative to kind of your question, am I going to see the major change, that business alone is changing slightly, but the others will be smaller than that.

Michael Cherny

Thanks. And then, just one quick clarifications if I can. On the backlog adjustment, you mentioned how some that came from the change in the Adventist contract. It's obviously means we're higher in terms of – versus where the adjustments have been over the last few quarters. Should we think about that as the only adjustment that drives it meaningfully higher in terms of the backlog adjustment versus where it's been the last few quarters? Are there other kind of one-time items in there that drove some of the changes to the backlog?

Marc Naughton

That would be the major driver.

Michael Cherny

Okay, awesome. Thanks.

Operator

Thank you. Our next question comes from the line of Jamie Stockton with Wells Fargo. Your line is open.

Jamie Stockton

Thanks for taking my questions. I guess maybe two quick ones. Marc, the bookings commentary for Q4, I think you said, hey, I'm not going to have as many long-term oriented deals, deemphasizing some of that stuff. You also called out Adventist and like extensions of that RevWorks contract. I guess, my questions around that are, is that something that happened every year or you really just [indiscernible] because there was a big impact in Q4 of last year? And then, is there any way to think about the size of that, if it was every year?

Marc Naughton

Sure. This is Marc. The rhythm with them was we were – added one more year to the dealer every year. And that one more deal would have been given the revenue number we talked. It would have been a little bit higher than the revenue number based on other elements of it. So, [indiscernible] $200 million of bookings, that would've been on our radar when we started the year that are not going to be in Q4 this this year and would have been in Q4 last year as a direct apples-to-apples comparison. That's the key difference there. And it's just because it was every Q4, that number hit the bookings.

Jamie Stockton

Okay. And then, maybe just one more quick one. On pro services, I think you called out just implementation activity as a driver of the strength there during the quarter. Should we think about that as primarily centered around the government? I think John called out four DoD sites going live in September. And is it DoD at this point that we should be more focused on as the driver if it is government or is there already some VA starting to kick in at a healthy level?

John Peterzalek

Yeah. I'll answer it in a general term that, obviously, the DoD and the VA drive services through our model. But we also saw a very strong services in our optimization components. We have the get current, stay current component going on as we push our clients and with our clients to make sure they not only have the most current releases, but are aligned with our model solutions that we know that if you get aligned, you have a much better experience. All of those are components and drivers of our services, better business and of services that drive value to our clients. So, while the federal government, obviously, consumes services, it's not the only thing where we're seeing growth and upside.

Brent Shafer

And, clearly, the federal is helpful. The VA ways are going to start kicking off in the spring and there's work that's done prior to those getting kicked off. We've had a lot of interaction with the VA on our campus recently and I think that's getting all the training and things done. So, those will big – but as John said, it was the broad support of the professional services business was heartening because it does show the overall business is growing and that the government is contributing additional growth for that.

Brent Shafer

Hey, given the time, why don't we go ahead and stop the questions at this point. I thank everybody for their time. I know you've got other things to get on to. So, I look forward to talk to you soon. Thank you.

Operator

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect. Everyone, have a wonderful day.