ALLEGHENY TECHNOLOGIES INC
Form 10-Q
May 04, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended March 31, 2015
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 1-12001

ALLEGHENY TECHNOLOGIES INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	25-1792394 (I.R.S. Employer Identification No.)
1000 Six PPG Place Pittsburgh, Pennsylvania (Address of Principal Executive Offices)	15222-5479 (Zip Code)

(412) 394-2800
(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 ý No ¨
Indicate by check mark whether the Registrant 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 ý 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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer o (Do not check if a smaller reporting company)	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 ý

At April 24, 2015, the registrant had outstanding 109,215,499 shares of its Common Stock.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Allegheny Technologies Incorporated and Subsidiaries

Consolidated Balance Sheets

(In millions, except share and per share amounts)

(Current period unaudited)

	March 31, 2015	December 31, 2014
ASSETS		
Current Assets:		
Cash and cash equivalents	$238.0	$269.5
Accounts receivable, net of allowances for doubtful accounts of $4.8 as of March 31, 2015 and December 31, 2014	690.9	603.6
Inventories, net	1,472.6	1,472.8
Prepaid expenses and other current assets	64.1	136.2
Total Current Assets	2,465.6	2,482.1
Property, plant and equipment, net	2,943.7	2,961.8
Cost in excess of net assets acquired	777.9	780.4
Other assets	369.6	358.3
Total Assets	$6,556.8	$6,582.6
LIABILITIES AND EQUITY		
Current Liabilities:		
Accounts payable	$559.5	$556.7
Accrued liabilities	288.8	323.2
Deferred income taxes	70.8	62.2
Short term debt and current portion of long-term debt	17.9	17.8
Total Current Liabilities	937.0	959.9
Long-term debt	1,509.1	1,509.1
Accrued postretirement benefits	407.1	415.8
Pension liabilities	730.2	739.3
Deferred income taxes	91.3	80.9
Other long-term liabilities	162.0	156.2
Total Liabilities	3,836.7	3,861.2
Redeemable noncontrolling interest	12.1	12.1
Equity:		
ATI Stockholders' Equity:		
Preferred stock, par value $0.10: authorized-50,000,000 shares; issued-none	—	—
Common stock, par value $0.10: authorized-500,000,000 shares; issued-109,695,171 shares at March 31, 2015 and December 31, 2014; outstanding- 109,172,045 shares at March 31, 2015 and 108,710,914 shares at December 31, 2014	11.0	11.0
Additional paid-in capital	1,154.2	1,164.2
Retained earnings	2,382.4	2,398.9
Treasury stock: 523,126 shares at March 31, 2015 and 984,257 shares at December 31, 2014	(22.2)	(44.3)
Accumulated other comprehensive loss, net of tax	(930.8)	(931.4)
Total ATI stockholders' equity	2,594.6	2,598.4
Noncontrolling interests	113.4	110.9
Total Equity	2,708.0	2,709.3
Total Liabilities and Equity	$6,556.8	$6,582.6

The accompanying notes are an integral part of these statements.

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Allegheny Technologies Incorporated and Subsidiaries
Consolidated Statements of Operations
(In millions, except per share amounts)
(Unaudited)

	Three months ended March 31,	
	2015	2014
Sales	$1,125.5	$987.3
Costs and expenses:		
Cost of sales	1,016.0	917.1
Selling and administrative expenses	63.1	67.7
Income before interest, other income and income taxes	46.4	2.5
Interest expense, net	(26.7)	(29.1)
Other income, net	0.9	0.6
Income (loss) from continuing operations before income taxes	20.6	(26.0)
Income tax provision (benefit)	8.0	(10.0)
Income (loss) from continuing operations	12.6	(16.0)
Loss from discontinued operations, net of tax	—	(1.9)
Net income (loss)	12.6	(17.9)
Less: Net income attributable to noncontrolling interests	2.6	2.1
Net income (loss) attributable to ATI	$10.0	$(20.0)
Income (loss) per common share:		
Basic		
Continuing operations attributable to ATI per common share	$0.09	$(0.17)
Discontinued operations attributable to ATI per common share	—	(0.02)
Basic net income (loss) attributable to ATI per common share	$0.09	$(0.19)
Diluted		
Continuing operations attributable to ATI per common share	$0.09	$(0.17)
Discontinued operations attributable to ATI per common share	—	(0.02)
Diluted net income (loss) attributable to ATI per common share	$0.09	$(0.19)
Dividends declared per common share	$0.18	$0.18
Amounts attributable to ATI common stockholders:		
Income (loss) from continuing operations, net of tax	$10.0	$(18.1)
Loss from discontinued operations, net of tax	—	(1.9)
Net income (loss)	$10.0	$(20.0)

The accompanying notes are an integral part of these statements.

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Allegheny Technologies Incorporated and Subsidiaries
Consolidated Statements of Comprehensive Income
(In millions)
(Unaudited)

	Three months ended March 31,	
	2015	2014
Net income (loss)	$12.6	$(17.9)
Currency translation adjustment		
Unrealized net change arising during the period	(21.8)	(3.3)
Unrealized holding gain on securities		
Net gain (loss) arising during the period	—	—
Derivatives		
Net derivatives gain on hedge transactions	18.5	9.3
Reclassification to net income of net realized loss (gain)	(2.7)	2.1
Income taxes on derivative transactions	6.1	4.4
Total	9.7	7.0
Postretirement benefit plans		
Amortization of net actuarial loss	18.7	22.0
Prior service cost		
Amortization to net income of net prior service cost (credits)	1.5	(0.2)
Income taxes on postretirement benefit plans	7.7	8.4
Total	12.5	13.4
Other comprehensive income, net of tax	0.4	17.1
Comprehensive income (loss)	13.0	(0.8)
Less: Comprehensive income attributable to noncontrolling interests	2.4	0.2
Comprehensive income (loss) attributable to ATI	$10.6	$(1.0)

The accompanying notes are an integral part of these statements.

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Allegheny Technologies Incorporated and Subsidiaries
Consolidated Statements of Cash Flows
(In millions)
(Unaudited)

	Three months ended March 31,	
	2015	2014
Operating Activities:		
Net income (loss)	$12.6	$(17.9)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	45.6	44.0
Deferred taxes	5.0	(1.7)
Changes in operating asset and liabilities:		
Inventories	0.3	(82.6)
Accounts receivable	(87.3)	(28.6)
Accounts payable	2.7	45.9
Retirement benefits	2.5	4.2
Accrued income taxes	60.6	(10.9)
Accrued liabilities and other	(30.0)	(9.3)
Cash provided by (used in) operating activities	12.0	(56.9)
Investing Activities:		
Purchases of property, plant and equipment	(22.6)	(39.6)
Purchases of businesses, net of cash acquired	—	(71.1)
Asset disposals and other	0.1	1.8
Cash used in investing activities	(22.5)	(108.9)
Financing Activities:		
Payments on long-term debt and capital leases	(0.3)	(0.1)
Dividends paid to stockholders	(19.3)	(19.3)
Shares repurchased for income tax withholding on share-based compensation	(1.4)	(3.9)
Cash used in financing activities	(21.0)	(23.3)
Decrease in cash and cash equivalents	(31.5)	(189.1)
Cash and cash equivalents at beginning of period	269.5	1,026.8
Cash and cash equivalents at end of period	$238.0	$837.7

The accompanying notes are an integral part of these statements.

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Allegheny Technologies Incorporated and Subsidiaries
Statements of Changes in Consolidated Equity
(In millions, except per share amounts)
(Unaudited)

	ATI Stockholders						
	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interests	Total Equity
Balance, December 31, 2013	$11.0	$1,185.9	$2,490.1	$(79.6)	$ (713.2)	$100.5	$2,994.7
Net income (loss)	—	—	(20.0)	—	—	2.1	(17.9)
Other comprehensive income (loss)	—	—	—	—	18.9	(1.8)	17.1
Cash dividends on common stock ($0.18 per share)	—	—	(19.3)	—	—	—	(19.3)
Employee stock plans	—	(25.7)	(10.1)	28.3	—	—	(7.5)
Balance, March 31, 2014	$11.0	$1,160.2	$2,440.7	$(51.3)	$ (694.3)	$100.8	$2,967.1
Balance, December 31, 2014	$11.0	$1,164.2	$2,398.9	$(44.3)	$ (931.4)	$110.9	$2,709.3
Net income	—	—	10.0	—	—	2.6	12.6
Other comprehensive income (loss)	—	—	—	—	0.6	(0.2)	0.4
Cash dividends on common stock ($0.18 per share)	—	—	(19.3)	—	—	—	(19.3)
Redeemable noncontrolling interest	—	—	(0.1)	—	—	0.1	—
Employee stock plans	—	(10.0)	(7.1)	22.1	—	—	5.0
Balance, March 31, 2015	$11.0	$1,154.2	$2,382.4	$(22.2)	$ (930.8)	$113.4	$2,708.0

The accompanying notes are an integral part of these statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Unaudited
Note 1. Accounting Policies
The interim consolidated financial statements include the accounts of Allegheny Technologies Incorporated and its subsidiaries. Unless the context requires otherwise, “Allegheny Technologies”, “ATI” and “the Company” refer to Allegheny Technologies Incorporated and its subsidiaries.
These unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and note disclosures required by U.S. generally accepted accounting principles for complete financial statements. In management’s opinion, all adjustments (which include only normal recurring adjustments) considered necessary for a fair presentation have been included. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s 2014 Annual Report on Form 10-K. The results of operations for these interim periods are not necessarily indicative of the operating results for any future period. The December 31, 2014 financial information has been derived from the Company’s audited consolidated financial statements.
In 2013, the Company sold or announced closures of certain businesses that are reported as discontinued operations. Remaining closure activities were completed in 2014. Financial results for discontinued operations for the first quarter of 2014 were sales of $5.2 million, pretax losses of $2.8 million, and net assets of $2.9 million as of March 31, 2014.
New Accounting Pronouncements Adopted
In January 2015, the Company adopted changes issued by the Financial Accounting Standards Board (FASB) to the criteria for reporting discontinued operations. Under the new criteria, a disposal of a component of an entity is required to be reported as discontinued operations only if the disposal represents a strategic shift that has, or will have, a major effect on an entity’s operations and financial results. The criteria that there be no significant continuing involvement in the operations of the component after the disposal transaction has been removed under the new guidance. The new guidance also requires the presentation of the assets and liabilities of a disposal group that includes a discontinued operation for each comparative period and requires additional disclosures about discontinued operations, including the major line items constituting the pretax profit or loss of the discontinued operation, certain cash flow information for the discontinued operation, expanded disclosures about an entity’s significant continuing involvement in a discontinued operation, and disclosures about a disposal of an individually significant component of an entity that does not qualify for discontinued operations presentation. The provisions of the new guidance are effective for all disposals that occur for the Company beginning in fiscal year 2015. The adoption of these changes had no impact on the consolidated financial statements.
Pending Accounting Pronouncements

In April 2015, the FASB issued new guidance on presentation of debt issuance costs. This guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this guidance. This update will be effective for the Company beginning in fiscal year 2016, with early adoption permitted, and is applied on a retrospective basis. As of March 31, 2015 and December 31, 2014, the Company had $10.6 million and $10.9 million, respectively, of debt issuance costs reported as assets on the consolidated balance sheet that will be reclassified to a reduction of the carrying amount of the debt liability upon the Company’s adoption of this new guidance.

In May 2014, the FASB issued changes to revenue recognition with customers. This update provides a five-step analysis of transactions to determine when and how revenue is recognized. An entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This update will be effective for the Company beginning in fiscal year 2017. This update may be applied retrospectively to each prior reporting period presented or

retrospectively with the cumulative effect of initially applying this update recognized at the date of initial application. The Company is currently evaluating the impact of the new guidance on its consolidated financial statements.

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Note 2. Inventories

Inventories at March 31, 2015 and December 31, 2014 were as follows (in millions):

	March 31, 2015	December 31, 2014
Raw materials and supplies	$234.5	$249.3
Work-in-process	1,186.3	1,184.1
Finished goods	177.0	172.2
Total inventories at current cost	1,597.8	1,605.6
Adjustment from current cost to LIFO cost basis	4.3	4.8
Inventory valuation reserves	(66.4)	(68.8)
Progress payments	(63.1)	(68.8)
Total inventories, net	$1,472.6	$1,472.8

Inventories are stated at the lower of cost (last-in, first-out (“LIFO”), first-in, first-out (“FIFO”), and average cost methods) or market, less progress payments. Most of the Company’s inventory is valued utilizing the LIFO costing methodology. Inventory of the Company’s non-U.S. operations is valued using average cost or FIFO methods. The effect of using the LIFO methodology to value inventory, rather than FIFO, increased cost of sales by $0.5 million for the first three months of 2015, which was offset by a $0.5 million reduction in net realizable value reserves on the carrying value of LIFO-based inventory. The first three months of 2014 results included a $9.0 million increase in cost of sales from using the LIFO costing methodology, which was offset by a $9.0 million reduction in net realizable value reserves on the carrying value of LIFO-based inventory. The first three months of 2015 and 2014 results included $5.3 million and $8.3 million, respectively, in inventory valuation charges related to the market-based valuation of industrial titanium products in the Flat Rolled Products segment.

Note 3. Property, Plant and Equipment

Property, plant and equipment at March 31, 2015 and December 31, 2014 was as follows (in millions):

	March 31, 2015	December 31, 2014
Land	$30.0	$30.2
Buildings	1,053.1	1,048.9
Equipment and leasehold improvements	3,714.6	3,702.5
	4,797.7	4,781.6
Accumulated depreciation and amortization	(1,854.0)	(1,819.8)
Total property, plant and equipment, net	$2,943.7	$2,961.8

The construction in progress portion of property, plant and equipment at March 31, 2015 was $57.2 million.

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Note 4. Debt

Debt at March 31, 2015 and December 31, 2014 was as follows (in millions):

	March 31, 2015	December 31, 2014
Allegheny Technologies 5.875% Notes due 2023 (a)	$500.0	$500.0
Allegheny Technologies 5.95% Notes due 2021	500.0	500.0
Allegheny Technologies 9.375% Notes due 2019	350.0	350.0
Allegheny Ludlum 6.95% debentures due 2025	150.0	150.0
ATI Ladish Series B 6.14% Notes due 2016 (b)	11.7	11.9
ATI Ladish Series C 6.41% Notes due 2015 (c)	10.2	10.3
Domestic Bank Group $400 million credit facility	—	—
Foreign credit facilities	—	—
Industrial revenue bonds, due through 2020, and other	5.1	4.7
Total short-term and long-term debt	1,527.0	1,526.9
Short-term debt and current portion of long-term debt	17.9	17.8
Total long-term debt	$1,509.1	$1,509.1

(a) Bearing interest at 6.375% effective February 15, 2015.
(b) Includes fair value adjustments of $0.3 million at March 31, 2015 and $0.4 million at December 31, 2014.
(c) Includes fair value adjustments of $0.2 million at March 31, 2015 and $0.3 million at December 31, 2014.

During the first quarter of 2015, Standard & Poor's ("S&P") downgraded the Company's credit rating one notch to BB+ from BBB-, resulting in an increase of the interest rate on the Senior Notes due 2023 (the "2023 Notes") from 6.125% as of December 31, 2014 to 6.375% effective with the interest period beginning February 15, 2015. Future downgrades of the Company's credit ratings could result in additional increases to the interest cost with respect to the 2023 Notes.
There were no outstanding borrowings made under the Company's $400 million senior domestic credit facility ("credit facility") expiring May 31, 2018 as of March 31, 2015, although approximately $4.7 million has been utilized to support the issuance of letters of credit. Average borrowings under the credit facility for the first quarter of 2015 were $73.7 million, bearing an average annual interest rate of 1.9%. The credit facility provides for a springing lien on certain of the Company's accounts receivable and inventory. This springing lien became effective during the first quarter of 2015 as the Company's credit ratings from both S&P's and Moody's are now below investment grade following S&P's downgrade in the first quarter 2015 discussed above. This springing lien will be subsequently released if the Company's credit rating returns to investment grade from either rating agency, assuming no event of default condition exists. The credit facility requires the Company to maintain a leverage ratio (measured as consolidated total indebtedness net of cash on hand in excess of $50 million, divided by consolidated EBITDA, defined as earnings before interest, taxes, depreciation and amortization, and non-cash pension expense, with the definition of consolidated EBIT excluding any gain or loss attributable to sale or other dispositions of assets outside the ordinary course of business, for the four prior fiscal quarters) of not greater than 5.00 for the quarter ended March 31, 2015, 4.50 for the quarter ended June 30, 2015, 3.75 for the quarter ended September 30, 2015, and 3.50 for the quarter ended December 31, 2015 and for each fiscal quarter thereafter. The credit facility also requires the Company to maintain an interest coverage ratio (consolidated EBITDA as calculated for the leverage ratio, divided by interest expense) of not less than 2.50 for the quarter ended March 31, 2015, 3.00 for the quarter ended June 30, 2015, 3.25 for the quarter ended September 30, 2015, and 3.50 for the quarter ended December 31, 2015 and for each fiscal quarter thereafter. At March 31, 2015, the leverage ratio was 3.73 and the interest coverage ratio was 3.26. The Company was in compliance with these required ratios during all applicable periods.
The Company has an additional separate credit facility for the issuance of letters of credit. As of March 31, 2015, $32 million in letters of credit were outstanding under this facility.
In addition, Shanghai STAL Precision Stainless Steel Company Limited (STAL), the Company's Chinese joint venture company in which ATI has a 60% interest, entered into a 125 million renminbi (approximately $20 million at

March 31, 2015 exchange rates) revolving credit facility in April 2015, replacing a previous revolving credit facility that expired in 2014. Borrowings may be either in renminbi or U.S. dollars, with interest rates based on published Chinese or U.S. interbank offer rates, respectively. The credit facility is supported solely by STAL's financial capability without any guarantees from the joint

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venture partners. The credit facility requires STAL to maintain a minimum level of shareholders' equity, and certain financial ratios.

The ATI Ladish Series B and Series C Notes are guaranteed by ATI and are equally ranked with all of ATI's existing and future senior unsecured debt.

Note 5. Derivative Financial Instruments and Hedging

As part of its risk management strategy, the Company, from time-to-time, utilizes derivative financial instruments to manage its exposure to changes in raw material prices, energy costs, foreign currencies, and interest rates. In accordance with applicable accounting standards, the Company accounts for most of these contracts as hedges. In general, hedge effectiveness is determined by examining the relationship between offsetting changes in fair value or cash flows attributable to the item being hedged, and the financial instrument being used for the hedge. Effectiveness is measured utilizing regression analysis and other techniques to determine whether the change in the fair market value or cash flows of the derivative exceeds the change in fair value or cash flow of the hedged item. Calculated ineffectiveness, if any, is immediately recognized in the consolidated statements of operations.

The Company sometimes uses futures and swap contracts to manage exposure to changes in prices for forecasted purchases of raw materials, such as nickel, and natural gas. Under these contracts, which are generally accounted for as cash flow hedges, the price of the item being hedged is fixed at the time that the contract is entered into and the Company is obligated to make or receive a payment equal to the net change between this fixed price and the market price at the date the contract matures.

The majority of ATI's products are sold utilizing raw material surcharges and index mechanisms. However, as of March 31, 2015, the Company had entered into financial hedging arrangements, primarily at the request of its customers, related to firm orders, for an aggregate notional amount of approximately 20% of its estimated annual nickel requirements. These nickel hedges extend to 2020.

At March 31, 2015, the outstanding financial derivatives used to hedge the Company's exposure to energy cost volatility included natural gas cost hedges for approximately 80% of its annual forecasted domestic requirements for 2015, approximately 75% for 2016, and approximately 45% for 2017.

While the majority of the Company's direct export sales are transacted in U.S. dollars, foreign currency exchange contracts are used, from time-to-time, to limit transactional exposure to changes in currency exchange rates for those transactions denominated in a non-U.S. currency. The Company sometimes purchases foreign currency forward contracts that permit it to sell specified amounts of foreign currencies expected to be received from its export sales for pre-established U.S. dollar amounts at specified dates. The forward contracts are denominated in the same foreign currencies in which export sales are denominated. These contracts are designated as hedges of the variability in cash flows of a portion of the forecasted future export sales transactions which otherwise would expose the Company to foreign currency risk, primarily euros. At March 31, 2015, the Company held euro forward sales contracts designated as hedges with a notional value of approximately 375 million euro with maturity dates through February 2018, including approximately 157 million euro with maturities in 2015. In addition, the Company may also designate cash balances held in foreign currencies as hedges of forecasted foreign currency transactions.

During the first quarter of 2015, the Company net settled 126.5 million euro notional value of foreign currency forward contracts designated as cash flow hedges with 2015 maturity dates, receiving cash proceeds of $26.1 million which is reported in cash provided by operating activities on the consolidated cash flow statement. Deferred gains on these settled cash flow hedges currently recognized in accumulated other comprehensive income will be reclassified to earnings when the underlying transactions occur. The Company subsequently entered into 115 million euro notional value of foreign currency forward contracts designated as fair value hedges in the first quarter of 2015, all with 2015 maturity dates, and recorded a $5.0 million benefit in costs of sales on the consolidated statement of operations in the first quarter of 2015 for subsequent mark-to-market changes on these fair value hedges.

The Company may enter into derivative interest rate contracts to maintain a reasonable balance between fixed- and floating-rate debt. There were no unsettled derivative financial instruments related to debt balances for the periods presented.

There are no credit risk-related contingent features in the Company's derivative contracts, and the contracts contained no provisions under which the Company has posted, or would be required to post, collateral. The counterparties to the

Company's derivative contracts are substantial and creditworthy commercial banks that are recognized market makers. The Company controls its credit exposure by diversifying across multiple counterparties and by monitoring credit ratings and credit default swap spreads of its counterparties. The Company also enters into master netting agreements with counterparties when possible.

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The fair values of the Company's derivative financial instruments are presented below, representing the gross amounts recognized which are not offset by counterparty or by type of item hedged. All fair values for these derivatives were measured using Level 2 information as defined by the accounting standard hierarchy, which includes quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs derived principally from or corroborated by observable market data.

(In millions) Asset derivatives	Balance sheet location	March 31, 2015	December 31, 2014
Derivatives designated as hedging instruments:			
Foreign exchange contracts	Prepaid expenses and other current assets	$23.1	$23.6
Nickel and other raw material contracts	Prepaid expenses and other current assets	—	1.1
Foreign exchange contracts	Other assets	46.0	28.3
Nickel and other raw material contracts	Other assets	—	0.5
Total derivatives designated as hedging instruments		69.1	53.5
Derivatives not designated as hedging instruments:			
Foreign exchange contracts	Prepaid expenses and other current assets	—	6.4
Total derivatives not designated as hedging instruments		—	6.4
Total asset derivatives		$69.1	$59.9
Liability derivatives	Balance sheet location		
Derivatives designated as hedging instruments:			
Natural gas contracts	Accrued liabilities	$12.1	$10.2
Nickel and other raw material contracts	Accrued liabilities	9.9	5.8
Electricity contracts	Accrued liabilities	—	0.1
Natural gas contracts	Other long-term liabilities	11.8	7.9
Nickel and other raw material contracts	Other long-term liabilities	9.4	3.0
Total derivatives designated as hedging instruments		43.2	27.0
Derivatives not designated as hedging instruments:			
Foreign exchange contracts	Accrued liabilities	0.4	—
Total derivatives not designated as hedging instruments		0.4	—
Total liability derivatives		$43.6	$27.0

For derivative financial instruments that are designated as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income (OCI) and reclassified into earnings in the same period or periods during which the hedged item affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current period results. For derivative financial instruments that are designated as fair value hedges, changes in the fair value of these derivatives are recognized in current period results. The Company did not use net investment hedges for the periods presented. The effects of derivative instruments in the tables below are presented net of related income taxes.

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Activity with regard to derivatives designated as cash flow hedges for the three month periods ended March 31, 2015 and 2014 was as follows (in millions):

Derivatives in Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)		Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) (a)		Amount of Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing) (b)	
	Three months ended March 31,		Three months ended March 31,		Three months ended March 31,	
	2015	2014	2015	2014	2015	2014
Nickel and other raw material contracts	$(9.6)	$3.0	$(2.2)	$(1.7)	$—	$—
Natural gas contracts	(6.0)	2.3	(2.4)	1.4	—	—
Electricity contracts	—	0.9	(0.1)	0.4	—	—
Foreign exchange contracts	27.0	(0.5)	6.4	(1.4)	—	—
Total	$11.4	$5.7	$1.7	$(1.3)	$—	$—

(a) The gains (losses) reclassified from accumulated OCI into income related to the effective portion of the derivatives are presented in cost of sales in the same period or periods in which the hedged item affects earnings.

(b) The gains (losses) recognized in income on derivatives related to the ineffective portion and the amount excluded from effectiveness testing are presented in selling and administrative expenses.

Assuming market prices remain constant with those at March 31, 2015, a gain of $0.7 million is expected to be recognized over the next 12 months.

The disclosures of gains or losses presented above for nickel and other raw material contracts and foreign currency contracts do not take into account the anticipated underlying transactions. Since these derivative contracts represent hedges, the net effect of any gain or loss on results of operations may be fully or partially offset.

During the first quarter of 2015, the Company net settled 40.3 million euro notional value of foreign currency forward contracts that were not designated as hedges, receiving cash proceeds of $11.8 million which is reported in cash provided by operating activities on the consolidated cash flow statement. The Company also entered into 30 million euro notional value of foreign currency forward contracts not designated as hedges in the first quarter of 2015 with maturity dates through February 2016.

Derivatives that are not designated as hedging instruments were as follows:

(In millions) Derivatives Not Designated as Hedging Instruments	Amount of Gain (Loss) Recognized in Income on Derivatives Three months ended March 31,	
	2015	2014
Foreign exchange contracts	$3.5	$0.2

Changes in the fair value of foreign exchange contract derivatives not designated as hedging instruments are recorded in cost of sales.

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Note 6. Fair Value of Financial Instruments

The estimated fair value of financial instruments at March 31, 2015 was as follows:

(In millions)	Total Carrying Amount	Fair Value Measurements at Reporting Date Using		
		Total Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets(Level 1)	Significant Observable Inputs (Level 2)
Cash and cash equivalents	$238.0	$238.0	$238.0	$—
Derivative financial instruments:				
Assets	69.1	69.1	—	69.1
Liabilities	43.6	43.6	—	43.6
Debt	1,527.0	1,679.6	1,652.6	27.0

The estimated fair value of financial instruments at December 31, 2014 was as follows:

(In millions)	Total Carrying Amount	Fair Value Measurements at Reporting Date Using		
		Total Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)
Cash and cash equivalents	$269.5	$269.5	$269.5	$—
Derivative financial instruments:				
Assets	59.9	59.9	—	59.9
Liabilities	27.0	27.0	—	27.0
Debt	1,526.9	1,616.0	1,589.1	26.9

In accordance with accounting standards, fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Accounting standards established three levels of a fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. No transfers between levels were reported in 2015 or 2014.

The following methods and assumptions were used by the Company in estimating the fair value of its financial instruments:

Cash and cash equivalents: Fair value was determined using Level 1 information.

Derivative financial instruments: Fair values for derivatives were measured using exchange-traded prices for the hedged items. The fair value was determined using Level 2 information, including consideration of counterparty risk and the Company’s credit risk.
Short-term and long-term debt: The fair values of the Company’s publicly traded debt were based on Level 1 information. The fair values of the other short-term and long-term debt were determined using Level 2 information.

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Note 7. Pension Plans and Other Postretirement Benefits

The Company has defined benefit pension plans or defined contribution plans covering substantially all employees. Benefits under the defined benefit pension plans are generally based on years of service and/or final average pay. The Company funds the U.S. pension plans in accordance with the Employee Retirement Income Security Act of 1974, as amended, and the Internal Revenue Code.

The Company also sponsors several postretirement plans covering certain salaried and hourly employees. The plans provide health care and life insurance benefits for eligible retirees. In most plans, Company contributions towards premiums are capped based on the cost as of a certain date, thereby creating a defined contribution. For the non-collectively bargained plans, the Company maintains the right to amend or terminate the plans at its discretion.

For the three month periods ended March 31, 2015 and 2014, the components of pension expense and components of other postretirement benefit expense for the Company's defined benefit plans included the following (in millions):

	Pension Benefits		Other Postretirement Benefits	
	Three months ended March 31,		Three months ended March 31,	
	2015	2014	2015	2014
Service cost - benefits earned during the year	$5.7	$7.4	$0.7	$0.7
Interest cost on benefits earned in prior years	30.3	33.4	4.5	6.0
Expected return on plan assets	(42.1)	(46.1)	—	—
Amortization of prior service cost (credit)	0.3	0.6	1.2	(0.8)
Amortization of net actuarial loss	15.1	18.5	3.6	3.5
Total retirement benefit expense	$9.3	$13.8	$10.0	$9.4

Other postretirement benefit costs for a defined contribution plan were $0.7 million for the three months ended March 31, 2014.

Note 8. Income Taxes

First quarter 2015 results included a provision for income taxes of $8.0 million, or 38.8% of income from continuing operations before income tax, compared to a benefit of $10.0 million, or 38.5% of loss from continuing operations before income tax, for the 2014 comparable period. The income tax rate in 2015 is higher than normal due to the Company's inability to use the federal domestic manufacturing deduction tax benefit due to net operating loss carryforwards. A federal income tax refund of $59.9 million was received in the first quarter of 2015. Income taxes in the first quarter 2014 included discrete tax benefits of $2.2 million primarily associated with adjustments to prior years' and foreign taxes.

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Note 9. Business Segments

The Company operates in two business segments: High Performance Materials & Components and Flat Rolled Products. The measure of segment operating profit, which is used to analyze the performance and results of the business segments, excludes income taxes, corporate expenses, net interest expense, retirement benefit expense, closed company expenses and restructuring costs, if any. Discontinued operations are also excluded. Management believes segment operating profit, as defined, provides an appropriate measure of controllable operating results at the business segment level. Following is certain financial information with respect to the Company's business segments for the periods indicated (in millions):

	Three months ended March 31,	
	2015	2014
Total sales:		
High Performance Materials & Components	$564.9	$504.1
Flat Rolled Products	604.7	529.6
	1,169.6	1,033.7
Intersegment sales:		
High Performance Materials & Components	22.1	19.7
Flat Rolled Products	22.0	26.7
	44.1	46.4
Sales to external customers:		
High Performance Materials & Components	542.8	484.4
Flat Rolled Products	582.7	502.9
	$1,125.5	$987.3
Operating profit (loss):		
High Performance Materials & Components	$75.9	$69.1
Flat Rolled Products	7.9	(25.6)
Total operating profit	83.8	43.5
Corporate expenses	(11.8)	(11.5)
Interest expense, net	(26.7)	(29.1)
Closed company and other expenses	(5.4)	(5.0)
Retirement benefit expense	(19.3)	(23.9)
Income (loss) from continuing operations before income taxes	$20.6	$(26.0)

Retirement benefit expense represents defined benefit pension expense and other postretirement benefit expense for both defined benefit and defined contribution plans. Operating profit with respect to the Company's business segments excludes any retirement benefit expense. Costs associated with multiemployer pension plans are included in segment operating profit, and costs associated with defined contribution retirement plans are included in segment operating profit or corporate expenses, as applicable.

Interest expense, net of interest income, in the first quarter 2015 was $26.7 million, compared to net interest expense of $29.1 million in the first quarter 2014. The decrease in interest expense was primarily due to lower debt levels. Interest expense benefited from the capitalization of interest costs of $0.6 million in the first quarter 2015 compared to $2.3 million in the first quarter 2014. The decrease in capitalized interest primarily related to the Flat Rolled Products segment Hot-Rolling and Processing Facility.

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Note 10. Redeemable Noncontrolling Interest

The holders of the 15% noncontrolling interest in ATI Flowform Products have a put option to require the Company to purchase their equity interest at a redemption value determinable from a specified formula based on a multiple of EBITDA (subject to a fixed minimum linked to the original acquisition date value). The put option is fully exercisable beginning in the second quarter of 2017, and is also exercisable under certain other circumstances. The put option cannot be separated from the noncontrolling interest, and the combination of a noncontrolling interest and the redemption feature requires classification as redeemable noncontrolling interest in the consolidated balance sheet, separate from Stockholders' Equity.

The carrying amount of the redeemable noncontrolling interest approximates its maximum redemption value. Any subsequent change in maximum redemption value is adjusted through retained earnings. The adjustment to the carrying amount for the quarter ended March 31, 2015 reduced retained earnings by $0.1 million. The Company applied the two-class method of calculating earnings per share, and as such this adjustment to the carrying amount was reflected in earnings per share. The redeemable noncontrolling interest was $12.1 million as of March 31, 2015 and December 31, 2014, which was unchanged from the acquisition date value.

Note 11. Per Share Information

The following table sets forth the computation of basic and diluted income from continuing operations per common share:

(In millions, except per share amounts)	Three Months Ended March 31, 2015	2014
Numerator for basic income (loss) from continuing operations per common share –		
Income (loss) from continuing operations attributable to ATI	$10.0	$(18.1)
Redeemable noncontrolling interest (Note 10)	(0.1)	—
Numerator for diluted income (loss) from continuing operations per common share –		
Income (loss) from continuing operations available to ATI after assumed conversions	$9.9	$(18.1)
Denominator for basic net income (loss) per common share-weighted average shares	107.2	107.0
Effect of dilutive securities:		
Share-based compensation	0.8	—
4.25% Convertible Notes due 2014	—	—
Denominator for diluted net income (loss) per common share – adjusted weighted average shares assuming conversions	108.0	107.0
Basic income (loss) from continuing operations attributable to ATI per common share	$0.09	$(0.17)
Diluted income (loss) from continuing operations attributable to ATI per common share	$0.09	$(0.17)

Common stock that would be issuable upon the assumed conversion of the 2014 Convertible Notes (prior to maturity on June 2, 2014) and other option equivalents and contingently issuable shares are excluded from the computation of contingently issuable shares, and therefore, from the denominator for diluted earnings per share, if the effect of inclusion is anti-dilutive. There were no anti-dilutive shares for the three month period ended March 31, 2015 and 10.0 million anti-dilutive shares for the three month period ended March 31, 2014.

Note 12. Financial Information for Subsidiary and Guarantor Parent

The payment obligations under the $150 million 6.95% debentures due 2025 issued by Allegheny Ludlum, LLC (the "Subsidiary") are fully and unconditionally guaranteed by Allegheny Technologies Incorporated (the "Guarantor Parent"). In accordance with positions established by the Securities and Exchange Commission, the following financial information sets forth separately financial information with respect to the Subsidiary, the Non-guarantor Subsidiaries and the Guarantor Parent. The principal elimination entries eliminate investments in subsidiaries and certain intercompany balances and transactions.

ATI is the plan sponsor for the U.S. qualified defined benefit pension plan (the "Plan") which covers certain current and former employees of the Subsidiary and the Non-guarantor Subsidiaries. As a result, the balance sheets presented for the Subsidiary and the Non-guarantor Subsidiaries do not include any Plan assets or liabilities, or the related deferred taxes. The Plan assets, liabilities and related deferred taxes and pension income or expense are recognized by the

Guarantor Parent. Management and royalty fees charged to the Subsidiary and to the Non-guarantor Subsidiaries by the Guarantor Parent have been excluded solely for purposes of this presentation.

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Allegheny Technologies Incorporated
Financial Information for Subsidiary and Guarantor Parent
Balance Sheets
March 31, 2015

(In millions)	Guarantor Parent	Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Assets:					
Cash and cash equivalents	$2.5	$12.0	$223.5	$—	$238.0
Accounts receivable, net	0.1	222.4	468.4	—	690.9
Intercompany notes receivable	—	—	2,367.9	(2,367.9)	—
Inventories, net	—	399.6	1,073.0	—	1,472.6
Prepaid expenses and other current assets	3.0	8.9	52.2	—	64.1
Total current assets	5.6	642.9	4,185.0	(2,367.9)	2,465.6
Property, plant and equipment, net	2.5	1,544.9	1,396.3	—	2,943.7
Cost in excess of net assets acquired	—	126.6	651.3	—	777.9
Intercompany notes receivable	—	—	200.0	(200.0)	—
Investment in subsidiaries	6,149.2	37.7	—	(6,186.9)	—
Other assets	23.5	27.7	318.4	—	369.6
Total assets	$6,180.8	$2,379.8	$6,751.0	$(8,754.8)	$6,556.8
Liabilities and stockholders' equity:					
Accounts payable	$2.8	$336.9	$219.8	$—	$559.5
Accrued liabilities	31.7	60.3	196.8	—	288.8
Intercompany notes payable	1,179.0	1,188.9	—	(2,367.9)	—
Deferred income taxes	70.8	—	) (300)		
Amounts charged against earnings, before income tax benefit	$21,416	$20,447	$40,782	$36,904	
Amount of related income tax benefit recognized in earnings	$6,793	$6,664	$12,748	$12,197	

Treasury Stock

In March 2016, our Board of Directors authorized a share repurchase program that allows the Company to repurchase shares of our common stock up to $300 million, excluding transaction costs. The repurchases are to be effectuated in the open market, by block purchase, or possibly through other transactions managed by broker-dealers. No time limit was set for completion of the program.

During the six months ended July 2, 2016, we repurchased 3.7 million shares for consideration of $200 million. These shares were recorded as treasury stock and accounted for under the cost method. No repurchased shares have been retired. At July 2, 2016, $100 million remains available for repurchase under the program.

(9) Contingencies

We accrue estimates for resolution of any legal and other contingencies when losses are probable and estimable, in accordance with ASC 450, 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 judgments or settlements to third parties related to these indemnification provisions pertaining to 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.

In addition to commitments and obligations in the ordinary course of business, we are subject to various legal proceedings and claims, including for example, employment disputes and litigation alleging solution defects, personal injury, intellectual property infringement, violations of law and breaches of contract and warranties. Many of these proceedings are at preliminary stages and many seek an indeterminate amount of damages.

No less than quarterly, we review the status of each significant matter and assess our potential financial exposure. We accrue a liability for an estimated loss if the potential loss from any legal proceeding or claim is considered probable and the amount can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether the amount of an exposure is reasonably estimable, and accruals are based only on the information available to our management at the time the judgment is made. Furthermore, the outcome of legal proceedings is inherently uncertain, and we may incur substantial defense costs and expenses defending any of these matters. Should any one or a combination of more than one of these proceedings be successful, or should we determine to settle any or a combination of these matters, we may be required to pay substantial sums, become subject to the entry of an injunction or be forced to change the manner in which we operate our business, which could have a material adverse impact on our business, results of operations or financial condition.

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(10) 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, expenses associated with our managed services business, marketing expenses, communications expenses and unreimbursed travel expenses. "Other" includes expenses that have not been allocated to the operating segments, such as software development, general and administrative expenses, acquisition costs and related adjustments, share-based compensation expense, and certain amortization and depreciation. Performance of the segments is assessed at the operating earnings level by our chief operating decision maker, who is our Chief Executive Officer. 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 six months ended July 2, 2016 and July 4, 2015:

(In thousands)	Domestic	Global	Other	Total
Three Months Ended 2016				
Revenues	$1,072,564	$143,398	$—	$1,215,962
Cost of revenues	177,510	28,046	—	205,556
Operating expenses	432,468	64,523	272,103	769,094
Total costs and expenses	609,978	92,569	272,103	974,650
Operating earnings (loss)	$462,586	$50,829	$(272,103)	$241,312

(In thousands)	Domestic	Global	Other	Total
Three Months Ended 2015				
Revenues	$994,746	$131,251	$—	$1,125,997
Cost of revenues	168,189	24,133	—	192,322
Operating expenses	393,305	59,827	308,807	761,939
Total costs and expenses	561,494	83,960	308,807	954,261
Operating earnings (loss)	$433,252	$47,291	$(308,807)	$171,736

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(In thousands)	Domestic	Global	Other	Total
Six Months Ended 2016				
Revenues	$2,077,529	$276,568	$—	$2,354,097
Cost of revenues	326,779	54,370	—	381,149
Operating expenses	858,027	123,394	534,767	1,516,188
Total costs and expenses	1,184,806	177,764	534,767	1,897,337
Operating earnings (loss)	$892,723	$98,804	$(534,767)	$456,760

(In thousands)	Domestic	Global	Other	Total
Six Months Ended 2015				
Revenues	$1,865,253	$256,833	$—	$2,122,086
Cost of revenues	310,906	50,076	—	360,982
Operating expenses	754,391	110,398	557,667	1,422,456
Total costs and expenses	1,065,297	160,474	557,667	1,783,438
Operating earnings (loss)	$799,956	$96,359	$(557,667)	$338,648

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following Management Discussion and Analysis (MD&A) is intended to help the reader understand the results of operations and financial condition of Cerner Corporation (Cerner, the Company, we, us or our). This MD&A is provided as a supplement to, and should be read in conjunction with, our financial statements and the accompanying notes to the financial statements (Notes) found above.

The 2016 and 2015 second quarters ended on July 2, 2016 and July 4, 2015, respectively. All references to years in this MD&A represent the respective three or six months ended on such dates, unless otherwise noted.

Except for the historical information and discussions contained herein, statements contained in this quarterly report on Form 10-Q may constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended (the Exchange Act). Forward-looking statements are based on the current beliefs, expectations and assumptions of Cerner's management with respect to future events and are subject to a number of significant risks and uncertainties. It is important to note that Cerner's performance, and actual results, financial condition or business could differ materially from those expressed in such forward-looking statements. These statements can often be identified by the use of forward-looking terminology, such as "could," "should," "will," "intended," "continue," "believe," "may," "expect," "hope," "anticipate," "goal," "forecast," "plan," "guidance," "opportunity," "prospects" or "estimate" or the negative of these words, variations thereof or similar expressions. These statements involve a number of risks, uncertainties and other factors that could cause actual results to differ materially, including without limitation: the possibility of product-related liabilities; potential claims for system errors and warranties; the possibility of interruption at our data centers or client support facilities; the possibility of increased expenses, exposure to claims and regulatory actions and reputational harm associated with a cyberattack or other breach in our IT security; our proprietary technology may be subject to claims for infringement or misappropriation of intellectual property rights of others, or may be infringed or misappropriated by others; material adverse resolution of legal proceedings; risks associated with our global operations; risks associated with fluctuations in foreign currency exchange rates; the potential for tax legislation initiatives that could adversely affect our tax position and/or challenges to our tax positions in the U.S. and non-U.S. countries; risks associated with our recruitment and retention of key personnel; risks related to our dependence on third party suppliers; difficulties and operational and financial risks associated with successfully completing the integration of the Cerner Health Services (formerly Siemens Health Services) business into our business or the failure to realize the synergies and other benefits expected from the acquisition; risks inherent with business acquisitions and combinations and the integration thereof; the potential for losses resulting from asset impairment charges; risks associated with volatility and disruption resulting from global economic or market conditions; managing growth in the new markets in which we offer solutions, health care devices and services; continuing to incur significant expenses relating to the integration of the Cerner Health Services (formerly Siemens Health Services) business into Cerner; risks inherent in contracting with government clients; risks associated with our outstanding and future indebtedness, such as compliance with restrictive covenants, which may restrict our flexibility to operate our business; changing political, economic, regulatory and judicial influences, which could impact the purchasing practices and operations of our clients and increase costs to deliver compliant solutions and services; government regulation; significant competition and our ability to respond to market changes and changing technologies; variations in our quarterly operating results; potential inconsistencies in our sales forecasts compared to actual sales; volatility in the trading price of our common stock and the timing and volume of market activity; our directors' authority to issue preferred stock and the anti-takeover provisions in our corporate governance documents; and, other risks, uncertainties and factors discussed elsewhere in this Form 10-Q, in our other filings with the Securities and Exchange Commission, including those under the caption "Risk Factors" in our latest annual report on Form 10-K, or in materials incorporated herein or therein by reference. Forward-looking statements are not guarantees of future performance or results. The reader should not place undue reliance on forward-looking statements since the statements speak only as of the date they are made. Except as required by law, we undertake no obligation to update or revise forward-looking statements

to reflect changed assumptions, the occurrence of unanticipated events or changes in future operating results, financial condition or business over time.

Management Overview

Our revenues are primarily derived by selling, implementing and supporting software solutions, clinical content, hardware, devices and services that give health care providers secure access to clinical, administrative and financial data in real or near-real time, helping them improve quality, safety and efficiency in the delivery of health care.

Our fundamental strategic focus is the creation of organic growth by investing in research and development (R&D) to create solutions and services for the health care industry. This strategy has driven strong growth over the long-term, as reflected in five- and ten-year compound annual revenue growth rates of 14% or more. This growth has also created an important strategic footprint in health care, with Cerner® solutions in more than 20,000 facilities worldwide, including hospitals, physician

practices, laboratories, ambulatory centers, behavioral health centers, cardiac facilities, radiology clinics, surgery centers, extended care facilities, retail pharmacies, and employer sites. Selling additional solutions back into this client base is an important element of our future revenue growth. We are also focused on driving growth through market share expansion by strategically aligning with health care providers that have not yet selected a supplier and by displacing competitors in health care settings that are looking to replace their current supplier. We may also supplement organic growth with acquisitions.

We expect to drive growth through solutions and services that reflect our ongoing ability to innovate and expand our reach into health care. Examples of these include our CareAware® health care device architecture and devices, Cerner ITWorks℠ services, revenue cycle solutions and services, and population health solutions and services. Finally, we believe there is significant opportunity for growth outside of the United States, with many non-U.S. markets focused on health care information technology as part of their strategy to improve the quality and lower the cost of health care.

Beyond our strategy for driving revenue growth, we are also focused on earnings growth. Similar to our history of growing revenue, our net earnings have increased at compound annual rates of 17% or more over the most recent five- and ten-year periods. We expect to drive continued earnings growth through ongoing revenue growth coupled with margin expansion, which we expect to achieve through efficiencies in our implementation and operational processes and by leveraging R&D investments and controlling general and administrative expenses.

We are also focused on continuing to deliver strong levels of cash flow, which we expect to accomplish by continuing to grow earnings and prudently managing capital expenditures.

Siemens Health Services
On February 2, 2015, we acquired Siemens Health Services (now referred to as "Cerner Health Services"), as further described in Note (2) of the notes to condensed consolidated financial statements. The addition of the Cerner Health Services business impacts the comparability of our condensed consolidated financial statements for the six months ended July 2, 2016, in relation to the six months ended July 4, 2015, presented herein.

Results Overview
The Company delivered strong levels of bookings, revenues, earnings, and operating cash flow in the second quarter of 2016.

New business bookings revenue, which reflects the value of executed contracts for software, hardware, professional services and managed services, was $1.4 billion in the second quarter of 2016, which is an increase of 9% compared to $1.3 billion in the second quarter of 2015.

Revenues for the second quarter of 2016 increased 8% to $1.2 billion compared to $1.1 billion in the second quarter of 2015. The year-over-year increase in revenue reflects ongoing demand for Cerner's core solutions and services driven by our clients' needs to keep up with regulatory requirements; contributions from Cerner ITWorks℠ and revenue cycle solutions and services; and attaining new clients.

Second quarter 2016 net earnings increased 45% to $166 million compared to $115 million in the second quarter of 2015. Diluted earnings per share increased 45% to $0.48 compared to $0.33 in the second quarter of 2015. The growth in net earnings and diluted earnings per share was primarily a result of increased revenues, combined with a decline in costs related to our 2015 voluntary separation plan and acquisition costs and related adjustments associated with our acquisition of the Cerner Health Services business.

We had cash collections of receivables of $1.3 billion in the second quarter of 2016 compared to $1.1 billion in the second quarter of 2015. Days sales outstanding was 74 days for the second quarter of 2016 compared to 76 days for

the first quarter of 2016 and 81 days for the second quarter of 2015. Operating cash flows for the second quarter of 2016 were $255 million compared to $109 million in the second quarter of 2015.

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Results of Operations

Three Months Ended July 2, 2016 Compared to Three Months Ended July 4, 2015

The following table presents a summary of the operating information for the second quarters of 2016 and 2015:

(In thousands)	2016	% of Revenue	2015	% of Revenue	% Change
Revenues					
System sales	$333,104	27 %	$315,109	28 %	6 %
Support and maintenance	256,829	21 %	254,663	23 %	1 %
Services	603,922	50 %	538,164	48 %	12 %
Reimbursed travel	22,107	2 %	18,061	2 %	22 %
Total revenues	1,215,962	100 %	1,125,997	100 %	8 %
Costs of revenue					
Costs of revenue	205,556	17 %	192,322	17 %	7 %
Total margin	1,010,406	83 %	933,675	83 %	8 %
Operating expenses					
Sales and client service	520,265	43 %	463,435	41 %	12 %
Software development	135,164	11 %	138,451	12 %	(2)%
General and administrative	90,027	7 %	135,545	12 %	(34)%
Amortization of acquisition-related intangibles	23,638	2 %	24,508	2 %	(4)%
Total operating expenses	769,094	63 %	761,939	68 %	1 %
Total costs and expenses	974,650	80 %	954,261	85 %	2 %
Operating earnings	241,312	20 %	171,736	15 %	41 %
Other income (expense), net	2,470		(1,079)		
Income taxes	(77,328)		(55,619)		
Net earnings	$166,454		$115,038		45 %

Revenues & Backlog

Revenues increased 8% to $1.2 billion in the second quarter of 2016, as compared to $1.1 billion in the second quarter of 2015.

- System sales, which include revenues from the sale of licensed software (including perpetual license sales and software as a service), technology resale (hardware, devices, and sublicensed software), deployment period licensed software upgrade rights, installation fees, transaction processing and subscriptions, increased 6% to $333 million in the second quarter of 2016 from $315 million for the same period in 2015. The increase in system sales was primarily driven by growth in software revenue.
- Support and maintenance revenues increased 1% to $257 million in the second quarter of 2016 compared to $255 million during the same period in 2015. Such revenue was basically flat period-over-period.
- Services revenue, which includes professional services, excluding installation, and managed services, increased 12% to $604 million in the second quarter of 2016 from $538 million for the same period in 2015. This increase was driven by growth in managed services of $34 million as a result of continued demand for our hosting services and a $32 million increase in professional services due to growth in implementation and consulting activities.

Revenue backlog, which reflects contracted revenue that has not yet been recognized as revenue, increased 13% to $15.0 billion in the second quarter of 2016 compared to $13.3 billion for the same period in 2015. This increase was driven by growth in new business bookings during the past four quarters, including continued strong levels of managed services, Cerner ITWorks[SM] and revenue cycle services bookings that typically have longer contract terms.

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Costs of Revenue

Cost of revenues as a percent of total revenues was 17% in the second quarter of both 2016 and 2015.

Cost of revenues includes the cost of reimbursed travel expense, sales commissions, third party consulting services and subscription content and 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. Such costs, as a percent of revenues, typically have varied as the mix of revenue (software, hardware, devices, maintenance, support, services and reimbursed travel) carrying different margin rates changes from period to period. Cost of revenues does not include the costs of our client service personnel who are responsible for delivering our service offerings. Such costs are included in sales and client service expense.

Operating Expenses

Total operating expenses increased 1% to $769 million in the second quarter of 2016 compared with $762 million in the second quarter of 2015.

- Sales and client service expenses as a percent of total revenues were 43% in the second quarter of 2016 compared to 41% in the same period of 2015. These expenses increased 12% to $520 million in the second quarter of 2016, from $463 million in the same period of 2015. Sales and client service expenses include salaries and benefits of sales, marketing, support, and services personnel, depreciation and other expenses associated with our managed services business, communications expenses, unreimbursed travel expenses, expense for share-based payments, and trade show and advertising costs. The increase as a percent of revenue reflects a higher mix of services during the quarter that was driven by services revenue growth.
- Software development expenses as a percent of revenue were 11% in the second quarter of 2016 compared to 12% in the same period of 2015. Expenditures for software development include ongoing development and enhancement of the Cerner Millennium® and HealtheIntent™ platforms, with a focus on supporting key initiatives to enhance physician experience, revenue cycle and population health solutions. A summary of our total software development expense in the second quarters of 2016 and 2015 is as follows:

(In thousands)	Three Months Ended 2016	2015
Software development costs	$ 180,736	$ 178,630
Capitalized software costs	(79,085)	(69,116)
Capitalized costs related to share-based payments	(750)	(681)
Amortization of capitalized software costs	34,263	29,618
Total software development expense	$ 135,164	$ 138,451

- General and administrative expenses as a percent of total revenues were 7% in the second quarter of 2016, compared to 12% in the same period of 2015. These expenses decreased 34% to $90 million in the second quarter of 2016, from $136 million for the same period in 2015. General and administrative expenses include salaries and benefits for corporate, financial and administrative staffs, utilities, communications expenses, professional fees, depreciation and amortization, transaction gains or losses on foreign currency, expense for share-based payments, acquisition costs and related adjustments. The decrease as a percent of revenues was primarily driven by expenses incurred in 2015 related to our voluntary separation plan and acquisition costs and related adjustments associated with our acquisition of the Cerner Health Services business of $42 million and $9 million, respectively.

- Amortization of acquisition-related intangibles as a percent of total revenues was 2% in the second quarter of both 2016 and 2015. These expenses decreased 4% to $24 million in the second quarter of 2016, from $25 million for the same period in 2015. Amortization of acquisition-related intangibles includes the amortization of customer relationships, acquired technology, trade names, and non-compete agreements recorded in connection with our business acquisitions. The decrease in amortization of acquisition-related intangibles includes the impact of certain

intangible assets becoming fully amortized.

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Non-Operating Items

- Other income (expense) was $2 million in the second quarter of 2016 and $(1) million in the same period of 2015. This increase is primarily due to increased capitalization of interest on construction in process, primarily related to our Innovations Campus (office space development located in Kansas City, Missouri, formerly referred to as our Trails Campus).

- Our effective tax rate was 31.7% for the second quarter of 2016 and 32.6% for the second quarter of 2015. The decrease in the 2016 effective tax rate is primarily the result of the permanent reinstatement of the U.S. research and development tax credit in December 2015.

Operations by Segment

We have two operating segments: Domestic and Global. The Domestic segment includes revenue contributions and expenditures associated with business activity in the United States. The Global segment includes revenue contributions and expenditures linked to business activity in Aruba, Australia, Austria, Belgium, Brazil, Canada, Cayman Islands, Chile, Denmark, Egypt, England, Finland, France, Germany, Guam, India, Ireland, Kuwait, Luxembourg, Malaysia, Mexico, Netherlands, Norway, Portugal, Qatar, Romania, Saudi Arabia, Singapore, Slovakia, Spain, Sweden, Switzerland and the United Arab Emirates. Refer to Note (10) of the notes to condensed consolidated financial statements for further information regarding our reportable segments.

The following table presents a summary of the operating segment information for the second quarters of 2016 and 2015:

(In thousands)	2016	% of Revenue	2015	% of Revenue	% Change
Domestic Segment					
Revenues	$1,072,564	100%	$994,746	100%	8%
Costs of revenue	177,510	17%	168,189	17%	6%
Operating expenses	432,468	40%	393,305	40%	10%
Total costs and expenses	609,978	57%	561,494	56%	9%
Domestic operating earnings	462,586	43%	433,252	44%	7%
Global Segment					
Revenues	143,398	100%	131,251	100%	9%
Costs of revenue	28,046	20%	24,133	18%	16%
Operating expenses	64,523	45%	59,827	46%	8%
Total costs and expenses	92,569	65%	83,960	64%	10%
Global operating earnings	50,829	35%	47,291	36%	7%
Other, net	(272,103)		(308,807)		(12)%
Consolidated operating earnings	$241,312		$171,736		41%

Domestic Segment

- Revenues increased 8% to $1.1 billion in the second quarter of 2016 from $995 million in the same period of 2015. This increase was primarily driven by growth in services revenue.
- Cost of revenues as a percent of revenues was 17% in the second quarter of both 2016 and 2015.

- Operating expenses as a percent of revenues were 40% in the second quarter of both 2016 and 2015.

Global Segment

- Revenues increased 9% to $143 million in the second quarter of 2016 from $131 million in the same period of 2015. This increase was primarily driven by growth in software revenue.

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- Cost of revenues as a percent of revenues was 20% in the second quarter of 2016 compared to 18% in the same period of 2015. The higher cost of revenues in 2016 was primarily driven by a higher amount of third party resources utilized for support and services.
- Operating expenses as a percent of revenues were 45% in the second quarter of 2016 compared to 46% in the same period in 2015. Such expenses as a percent of revenues were basically flat period-over-period.

Other, net

Operating results not attributed to an operating segment include expenses such as software development, general and administrative expenses, acquisition costs and related adjustments, share-based compensation expense, and certain amortization and depreciation. These expenses decreased 12% to $272 million in the second quarter of 2016 from $309 million in the same period of 2015. This decrease was primarily driven by expenses incurred in 2015 related to our voluntary separation plan and acquisition costs and related adjustments associated with our acquisition of the Cerner Health Services business of $42 million and $9 million, respectively.

Six Months Ended July 2, 2016 Compared to Six Months Ended July 4, 2015

The following table presents a summary of the operating information for the first six months of 2016 and 2015:

(In thousands)	2016	% of Revenue	2015	% of Revenue	% Change
Revenues					
System sales	$612,458	26 %	$574,678	27 %	7 %
Support and maintenance	507,740	22 %	483,428	23 %	5 %
Services	1,192,649	51 %	1,027,769	48 %	16 %
Reimbursed travel	41,250	2 %	36,211	2 %	14 %
Total revenues	2,354,097	100 %	2,122,086	100 %	11 %
Costs of revenue					
Costs of revenue	381,149	16 %	360,982	17 %	6 %
Total margin	1,972,948	84 %	1,761,104	83 %	12 %
Operating expenses					
Sales and client service	1,022,092	43 %	883,617	42 %	16 %
Software development	268,696	11 %	265,722	13 %	1 %
General and administrative	180,161	8 %	230,356	11 %	(22)%
Amortization of acquisition-related intangibles	45,239	2 %	42,761	2 %	6 %
Total operating expenses	1,516,188	64 %	1,422,456	67 %	7 %
Total costs and expenses	1,897,337	81 %	1,783,438	84 %	6 %
Operating earnings	456,760	19 %	338,648	16 %	35 %
Other income (expense), net	4,151		(871)		
Income taxes	(144,097)		(111,805)		
Net earnings	$316,814		$225,972		40 %

Revenues

Revenues increased 11% to $2.4 billion in the first six months of 2016, as compared to $2.1 billion in the first six months of 2015.

- System sales increased 7% to $612 million in the first six months of 2016 from $575 million for the same period in 2015. The increase in system sales was primarily driven by growth in subscriptions and software of $31 million and $27 million, respectively, partially offset by a $21 million decline in technology resale.

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- Support and maintenance revenues increased 5% to $508 million in the first six months of 2016 compared to $483 million during the same period in 2015. This increase was primarily attributable to continued success selling Cerner Millennium® applications and implementing them at client sites.
- Services revenue increased 16% to $1.2 billion in the first six months of 2016 from $1.0 billion for the same period in 2015. This increase was driven by growth in managed services of $74 million as a result of continued demand for our hosting services and a $91 million increase in professional services due to growth in implementation and consulting activities

Costs of Revenue

Cost of revenues as a percent of total revenues was 16% in the first six months of 2016 compared to 17% in the same period of 2015. The lower cost of revenues as a percent of revenue was primarily driven by a lower mix of technology resale, which carries a higher cost of revenue.

Operating Expenses

Total operating expenses increased 7% to $1.5 billion in the first six months of 2016, compared with $1.4 billion in the same period of 2015.

- Sales and client service expenses as a percent of total revenues were 43% in the first six months of 2016 compared to 42% in the same period of 2015. These expenses increased 16% to $1.0 billion in the first six months of 2016, from $884 million in the same period of 2015. The increase as a percent of revenue reflects a higher mix of services during the period that was driven by services revenue growth.
- Software development expenses as a percent of revenue were 11% in the first six months of 2016, compared to 13% in the same period of 2015. Expenditures for software development include ongoing development and enhancement of the Cerner Millennium® and HealtheIntent™ platforms, with a focus on supporting key initiatives to enhance physician experience, revenue cycle and population health solutions. A summary of our total software development expense in the first six months of 2016 and 2015 is as follows:

	Six Months Ended	
(In thousands)	2016	2015
Software development costs	$356,994	$339,879
Capitalized software costs	(153,697)	(131,640)
Capitalized costs related to share-based payments	(1,478)	(1,224)
Amortization of capitalized software costs	66,877	58,707
Total software development expense	$268,696	$265,722

- General and administrative expenses as a percent of total revenues were 8% in the first six months of 2016 compared to 11% in the same period of 2015. These expenses decreased 22% to $180 million in the first six months of 2016, from $230 million for the same period in 2015. The decrease as a percent of revenues was primarily driven by expenses incurred in 2015 related to our voluntary separation plan and acquisition costs and related adjustments associated with our acquisition of the Cerner Health Services business of $42 million and $34 million, respectively.
- Amortization of acquisition-related intangibles as a percent of total revenues was 2% in the first six months of both 2016 and 2015. These expenses increased 6% to $45 million in the first six months of 2016, from $43 million for the same period in 2015. The increase was primarily driven by the additional month of amortization in the first six months of 2016, on intangibles recorded in connection with the acquisition of the Cerner Health Services business, as compared to the same period in 2015.

Non-Operating Items

- Other income (expense) increased to $4 million in the first six months of 2016 from $(1) million in the same period of 2015. This increase is primarily due to increased capitalization of interest on construction in process, primarily related to our Innovations Campus.

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- Our effective tax rate was 31.3% for the first six months of 2016 and 33.1% for the first six months of 2015. The decrease in the 2016 effective tax rate is primarily the result of the permanent reinstatement of the U.S. research and development tax credit in December 2015.

Operations by Segment

The following table presents a summary of the operating segment information for the first six months of 2016 and 2015:

(In thousands)	2016	% of Revenue	2015	% of Revenue	% Change
Domestic Segment					
Revenues	$2,077,529	100%	$1,865,253	100%	11%
Costs of revenue	326,779	16%	310,906	17%	5%
Operating expenses	858,027	41%	754,391	40%	14%
Total costs and expenses	1,184,806	57%	1,065,297	57%	11%
Domestic operating earnings	892,723	43%	799,956	43%	12%
Global Segment					
Revenues	276,568	100%	256,833	100%	8%
Costs of revenue	54,370	20%	50,076	19%	9%
Operating expenses	123,394	45%	110,398	43%	12%
Total costs and expenses	177,764	64%	160,474	62%	11%
Global operating earnings	98,804	36%	96,359	38%	3%
Other, net	(534,767)		(557,667)		(4)%
Consolidated operating earnings	$456,760		$338,648		35%

Domestic Segment

- Revenues increased 11% to $2.1 billion in the first six months of 2016 from $1.9 billion in the same period of 2015. This increase was primarily driven by growth in services revenue.
- Cost of revenues as a percent of revenues was 16% in the first six months of 2016 compared to 17% in the same period of 2015. The lower cost of revenues as a percent of revenue was primarily driven by a lower mix of technology resale, which carries a higher cost of revenue.
- Operating expenses as a percent of revenues were 41% in the first six months of 2016 compared to 40% in the same period of 2015. The increase as a percent of revenue reflects higher personnel costs associated with a higher mix of services during the period that was driven by services revenue growth.

Global Segment

- Revenues increased 8% to $277 million in the first six months of 2016 from $257 million in the same period of 2015. This increase was primarily driven by growth in software revenue.
- Cost of revenues as a percent of revenues was 20% in the first six months of 2016 compared to 19% in the same period of 2015. The higher cost of revenues in 2016 was primarily driven by a higher amount of third party resources utilized for support and services.
- Operating expenses as a percent of revenues were 45% in the first six months of 2016 compared to 43% in the same period in 2015. The increase as a percent of revenues is primarily due to increased personnel costs.

Other, net

These expenses decreased 4% to $535 million in the first six months of 2016 from $558 million in the same period of 2015. This decrease was primarily driven by expenses incurred in 2015 related to our voluntary separation plan and acquisition costs and related adjustments associated with our acquisition of the Cerner Health Services business of $42 million and $34 million, respectively, partially offset by increases in corporate and development personnel costs.

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Liquidity and Capital Resources

Our liquidity is influenced by many factors, including the amount and timing of our revenues, our cash collections from our clients and the amount we invest in software development, acquisitions and capital expenditures.

Our principal sources of liquidity are our cash and cash equivalents, which primarily consist of money market funds and time deposits with original maturities of less than 90 days, and short-term investments. At July 2, 2016, we had cash and cash equivalents of $378 million and short-term investments of $252 million, as compared to cash and cash equivalents of $402 million and short-term investments of $111 million at January 2, 2016.

The non-U.S. subsidiaries for which we have elected to indefinitely reinvest earnings outside of the U.S. held approximately 28% of our aggregate cash, cash equivalents and short-term investments at July 2, 2016. As part of our current business strategy, we plan to indefinitely reinvest the earnings of these foreign operations; however, should the earnings of these foreign operations be repatriated, we would accrue and pay tax on such earnings, which may be material.

We maintain a $100 million multi-year revolving credit facility, which expires in October 2020. The facility provides an unsecured revolving line of credit for working capital purposes, along with a letter of credit facility. We have the ability to increase the maximum capacity to $200 million at any time during the facility's term, subject to lender participation. As of July 2, 2016, we had no outstanding borrowings under this facility; however, we had $19 million of outstanding letters of credit, which reduced our available borrowing capacity to $81 million.

We believe that our present cash position, together with cash generated from operations, short-term investments and, if necessary, our available line of credit, will be sufficient to meet anticipated cash requirements during 2016.

The following table summarizes our cash flows in the first six months of 2016 and 2015:

	Six Months Ended	
(In thousands)	2016	2015
Cash flows from operating activities	$582,025	$322,911
Cash flows from investing activities	(437,981)	(1,230,780)
Cash flows from financing activities	(165,767)	573,104
Effect of exchange rate changes on cash	(2,817)	(6,459)
Total change in cash and cash equivalents	(24,540)	(341,224)
Cash and cash equivalents at beginning of period	402,122	635,203
Cash and cash equivalents at end of period	$377,582	$293,979
Free cash flow (non-GAAP)	$209,255	$22,913

Cash from Operating Activities

	Six Months Ended	
(In thousands)	2016	2015
Cash collections from clients	$2,515,158	$2,061,276
Cash paid to employees and suppliers and other	(1,818,992)	(1,674,522)
Cash paid for interest	(9,303)	(2,478)
Cash paid for taxes, net of refunds	(104,838)	(61,365)
Total cash from operations	$582,025	$322,911

Cash flow from operations increased $259 million in the first six months of 2016 when compared to the same period of 2015 due to an increase in cash impacting earnings, along with a reduction in cash used to fund working capital

requirements. During the first six months of 2016 and 2015, we received total client cash collections of $2.5 billion and $2.1 billion, respectively. Days sales outstanding was 74 days in the second quarter of 2016, compared to 76 days in the first quarter of 2016 and 81 days in the second quarter of 2015. Revenues provided under support and maintenance agreements represent recurring cash flows. We expect these revenues to continue to grow as the base of installed systems grows.

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Cash from Investing Activities

(In thousands)	Six Months Ended 2016	2015
Capital purchases	$(217,595)	$(167,134)
Capitalized software development costs	(155,175)	(132,864)
Purchases of investments, net of sales and maturities	(57,850)	448,127
Purchases of other intangibles	(7,361)	(6,895)
Acquisition of businesses	—	(1,372,014)
Total cash flows from investing activities	$(437,981)	$(1,230,780)

Cash flows from investing activities consist primarily of capital spending, short-term investment, and acquisition activities.

Our capital spending in the first six months of 2016 was driven by capitalized equipment purchases primarily to support growth in our managed services business, investments in a cloud infrastructure to support cloud-based solutions, building and improvement purchases to support our facilities requirements and capitalized spending to support our ongoing software development initiatives. Capital spending in 2016 is expected to remain elevated as we continue our current capital and software development initiatives, including the construction on our Innovations Campus.

Short-term investment activity historically consists of the investment of cash generated by our business in excess of what is necessary to fund operations. In the first six months of 2015 we had a net cash inflow from investments due to the use of proceeds from investment sales and maturities to partially fund our February 2, 2015 acquisition of the Cerner Health Services business. In 2016, we returned to net purchases of investments, which we expect to continue in subsequent periods, as we expect strong levels of cash flow.

On February 2, 2015, we acquired the Cerner Health Services business, and paid cash consideration of $1.37 billion in the first six months of 2015. We used a combination of cash on hand and proceeds from sales and maturities of investments to fund the acquisition. We expect to continue seeking and completing strategic business acquisitions that are complementary to our business. Refer to Note (2) of the notes to condensed consolidated financial statements for further information regarding our acquisition of the Cerner Health Services business.

Cash from Financing Activities

(In thousands)	Six Months Ended 2016	2015
Long-term debt issuance	$—	$500,000
Cash from option exercises (including excess tax benefits)	36,382	84,907
Treasury stock purchases	(200,075)	—
Contingent consideration payments for acquisition of businesses	(2,074)	(11,012)
Other, net	—	(791)
Total cash flows from financing activities	$(165,767)	$573,104

In January 2015, we issued $500 million in aggregate principal amount of Senior Notes. Proceeds from the Senior Notes are available for general corporate purposes. We do not expect to issue additional long-term debt in 2016.

Cash inflows from stock option exercises are dependent on a number of factors, including the price of our common stock, grant activity under our stock option and equity plans, and overall market volatility. We expect cash inflows

from stock option exercises to continue throughout 2016 based on the number of exercisable options as of July 2, 2016 and our current stock price.

During the first six months of 2016, we repurchased 3.7 million shares of our common stock under our share repurchase program for total consideration of $200 million. At July 2, 2016, $100 million remains available for repurchase under the current program. We may continue to repurchase shares under this program in 2016, which will be dependent on a number of factors, including the price of our common stock. Refer to Note (8) of the notes to condensed consolidated financial statements for further information regarding our share repurchase program.

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During the first six months of 2016, we paid $2 million of contingent consideration related to our acquisition of InterMedHx, LLC. During the first six months of 2015, we paid an aggregate of $11 million of contingent consideration related to our acquisitions of InterMedHx, LLC and Kaufman & Keen, LLC (doing business as PureWellness). We do not expect additional contingent consideration payments for the remainder of 2016.

Free Cash Flow (Non-GAAP)

	Three Months Ended		Six Months Ended	
(In thousands)	2016	2015	2016	2015
Cash flows from operating activities (GAAP)	$254,942	$108,664	$582,025	$322,911
Capital purchases	(118,244)	(84,870)	(217,595)	(167,134)
Capitalized software development costs	(79,835)	(69,797)	(155,175)	(132,864)
Free cash flow (non-GAAP)	$56,863	$(46,003)	$209,255	$22,913

Free cash flow increased $186 million in the first six months of 2016 compared to the same period in 2015. This increase is primarily due to increased cash from operations, partially offset by both capital spending to support our growth initiatives and facilities requirements, and increased capitalized spending to support our ongoing software development initiatives. Free cash flow is a non-GAAP financial measure used by management along with GAAP results to analyze our earnings quality and overall cash generation of the business. We define free cash flow as cash flows from operations reduced by capital purchases and capitalized software development costs. The table above sets forth a reconciliation of free cash flow to cash flows from operating activities, which we believe to be the GAAP financial measure most directly comparable to free cash flow. The presentation of free cash flow is not meant to be considered in isolation, nor as a substitute for, or superior to, GAAP results, and investors should be aware that non-GAAP measures have inherent limitations and should be read only in conjunction with our consolidated financial statements prepared in accordance with GAAP. Free cash flow may also be different from similar non-GAAP financial measures used by other companies and may not be comparable to similarly titled captions of other companies due to potential inconsistencies in the method of calculation. We believe free cash flow is important to enable investors to better understand and evaluate our ongoing operating results and allows for greater transparency in the review of our overall financial, operational and economic performance, because free cash flow takes into account certain capital expenditures necessary to operate our business.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

No material changes.

Item 4. Controls and Procedures

a) Evaluation of Disclosure Controls and Procedures.

The Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO) have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report on Form 10-Q (the Evaluation Date). They have concluded that, as of the Evaluation Date, these disclosure controls and procedures were effective to ensure that material information relating to the Company and its consolidated subsidiaries would be made known to them by others within those entities and would be disclosed on a timely basis. The CEO and CFO have concluded that the Company's disclosure controls and procedures are designed, and are effective, to give reasonable assurance that the information required to be disclosed by the Company in reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the rules and forms of the SEC. They have also concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that are filed or submitted under the Exchange Act are accumulated and communicated to the Company's management to allow timely decisions regarding required disclosure.

b) Changes in Internal Control over Financial Reporting.

There were no changes in the Company's internal controls over financial reporting during the fiscal quarter ended July 2, 2016, that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

c) Limitations on Controls.

The Company's management, including its CEO and CFO, has concluded that our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives and are effective at that reasonable assurance level. However, the Company's management can provide no assurance that our disclosure controls and procedures or our internal control over financial reporting can prevent all errors and all fraud under all circumstances. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been or will be detected. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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Part II. Other Information

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) Issuer Purchases of Equity Securities

The table below provides information with respect to Common Stock purchases by the Company during the second fiscal quarter of 2016.

Period	Total Number of Shares Purchased (a)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (b)	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs (b)
April 3, 2016 - April 30, 2016	742	$ 56.26	—	$ 150,000,000
May 1, 2016 - May 28, 2016	938,762	53.30	938,057	100,000,000
May 29, 2016 - July 2, 2016	47,822	55.81	—	100,000,000
Total	987,326	$ 53.43	938,057	

(a) Of the 987,326 shares of common stock, par value $0.01 per share, presented in the table above, 49,269 were originally granted to employees as restricted stock pursuant to our 2011 Omnibus Equity Incentive Plan (the "Omnibus Plan"). The Omnibus Plan allows for the withholding of shares to satisfy the minimum tax obligations due upon the vesting of restricted stock. Pursuant to the Omnibus Plan, the shares reflected above were relinquished by employees in exchange for our agreement to pay U.S. federal and state withholding obligations resulting from the vesting of the Company's restricted stock.

(b) As announced on March 8, 2016, our Board of Directors authorized a new share repurchase program for an aggregate purchase of up to $300 million of our common stock, excluding transaction costs. During the six months ended July 2, 2016, the Company repurchased 3.7 million shares for total consideration of $200 million pursuant to a Rule 10b5-1 plan. As of July 2, 2016, $100 million remained available for repurchase. No time limit has been set for completion of the program. Refer to Note (8) of the notes to condensed consolidated financial statements for further information regarding our share repurchase program.

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Item 6. Exhibits

(a) Exhibits

10.1	Cerner Corporation Performance-Based Compensation Plan (as Amended and Restated May 27, 2016) filed as Exhibit 10.1 to Form 8-K/A filed on June 1, 2016 is incorporated herein by reference as Exhibit 10.1.
10.2	Cerner Corporation 2011 Omnibus Equity Incentive Plan - Non-Qualified Stock Option Grant Certificate
31.1	Certification of Neal L. Patterson pursuant to Section 302 of Sarbanes-Oxley Act of 2002
31.2	Certification of Marc G. Naughton pursuant to Section 302 of Sarbanes-Oxley Act of 2002
32.1	Certification of Neal L. Patterson pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002
32.2	Certification of Marc G. Naughton pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CERNER CORPORATION
Registrant

Date: August 3, 2016 By: /s/ Marc G. Naughton
Marc G. Naughton
Executive Vice President and Chief
Financial Officer (duly authorized
officer and principal financial officer)