

CERNER CORP /MO/
Form 10-K
February 05, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 28, 2013

OR

() TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 0-15386

CERNER CORPORATION
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)
2800 Rockcreek Parkway
North Kansas City, MO
(Address of principal executive offices)

43-1196944
(I.R.S. Employer Identification
Number)
64117
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$0.01 par value per share	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes [X] No []

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes [] No [X]

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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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of June 29, 2013, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$14.6 billion based on the closing sale price as reported on the NASDAQ Global Select Market.

Indicate the number of shares outstanding of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at January 31, 2014
Common Stock, \$0.01 par value per share	343,946,094 shares

DOCUMENTS INCORPORATED BY REFERENCE

Document	Parts into Which Incorporated
Proxy Statement for the Annual Shareholders' Meeting to be held May 23, 2014	Part III

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CERNER CORPORATION

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PART I.

Item 1. Business

Overview

Cerner Corporation started doing business in 1980, and it was organized as a Delaware corporation in 1986. Unless the context otherwise requires, references in this report to “Cerner,” the “Company,” “we,” “us” or “our” mean Cerner Corporation and its subsidiaries.

Our corporate world headquarters is located in a Company-owned office park in North Kansas City, Missouri, with our principal place of business located at 2800 Rockcreek Parkway, North Kansas City, Missouri 64117. Our telephone number is 816.201.1024. Our Web site address, which we use to communicate important business information, can be accessed at: www.cerner.com. We make our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports available free of charge on or through this Web site as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (SEC).

Cerner’s mission is to contribute to the systemic improvement of health care delivery and the health of communities. We are a leading supplier of health care information technology (HCIT), and offer a comprehensive range of software, professional services, medical device integration, remote hosting and employer health and wellness services. Cerner systems are used by everyone from individual consumers, to single-doctor practices, hospitals, employers and entire countries. Taking what we’ve learned over more than three decades, Cerner is building on the knowledge that is in the system to support evidence-based clinical decisions, prevent medical errors and empower patients in their care.

Cerner® solutions are licensed by approximately 14,000 facilities around the world, including more than 3,000 hospitals; 4,900 physician practices; 60,000 physicians; 590 ambulatory facilities, such as laboratories, ambulatory centers, behavioral health centers, cardiac facilities, radiology clinics and surgery centers; 3,500 extended care facilities; 150 employer sites and 1,790 retail pharmacies.

Cerner solutions are offered on the unified Cerner Millennium® architecture, a person-centric computing framework, which combines clinical, financial and management information systems. This architecture allows providers to securely access an individual’s electronic health record (EHR) at the point of care, and it organizes and proactively delivers information to meet the specific needs of physicians, nurses, laboratory technicians, pharmacists, front- and back-office professionals and consumers. In recent years, we have extended this platform to include the next evolution of Cerner Millennium, Millennium+™, which leverages the cloud and enables greater mobility. We have also created the Healthe Intent™ platform, a cloud-based platform that enables a new generation of solutions to leverage the increasing amount of data being captured as the health care industry is digitized. On the Healthe Intent platform, we are building EHR-agnostic solutions based on sophisticated, statistical algorithms that are intended to help providers predict and improve outcomes, control costs, and improve quality.

We offer a broad range of services, including implementation and training, remote hosting, operational management services, revenue cycle services, support and maintenance, health care data analysis, clinical process optimization, transaction processing, employer health centers, employee wellness programs and third party administrator (TPA) services for employer-based health plans.

In addition to software and services, we offer a wide range of complementary hardware and devices, both directly from Cerner and as a reseller for third parties.

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The following table presents our consolidated revenues by major solutions and services and by segment, as a percentage of total revenues:

	For the Years Ended			
	2013	2012	2011	
Revenues by Solutions & Services				
System sales	29	% 34	% 32	%
Support and maintenance	23	% 23	% 25	%
Services	46	% 41	% 41	%
Reimbursed travel	2	% 2	% 2	%
	100	% 100	% 100	%
Revenues by Segment				
Domestic	88	% 88	% 86	%
Global	12	% 12	% 14	%
	100	% 100	% 100	%

Health Care and Health Care IT Industry

We believe there are several ongoing trends in health care that create a favorable environment for Cerner. One is the unsustainable rate of growth in health care spending. The Centers for Medicare and Medicaid Services (CMS) estimates United States health care spending in 2013 at \$2.9 trillion, or 18.0 percent of Gross Domestic Product (GDP), and projects it to be 19.9 percent of GDP by 2022. We believe health care IT is one of few remaining levers that can change this trajectory. Further, most United States health care providers recognize that they must invest in HCIT to meet regulatory requirements, adapt to shifting reimbursement structures, and qualify for incentives. The importance of HCIT in facilitating this compliance along with the benefits of improving safety, efficiency and reducing costs, leads to investments in HCIT being viewed as more strategic than many other capital purchases and supports our belief that we are positioned for continued growth.

An ongoing contributor to our growth is the inclusion of HCIT incentives in the American Recovery and Reinvestment Act (ARRA). The Health Information Technology for Economic and Clinical Health (HITECH) provisions within ARRA include more than \$35 billion in incentives for health care organizations to modernize operations through "Meaningful Use" of HCIT. Hospitals and physicians that met the first of three stages of Meaningful Use criteria of the ARRA began receiving incentive funds in 2011, and the ongoing incentive program is contributing to continued demand for HCIT solutions and services in the United States. In addition to the demand created by existing clients seeking solutions and services to ensure they are positioned to qualify for incentives, we are seeing significant demand outside of our installed base from hospitals that previously chose a system from another supplier. We believe these hospitals are looking to change to a platform that better positions them for success as later stages of Meaningful Use and other regulatory requirements require more sophisticated IT systems.

Another trend in the United States marketplace that we believe will contribute to demand is the shift away from fee-for-service or volume-based reimbursement towards value-based or outcomes-based reimbursement. Payers, including health insurance companies and federal and state governments, are implementing programs to link reimbursement to quality measurements and outcomes, and we believe this alignment creates significant financial motivation for HCIT adoption. Ultimately, we believe all of these shifts are leading to an environment in which health care providers will become accountable for proactively managing the health of the populations they serve, and this will require ongoing investment in sophisticated information technology solutions that will enable them to predict when intervention is needed so they can improve outcomes and lower the cost of providing care.

As providers position themselves for these shifts, there has been an increase in industry consolidation, with health systems acquiring hospitals, physician practices, and other venues to control more of the care continuum and achieve economies of scale. We believe this is a positive trend for Cerner as we have relationships with the majority of the largest health systems responsible for most of the acquisition activity, creating an opportunity to offer our solutions and services to the acquired facilities.

The increasingly complex and more clinical outcomes-based reimbursement environment is also contributing to a heightened demand for revenue cycle solutions and a desire for these solutions to be closely aligned with clinical solutions. We believe

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this trend is positive for Cerner because our revenue cycle solutions are integrated with our clinical solutions, creating a clinically driven revenue cycle solution that has had significant adoption in recent years.

We have also seen a shift in the United States marketplace towards a preference for a single platform across inpatient and ambulatory settings. The number of physicians employed by hospitals has increased significantly as hospitals have acquired physician groups in order to ensure a consistent stream of referrals, and health systems are recognizing the benefit of having a single patient record at the hospital and the physician office. We are benefiting from this trend due to our unified Cerner Millennium platform that spans multiple venues and due to significant enhancements we have made to our physician solutions in recent years.

Another industry observation is that operational and financial pressures on health care providers continue to increase. It is a challenge for them to keep up with Meaningful Use, health care reform, Value-Based Purchasing, and other requirements - all while facing ongoing pressure on reimbursement. As discussed, we believe our solutions and services are well aligned with helping our clients navigate these challenges, which is why we continue to have a positive outlook.

Outside the United States, the economic downturn of the last several years has impacted and could continue to impact our results of operations. However, we have observed improving conditions in many global markets and believe long-term revenue growth opportunities outside the United States remain significant because other countries are also focused on controlling health care spending while improving the efficiency and quality of care that is delivered, and many of these countries recognize HCIT as an important piece of the solution to these issues.

Cerner Vision and Growth Strategy

For more than 30 years, Cerner has been executing its vision to make health care safer and more efficient. We started with the foundation of digitizing paper processes and now offer what we believe to be the most comprehensive array of solutions, services, hardware, and devices to the health care industry. Since our company began, we have been committed to transformational change in the vital task of keeping people healthy. We focus on developing innovations that will help improve the entire health care system, as we believe health care is personal and nothing matters more than our health and the health of our families.

Our vision has always guided our large investments in research and development, which have created strong levels of organic growth throughout our history. Our proven ability to innovate has led to what we believe to be industry-leading solution and device architectures and an unmatched breadth and depth of solutions and services. We believe these strengths position us well to gain market share in the United States during a period of expected strong demand driven by the HITECH provisions of ARRA, the nation's focus on improving the efficiency and quality of health care and the need for continued investments in solutions and services to adapt to ongoing changes in reimbursement structures that will require the ability to proactively manage the health of populations, not just reactively provide care. We also have a strong global brand and a presence in more than 25 countries and believe we have a strong opportunity to gain market share outside of the United States.

In addition to growth by gaining market share, we have a significant opportunity to grow revenues by expanding our solution footprint with existing clients. There is opportunity to expand penetration of our core solutions, such as EHRs and computerized physician order entry, and increase penetration of our broad range of complementary solutions that can be offered into our existing client base. Examples include women's health, anesthesiology, imaging, clinical process optimization, critical care, medical devices, device connectivity, emergency department, revenue cycle and surgery.

We have also introduced services in recent years that are targeted at capturing a larger percentage of our clients' existing IT spending. These services leverage our proven operational capabilities and the success of our

CernerWorksSM managed services business, where we have demonstrated the ability to improve our clients' service levels at a cost that is at or below amounts they were previously spending. One of these services is Cerner ITWorksSM, a suite of solutions and services that improve the ability of hospital IT departments to meet their organization's needs while also creating a closer alignment between Cerner and our clients. A second example is Cerner RevWorksSM, which includes solutions and services to help health care organizations improve their revenue cycle functions.

We have made progress over the past several years at reducing the total cost of ownership of our solutions, which expands our end market opportunities by allowing us to offer lower-cost, higher-value solutions and services to smaller community hospitals, critical access hospitals and physician practices. For example, our CommunityWorksTM offering leverages a shared instance of the Cerner Millennium platform across multiple clients, which decreases the total cost of ownership for these clients.

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We also expect to drive growth over the course of the next decade through initiatives outside the core HCIT market. For example, we offer clinic, pharmacy, wellness and third-party administrator services directly to employers. These offerings have been shaped by what we have learned from changes we have implemented at Cerner over the past six years. We have removed our third-party administrator and become self-administered, launched an on-site clinic and pharmacy, incorporated biometric measurements for our population, realigned the economic incentives for associates in our health plan, and implemented a data-driven wellness management program. These changes have had a significant impact on the health of our associates and have allowed us to do what all employers want to do - reduce health care costs.

As discussed below, another opportunity for future growth, and a significant area of investment for Cerner, is leveraging the vast amounts of data being created as the health care industry is digitized and using this data to help providers manage the health of populations.

Population Health

Today's system of episodic, fee-for-service care is characterized by episodic visits to providers for an acute illness, rather than an ongoing focus on maintaining health. We believe information technology will play a key role in providing real time and predictive information to providers which will facilitate the promotion and management of health and result in lower costs and higher quality interventions.

For health care providers, population health management means serving patients with more precision. It means preventing potentially avoidable complications by developing prescriptive personalized health plans and applying preventive care to keep more people in a state of health, delaying and possibly preventing or reversing the effects of chronic disease.

While this approach is logical and desirable, our system of care is still mostly structured so that physicians and hospitals are paid when people experience illness, not when they remain healthy. This is beginning to change through the formation of organizations, often called Accountable Care Organizations, which reward health systems for keeping healthy people healthy and for delivering higher quality and lower cost care to a defined population. As the industry continues down this path of creating incentives for managing the health of populations, we believe there will be significant new opportunities for Cerner.

We are already providing solutions and services to many of our clients that are foundational elements for population health. Examples of these include data liquidity through our Cerner Network interoperability and health information exchange offerings, Lighthouse Enterprise Data Warehousing and Quality solutions, our patient portal platform and personal health record solutions that offer a range of device and provider connectivity options and wellness offerings.

Supporting these solutions is Healthe Intent, which is our cloud-based platform for population health that is agnostic to the source EHR and is also able to capture research, evidence, and financial and operational data. Healthe Intent also supports Chart Search, which leverages knowledge of the clinical meanings of words located within the EHR as well as the context in which those words occur to create algorithms that identify and rank the most important information contextually. This capability allows the physician to efficiently search through a patient's health record and identify relevant information in a matter of seconds.

The Healthe Intent platform also provides the ability to apply sophisticated, statistical algorithms against contextual clinical activity to recommend clinical action. We have illustrated this with our sepsis agent, which can assist in detecting the conditions that indicate a patient may be developing sepsis, a potentially fatal condition in which the bloodstream is overwhelmed by bacteria. Clients that have implemented this agent as part of a comprehensive sepsis prevention process have experienced significant reductions in sepsis mortality rates, and the adoption in our client base continues to steadily increase.

We are investing heavily in expanding the Health Intent platform and our overall capabilities to support population health. One of the ways we are expanding our capabilities is working closely with clients that are early movers at taking accountability for keeping the populations they serve healthy. A key partner with whom we are working is Advocate Health Care. One of the first outcomes of this partnership was the joint development in 2012 of a predictive agent for readmissions that has demonstrated significant improvement in predictive power as compared to the majority of existing models. Our relationship expanded in early 2013 to further advance clinical integration and population health management capabilities across the continuum of care for the 500,000 lives for which they have gone at risk. We are enabling them to identify who in their population meets criteria across 16 specific registries and 60 performance improvement scorecards with parameters Advocate has created. As members needing care are identified, we will facilitate personalized interventions, enrollment in care management programs, and ongoing monitoring to allow Advocate to keep people healthy.

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This work with Advocate is going at a fast pace and is very complex. An example of the complexity is that we are aggregating and normalizing data from more than 50 different data sources, including multiple EHRs, private and public payers, third party billing and registration systems, and physician specialty scorecards. This requires the ability to take both structured and unstructured data and run it through our big data engine using medical language processing, not just the more commonly used natural language processing, or NLP. This allows us to enhance the data and map it to a normalized standard, resulting in a highly structured, longitudinal record that enables real-time analytics.

In September 2013, Cerner and Advocate took a major step forward in delivering our shared vision for population health when we released our Healthe Intent Smart Registries™ solution to Advocate after just seven months of development. Healthe Intent Smart Registries provide the capability to stratify patient populations based on risk, conditions, and attributed physicians. In addition, the registries enable care managers to quickly determine what key quality measures specific to the designated condition of the patient have been met. It is also noteworthy that Healthe Intent Smart Registries and our other population health solutions are EHR agnostic, which substantially broadens our addressable market. We have already sold these solutions outside of our installed client base, and there is a good pipeline both inside and outside of our client base.

In summary, we believe our comprehensive architectural approach to population health is differentiated in the marketplace. We expect this platform to create significant opportunities for Cerner as health care continues to evolve towards a model that incents keeping people healthy.

Software Development

We commit significant resources to developing new health information system solutions and services. As of the end of 2013, approximately 3,800 associates were engaged in research and development activities. Total expenditures for the development and enhancement of our software solutions were approximately \$418.7 million, \$319.8 million and \$290.6 million during the 2013, 2012 and 2011 fiscal years, respectively. These figures include both capitalized and non-capitalized portions and exclude amounts amortized for financial reporting purposes.

As discussed above, continued investment in research and development remains a core element of our strategy. This will include ongoing enhancement of our core solutions and development of new solutions and services.

Sales and Marketing

The markets for Cerner HCIT solutions, health care devices and services include integrated delivery networks, physician groups and networks, managed care organizations, hospitals, medical centers, free-standing reference laboratories, home health agencies, blood banks, imaging centers, pharmacies, pharmaceutical manufacturers, employers, governments and public health organizations. The majority of our sales are sales of clinical and revenue cycle solutions and services to hospitals and health systems, but our solutions and services are highly scalable and sold to organizations ranging from physician practices, to community hospitals, to complex integrated delivery networks, to local, regional and national government agencies.

Sales to large health systems typically take approximately nine to 18 months, while the sales cycle is often shorter when selling to smaller hospitals and physician practices. In some instances, the HITECH provisions of ARRA have shortened the sales process due to the timeline required for hospitals to qualify for stimulus incentives.

Our executive marketing management is located at our Innovation Campus in Kansas City, Missouri, while our client representatives are deployed across the United States and globally. In addition to the United States, through our subsidiaries, we have sales associates and/or offices giving us a presence in more than 25 countries.

We support our sales force with technical personnel who perform demonstrations of Cerner solutions and services and assist clients in determining the proper hardware and software configurations. Our primary direct marketing strategy is to generate sales contacts from our existing client base and through presentations at industry seminars and tradeshows. We market the PowerWorks® solutions, offered on a subscription basis, directly to the physician practice market using telemarketing, channel partners and through existing acute care clients that are looking to extend Cerner solutions to affiliated physicians. We attend a number of major tradeshows each year and sponsor executive user conferences, which feature industry experts who address the HCIT needs of large health care organizations.

Client Services

Substantially all of Cerner's clients that buy software solutions also enter into software support agreements with us for maintenance and support of their Cerner systems. In addition to immediate software support in the event of problems, these agreements allow clients to access new releases of the Cerner solutions covered by support agreements. Each client has

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24-hour access to the client support team located at our world headquarters in North Kansas City, Missouri, our Continuous Campus in Kansas City, Kansas and our global support organizations in England and Ireland.

Most clients who buy hardware through Cerner also enter into hardware maintenance agreements with us. These arrangements normally provide for a fixed monthly fee for specified services. In the majority of cases, we utilize subcontractors to meet our hardware maintenance obligations. We also offer a set of managed services that include remote hosting, operational management services and disaster recovery.

Backlog

At the end of 2013, we had a contract backlog of \$8.1 billion as compared to \$6.5 billion at the end of 2012. Such backlog represents system sales and services from signed contracts that have not yet been recognized as revenue. At the end of 2013, we had a software support and maintenance backlog of \$786.0 million as compared to \$738.2 million at the end of 2012. Such backlog represents contracted software support and hardware maintenance services for a period of 12 months. We estimate that approximately 28 percent of the aggregate backlog at the end of 2013 of \$8.9 billion will be recognized as revenue during 2014.

Competition

The market for HCIT solutions, devices and services is intensely competitive, rapidly evolving and subject to rapid technological change. Our principal competitors in the health care solutions and services market include, but are not limited to: Allscripts Healthcare Solutions, Inc. (Allscripts), Computer Programs and Systems, Inc. (CPSI), Epic Systems Corporation (Epic), GE Healthcare Technologies (GE), Healthcare Management Systems, Inc. (HMS), Healthland, Inc., Computer Sciences Corporation (iSoft), McKesson Corporation (McKesson), Medical Information Technology, Inc. (Meditech), Siemens Medical Solutions Health Services Corporation (Siemens), and Quadramed Corporation (Quadramed), each of which offers a suite of software solutions that compete with many of our software solutions and services.

Other competitors focus on only a portion of the market that we address. For example, competitors, without limitation, such as Accenture plc, Clinovations, Inc., Dell, Inc. (Dell), Deloitte Consulting LLP (Deloitte), Encore Health Resources, LLC, IBM Corporation, Leidos Holding, Inc. and Xerox Corporation Ltd. offer HCIT services that compete directly with some of our service offerings. Allscripts, AmazingCharts.com, Inc., Athenahealth, Inc., eClinicalWorks LLC, e-MDs, Inc., MED3000, Inc., Practice Fusion, Inc., Quality Systems, Inc., SRSsoft and Vitera Healthcare Solutions offer solutions to the physician practice market but do not currently have a significant presence in the health systems and independent hospital market.

Cerner partners with third parties as a reseller of devices and markets its own competing proprietary health care devices. We view our principal competitors in the health care device market to include, without limitation: API Healthcare, CapsuleTech, Inc., CareFusion Corporation, GE, iSirona, LLC, McKesson and Omnicell, Inc. We view our principal competitors in the health care revenue cycle transactions market to include, without limitation: Accretive Health, Inc., Allscripts, Confier Health Solutions, Dell, Deloitte, Emdeon Corporation, Epic, GE, McKesson, MedAssets, Inc., Meditech, Optum, Inc., Quadramed, Siemens, SSI Group, Inc. and 3M Company with almost all of these competitors being substantially larger or having more experience and market share than us in their respective markets.

In addition, we expect that major software information systems companies, large information technology consulting service providers and system integrators, start-up companies, managed care companies and others specializing in the health care industry may offer competitive software solutions, devices or services. The pace of change in the HCIT market is rapid and there are frequent new software solutions, devices or services introductions, enhancements and evolving industry standards and requirements. We believe that the principal competitive factors in this market include the breadth and quality of solution and service offerings, the stability of the solution provider, the features and

capabilities of the information systems and devices, the ongoing support for the systems and devices and the potential for enhancements and future compatible software solutions and devices.

Number of Employees (Associates)

At the end of 2013, we employed approximately 14,200 associates worldwide.

Operating Segments

Information about our operating segments, which are geographically based, may be found in Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” below and in Note (19) to the consolidated financial statements.

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Executive Officers of the Registrant

The following table sets forth the names, ages, positions and certain other information regarding the Company's executive officers as of January 31, 2014. Officers are elected annually and serve at the discretion of the Board of Directors.

Name	Age	Positions
Neal L. Patterson	64	Chairman of the Board of Directors and Chief Executive Officer
Clifford W. Illig	63	Vice Chairman of the Board of Directors
Zane M. Burke	48	President
Marc G. Naughton		