

GARTNER INC
Form 10-Q
May 01, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
(Mark One)

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

For the quarterly period ended March 31, 2014

OR

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

Commission File Number 1-14443

Gartner, Inc.

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

04-3099750

(I.R.S. Employer
Identification Number)

P.O. Box 10212

56 Top Gallant Road

Stamford, CT

(Address of principal executive offices)

06902-7700

(Zip Code)

Registrant's telephone number, including area code: (203) 316-1111

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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405) 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 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. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller reporting company ☐
(Do not check if a smaller reporting company)

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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 April 25, 2014, 90,225,465 shares of the registrant's common shares were outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GARTNER, INC.

Condensed Consolidated Balance Sheets

(Unaudited; in thousands)

	March 31, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$283,284	\$423,990
Fees receivable, net of allowances of \$7,100 and \$7,000, respectively	496,997	490,923
Deferred commissions	97,610	106,287
Prepaid expenses and other current assets	67,777	63,682
Total current assets	945,668	1,084,882
Property, equipment and leasehold improvements, net	94,208	91,759
Goodwill	589,786	519,203
Intangible assets, net	34,537	6,107
Other assets	93,514	81,631
Total Assets	\$1,757,713	\$1,783,582
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$211,566	\$325,059
Deferred revenues	832,555	766,114
Current portion of long-term debt	222,500	68,750
Total current liabilities	1,266,621	1,159,923
Long-term debt	132,500	136,250
Other liabilities	121,869	126,093
Total Liabilities	1,520,990	1,422,266
Stockholders' Equity		
Preferred stock, \$.01 par value, 5,000,000 shares authorized; none issued or outstanding	—	—
Common stock, \$.0005 par value, 250,000,000 shares authorized; 156,234,415 shares issued for both periods	78	78
Additional paid-in capital	733,139	718,644
Accumulated other comprehensive income, net	8,552	8,345
Accumulated earnings	1,129,019	1,091,283
Treasury stock, at cost, 66,011,939 and 64,268,863 common shares, respectively	(1,634,065)	(1,457,034)
Total Stockholders' Equity	236,723	361,316
Total Liabilities and Stockholders' Equity	\$1,757,713	\$1,783,582

See the accompanying notes to the condensed consolidated financial statements.

GARTNER, INC.

Condensed Consolidated Statements of Operations

(Unaudited; in thousands, except per share data)

	Three Months Ended March 31,	
	2014	2013
Revenues:		
Research	\$348,114	\$310,331
Consulting	84,271	72,633
Events	14,317	23,790
Total revenues	446,702	406,754
Costs and expenses:		
Cost of services and product development	170,821	163,737
Selling, general and administrative	204,617	180,478
Depreciation	7,459	7,100
Amortization of intangibles	1,279	1,334
Acquisition and integration charges	3,356	100
Total costs and expenses	387,532	352,749
Operating income	59,170	54,005
Interest expense, net	(2,250)	(2,436)
Other (expense) income, net	(229)	211
Income before income taxes	56,691	51,780
Provision for income taxes	18,955	15,105
Net income	\$37,736	\$36,675
Earnings per common share:		
Basic	\$0.41	\$0.39
Diluted	\$0.40	\$0.38
Weighted average shares outstanding:		
Basic	91,669	93,595
Diluted	93,209	95,537

See the accompanying notes to the condensed consolidated financial statements.

GARTNER, INC.

Condensed Consolidated Statements of Comprehensive Income

(Unaudited; in thousands)

	Three Months Ended March 31,	
	2014	2013
Net income	\$37,736	\$36,675
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	(278	) (3,789
Interest rate hedge – gain	470	561
Pension – actuarial gain	15	23
Other comprehensive income (loss)	207	(3,205
Comprehensive income	\$37,943	\$33,470

See the accompanying notes to the condensed consolidated financial statements.

GARTNER, INC.

Condensed Consolidated Statements of Cash Flows

(Unaudited; in thousands)

	Three Months Ended March 31,	
	2014	2013
Operating activities:		
Net income	\$37,736	\$36,675
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,738	8,434
Stock-based compensation expense	13,752	12,342
Excess tax benefits from stock-based compensation	(11,146)	(13,219)
Deferred taxes	7,351	(1,872)
Amortization and write-off of debt issue costs	581	858
Changes in assets and liabilities, net of acquisition:		
Fees receivable, net	(4,210)	17,851
Deferred commissions	8,578	4,113
Prepaid expenses and other current assets	(4,366)	(4,467)
Other assets	(1,311)	(6,467)
Deferred revenues	65,280	51,019
Accounts payable, accrued, and other liabilities	(104,513)	(85,574)
Cash provided by operating activities	16,470	19,693
Investing activities:		
Additions to property, equipment and leasehold improvements	(9,185)	(9,648)
Acquisition - cash paid (net of cash acquired)	(101,770)	—
Acquisition - increase in restricted cash (escrow)	(13,500)	—
Cash used in investing activities	(124,455)	(9,648)
Financing activities:		
Proceeds from stock issued under stock plans	2,428	1,955
Proceeds from debt issuance	151,875	200,000
Payments for debt issuance costs	—	(3,553)
Payments on debt	(1,875)	(200,000)
Purchases of treasury stock	(195,850)	(48,527)
Excess tax benefits from stock-based compensation	11,146	13,219
Cash used in financing activities	(32,276)	(36,906)
Net increase in cash and cash equivalents	(140,261)	(26,861)
Effects of exchange rates on cash and cash equivalents	(445)	(3,928)
Cash and cash equivalents, beginning of period	423,990	299,852
Cash and cash equivalents, end of period	\$283,284	\$269,063

See the accompanying notes to the condensed consolidated financial statements.

GARTNER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1 — Business and Basis of Presentation

Business. Gartner, Inc. is a global information technology research and advisory company founded in 1979 with its headquarters in Stamford, Connecticut. Gartner delivers its products and services globally through three business segments: Research, Consulting, and Events. When used in these notes, the terms “Gartner,” “Company,” “we,” “us,” or “our” refer to Gartner, Inc. and its consolidated subsidiaries.

Basis of presentation. The accompanying interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”), as defined in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (“ASC”) Topic 270 for interim financial information and with the applicable instructions of the U.S. Securities & Exchange Commission (“SEC”) Rule 10-01 of Regulation S-X on Form 10-Q and should be read in conjunction with the consolidated financial statements and related notes of the Company filed in its Annual Report on Form 10-K for the year ended December 31, 2013.

The fiscal year of Gartner represents the twelve-month calendar period from January 1 through December 31. In the opinion of management, all normal recurring accruals and adjustments considered necessary for a fair presentation of financial position, results of operations and cash flows at the dates and for the periods presented herein have been included. The results of operations for the three months ended March 31, 2014 may not be indicative of the results of operations for the remainder of 2014.

Principles of consolidation. The accompanying interim condensed consolidated financial statements include the accounts of the Company and its wholly- and majority-owned subsidiaries. All significant intercompany transactions and balances have been eliminated.

Use of estimates. The preparation of the accompanying interim condensed consolidated financial statements requires management to make estimates and assumptions about future events. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities, and reported amounts of revenues and expenses. Such estimates include the valuation of fees receivable, goodwill, intangible assets, and other long-lived assets, as well as tax accruals and other liabilities. In addition, estimates are used in revenue recognition, income tax expense, performance-based compensation charges, depreciation and amortization, and the allowance for losses. Management believes its use of estimates in these interim condensed consolidated financial statements to be reasonable.

Management continually evaluates and revises its estimates using historical experience and other factors, including the general economic environment and actions it may take in the future. Management adjusts these estimates when facts and circumstances dictate. However, these estimates may involve significant uncertainties and judgments and cannot be determined with precision. In addition, these estimates are based on management’s best judgment at a point in time. As a result, differences between our estimates and actual results could be material and would be reflected in the Company’s consolidated financial statements in future periods.

Adoption of new accounting rules. The Company adopted two new accounting rules issued by the FASB effective January 1, 2014, as follows:

The Company adopted ASU No. 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" ("ASU 2013-11"). ASU 2013-11 addresses

the balance sheet presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The balance sheet impact from the adoption of ASU 2013-11 was not material to the Company.

The Company adopted ASU No. 2013-05, Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity. ASU No. 2013-05 provides updated guidance to resolve diversity in practice concerning the release of the cumulative foreign currency translation adjustment into net income when a parent sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets within a foreign entity. When a company ceases to have a controlling financial interest, the company should recognize any related cumulative translation adjustment into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary had resided. Upon a

partial sale, the company should release into earnings a pro rata portion of the cumulative translation adjustment. The adoption of ASU 2013-05 did not impact the Company's financial statements and will only have an impact upon the occurrence of a transaction within its scope.

Acquisition. On March 7, 2014, the Company acquired Software Advice, Inc., ("Software Advice"), a privately-owned company based in Austin, Texas with 120 employees. Software Advice assists customers with software purchases. At closing, the Company paid \$103.2 million in cash for 100% of the outstanding shares of Software Advice.

The Company is also obligated to pay up to an additional \$31.9 million in cash related to the acquisition. This includes \$13.5 million placed in escrow as security for potential losses. Release of the escrowed funds is also subject to the achievement of certain employment conditions. The escrow amount is considered restricted cash and is recorded in Other Assets in the Condensed Consolidated Balance Sheets. An additional \$18.4 million is payable contingent on the achievement of certain employment conditions. This amount is also subject to any indemnified losses in excess of the escrowed funds. The \$31.9 million will be expensed ratably (adjusted for any indemnified losses) over the required service periods of the relevant employees (two years) and recorded in Acquisition and integration charges in the Condensed Consolidated Statements of Operations. If the employment conditions are not met, any expense previously accrued will be reversed in the period employment terminates.

The Company's financial statements include the operating results of Software Advice beginning with the date of acquisition, which were not material to the Company's first quarter 2014 operating results. Had the Company acquired Software Advice on January 1, 2012, the impact to the Company's operating results for prior periods would not have been material, and as a result pro forma financial information for prior periods has not been presented. The Company recorded \$3.4 million of pre-tax acquisition and integration charges in the first quarter of 2014, which are classified in Acquisition and integration charges in the Condensed Consolidated Statements of Operations. Included in these charges are legal, consulting, retention, severance, and other direct acquisition and integration costs.

The Company accounts for acquisitions in accordance with the acquisition method of accounting as prescribed by FASB ASC Topic 805, Business Combinations. The acquisition method of accounting requires the consideration paid to be allocated to the net assets and liabilities acquired based on their estimated fair values as of the acquisition date, and any excess of the purchase price over the estimated fair value of the net assets acquired, including identifiable intangible assets, must be allocated to goodwill.

The following table summarizes the preliminary allocation of the purchase price to the fair value of the assets acquired and liabilities assumed in the acquisition (in thousands):

Assets:	
Cash	\$1,450
Fees receivable and other current assets	3,785
Property, equipment, and leasehold improvements	234
Amortizable intangible assets (1)	29,690
Goodwill (1)	70,936
Total assets	\$106,095
Liabilities:	
Accounts payable and accrued liabilities	\$2,875
Total liabilities	\$2,875

(1)See Note 6 - Goodwill and Intangible Assets for additional information.

The determination of the fair values of the amortizable intangibles required management judgment and the consideration of a number of factors, significant among them the historical financial performance of the acquired business and projected performance, estimates surrounding customer turnover, and assumptions regarding competition. The fair values of the intangibles was primarily based on discounted cash flow methodologies. Establishing the useful lives of the amortizable intangibles also required management judgment and the evaluation of a number of factors, among them projected cash flows and the likelihood of competition.

The Company considers the allocation of the purchase price to be preliminary with respect to certain tax and other contingencies. All of the recorded goodwill and intangibles from the transaction will be deductible for tax purposes over 15 years. The recorded

goodwill was included in the Company's Research segment. The Company believes the recorded goodwill is supported by the anticipated revenue synergies resulting from the combined operations.

Note 2 — Comprehensive Income

The following tables disclose information about changes in accumulated other comprehensive income ("AOCI") by component and amounts reclassified out of AOCI to income during the period (net of tax, in thousands) (1):

For the three months ended March 31, 2014:

	Interest Rate Swap	Defined Benefit Pension Plans	Foreign Currency Translation Adjustments	Total
Balance – December 31, 2013	\$(3,903	) \$(1,811	) \$14,059	\$8,345
Changes during the period:				
Other comprehensive income (loss) before reclassifications	(132	) —	(278	) (410
Reclassifications from AOCI to income (2), (3)	602	15	—	617
Other comprehensive income (loss) for the period	470	15	(278	) 207
Balance – March 31, 2014	\$(3,433	) \$(1,796	) \$13,781	\$8,552

For the three months ended March 31, 2013:

	Interest Rate Swap	Defined Benefit Pension Plans	Foreign Currency Translation Adjustments	Total
Balance – December 31, 2012	\$(6,010	) \$(1,578	) \$13,556	\$5,968
Changes during the period:				
Other comprehensive income (loss) before reclassifications	(4	) 17	(3,789	) (3,776
Reclassifications from AOCI to income (2), (3)	565	6	—	571
Other comprehensive income (loss) for the period	561	23	(3,789	) (3,205
Balance – March 31, 2013	\$(5,449	) \$(1,555	) \$9,767	\$2,763

(1) Amounts in parentheses represent debits (deferred losses).

The reclassifications related to the interest rate swap (cash flow hedge) were recorded in Interest expense, net and (2) exclude \$0.4 million of tax benefit reflected in the Provision for income taxes for both the three months ended March 31, 2014 and 2013. See Note 10 – Derivatives and Hedging for information regarding the hedge.

The reclassifications related to defined benefit pension plans were recorded in Selling, general and administrative (3) expense and had an immaterial tax effect for both periods. See Note 12 – Employee Benefits for information regarding the Company's defined benefit pension plans.

Note 3 — Earnings per Share

The following table sets forth the calculations of basic and diluted earnings per share (in thousands, except per share data):

	Three Months Ended March 31,	
Numerator:	2014	2013