GARTNER INC
Form 10-Q
November 07, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
(Mark One)

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

For the quarterly period ended September 30, 2013

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	04-3099750
(State or other jurisdiction of incorporation or organization)	(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 þ 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 þ 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 þ Accelerated filer ¨ Non-accelerated filer ¨ (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 þ

As of October 28, 2013, 92,177,533 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)

	September 30, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$374,521	$299,852
Fees receivable, net of allowances of $6,100 and $6,400, respectively	392,174	463,968
Deferred commissions	77,390	87,933
Prepaid expenses and other current assets	91,070	75,713
Total current assets	935,155	927,466
Property, equipment and leasehold improvements, net	90,198	89,089
Goodwill	518,555	519,506
Intangible assets, net	7,535	11,821
Other assets	76,955	73,395
Total Assets	$1,628,398	$1,621,277
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$224,873	$287,763
Deferred revenues	754,120	692,237
Current portion of long-term debt	65,000	90,000
Total current liabilities	1,043,993	1,070,000
Long-term debt	140,000	115,000
Other liabilities	122,770	129,604
Total Liabilities	1,306,763	1,314,604
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	707,439	679,871
Accumulated other comprehensive income, net	6,734	5,968
Accumulated earnings	1,029,865	908,482
Treasury stock, at cost, 64,059,116 and 62,873,100 common shares, respectively	(1,422,481)	(1,287,726)
Total Stockholders' Equity	321,635	306,673
Total Liabilities and Stockholders' Equity	$1,628,398	$1,621,277

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 September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenues:				
Research	$316,518	$284,048	$938,082	$836,970
Consulting	70,149	71,731	228,710	222,970
Events	24,038	18,627	96,714	81,119
Total revenues	410,705	374,406	1,263,506	1,141,059
Costs and expenses:				
Cost of services and product development	161,735	151,143	503,376	458,853
Selling, general and administrative	181,546	164,888	547,653	492,627
Depreciation	7,258	6,301	21,375	18,378
Amortization of intangibles	1,351	1,362	4,089	3,029
Acquisition and integration charges	72	944	278	2,126
Total costs and expenses	351,962	324,638	1,076,771	975,013
Operating income	58,743	49,768	186,735	166,046
Interest expense, net	(2,124)	(2,209)	(6,704)	(6,557)
Other income (expense), net	5	(748)	(64)	(1,802)
Income before income taxes	56,624	46,811	179,967	157,687
Provision for income taxes	18,430	15,436	58,584	50,607
Net income	$38,194	$31,375	$121,383	$107,080
Income per common share:				
Basic	$0.41	$0.34	$1.30	$1.15
Diluted	$0.40	$0.33	$1.28	$1.12
Weighted average shares outstanding:				
Basic	92,689	93,522	93,286	93,429
Diluted	94,355	95,611	95,100	95,791

See the accompanying notes to the condensed consolidated financial statements.

GARTNER, INC.

Condensed Consolidated Statements of Comprehensive Income

(Unaudited; in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	$38,194	$31,375	$121,383	$107,080
Other comprehensive income, net of tax:				
Interest rate swap (cash flow hedge) – gain (loss)	261	(282)	1,636	(683)
Defined benefit pension plans – actuarial gain (loss)	6	(51)	30	(157)
Foreign currency translation adjustments	4,109	5,383	(900)	3,720
Other comprehensive income	4,376	5,050	766	2,880
Comprehensive income	$42,570	$36,425	$122,149	$109,960

See the accompanying notes to the condensed consolidated financial statements.

GARTNER, INC.

Condensed Consolidated Statements of Cash Flows

(Unaudited; in thousands)

	Nine Months Ended September 30, 2013	2012
Operating activities:		
Net income	$121,383	$107,080
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of intangibles	25,464	21,407
Stock-based compensation expense	27,049	28,021
Excess tax benefits from stock-based compensation	(18,412)	(20,366)
Deferred taxes	4,989	(3,268)
Amortization and write-off of debt issue costs	2,107	1,512
Changes in assets and liabilities, net of acquisition:		
Fees receivable, net	69,732	54,157
Deferred commissions	10,055	13,202
Prepaid expenses and other current assets	(20,840)	(18,803)
Other assets	(3,064)	2,429
Deferred revenues	64,662	60,681
Accounts payable, accrued, and other liabilities	(41,056)	(37,301)
Cash provided by operating activities	242,069	208,751
Investing activities:		
Additions to property, equipment and leasehold improvements	(27,772)	(30,800)
Acquisition (net of cash acquired)	—	(10,336)
Cash used in investing activities	(27,772)	(41,136)
Financing activities:		
Proceeds from stock issued under stock plans	4,539	10,560
Proceeds from debt issuance	203,750	22,500
Payments for debt issuance costs	(3,553)	—
Payments on debt	(203,750)	(22,500)
Purchases of treasury stock	(157,251)	(89,300)
Excess tax benefits from stock-based compensation	18,412	20,366
Cash used by financing activities	(137,853)	(58,374)
Net increase in cash and cash equivalents	76,444	109,241
Effects of exchange rates on cash and cash equivalents	(1,775)	3,411
Cash and cash equivalents, beginning of period	299,852	142,739
Cash and cash equivalents, end of period	$374,521	$255,391

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, 2012.

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 and nine months ended September 30, 2013 may not be indicative of the results of operations for the remainder of 2013.

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 accounts 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 is reasonable.

Management continuously 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 new accounting rules in the nine months ended September 30, 2013 related to accumulated other comprehensive income (see Note 2 — Comprehensive Income) and balance sheet offsetting of receivables and payables arising from derivative contracts (see Note 10 — Derivatives and Hedging). The adoption of these new rules resulted in additional disclosure only.

Note 2 — Comprehensive Income

On January 1, 2013, the Company adopted FASB Accounting Standards Update (“ASU”) 2013-2, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, an amendment to FASB ASC Topic 220, Comprehensive Income. ASU 2013-2 requires entities to prospectively disclose additional information about changes in accumulated other comprehensive income (“AOCI’) balances by component and items reclassified out of AOCI to income during the period. ASU 2013-2 does not change the existing requirement to present the components of comprehensive income in the financial statements and is intended to improve the transparency of reclassification amounts and their impact on the financial statements. The information required by ASU 2013-2 is presented below.

The changes in AOCI by component (net of tax) are presented in the following tables (in thousands) (1):

For the three months ended September 30, 2013:

	Interest Rate Swap (Cash Flow Hedge)	Defined Benefit Pension Plans	Foreign Currency Translation Adjustments	Total
Balance – June 30, 2013	$(4,635)	$(1,554)	$8,547	$2,358
Changes during the period:				
Other comprehensive income (loss) before reclassifications	(360)	—	4,109	3,749
Reclassifications from AOCI to income (2), (3)	621	6	—	627
Other comprehensive income for the period	261	6	4,109	4,376
Balance – September 30, 2013	$(4,374)	$(1,548)	$12,656	$6,734

For the nine months ended September 30, 2013:

	Interest Rate Swap (Cash Flow Hedge)	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	(153)	17	(900)	(1,036)
Reclassifications from AOCI to income (2), (3)	1,789	13	—	1,802
Other comprehensive income (loss) for the period	1,636	30	(900)	766
Balance – September 30, 2013	$(4,374)	$(1,548)	$12,656	$6,734

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

(2) The reclassifications related to the interest rate swap (cash flow hedge) were recorded in Interest expense, net and exclude $0.4 million and $1.2 million of tax benefit reflected in the Provision for income taxes for the three and nine months ended September 30, 2013, respectively. See Note 10 – Derivatives and Hedging for information regarding the hedge.

(3) The reclassifications related to defined benefit pension plans were recorded in Selling, general and administrative expense and had an immaterial tax effect. 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 September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Numerator:				
Net income used for calculating basic and diluted earnings per share	$38,194	$31,375	$121,383	$107,080
Denominator:				
Weighted average number of common shares used in the calculation of basic earnings per share	92,689	93,522	93,286	93,429
Common stock equivalents associated with stock-based compensation plans (1)	1,666	2,089	1,814	2,362
Shares used in the calculation of diluted earnings per share	94,355	95,611	95,100	95,791
Basic earnings per share	$0.41	$0.34	$1.30	$1.15
Diluted earnings per share	$0.40	$0.33	$1.28	$1.12

(1) Certain common stock equivalents were not included in the computation of diluted earnings per share because the effect would have been anti-dilutive. These shares totaled 0.4 million for both the three months ended September 30, 2013 and 2012 and 0.3 million and 0.7 million for the nine months ended September 30, 2013 and 2012, respectively.

Note 4 — Stock-Based Compensation

The Company grants stock-based compensation awards as an incentive for employees and directors to contribute to the Company's long-term success. The Company currently awards stock-settled stock appreciation rights, service-based and performance-based restricted stock units, and common stock equivalents. At September 30, 2013, the Company had 6.1 million shares of its common stock, par value $.0005 per share (the "Common Stock") available for awards of stock-based compensation under its 2003 Long-Term Incentive Plan.

The Company accounts for stock-based compensation awards in accordance with FASB ASC Topics 505 and 718, as interpreted by SEC Staff Accounting Bulletins No. 107 ("SAB No. 107") and No. 110 ("SAB No. 110"). Stock-based compensation expense is based on the fair value of the award on the date of grant, which is then recognized as expense over the related service period, net of estimated forfeitures. The service period is the period over which the related service is performed, which is generally the same as the vesting period. Currently the Company issues treasury shares upon the exercise, release or settlement of stock-based compensation awards.

Determining the appropriate fair value model and calculating the fair value of stock-based compensation awards requires the input of certain complex and subjective assumptions, including the expected life of the stock compensation awards and the Common Stock price volatility. In addition, determining the appropriate amount of associated periodic expense requires management to estimate the amount of employee forfeitures and the likelihood of the achievement of certain performance targets. The assumptions used in calculating the fair value of stock-based compensation awards and the associated periodic expense represent management's best estimates, but these estimates involve inherent uncertainties and the application of judgment. As a result, if factors change and the Company deems it necessary in the future to modify the assumptions it made or to use different assumptions, or if the quantity and nature of the Company's stock-based compensation awards changes, then the amount of expense may need to be adjusted and future stock-based compensation expense could be materially different from what has been recorded in the current period.

Stock-Based Compensation Expense

The Company recognized the following amounts of stock-based compensation expense by award type and expense category in the periods indicated (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
Award type:	2013	2012	2013	2012
Stock appreciation rights	$1.1	$2.4	$4.1	$5.0
Common stock equivalents	0.1	0.1	0.4	0.4
Restricted stock units	6.2	6.7	22.5	22.6
Total	$7.4	$9.2	$27.0	$28.0

	Three Months Ended September 30,		Nine Months Ended September 30,	
Amount recorded in:	2013	2012	2013	2012
Cost of services and product development	$3.2	$3.5	$12.0	$12.0
Selling, general and administrative	4.2	5.7	15.0	16.0
Total stock-based compensation expense (1)	$7.4	$9.2	$27.0	$28.0

(1) Includes charges of $1.8 million and $1.5 million for the three months ended September 30, 2013 and 2012, respectively, for awards to retirement-eligible employees since these awards vest on an accelerated basis. The nine months ended September 30, 2013 and 2012 include retirement-eligible charges of $10.6 million and $4.7 million, respectively.

As of September 30, 2013, the Company had $48.4 million of total unrecognized stock-based compensation cost, which is expected to be expensed over the remaining weighted-average service period of approximately 2.3 years.

Stock-Based Compensation Awards

The following disclosures provide information regarding the Company’s stock-based compensation awards, all of which are classified as equity awards in accordance with FASB ASC Topic 505:

Stock Appreciation Rights

Stock-settled stock appreciation rights (SARs) permit the holder to participate in the appreciation of the Common Stock. SARs are settled in shares of Common Stock by the employee once the applicable vesting criteria have been met. SARs vest ratably over a four-year service period and expire seven years from the grant date. The fair value of SARs awards is recognized as compensation expense on a straight-line basis over four years. SARs have only been awarded to the Company’s executive officers.

When SARs are exercised, the number of shares of Common Stock issued is calculated as follows: (1)the total proceeds from the SARs exercise (calculated as the closing price of the Common Stock on the date of exercise less the exercise price of the SARs, multiplied by the number of SARs exercised) is divided by (2) the closing price of the Common Stock as reported on the New York Stock Exchange on the exercise date. The Company withholds a portion of the shares of Common Stock issued upon exercise to satisfy minimum statutory tax withholding requirements. SARs recipients do not have any stockholder rights until after actual shares of Common Stock are issued in respect of the award, which is subject to the prior satisfaction of the vesting and other criteria relating to such grants.

The following table summarizes changes in SARs outstanding during the nine months ended September 30, 2013:

	SARs (in millions)	Per Share Weighted-Average Exercise Price	Per Share Weighted-Average Grant Date Fair Value	Weighted Average Remaining Contractual Term
Outstanding at December 31, 2012	2.0	$24.59	$9.04	4.10 years
Granted	0.4	49.37	14.88	6.37
Forfeited	—	—	—	n/a
Exercised	(0.4)	18.80	7.02	n/a
Outstanding at September 30, 2013 (1), (2)	2.0	$30.11	$10.46	4.18
Vested and exercisable at September 30, 2013 (2)	1.0	$21.00	$7.98	3.17 years

n/a=not applicable.

(1) As of September 30, 2013, 1.0 million of the SARs outstanding were unvested. The Company expects that substantially all of these unvested awards will vest in future periods.

(2) Total SARs outstanding had an intrinsic value of $59.3 million. SARs vested and exercisable had an intrinsic value of $39.8 million.

The fair value of the SARs was estimated on the date of grant using the Black-Scholes-Merton valuation model with the following weighted-average assumptions: