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EDITED TRANSCRIPT

IT - Q2 2016 Gartner Inc Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Gartner's earnings conference call for the second quarter of 2016.

The replay for the call will be available through September 4, 2016. The replay can be accessed by dialing (888)286-8010 for domestic calls and (617)801-6888 for international calls and by entering passcode 21946131. This call is being simultaneously webcast and will be archived on Gartner's website at www.Gartner.com for approximately 30 days.

I will now turn the conference over to Sherief Bakr, Gartner's Group Vice President of Investor Relations, for opening remarks and introductions. Please go ahead, sir.

Sherief Bakr - *Gartner Inc - Group VP of IR*

Thank you, Sue, and good morning, everyone. Welcome to Gartner's second quarter 2016 earnings conference call. With me today in Stanford is our Chief Executive Officer, Gene Hall, and our Chief Financial Officer, Craig Safian.

This call include a discussion of Q2 2016 financial results as disclosed in today's press release, as well as our outlook for 2016. After our prepared remarks, you will have an opportunity to ask questions. I would like to remind everyone that the press release is available on our website, www.investor.gartner.com.

Before we begin, I'd like to remind you that certain statements made on this call may constitute forward-looking statements. Forward-looking statements can vary materially from actual results and are subject to a number of risks and uncertainties, including those contained in the Company's 2015 annual report Form 10-K and 2016 quarterly reports on Form 10-Q, as well as in other filings with the SEC. I would encourage all of you to review the risk factors listed in these documents.

With that, I'd like to hand the call over to Gartner's Chief Executive Officer, Gene Hall.

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Gene Hall - *Gartner Inc - CEO*

Good morning, everyone, and welcome to our quarterly earnings call. Q2 was a robust quarter with strong performances across our business. As on prior calls, I will review our key operating metrics on an FX neutral basis.

We do business in more than 90 countries around the world and with ongoing currency fluctuations, that's the best way to understand the underlying health of our business. For the second quarter of 2016, total Company revenues grew 12%, and we continue to see robust demand for our products and services. Research, which is our largest and most profitable segment, achieved 17% revenue growth over the same quarter last year.

These results were driven by double-digit contract value growth and contributions from our recent acquisitions. Our contract value grew 13% with double-digit growth in every region, across every client size, and in virtually every industry. Client retention and wallet retention were strong at 83% and 104%, respectively, while down modestly from our recent all-time highs. Our consulting segment deepened relationships with our largest clients and for Q2, our consulting business achieved 6% revenue growth with utilization up 1 point over the same quarter last year. Backlog, which is a leading indicator of future revenue growth for this business segment, grew 15% over this time last year.

Our events segment continues to drive strong growth while extending our brand. For the second quarter of 2016, event revenues were up 16% on a same events basis. We hosted more than 15,000 attendees across 25 events that we held in the quarter. Our results reflect the tremendous value we deliver to our clients. Technology is critical for every enterprise around the world.

Every enterprise has cybersecurity risks. Every enterprise is worried about technology disruption, and technology is the key to fueling cost reduction whether enterprise is funding new growth initiatives or improving margins. Enterprises know they need help, and Gartner is the best and most cost-effective source for that help.

Our clients rely on us for independent, objective, fact-based insights when making critical technology decisions. Our services deliver tremendous value and in most cases pay back and many times over.

There are a number of factors in the global economy today that impact our clients. Economic growth has slowed in countries around the world. Oil and other commodity prices have fallen dramatically. Exchange rates are at levels that challenge US exporters, and challenge non-US importers. And most recently, there's Brexit. As a result of these factors, we see a higher proportion of our clients with financial challenges compared to the past few years.

In the US, the S&P 500 is having its fourth consecutive quarter of negative earnings growth. In Europe, the S&P 350 is expected to have negative earnings growth this year. In any of our markets, we always clients who are doing great, clients who are doing okay, and clients who are in economic distress. We know how to be successful with all clients whether they are thriving or in financial distress, which is why we've consistently delivered double-digit growth in every geography, in virtually every industry, and across every client size segment.

However, when clients are in distress, decisions like those can get extended as they scrutinize every expense. Because of the pervasive criticality of technology, and the incredibly strong value we deliver, we win with these clients. But decisions like this can take longer, which has led to a modest reduction in our growth rate. Whether an enterprise is thriving or facing economic challenges, Gartner is the insight and advise our clients need to achieve success in their mission-critical priorities.

So summarizing, we had a very robust Q2 with strong performances across our business. Our client base is highly diversified with more than 10,000 client enterprises in every size from the largest in the world to the smallest, in more than 90 countries and across every industry. We had double-digit contract value growth in all geographies, all client sizes, and virtually all industries.

We have a huge untapped market opportunity. We have robust demand for offerings, and our pipeline is strong. And we're not standing still. We attract the best talent in the industry. We continue to invest in innovations to improve our content, products, hiring, training, and tools to drive continued improvement in our operational effectiveness.

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We are committed to enhancing shareholder value through investment in our business, strategic acquisitions and share repurchases. Our 2016 and long-term outlook is strong. With that, I'll hand the call over to Craig.

Craig Safian - *Gartner Inc - CFO*

Thank you, Gene, and good morning, everyone. Gartner's second quarter performance continues our long-term trend of double-digit growth. Despite challenges in the economic environment, we see robust demand for our products and services, and our sales pipeline is strong. The combination of the tremendous value we provide to our clients around the world, the investments we are making to capture our vast market opportunity, and our exceptional business model allows us to consistently deliver double-digit revenue, earnings, and free cash flow growth.

Our first half performance, combined with our expectations for the balance of the year indicate that we are well on track to continue that trend for the full-year 2016. On an FX-neutral basis our year-on-year financial performance for the second quarter of 2016 included contract value growth of 13% and research revenue growth of 17%; events revenue growth of 16% on a same events basis; consulting revenue growth of 6% with backlog growth of 15%; normalized EBITDA growth of 5% or 14% when adjusted for the shift in the timing of events; and diluted EPS, excluding acquisition adjustments of $0.71 per share. This compares to $0.65 per share in the second quarter of 2015 and our guidance range of $0.66 to $0.70.

In addition, our exceptional business model and focus on cash flow continues to create a consistently high level of free cash flow conversion. On a rolling four quarter basis, our free cash flow conversion was 142% of normalized net income.

For the first half of the year, which normalizes for the calendar shift in events, our year-over-year FX neutral performance highlights are as follows, total revenue growth of 16%; research revenue growth of 18%; consulting revenue growth of 9%; events revenue growth of 14%; normalized EBITDA growth of 16%; and diluted earnings per share, excluding acquisition adjustments, of $1.32 per share. This compares to $1.02 per share in the first half of 2015, an increase of 29% on a reported basis.

I will now discuss our second quarter business segment performance in- depth, and then turn to our balance sheet and cash flow dynamics. I will then close with remarks on our guidance for Q3 and outlook for the full-year. We will then be happy to take your questions.

Beginning with research, research revenue grew 16% on an as-reported basis and 17% on an FX-neutral basis in the second quarter. Excluding the impact of our newest acquisitions and FX, research revenues were up organically by over 12%. Our recently acquired businesses continue to perform strongly.

The gross contribution margin for research was 70% or the same level compared with the second quarter of 2015. All of our other research business metrics remained strong. Total contract value was $1.754 billion as of the end of Q2, FX neutral growth of 13% versus the prior year. For reference and comparison, our Q2 2015 total contract value at current year FX rates was $1.549 billion.

We have a highly diversified business. We serve clients in more than 90 countries. Our clients operate in every industry vertical, and we serve the largest enterprises in the world, down to the smallest businesses.

This diversified client base is a strength as it helps us to mitigate against problems in any one region, any one industry, or any one size of client. Consistent with this, our growth in contract value continues to be broad-based. Every region, every client size, and virtually every industry segment grew at double-digit rates. As Gene mentioned, client retention was 83% for Q2, down 2 points from the second quarter of 2015. Wallet retention ended at 104% for the quarter, also down 2 points year-on-year.

As Gene mentioned earlier, we are seeing a higher proportion of our clients experiencing financial challenges. These challenges impact our retention and productivity metrics. For example, decision cycles can lengthen, and if those decisions stretch over a quarter, it can impact retention and productivity. That said, we still offer our clients great value and know how to operate successfully, whether our clients are in growth mode or are facing challenges.

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New business increased 11% year-on-year in Q2. The new business mix is consistent with prior quarters and remains balanced between sales from new clients and sales of additional services and upgrades to existing clients. And as always, we continue to benefit from our consistent price increases and discipline around pricing.

Our new business growth reflects our success in penetrating our vast market opportunity with both new and existing client enterprises. We ended the second quarter with 10,477 enterprise clients, up 5% compared to Q2 2015. The average spend per enterprise also continues to grow. It now stands at $167,000 per enterprise, up 7% versus prior year on an FX-neutral basis. This increase in average spend reflects our ability to drive CV growth through both new and existing enterprises.

Turning to sales productivity. As we have detailed in the past, we calculate sales productivity as the net contract value increase, what we call NCVI, per account executive. We look at it on a rolling four-quarter basis to eliminate seasonality, and we use opening sales headcount as the period denominator. Over the last 12 months, we grew our contract value by $205 million in FX-neutral terms.

Using our Q2 2015 ending sales headcount of 2,070 as are beginning of period denominator, yields NCVI per AE of $98,000 on a rolling four-quarter basis, or a 14% decline over the second quarter of last year, when the comparable figure was $114,000 per account executive at constant currency rates. As always, we remain highly focused on improving our sales productivity, and remain confident that the initiatives we have implemented to drive productivity will positively impact our results over the long-term.

Consistent with this, our strategic priority continues to be on investing to capture the vast market opportunity ahead of us and to drive long-term earnings and cash flow growth for our shareholders. We continually evaluate and adjust the pace of these investments, taking a highly analytical approach to how and where we allocate sales resources, all the way down to the individual team level. We do not take a one-size-fits-all approach. For example, if we are seeing strong CV growth and good productivity trends in a team or region then we would plan to increase headcount faster than the average in those areas. Similarly, if we were to see decelerating CV growth and declining productivity metrics, we would slow headcount growth. We will continue to make operational adjustments where needed and report back to you on our progress.

To sum up, we delivered a solid quarter in research with 13% contract value growth and strong growth from our most recent acquisitions. While sales productivity declined in the quarter, we are confident that the productivity initiatives we have in place will positively impact contract value growth in 2016 and, ultimately, revenue -- research revenue growth over the long-term.

Moving to events. On a same event and FX-neutral basis, events revenues increased 16% year-on-year in Q2. As noted last quarter, we moved three larger events that occurred in Q2 2015 into the first quarter of 2016, which impacted the reported results in both Q1 and Q2 of this year. In the second quarter, we held 25 events with 15,451 attendees compared to 26 events and 17,107 attendees in the second quarter of 2015. On a same events basis, we had a 5% increase in attendees. Events Q2 gross contribution margin was 54%, up slightly compared to the lighter year-ago quarter. As I mentioned earlier, events revenue increased by 14% on an FX-neutral basis in the first half of 2016.

Consulting had a strong quarter, generating a 6% year-on-year FX-neutral increase in revenues. The labor-based business was up 10% versus Q2 of last year on an FX-neutral basis, with broad-based growth. The contract optimization practice declined for Q2 versus 2015, but has shown growth on a year-to-date basis.

The underlying operating metrics of our consulting business remains strong. On the labor-based side, global headcount of 626 was up 11% from the year-ago quarter, and second quarter annualized revenue for global headcount ended at $408,000, which was approximately flat year-on-year on an FX-neutral basis.

Our ongoing invested -- investment in managing partners continues to drive demand for our services, and we had 112 managing partners at the end of Q2, a 12% increase over the year-ago quarter. Related to this, backlog, the key leading indicator of future revenue growth for our consulting business, ended the quarter at $109 million, up 15% year-on-year on an FX-neutral basis. This represents over four months of forward backlog.

Moving down the income statement. SG&A increased by 14% year-over-year in the second quarter, primarily driven by the growth in our sales force. As of the end of Q2, we had 2,297 direct quota-bearing sales associates, an increase of 227 or 11% from a year ago.

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At June 30, we had a large number of new sales associates who were still in training, and thus not in the final count. If we normalize for the timing of these hires, our year-on-year sales headcount growth was 14% for the quarter.

Moving on to EBITDA and earnings. Normalized EBITDA was $118 million in the second quarter, up 7% year-on-year on a reported basis and up 5% on an FX-neutral basis. Excluding the shift in events I mentioned earlier, normalized EBITDA would have been up approximately 14% in the quarter. On a year-to-date basis, normalized EBITDA is up 16% versus the prior year on both a reported and FX-neutral basis.

Moving down the income statement, depreciation, amortization, and acquisition and integration charges all increased year-over-year, reflecting higher capital spending to support our growth, as well as the impact of our recent acquisitions. Net interest expense was $7 million in Q2, reflecting our increased borrowing. Our GAAP tax rate for the quarter was 37.9%, which is higher than our full-year GAAP tax rate guidance of approximately 36% due to Q2 timing of tax costs. Adjusting for acquisition charges, our normalized tax rate for the quarter was 35.1%, which is in line with our full-year normalized tax rate guidance of approximately 35%.

GAAP diluted earnings per share was $0.57 in Q2. Our GAAP EPS included roughly $0.14 worth of acquisition and integration charges. EPS, excluding acquisition and integration charges, was $0.71 per share in Q2, up 9% versus Q2 of 2015. On a year-to-date basis, EPS excluding acquisition and integration charges is up 29% year-over-year.

Turning now to cash, for Q2, operating cash flow was $145 million, approximately flat on a year-on-year basis. We define free cash flow as operating cash flow, less capital expenditures with cash acquisition and integration payments added back. In the second quarter, free cash flow was $127 million compared to $132 million in Q2 2015.

Managing our business to generate strong cash flow one of our top priorities. Year-to-date free cash flow was impacted by three primary factors. First, the modest deceleration of our CV growth rates; second, the timing of bookings across all of our businesses; and third, modestly higher capital expenditures to support the growth of the business. Our full-year outlook still shows free cash flow growth of 11% to 19%. Consistent with the negative working capital dynamics that are a key characteristics of our of our subscription-based business model, we continue to generate free cash flow well in excess of net income on a rolling four-quarter basis.

At the end of Q2, this equated to a rolling four quarter free cash flow of $320 million. This represents a net income to free cash flow conversion of 142%. Strategic acquisitions and share repurchases continue to be the primary uses of our free cash flow and available capital. Our number one priority remains executing on value-creating, acquisition opportunities, and our M&A pipeline remains active.

At the end of the second quarter, we announced and closed the acquisition of SCM World, the leading cross industry peer network and learning community providing subscription-based research and conferences for supply chain executives, spending $29 million in Q2. As you will see in our 10-Q, there are other contingent payments associated with this deal based upon employment and performance criteria. We were able to use our overseas cash to fund this acquisition.

During the second quarter, we repurchased $7 million worth of our shares. On a year-to-date basis, we have repurchased [$52 million] of shares. As of June 30, with had approximately $1.1 billion available under our share repurchase authorization.

We ended the quarter with a strong balance sheet, cash position, and enhanced liquidity profile. As of June 30, we had gross debt of $835 million. When combined with our cash balance of $445 million, it represents a net debt position of $390 million, or about 0.9 times normalized EBITDA.

In June we closed on a new $1.8 billion secured credit facility consisting of a $600 million term loan and a $1.2 billion revolver. As we assessed our projected growth, our potential future needs, as well as the attractiveness of the bank markets, we decided to take the opportunity to expand and extend our credit facility. As of June 30 we have an additional $966 million of revolver capacity. That and our ongoing free cash flow generation gives us ample liquidity to continue to grow our business and execute initiatives that drive shareholder value.

Before discussing our guidance, I did want to mention Brexit, as I know many of you have been asking questions related to it and our exposure in the UK. We generate approximately 7% of our revenues in the UK. More importantly, and as I mentioned earlier, we know how to operate and

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execute in times of uncertainty. By staying focused on our customers' mission-critical priorities, we are confident that we can continue to provide value, whether our clients are thriving or under financial stress.

Turning now to guidance. Except for some modest changes to reflect the impact of our most recent acquisition, our guidance is unchanged from May. If you recall, we raised our guidance in May, and our Q2 performance is consistent with that outlook.

All of the guidance information is contained in our press release, so I will only focus on the highlights and the items that changed. Our 2016 guidance stills expect total revenues of $2.405 billion to $2.465 billion. This is FX neutral growth of 13% to 15%. We continue to expect to deliver between $450 million and $480 million of normalized EBITDA, or 11% to 19% growth on an FX-neutral basis.

To account for additional amortization and acquisition and integration charges from the SCM World deal, we now expect approximately $0.05 more of acquisition and integration charges in 2016. As a result, we are updating our GAAP EPS guidance and now expect $2.22 to $2.44 per share in 2016. This includes $0.45 per share of acquisition-related charges. Excluding acquisition and integration charges, our guidance for EPS remains at $2.67 to $2.89 per share in 2016. This represents FX neutral growth of approximately 13% to 22%. There are no other changes to our outlook for the full-year 2016.

For the third quarter of 2016, we expect GAAP EPS of $0.36 to $0.40 per share, including $0.11 per share of acquisition and integration charges. This yields EPS excluding acquisition and integration charges of $0.47 to $0.51 per share. Q3 is historically one of our smallest quarters, and that is the case again in 2016.

In summary, Gartner delivered another very strong quarter in Q2 with all three of our businesses performing well. Despite some challenges in the economic environment, demand for our products and services continues to be robust, and our sales pipeline a strong. We continue to provide value to our clients and are in a great position to clients with our most important technology, supply chain, and digital marketing initiatives, whether they are in growth mode or are facing challenges.

Our strategic priority continues to be on investing organically, and through value enhancing initiatives to capture the vast market opportunity ahead of us, while also returning capital to shareholders. Our recent acquisitions and execution of our ongoing share repurchase program is consistent with this. We remain highly focused on driving sales force productivity and we are confident that the initiatives we have implemented to drive productivity will positively impact our results over the long-term.

We had a very strong first-half of 2016, and our full-year 2016 outlook is for double-digit growth in revenue, earnings, and cash flow. And finally, we continue to leverage our powerful business model which consistently delivers free cash flow well in excess of net income.

With that, I'll turn the call back over to the operator and we will be happy to take your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question comes from the line of Timothy McHugh, William Blair. Please proceed.

Timothy McHugh - *William Blair & Company - Analyst*

Thank you.

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I guess, first, I just want to ask on your comment about the little bit longer sales cycle. I guess it's understandable in this environment, but can you maybe elaborate -- I know you grew double digits in every region and client size, but were there areas of the world where you saw this more, and less? And was it any more pronounced later in the quarter surrounding Brexit, and some of that volatility earlier in the quarter?

Gene Hall - *Gartner Inc - CEO*

It's Gene.

To the last part first, we didn't see in the quarter anything we could directly trace to Brexit on anything. So within Q2, I would say we couldn't pick up any direct impact from Brexit. With regard to -- elaborate a little, if you think about -- I will use Brazil as an example. If you were selling to an enterprise in Brazil, whether it's public sector or private sector, the economy is just terrible. It's shrinking. They have a lot of problems, and they still buy. We are actually growing in Brazil, still. It's a lot lower than it was before.

And so what happens is, a client may want to -- in fact, this happens in the public sector, [personally] A client will want to renew. Because the government revenues are down so much, there's a lot of scrutiny, and sometimes that renewal will extend for three months, longer than we would have wanted had -- were it reduced right on time. That's an example. And it's in the areas you would expect, which is -- oil and gas has been really affected. Oil and gas, by the way, in aggregate were growing. Brazil was growing, but it's a lot slower growth than it used to be. And that's an example of the extended decision-making cycle. It's exactly where you'd expect it.

Timothy McHugh - *William Blair & Company - Analyst*

Are you surprised, though? It was kind of a volatile world in the first quarter as well. And so what feels different in Q2 than Q1 that you are highlighting it a little bit more?

Gene Hall - *Gartner Inc - CEO*

I think it's not that there is a dramatic change between first quarter and second quarter. It's kind of an incremental change -- where these -- when things get bad, companies hope they're going to get better. And when they stay bad -- again I'll use Brazil as an example -- when it becomes clearer and clearer that there's problems, incrementally things can go worse.

By the way, my sense in Brazil is, it's bottomed out, but I do think it was worse -- it was a little worse in Q2 than it was in Q1, and Q1 was a little worse than it was in Q4. That's just an example.

Timothy McHugh - *William Blair & Company - Analyst*

Okay. Thanks.

Craig, just a quick numbers one: can you give us any sense for the contract value or revenue for SCM?

Craig Safian - *Gartner Inc - CFO*

Tim, good morning.

It's small. It's a relatively small acquisition, as you have seen from the purchase price. It doesn't contribute all that much to the overall, and we typically don't break out the contract value from small businesses or from small acquisitions, but suffice it to say, we think it's a great deal for us. Really helps us and enhances our supply chain business selling into the key executives from a supply chain perspective. But relatively small from a contract value perspective.

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Timothy McHugh - *William Blair & Company - Analyst*

Okay, thanks.

Operator

Your next question comes from the line of Jeff Meuler, Baird. Please proceed.

Jeff Meuler - *Robert W. Baird & Company, Inc. - Analyst*

Thank you. Good morning.

Just given that you cite a lot of the research metrics on a rolling LTM basis, but given all of the commentary and prepared remarks, just to confirm: it does sound if you just look at the quarterly metrics, things are trending a little bit worse, or little bit slower growth in Q2 just on a quarterly metric basis than they were three or four quarters ago. Is that an accurate interpretation?

Craig Safian - *Gartner Inc - CFO*

Yes, Jeff. That's 100% accurate.

Again, I think a lot of it relates to what Gene just described both in his prepared remarks and in the Q&A -- as the sales cycles lengthen and things cross over quarters, as I described, we will often take down business that will impact the renewal rate. We stay in touch with the client. The client still really needs our value. We win back that business over subsequent months and quarters. But your assertion is correct, that Q2 you would see a slowdown in the contract value growth rate, as well as the retention measures.

Jeff Meuler - *Robert W. Baird & Company, Inc. - Analyst*

Okay. (multiple speakers) Go ahead.

Gene Hall - *Gartner Inc - CEO*

Go ahead, Jeff.

Jeff Meuler - *Robert W. Baird & Company, Inc. - Analyst*

Please add what you were going to.

Gene Hall - *Gartner Inc - CEO*

Keep in mind, We had great double-digit contract value growth. I don't want to overplay the point which is, we have tremendous market opportunity. Clients love our products. We had great double-digit growth. I mentioned our retention metric was down a little bit, but it was still very -- if you compare to any metric externally it's a terrific measure, and it's down from our all-time high. Actually, we are seeing great demand for our products. Just a little -- as you said, different than it was a year ago.

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Jeff Meuler - *Robert W. Baird & Company, Inc. - Analyst*

Okay. (multiple speakers).

Gene Hall - *Gartner Inc - CEO*

As you would expect.

Jeff Meuler - *Robert W. Baird & Company, Inc. - Analyst*

Understood.

And then on capital deployment, asking this question in the context of slower first-half share repurchases, coupled with the increased credit line -- anything that should be read into putting those two things together in terms of appetite for a larger deal? Or is there something about the credit facility that will help facilitate more aggressive share repurchases that was an obstacle in the first half? Or anything like that?

Craig Safian - *Gartner Inc - CFO*

Jeff, it's Craig.

When we look at capital deployment, there's really no change to how we think about the approach, whereas always we remain very focused on ensuring that we deploy our cash flow and our balance sheet flexibility and our capital to drive value for shareholders. We always talk about it, and this has not changed.

We have two priorities. Our number one priority is shareholder value enhancing strategic M&A, and we have proven over the last 2 years, 2.5 years, that we have been able to do that and get really great properties and bring them into Gartner and drive really great growth and really great value for our shareholders. In absence of those value-enhancing M&A, we still believe that return of capital to shareholders through share repurchase program is a great way to do that, and those remain the two top priorities.

But number one is still that value-enhancing strategic M&A. From a credit facility perspective, it's one of those things where, when you look at our growth, and where we're going, and making sure that we have access to capital to do the value-enhancing things we want to do, we looked at the markets, and we just wanted to make sure we took advantage of being able to upsize the credit facility, push out the term, at extraordinarily attractive rate.

It's really a combination of we're growing, and we want to make sure we have the right size credit facility; and then also being strategically opportunistic around of making sure we locked in at very attractive pricing.

Jeff Meuler - *Robert W. Baird & Company, Inc. - Analyst*

And finally for me, can you remind us how you calculate retention? And, specifically, I'm wondering, is there some sort of adjustment made for when a client drops out for a two- or three-month period, or is it just a pure mathematical calculation with no adjustment made for factors like that? Thank you.

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Craig Safian - *Gartner Inc - CFO*

It varies, Jeff. It's situational depending on the client situation. But generally speaking, if we take the business down, so if the client does not renew on time, generally speaking, that will come out of the retention in that given quarter. And then as we work it back, it goes back into the contract value base when they resume their services.

Jeff Meuler - *Robert W. Baird & Company, Inc. - Analyst*

Okay. Thanks, guys.

Operator

Your next question comes from the line of Gary Bisbee, RBC Capital Markets. Please proceed.

Gunnar Hansen - *RBC Capital Markets - Analyst*

This is Gunnar Hansen in for Gary.

Gene, you mentioned some of the post-Brexit comment that Q2 wasn't impacted. Now that we're a month or a little over a month beyond the vote, has there been any incremental headwind or slowness in that region you want to mention?

Gene Hall - *Gartner Inc - CEO*

What I said was, it's too early to tell, so again the -- it's too early to tell.

Gunnar Hansen - *RBC Capital Markets - Analyst*

Okay, fair enough.

And I guess, Craig, just with the sales force hiring, obviously you said there is a big [coafligit] towards the end of the month in June. Is it still the expectation -- any updated commentary on the guidance for the sales headcount for the year? It seems like it's likely to be a touch below the 15% you guys were guiding for earlier. Is that fair?

Craig Safian - *Gartner Inc - CFO*

Good morning.

We are still targeting in that 15% range, give or take. As I mentioned, if you normalize for the timing of that class, we're at 14%. We were at 16% in Q1 and 16% for full year last year. So based on everything we are looking at -- and again, as I mentioned, we are looking at the growth on a team-by-team level -- but based on everything we're looking at now, we would expect to be in that 15% range.

Gunnar Hansen - *RBC Capital Markets - Analyst*

Okay; and just last one, and a positive note -- I'll move away from some of the challenged sectors -- any regions or sectors or industries that you guys want to highlight that had particular strength in the quarter? Maybe something along the lines of productivity has improved and where you are making incremental additions to the sales force there?

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Gene Hall - *Gartner Inc - CEO*

It's Gene.

We have lots of areas that are doing well. First, if you look at Asia, Asia is doing well for us. Not every country in Asia, but Asia overall is doing very well for us. A lot of the emerging markets are doing very well for us. If you look within the US, there are certain industries that are doing very well. I don't want to break it out, but there are certain industries that are doing very well. In Europe, again, there are certain countries that are doing well.

Gunnar Hansen - *RBC Capital Markets - Analyst*

Okay, fair enough. Thanks.

Operator

Your next question comes from the line of Manav Patnaik from Barclays.

Manav Patnaik - *Barclays Capital - Analyst*

Good morning, gentlemen.

I think, obviously, the deceleration in some of the markets and so forth is probably not surprising given the macro challenges out there. But going forward, is the way we should think about it, given all of the positive commentary you had to say, Gene, and the hiring still on track to15%, irrespective of the deceleration you guys will still just power on with the 15% sales headcount growth even if that impacts productivity?

Gene Hall - *Gartner Inc - CEO*

Where we struck from is this: as you know, we have this incredibly large untapped market opportunity, and we need to approach our business long term, which is, we want to make sure we continue to capture that market opportunity and position ourselves well for double-digit growth every single year.

Having said that, as you know, we also then take that and we look at each individual sales team. We go down to an individual manager level and say, based on the macroeconomic environment they are facing -- based on industry specifics they are facing, based on the bandwidth of that particular manager, can we add capacity there?

So, again, if I looked at -- again I'll go back to Brazil -- most of our managers in Brazil we are not adding headcount to because they have their hands full dealing with the economic issues there. Again, we are still growing in Brazil. Just want to make sure I reinforce that. And so we would be adding a lot less headcount there. It would be unusual to add a lot in some place like Brazil.

On the other hand we do have areas that are growing very rapidly like Asia, where we might be growing our head count as much as 25% on those teams. And so the 15% is not a 15% target at a macro level, it's -- as we look at individual teams and say, based on the market condition that team is facing, and based on the capability of that manager to take on additional headcount and additional opportunity, how does that work out? Historically that's worked out around the 15% -- between 13% to 17% range.

And going forward, we're going to do the exact same thing. And so, if for some reason we see more teams that are challenged, you might see that toward the lower end of that range. And if you see fewer teams toward the higher of that range. But it's not through set at a macro level. It's set based on a bottoms-up level that gets us that.

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Manav Patnaik - *Barclays Capital - Analyst*

Okay, fair enough. Thanks for that color.

And then, Craig, did you say that 27% of your revenue is UK, or is that Europe as well? I think in the [bosh] you guys is that all of your country exposures mirror GDP and that seemed a little outside. Maybe you can help us there?

Craig Safian - *Gartner Inc - CFO*

I'm sorry, I said 7%.

Manav Patnaik - *Barclays Capital - Analyst*

Okay.

Craig Safian - *Gartner Inc - CFO*

Just 7% of our revenue is in the UK.

Manav Patnaik - *Barclays Capital - Analyst*

Got it. And just since you guys are calling up Brazil, oil and gas, any sense of what those exposures are?

Craig Safian - *Gartner Inc - CFO*

We've talked about them in the past. I think both are well below 5% of total contract value or total revenue. So they still represent very small exposures for us. That being said, they were, before they had those macro challenges, were two very fast-growing areas for us. A little bit of an overlap with oil and gas in Brazil, but they had been very fast-growing; and as Gene mentioned, they are continuing to grow, just not at the same rate that they had been growing previously.

Manav Patnaik - *Barclays Capital - Analyst*

Got it. Fair enough. Thanks a lot for that, guys.

Operator

Your next question comes from Toni Kaplan, Morgan Stanley.

Toni Kaplan - *Morgan Stanley - Analyst*

Good morning. Thanks for taking my questions.

Just regarding the elongated sales cycle, I just want to make sure I understand correctly -- it's just taking a little bit longer to close the sales, but you are still closing the deals? Meaning the pipeline isn't dramatically reduced; it's just that it's taking longer to actually close the sales. Is that correct?

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Gene Hall - *Gartner Inc - CEO*

So, most of our clients are doing fine, and our sales cycle has not extended or anything. It's just -- it's normal business. There are a few areas -- I picked on Brazil, but Brazil, with oil and gas, where they are under stress, they are looking at every expense. It does take a little longer. We do actually -- it's very unusual -- even if it takes longer, we do get the sale.

So your question is right. We actually do get the sale, but that's just for this piece of our business that's under more distressed, which isn't most of our business. And then our pipeline, actually, is way up compared to this time last year. It's way higher than our growth rate. And it's purposeful. We purposely built a very strong pipeline. Our pipeline is very robust.

Toni Kaplan - *Morgan Stanley - Analyst*

Okay, great.

And then I think you mentioned sort of adjusting headcount in different areas when you are seeing either really strong growth or really weak growth, adjusting it up and down. And so, how often -- are you doing that continuously? Do you do it once a quarter? How quickly can you adjust that? And I guess if you are adjusting up, maybe it takes a little bit of time for people to get to full productivity, but so, how should we think about that?

Gene Hall - *Gartner Inc - CEO*

We actually have a team that looks at that. We have a territory planning team that looks at that, and they do this on a continuous basis. We make real-time adjustments through the year. It's not like we sort of plan up front for the year and then it doesn't change based on what's going on that we actually experience. We actually look at it on ongoing basis, and we have the hiring plan each quarter for how many people we want to hire and we make real-time adjustments based on what we are really seeing.

Toni Kaplan - *Morgan Stanley - Analyst*

Okay, great. And lastly -- events margins actually looked really good this quarter. I know you have the three large events that moved into the first quarter, so I was actually thinking, year-over-year margins would be down. Anything to call out in terms of the strength there? Thanks.

Craig Safian - *Gartner Inc - CFO*

Toni, it's Craig.

We continue to grow that business really well. I think the right way to look at it is, look at it on a first-half basis to judge the margin. We're actually up a few points year over year on the year-to-date gross margin, and that's because we are driving really nice growth, organic growth into those events; and when we are able to do that, it does flow-through at the margin level.

Toni Kaplan - *Morgan Stanley - Analyst*

Thanks a lot. I appreciate it.

Operator

Your next question comes from the line of Anjaneya Singh from Credit Suisse. Please go ahead.

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Anjaneya Singh - *Credit Suisse - Analyst*

Good morning. Thanks for taking my questions.

Gene, first off I wanted to touch on your commentary that a larger portion of your client base is having problems versus a few years ago. So, in broad strokes would you be able to characterize what that proportion looks like today versus a few years ago? Would you characterize the pressure you are seeing being higher on the new sales front, or is it more on the retention end? It seems your new business growth continues to be steady in the quarter despite the tough comp from a year ago. I wanted to get a better sense of where the pressure may be.

Gene Hall - *Gartner Inc - CEO*

So, in terms of proportion, I'm not going to break it out in terms of a percent, because it's really a spectrum. It's not -- they're either in trouble or not. My point was to look at things like oil and gas, or Brazil, or the major commodity producers, for example, that they are under more stress than they were the past. And that's a different selling environment. We do well there, but it's a different selling environment.

In terms of new versus renewal, the same thing is true, which is, we have a very large market opportunity. We're making sales in all kinds of industries. We already have sales teams, for example, in Brazil. We want them to sell new business. That new business in Brazil is harder, just like renewals are harder. If I looked at some of the industries that are not under such stress -- I'll take healthcare as an example -- you see both new business and retention being easier in those industries.

So, it's a matter of where the industries are challenged it's tougher new business and tougher renewals. Where it's not as much, it's easier. I want to get back to even in these areas I characterize as being tougher -- as Craig said, take Brazil; it used to be much higher growth than average in the past. And now it's a bit lower than average. So that big swing is what's going on. We are still growing there. We still get good retention compared to most of the world and good new business.

Anjaneya Singh - *Credit Suisse - Analyst*

Understood.

And then, with regards to your SCM acquisition, can you talk about, perhaps, how big your supply chain-related business is today? I realize it's probably tiny, and you have spoken to a $4 billion addressable market there. But hoping you can talk a bit about where you are having success today and where you see the low-hanging fruit on that front?

Craig Safian - *Gartner Inc - CFO*

Yes, good morning. It's Craig.

So, as we have talked about in the past, our supply chain business, which is a great business, it is growing well faster than the average. We think it's a really big market opportunity, and with a combination now of what we had here at Gartner plus the SCM world capabilities and client base, we think it's a really great business on a go-forward basis. We believe that we can continue to grow that business at an accelerated rate. It is as under-penetrated as we are in the overall IT market.

I think that over the long term, because we can continue to grow our IT business, which is the bulk of it, at such a rapid rate, supply chain will continue to be a small piece of the overall portfolio. But clearly it's a place where we think we can drive really great growth and drive really amazing value for our clients. It's the same business model as our research business. It has high renewal rates, the same cash flow dynamics, et cetera. So, we're excited about it but it's still represents a small piece of the portfolio.

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Anjaneya Singh - *Credit Suisse - Analyst*

Okay, got it. One final one for me, and I apologize if I missed this.

You guys have had two quarters of strong backlog growth in consulting. I realize you guys increased your guidance last quarter. Is there a reason why you didn't tweak it this quarter and you're flattish year-over-year outlook for the second half?

Craig Safian - *Gartner Inc - CFO*

Yes, the business continues to perform really well, particularly on the labor-based side of the business, which is what the backlog supports. What I would say is, the range represents the relevant range of outcomes. As we look at things today, the outlook reflects that. And so, we didn't feel the need to update the guidance based on that.

That said, the business continues to perform really well, and based on our managing partner investments and based of the backlog, it's really more about the long-term sustainability of the business. And we're investing for that future growth as well.

Anjaneya Singh - *Credit Suisse - Analyst*

Okay. Thanks a lot.

Operator

Thank you. Your next question comes from the line of Joseph Foresi from Cantor Fitzgerald.

Joseph Foresi - *Cantor Fitzgerald - Analyst*

I was hoping you could help us reconcile some of the metrics around the sales per enterprise. It looks like that number has been moving up pretty consistently, but the number of enterprises that you are adding is decelerating, and maybe you could just help us understand how you are able to cross-sell into those areas? Because it seems it's going actually pretty well in that versus the commentary about the elongated sales cycles.

Craig Safian - *Gartner Inc - CFO*

Joe, good morning, it's Craig.

So I think, when we think about our market opportunity, we think about it, it really is in two primary places. One is, obviously, those 100,000 enterprises in our market space that we are currently not doing any business with; and we have made really good progress over the last several years of going from probably 6,000 enterprises to over 10,000 enterprises today. On top of that, when you look at the average contract value per enterprise, even today at $167,000 per enterprise, that is really low penetration. And as we look across our client base, we know that there are opportunities to drive significantly greater penetration within each of those existing enterprises. And we do that in a variety of ways.

We have a tier of services so we can upgrade clients once we are in there. We find additional users within the clients and buying centers that we are doing business with and then we find new buying centers as well within the clients. On top of that, our supply chain business and our marketing business allows us to even further penetrate those clients. Again, we think about market opportunity, it is the combination of further penetration of existing enterprises -- which we think that is an enormous opportunity -- plus all of that greenfield opportunity with the enterprises we currently don't do business with.

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Joseph Foresi - *Cantor Fitzgerald - Analyst*

Okay. Do you feel like that's going to be more difficult in the present environment, given the sales cycle elongation? Or do you expect that trend to continue? Are you seeing any disruption there?

Craig Safian - *Gartner Inc - CFO*

I don't see it as being more difficult at all. Again, think about our clients in different segments, which is, we have clients that are doing just great; they are figuratively speaking not in Brazil. And it's business as usual, and then we have clients that are figuratively speaking in Brazil, which are a little tougher. I think the -- you wouldn't want to characterize the sales cycle all over are worse. That's not right. There are specific segments in the global economy that are having trouble. Those are -- we still are growing them, but just not as rapidly as the others.

So, in terms of continuing to sell more to our existing clients, we're going to do that. We're going to have a lot of that. Typically it's been two-thirds of our growth, actually. It's part of our product strategy. We have products for multiple people in an organization; we keep adding more of those products so our salespeople have more to sell, which is why it's typically been two-thirds of our contract rate.

Joseph Foresi - *Cantor Fitzgerald - Analyst*

Got it. And maybe -- forgive me if I missed this maybe in the opening remarks -- but can you give us some idea what the impact from currency is? And is there any update for that, given Brexit and some of the recent movements?

Craig Safian - *Gartner Inc - CFO*

Sure, Joe.

We talked about our results, and what's happening from a foreign exchange perspective is -- and you probably see this in most global companies -- we are starting to lap the major strengthening of the US dollar that we saw from the back half of 2014 into the first half of 2015. That's why in the quarter you don't see that much of a difference between our reported results and our FX-neutral results. They are pretty tight. As we look out for the balance of the year, our outlook reflects where exchange rates are as of earlier this week. And as you know, some are going one way and some are going the other way.

And so, when we look at where we are with our major exchange rates compared to where we were when we started the year when we did our initial outlook, and then where we were back in May when we updated our outlook -- yes, the pound is weaker. Maybe the yen is a little bit stronger. But at the same time, there are other currencies that are going in both ways. The way we look at it right now is, we expect back half of the year to look a lot like what we experienced in Q2 from an FX exposure perspective.

Joseph Foresi - *Cantor Fitzgerald - Analyst*

Okay and the last one for me, I think.

Just to get away from Brexit for a little bit -- sales productivity. Maybe you can give us an update on your latest thoughts there, and any way we should start thinking about that within an elongated sales cycle over the next couple of quarters? Thanks.

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Craig Safian - *Gartner Inc - CFO*

Sales productivity is one of our top focus areas. We spend a lot of time and effort on it. The things that we are doing I think are getting better all the time. It falls into three main categories: recruiting -- just making sure we hire people that are the best possible fit with Gartner, where we're really focused on having the right analytics to help us make sure we get the right people and the right process.

The second category is then training, where we have, I think, what is one the best training programs for sales people in the industry. We continue to improve that training all the time and modify it. It's not static. As an example, one of the things we train our sales people on, in areas that are a little distressed, is, how do you deal with those and be very successful in an environment like that, which we know how to do.

The last one is in tools, where we are focused and having better tools for sales force. Technology is changing everything. Technology allows tools that help our salespeople to be more productive as well. We've got investors in all three of those areas focused on improved sales productivity, and we feel really good that those are all -- over time we're going to have a great impact on our sales productivity.

Joseph Foresi - *Cantor Fitzgerald - Analyst*

Thanks.

Operator

Thank you. Your last question comes from the line of Jeff Silver from BMO.

Henry Chien - *BMO Capital Markets - Analyst*

Good morning, it's Henry Chien for Jeff. A quick one for me, thanks.

Looking at your consulting revenues, can you just talk about what's driving some of these quarter-to-quarter shifts? It looks like backlog has been pretty strong over the past few quarters. I'm just wondering what's driving some of that deceleration in Q2? Thanks.

Craig Safian - *Gartner Inc - CFO*

Good morning, it's Craig.

I think there is two things going on. One is the labor-based business which makes up the bulk of the consulting revenue. We've seen pretty consistent performance there, and we had strong bookings and strong backlog coming out of Q4. That translated into a strong labor-based revenue quarter in Q1. We also replenished that backlog and entered Q2 with a strong backlog position. I think that led to the strong labor-based growth, which I talked about earlier. We were up 10% on our labor-based revenue in Q2 on an FX-neutral basis.

I think some of the volatility still comes from the contract optimization business. As I mentioned in my prepared remarks, in Q2, we were actually down on a year-over-year basis in contract optimization. In Q1 we were up a little bit. On a year-to-date basis, we're up modestly on that business, but that's the place that consistently causes some of that volatility. I think if you peel the onion back a little bit, you'll see our labor-based business has been performing really nicely and really consistently.

Again, that goes back to a lot of the investments we've made around managing partners and a lot of the things that the consulting leadership team has done to make that business more predictable with people, relationships, et cetera. I think you are starting to see that -- or you are not starting to, but you're seeing that flow through in our results. Again, gives us confidence around Q3 and Q4 given the backlog position we have during Q3.

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Henry Chien - *BMO Capital Markets - Analyst*

Okay. Fair enough. Thank you.

Operator

Ladies and gentlemen, thank you for your questions. I'd now like to turn the call over to Gene Hall for closing remarks.

Gene Hall - *Gartner Inc - CEO*

I'd like to summarize the key points of today's call. First, we are doing great as a company. We see robust demand for our services, and our sales pipeline is incredibly strong with a huge untapped market opportunity. We attract the best talent in the industry. We continue to invest in recruiting capability and training tools that drive sales productivity. We continue to invest in innovations in our content, products, hiring, training, and tools to drive continuing improvements and our operational effectiveness. We're committed to enhancing shareholder value through investment in our business, strategic acquisitions, and share repurchases. We are well on track to deliver another year of double-digit growth in contract value, revenue and earnings, coupled with strong cash flow conversion. And our long-term outlook remains equally strong.

Thanks for joining us today and we look forward to updating you again next quarter.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Thank you for joining and have a very good day.

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