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IT - Q1 2014 Gartner Earnings Conference Call

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OVERVIEW:

IT reported 1Q14 GAAP diluted EPS of \$0.40 and normalized EPS, excluding acquisition-related charges of \$0.44. Expects 2014 GAAP EPS to be \$1.96-2.13.



CORPORATE PARTICIPANTS

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Joseph Foresi *Janney Montgomery Scott - Analyst*

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PRESENTATION

Operator

Good morning ladies and gentlemen, and welcome to Gartner's Earnings Conference Call for First Quarter 2014.

(Operator Instructions)

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

Brian Shipman - *Gartner Inc - Group VP, IR*

Thank you and good morning, everyone. Welcome to Gartner's First Quarter 2014 Earnings Call. With me today is our Chief Executive Officer, Gene Hall, and our Chief Financial Officer, Chris Lafond. This call will include a discussion of Q1 2014 financial results as disclosed in today's Press Release.

Will also discuss our recent acquisition of Software Advice. After our prepared remarks, you will have the opportunity to ask questions. I'd like to remind everyone that the Press Release is available on our website at Gartner.com.

Before we begin, we need to remind you that certain things 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 2013 annual report on Form 10-K and 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. The Company undertakes no obligation to update any of its forward-looking statements.

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

Gene Hall - *Gartner Inc - CEO*

Thank you Brian, and good morning everyone. Welcome to our Q1 2014 earnings call.

2014 is off to a strong start. The continued successful execution of our proven strategy drove another quarter of double-digit growth in revenue, EBITDA, earnings-per-share, and contract value.

As we discussed with you last quarter, we're deploying our capital strategically. In the first quarter we made a great strategic acquisition of Software Advice. In addition we repurchased almost \$200 million of shares and expect it's going to be at least \$400 million in 2014.

I'll share a few performance highlights from each of our businesses and talk briefly about our recent acquisition of Software Advice. I'll then turn the call over to Chris to share more details. Research is our largest and most profitable segment and our research contract value grew 13% FX neutral.

As has been the case for a few years, we drove double-digit contract value growth in every region and client size and in almost every industry segment. We expect contract value growth to accelerate in 2014 as we continue to execute our growth strategy.

We also achieved strong retention rates. For the first quarter of 2014, enterprise client retention was at 84%, which is consistent with this time last year. And enterprise wallet retention was 104%, which was a point down from Q1 2013.

In consulting, we drove terrific performance for the quarter, led by our contract optimization business and strong sales bookings. Consulting revenues increased 16% compared to Q1 2013, and backlog was up 14%, achieving its highest level since 2008.

Our events business also deliver great performance. Our Q1 results were impacted by the shift of four events held in Q1 last year to the second quarter of this year. On the same events basis, growth was strong with a revenue increase of 17% year-over-year. These results continue to illustrate the ongoing success of our strategy and the tremendous value we bring to our clients.

I will now turn to our recent acquisition of Software Advice. As we discussed in the past, we continually track a range potential acquisition candidates. We're extremely disciplined and selective around acquisitions and will continue to be.

During Q1, we made a great strategic acquisition of Software Advice. Our traditional research business is target at serving the 108,000 largest enterprises in the world, and these enterprises make up our global market opportunity about \$47 billion, but smaller enterprises also need help in dealing with technology challenges. In fact, there are millions of small businesses in the US alone.

These represent a huge additional market that we've not previously addressed. Software Advice is a market leader in providing technology advice to enterprises that are smaller than those targeted by our traditional research business.

Brining this to life, imagine you manage a small medical practice that needs to establish an electronic medical record system. Most likely, you have no full-time IT staff. You need to identify and assess potential suppliers, decide which one to go with, and then transition to the new system.

Getting this right is critical to the success of your medical practice. You need help with these important decisions.

Software Advice addresses this market. They advise these small enterprises on what technologies are best for their specific situation, providing tremendous value to these clients.

For the past two years, Software Advice has been growing at a compound annual growth rate of more than 50% per year. Last year, revenues were more than \$15 million and the company was profitable.

Software Advice is a great acquisition that's a strong strategic fit with Gartner while expanding our market opportunity. We continue to manage an active pipeline of acquisition candidates, and we remain as diligent, disciplined, and selective as we have been in the past.

I've said this before and it remains just as true today. These are remarkable times for technology. Technology is transforming the world and driving change in every enterprise, in every industry, in the world on a scale seldom seen.

IT is transforming how we work and what we do and Gartner is at the heart of it. Every company, whether for-profit, not-for-profit, large, medium, or small, any government agency, is perfect as a potential client. That gives us a vast, untapped market opportunity for our services.

Gartner is the best source of help for enterprise leaders watching critical initiatives within the technology revolution. Our systems often make the difference between success and failure for our clients. And we are relevant whether an institution is growing or facing economic challenges.

The successful execution of the right strategy drives our consistent performance. As some of you know, the fundamentals for our strategy are to create extraordinary research insight, develop strong sales capability, to deliver high-value differentiated offerings, to provide world-class service, and to continually improve our operational effectiveness. This time-tested strategy will allow us to maintain sustained double-digit growth into the future.

I am confident in and excited about Gartner. The Gartner brand is in a class by itself. Our products, services, and people are superior to the competition. We have a great business model, and we're relevant to virtually every enterprise in the world.

In summary, I'd like to leave you with two key takeaways from today's call. First, the strong execution of our consistent winning strategy allowed us to once again deliver double-digit contract value growth. And with our share repurchase plan, and the acquisition of Software Advice, and our expanding market opportunity, we continue to be well-positioned to achieve sustained double-digit growth in our key metrics over the long term.

With that, I'll hand the call over to Chris.

Chris Lafond - *Gartner Inc - EVP and CFO*

Thanks Jean, and good morning.

2014 is off to a strong start with double-digit growth in contract value, revenue, and earnings in the first quarter, continuing the trend of the last several years of consistently strong financial performance. We continue to successfully execute our strategy and deliver on the financial objectives we have established and communicated. Year-over-year contract value growth accelerated to 13% as compared to 12% in Q4 2013 and retention rates ended at or near all-time highs.

Our consulting business grew 16% on an FX neutral basis for the first quarter on the strength of our contract optimization practice. And our events business increased by 17% year-over-year on the same events and FX neutral basis. Demand for our services was robust across all of our primary business segments in the first quarter.

Our strong top-line performance and effective execution in capitalizing on the operating leverage in our business allowed us to once again expand our gross contribution margins. Even if companies around the world face the uncertainties of the current macroeconomic environment, our business continues to grow at double-digit rates quarter after quarter. This is because our products and services provide great value to the IT, supply chain, and marketing professionals that we work with.

We're engaged on and relevant to the most important initiatives and projects. This is why we will continue to deliver consistent revenue growth and strong financial performance over the long term.

I'll now provide a review of our three business segments for the first quarter followed by a discussion of the Software Advice acquisition and will end with the details of our revised outlook for the remainder of 2014 before taking your calls. Let me begin with research.

Research revenue was up 12% on an as-reported basis in the first quarter and 13% excluding the impact of foreign exchange. The contribution margin in this segment increased 135 basis points to 71% in the first quarter. All of our key research business metrics remained strong. Contract value grew to a record level of \$1.408 billion, a growth rate of 11% year-over-year on a reported basis and 13% on an FX neutral basis.

As has been the case for the past several years, our growth in contract value in Q1 was extremely broad-based with every region and client size in almost every industry segment growing at double-digit rates. New business again increased year-over-year and the new business mix remains balanced between sales to new clients and sales of additional services and upgrades to existing clients. While our contract value growth continues to benefit from our discipline of annual price increases and no discounting, approximately 80% of our contract value growth came from volume with the balance from price increases.

We have consistently increased our prices by 3% to 6% per year on an annual basis since 2005, we implemented a price increase during the fourth quarter of 2013, and we expect to do so again this year. Our volume growth reflects our success in continuing to grow the business by penetrating our vast market opportunity with both new and existing clients.

As a result, we ended the quarter with 9,094 client enterprises, up 7% over last year's first quarter. We also ended the quarter with 13,983 client organizations, up 6% over last year's first quarter. Our client retention rate at the organizational level ended the quarter at 82% and we've maintained client retention of between 82% and 83% for the past 15 quarters.

In addition to retaining our research clients at an impressive rate, the clients we retain continue to increase their spending with Gartner. Organization-level wallet retention was at 99%, an uptick from the prior quarter. Wallet retention is higher than client retention due to the combination of increased spending by retained clients and the fact that we retained a higher percentage of our larger clients.

As we've discussed in the past our retention metrics are reported on a four quarter rolling basis in order to eliminate any seasonality. Historically, we've disclosed our retention metrics at the organization level. Organization is our internally-defined metric that defines and identifies individual buying centers within the enterprises we sell to.

We have found that organizations can fluctuate due to both internal and external factors. This makes the metric less indicative of the true business performance, and we've therefore decided to disclose our retention metrics at that enterprise level going forward. To give you some historical perspective on the enterprise retention metrics, as we make this transition, we will provide two years of historical data on the Investor Relations section of our website.

Our client retention rate at the enterprise level ended the quarter at 84%, and we've maintained client retention at the enterprise level of roughly 84% for the past two years. Wallet retention at the enterprise level ended 104% in the first of quarter has been between 104% and 105% for the past two years.

In summary, we delivered another strong quarter in our research segment. We grew our contract value by \$158 million on an FX neutral basis year-over-year, we continue to see strong demand from clients, and we continue to expect acceleration in contract value and revenue growth over the long term. We remain confident in our continued ability to deliver double-digit annual revenue growth in this business over the long term.

Turning now to events. On a same events basis, our events segment continued the trend of extremely strong year-over-year revenue growth we've delivered for the past four years. A reported basis, the move of four events out of the first quarter effected the year-over-year comparison of our operating results.

Three of the events moved out of Q1 were large mature events that were meaningful contributors to the segment's profit in 2013's first quarter. And as I will discuss in a few moments, we expect these four events to deliver solid growth and be meaningful contributors to our Q2 results. In the first quarter, events revenue decreased 40% year-over-year on an as-reported basis and declined 41% on an FX neutral basis as a result of the move of these four events.



During the first quarter we had eight events with 3,394 attendees, compared to 12 events with 5,788 attendees in the first quarter of 2013. On the same events basis, events revenue was up 17% year-over-year in the first quarter and attendee revenue increased 27%, and exhibitor revenue increased 13% for the quarter, also on a same events basis. The gross contribution margin of 21% for Q1 decreased roughly 9 percentage points from the first quarter year-ago, again reflecting the move of four mature events out of Q1 into Q2.

We expect our full-year contribution margin to be in line with our original expectations, as reflected in the annual guidance we issued in February. We've already held three of the four events that moved out of the first quarter in April; these three events performed extremely well with revenue growth of almost 40%. As a result we believe our events business remains well-positioned to deliver another strong year in 2014.

Moving on to consulting. Revenues in consulting increased 16% on both a reported and FX neutral basis in the first quarter. Our contract optimization business was the primary driver of the strength in consulting, as certain deals occurred earlier in the year than we anticipated. Our core consulting business was also solid with 5% revenue growth in the first quarter.

Billable headcount of 512 was down 3% from the first quarter of 2013, first quarter utilization was 64%, and revenue per billable headcount ended the quarter at \$421,000 per consultant. We are seeing steady demand for our consulting services. Backlog, the key leading indicator of future revenue growth for consulting business, ended the quarter at \$111 million.

This represents a 14% growth year-over-year and 5% growth from the fourth quarter of 2013, and represents a healthy four months of backlog, which is our target for this business. Backlog is not at the highest level we've reported since 2008. With the current backlog in visibility we have into the pipeline, the consulting business is positioned to deliver solid results in 2014.

Moving down the income statement, SG&A increased by \$24 million year-over-year during the first quarter, primarily driven by the growth in our sales force. As of March 31, we had 1,698 quota-bearing sales associates, an increase of 237 sales associates from a year ago. We continue to tightly control G&A costs across the entire Company. We believe this expense item will provide us with a source of operating leverage in the future, as G&A will continue to decline as a percent of revenue, as it did in Q1 as compared to the first quarter of 2013.

Moving on to earnings, we delivered another quarter of solid earnings growth. Normalized EBITDA was \$85 million in the first quarter, up 13% year-over-year, and GAAP diluted earnings per share was \$0.40, up 5% year-over-year. Our Q1 2014 GAAP diluted earnings per share includes \$0.04 in amortization and other costs associated with our acquisitions, including Software Advice and prior deals. Excluding acquisition-related charges, our normalized EPS grew 13% to \$0.44 in the first quarter.

Turning to cash, first-quarter operating cash flow decreased by \$3 million to \$16 million versus the first quarter of 2013, largely due to higher year-end bonus and commission payments made this year. The first quarter is the seasonally lightest of the year for operating cash flow and we still fully expect to achieve the guidance we set for the full year.

During the first quarter we utilized our cash to return capital to shareholders for our newly-established share repurchase authorization. During the first quarter we repurchased over 2.7 million shares and we used approximately \$196 million of cash for the share repurchases. We ended the quarter with a strong balance sheet and cash position despite the more aggressive pace of share repurchase and the Software Advice acquisition. As of March 31, we had net debt of \$72 million.

Our credit facility runs through March 2018 and at this time provides us with about \$389 million of remaining borrowing capacity. We have ample cash flow and liquidity to continue to grow our business, and execute initiatives that drive increased shareholder value.

We continue to look for attractive acquisition opportunities as a potential use of cash, such as the Software Advice acquisition we completed in the first quarter, and which I will discuss further in just a moment. We also continue to believe that repurchasing our shares remains a compelling use of our capital, absent other significant opportunities to deploy cash, we still expect to repurchase at least \$400 million of our own shares this year.



Let me now spend a few minutes discussing our recent acquisition of Software Advice, which I'd like to cover from three perspectives: The impact on cash flow our balance sheet, the impact to operating results, and lastly, the impact to GAAP earnings per share.

First, with respect to the cash flow statement and balance sheet, as you will see in our 10-Q we paid \$103 million at closing to acquire 100% percent of the outstanding shares of Software Advice. We also funded \$13.5 million of escrow, which we negotiated as protection against future potential losses. The escrow amount is considered restricted cash and recorded in other assets on our balance sheet.

From an operating perspective, the impact of Software Advice in our Q1 operating results is not material since we closed on March 7. For the full year, Software Advice will add modestly to our research segment. As a result, we've raised our guidance for the research revenue by \$20 million to both the low end and high end of our previous range to reflect the impact of integrating Software Advice into our operations.

We now expect research revenue to be between \$1.435 billion and \$1.455 billion. I would like to note that contracts with clients of Software Advice products will not be included in our contract value figures. Currently, Software Advice services are delivered on a transactional basis versus an annual subscription basis as with Gartner's research services. There are also a number of items that will impact GAAP earnings per share for both the quarter and the full year.

First, as you would expect, we incurred transaction fees in connection with the acquisition. We also had put in place retention bonuses for much of the Software Advice team. The combination of these two items will impact 2014 by about \$3 million.

Second, as with all of our prior acquisitions, there's a non-cash intangible amortization which will run through the P&L for several years post-acquisition. In 2014, we expect these amounts to be roughly \$4 million.

And then lastly there are amounts related to the acquisition that are being held back until certain employment conditions are met. These amounts will be accrued ratably as expense over the service periods of the relevant employees. We anticipate that just under \$17 million will accrue to the 2014 P&L.

If the employment conditions are not met, the expenses that had been previously accrued will be reversed. In total, we expect approximately \$24 million of acquisition in integration charges in 2014 related to the Software Advice transaction. Additionally, there will be roughly \$3.5 million of intangible amortization related to our past deals, which was included in all of our previous guidance.

These amounts will be included primarily on two lines on the face of P&L. Intangible amortization will flow through the amortization line while everything else will appear on the acquisition and integration charges line. This is consistent with how we've handled acquisitions in the past and how we will handle any future transactions.

Lastly, I'd like to note that these charges are excluded from our normalized EBITDA calculation, and our guidance for normalized EBITDA remains unchanged. We do not expect a material impact on normalized EBITDA from Software Advice in 2014, as we will make certain investments to allow this business to scale, thus ensuring strong growth into the future. However, we expect a more meaningful contribution to Gartner's normalized EBITDA in future years.

We will also now be providing guidance for both GAAP EPS and normalized EPS excluding acquisition and integration charges to help you better understand our true operating results. Our normalized EPS guidance of \$2.15 to \$2.32 per share is slightly higher than the EPS guidance we gave you in February as we've not broken out acquisition-related expenses stemming from past acquisitions and the impact was nominal at only \$0.02 to \$0.03 per share.

However we now expect GAAP EPS to be between \$1.96 and \$2.13 per share, reflecting the acquisition-related charges I just detailed from Software Advice and from prior transactions. For further information, you can review our most recent 10-Q, which contains the above information, as well as additional details related to the acquisition.



The other minor change to our guidance relates to our share count and interest expense. Because we were able to repurchase almost \$200 million worth of shares in Q1, we can now revise down our full-year weighted average share count assumptions to be between 91.5 million and 92 million shares. We still expect that on December 31, 2014, we will have less than 90 million shares outstanding.

We are also increasing our interest expense assumption modestly to \$10.5 million, primarily to reflect borrowing to fund the Software Advice acquisition. All other guidance we detailed in February remains unchanged. As we discussed with you on our Q4 earnings call and at our recent Investor Day, to provide additional visibility and transparency, we're going to provide quarterly EPS guidance for the upcoming quarters. We expect EPS, excluding acquisition and integration charges, to be between \$0.56 and \$0.60 per share for the second quarter of 2014.

Acquisition and integration charges are expected to be approximately \$0.06 in Q2. Based on everything we see today, we're comfortable with the midpoint of this EPS guidance range.

So to summarize, and before taking your questions, we delivered solid results for the seasonally light first quarter of 2014. Demand for our services is strong, and as a result we generated double-digit revenue growth and our key business metrics remained strong in the first quarter. Our initiatives to improve operational effectiveness, coupled with the positive operating leverage inherent in our businesses, delivered solid earnings and cash flow growth for Q1.

As always, we are actively exploring strategic alternatives for deploying our cash. We will continue to invest in our business and return capital to shareholders to an accelerated share repurchase program going forward. Finally, with double-digit growth in contract value in the first quarter of 2014, we established a solid foundation for delivering another year of strong revenue and earnings growth for the full year. We're well-positioned for double-digit revenue and earnings growth and increasing returns to our shareholders over the long term.

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

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Peter Appert, Piper Jaffray.

Peter Appert - Piper Jaffray & Co. - Analyst

Gene, given how strong the start was to the year, both in terms of the research revenue and the contract thing, I guess I'm a little surprised that you're not more optimistic in terms of the guidance. What's driving your thinking on that?

Chris Lafond - Gartner Inc - EVP and CFO

Obviously we're only three months into the year, and if you look at our performance, we feel very confident with what we're seeing across our business. I would note a couple things. We had expected to see acceleration in our research business, and so we're tracking right where we had hoped at this point in the year. Our events business is tracking, probably, marginally better than we thought, but it's still early in the year and a lot of our big events have not happened. Q1 is obviously a light events quarter.

In consulting, our business was primarily driven by contract optimization, as we've talked about many times, that business tends to be somewhat lumpy quarter to quarter. So we still expect that business to remain in that \$30 million to \$40 million range that we talk about for the full year. So as we sit here today, we still feel very comfortable with the guidance we gave and that's why the guidance is what it is at this point in the year.

Peter Appert - *Piper Jaffray & Co. - Analyst*

Chris, does the -- is the plan to accelerate sales force hiring as the year progresses or is the first quarter a good indication of how you think the full year goes?

Gene Hall - *Gartner Inc - CEO*

The plan with sales force hiring basically is to grow it in the 15% to 20% range for the year. We were in that in Q1, and we expect to be in that same range for the full year.

Peter Appert - *Piper Jaffray & Co. - Analyst*

No indication whether you're going to be at the high or low end of the range?

Gene Hall - *Gartner Inc - CEO*

No.

Peter Appert - *Piper Jaffray & Co. - Analyst*

One last thing, on the Software Advice acquisition, can talk about how you see this product being leveraged by Gartner? I would assume your sales organization really doesn't have the capability to sell this product since this is a smaller organization. How you get leverage from this? And while you're talking about that, can also just sort of comment on how you thought about the purchase price? Because it seems like a pretty rich valuation for a small business.

Gene Hall - *Gartner Inc - CEO*

So Peter, in terms of the business, what it does is, as I mentioned on my comments, Gartner has targeted the 108,000 largest enterprises in the world, and our business model isn't optimized to serve businesses smaller than that size, it's optimized to serve those 108,000. In the US alone, there are millions of small businesses. They have the same kind of IT problems that large businesses do, as well. And we've seen that as being a great market opportunity, it fits squarely with what we naturally do. Software Advice has the business model that's designed to address that. In particular, what they do is they look at the specific needs of each segment in these markets.

So I used an example of electronic medical records. Electronic medical records, actually, for small medical practices is not one market. There's different electronic medical record systems depending on which medical specialty you are. So what they do, obviously, is a very good approach for determining -- what are the options for each of these kinds of markets that smaller companies are in, which tend to be very specific to the nature of those small companies. Even though there's -- there could be, at any one segment, tens of thousands or even millions of companies fit within that segment.

In terms of the other part of your question, Chris will answer it.



Chris Lafond - *Gartner Inc - EVP and CFO*

Hi Peter, with regard to valuation, as you know, we have been extremely selective and thoughtful with regard to executing acquisitions over the years. Software Advice is no different. Valuation has always been extremely important to us in terms of when we choose to do deals, so we are very thoughtful about doing things at the right valuation, and that will drive shareholder value, and, again, we believe that's the case here. If you look at the valuation that we pay, we feel it's absolutely in line with what we're seeing in the marketplace today for similar assets and it's an extremely reasonable valuation and we're very happy with the acquisition.

Operator

Hamzah Mazari, Credit Suisse.

Unidentified Participant - *Credit Suisse - Analyst*

Hello, this is [Ansang] dialing in for Hamzah. My first question is just on SG&A. We see that it's up quite a bit year-over-year. Can you tell us what's driving that, and perhaps the sales and marketing portions, are trending versus the G&A?

Chris Lafond - *Gartner Inc - EVP and CFO*

Yes, just on SG&A, the increases I talked about a few minutes ago is driven by the continued increase in our sales force. Our sales headcount is up 16% year-over-year. G&A is actually down as a percent of revenue, and so we continue to really tightly manage G&A costs. So G&A continues to come down as a percent of revenue so the driver of our SG&A cost is our continued investment in the sales force.

Unidentified Participant - *Credit Suisse - Analyst*

One follow-up, can you give us a sense of how your business is doing in Europe and how that environment may have changed from last quarter, if at all?

Gene Hall - *Gartner Inc - CEO*

Our business in Europe is doing great. As I mentioned before, we've seen double-digit growth in all of our geographic regions, including Europe.

Operator

Tim McHugh, William Blair & Company.

Timothy McHugh - *William Blair & Company - Analyst*

First, I was going to ask, the contribution margin for research, I think you've talked a little bit about once you start approaching 70% it will be tougher to continue to drive that upward, but it looks like it was up pretty significantly, still, this quarter. Is there something underlying that or -- that made this quarter unusual in terms of upside, or perhaps, are you finding ways that makes you think you can extend beyond that previous hurdle rate you had before?



Chris Lafond - *Gartner Inc - EVP and CFO*

We still believe 70% is the right number on a full-year basis. There is some seasonality to our margin in that segment. In particular, fourth quarter tends to be lowest, first quarter tends to be highest. That's because, in the fourth quarter our analysts are traveling to symposiums, doing a lot of client meetings as we close out the year to close deals. So we would expect it to be a little higher at the beginning of the year, a little lower at the end of the year, and still be right around that 70% number. So we don't have any thought today but 70% is still not the right place to be for that segment.

Timothy McHugh - *William Blair & Company - Analyst*

On Software Advice, the margins, I understand you said you were investing in it accelerating, is that just adding salespeople ahead of growth? And just to make sure I understood the comments, did you expect to -- you expect you can get similar margins to the core business, or how would it compare it and how long will it take you to get there?

Chris Lafond - *Gartner Inc - EVP and CFO*

Just a couple things on that. The investments we're making are kind of across the business. So as you would imagine, in a smaller company like Software Advice, as much as we like the business and it's a very well-run business, in order to scale it, we believe we have to make investments in their technology platforms, in their operations to the business. So there's a number of places we're going to make some investments to make sure that we can scale that business over the long term and grow it geographically, as well.

In addition, from a margin perspective, we fully expect that this will be a nice positive contributor to our business, and over the long term, it's going to be a really nice margin enhancement to the overall Company.

Timothy McHugh - *William Blair & Company - Analyst*

One last numbers one, you mentioned the events, you had 40% growth. I think it was the events that moved out of the first quarter into the second. Was that just the same events that the revenue growth for those three?

Chris Lafond - *Gartner Inc - EVP and CFO*

Yes. We had four events moved. Three of them have already been held in the month of April. Those three events, as I mentioned, were very large, relatively large mature events. So they had a pretty significant impact in the Q1 2013 results, and since we've held them out, we saw similar great performance. In fact, as I said, those same three events, just those three, were up 40%. So from a same events perspective, really strong performance on the three we've held.

Operator

Gary Bisbee, RBC Capital Markets.

Gary Bisbee - *RBC Capital Markets - Analyst*

Can you explain the Software Advice revenue model a little more? I guess I understand that you said it's transactional and not subscription-based, but is that something you'll look to change? Within that transactional how recurring is that, or stable and predictable -- so is this different from the core business and research?

Gene Hall - *Gartner Inc - CEO*

It is different than the core business. To go back to my small medical practice, they typically buy things -- they typically have -- they tend to buy their software and their IT technology from the outside as opposed to, kind of, build it themselves, and it tends to be episodic. So they don't buy a new electronic medical record every month, every quarter, even every year. So what happens is that the way our economics work is it's more related to when they have specific transactions as opposed to, they pay an up-front fee for a year service. So when they need to do a deal that's kind of when we get paid as a part of that.

And so it's very specific -- it's not a one-year contract. It's related more to -- it's transactional. On other side of it though is, unlike our larger -- our traditional business, there are many millions of these companies at any given point in time. We think that will smooth out a lot of the individual transactions as opposed to a business that doesn't have that kind of nature to it.

Gary Bisbee - *RBC Capital Markets - Analyst*

And then how do they go to market or sell or find clients and how do we think about -- you said a 50% revenue CAGR, I guess \$20 million for the year. That's only 10 months, shows that's good growth versus that \$15 million you said for last year. Any sense how we think about the impact on the growth and maybe how penetrated the opportunity is?

Chris Lafond - *Gartner Inc - EVP and CFO*

The market opportunity is enormous. They have a very tiny portion of the market, and they're almost wholly in the US today, and they only have a tiny portion of the US market. So the opportunity for growth is huge there. We think it can have -- it will grow at a higher rate than our traditional business for a long period of time.

Gary Bisbee - *RBC Capital Markets - Analyst*

Just one last question, can we get an update on the sales productivity? I may calculate it slightly differently than you do but it looks like it fell again in Q1. I know you were talking about the Investor Day flat to maybe improving this year. As a second part of that, any change in those two positive metrics you mentioned a quarter ago, the retention of the sales force overall improving, and the cohort of new people from last year doing somewhat better versus prior cohort?

Chris Lafond - *Gartner Inc - EVP and CFO*

Sales productivity is essentially flat from last year when you look at it in the first quarter. However, if you look at just a standalone quarter, Q1 this year is better than last year's Q1. So we are certainly seeing, when you look at, just individual standalone quarters, we're seeing some nice improvement there. And it's flat to Q4 -- I'm sorry, it's flat to Q4 -- sorry, not to Q1 of last year. My apologies. I was talking about sequential. But standalone, if you look at Q1 versus Q1, we saw an increase.

So where we are today is effectively what we said in our guidance, which was, we did not expect in our guidance to see any dramatic increase in sales productivity. It would remain flattish and that's kind of roughly where we are. We're continuing to do lots of things and expect that what we're seeing in Q1 hopefully will continue to show benefit for the rest of the year and start to see that increase from here.

Gene Hall - *Gartner Inc - CEO*

And our turnover has had steady improvement. Sales turnover has had steady improvement on -- (technical difficulties).



Operator

Bill Warmington, Wells Fargo.

Bill Warmington - *Wells Fargo Securities - Analyst*

I wanted to ask if you're seeing a change for the better in clients' willingness to spend on your products, and if so, what's behind that?

Chris Lafond - *Gartner Inc - EVP and CFO*

A couple things I would say there. If you look at average spend per organization, it continues to increase. It's just over \$100,000, which continues to improve. I think that's up almost 7% from the first quarter of last year and up a couple of percentage points from the fourth quarter. So as we talk about all the time, we're seeing that mix coming from about 20% of an increase is really due to pricing and the other 80% is real volume. So we're continuing to penetrate the clients, continuing to sell more into those clients, so that trend has been the trend we've been on for quite some time and it is continuing.

Bill Warmington - *Wells Fargo Securities - Analyst*

I'm trying to parse whether -- the cyclical from the secular, whether some of it's coming from an improving economy? Or if some of it's coming from sort of an inflection point in terms of the client base seeing an increase in value or having an increase in need, giving a pick-up in the velocity of the change in technology.

Chris Lafond - *Gartner Inc - EVP and CFO*

Yes, so it's not the economic environment that has caused any change. I'd say, if you look at what's going on, the economic environment is not giving us any additional demand. The two things that are driving our increasing demand is -- one is all the initiatives we have on sales productivity, and the second one is what I talked about in my remarks which is just what's going on in the technology world in general where it's affecting every business, every industry, and it's becoming more pervasive all the time.

And so we have this underlying change that's going on in every enterprise where technology is becoming more important. So they see the need for it, and we're in the best position to do it. Then we couple that with our focus of making sure our salespeople are as productive as they can be.

Bill Warmington - *Wells Fargo Securities - Analyst*

One housekeeping question, the share count exiting Q1, fully diluted?

Chris Lafond - *Gartner Inc - EVP and CFO*

Fully diluted share count exiting Q1. Just give me a second. For the quarter we had [93.209 million]. That's the average for the quarter.

We're actually -- let me just give you the exact number. It's down a couple million, probably below that, but we'll get you the exact number for that.

Brian Shipman - *Gartner Inc - Group VP, IR*

We'll go to the next question and circle back with that share count number.

Operator

Manav Patnaik, Barclays.

Unidentified Participant - *Credit Suisse - Analyst*

This is Ryan filling in for Manav. Just to follow up on Gary's question, I just want to make sure I wrote that down right on the sales productivity metrics. So essentially flat from fourth quarter, and then this Q1 was better than last year on a standalone basis, did I hear that right?

Unidentified Company Representative - *Gartner Inc*

Yes. That's correct.

Unidentified Participant - *Credit Suisse - Analyst*

And then turning to Software Advice, I know you said the market opportunity is enormous. Is there any way to quantify that, kind of similar to how you break out the core research model just in terms of total size, the number of enterprises, or anything along those lines?

Gene Hall - *Gartner Inc - CEO*

We have not done that yet.

Unidentified Participant - *Credit Suisse - Analyst*

And that's -- we should think of them as wholly US so far and then is the plan to bring them internationally as, kind of, in line with your current business model?

Gene Hall - *Gartner Inc - CEO*

Yes. In the US alone, they have tiny penetration and they are overwhelmingly US. And because we're a global company one of the ways we expect to leverage them is, in fact, to build their business globally. What they do is just as relevant everywhere in the world.

Unidentified Participant - *Credit Suisse - Analyst*

And you mentioned you're seeing similar valuations for deals of this nature, so if we -- going forward, is this kind of the valuation we should expect on deals for this year?

Chris Lafond - *Gartner Inc - EVP and CFO*

From a valuation perspective, as I talked about, we are very thoughtful about all of the deals we do. Depending on the company, depending on the marketplace, and depending on the growth rate of the business, so there's a whole bunch of different factors that are going to weigh into valuation on individual transactions, so I wouldn't necessarily say one transaction is the market. We believe this transaction was done at a very good valuation, and we'll look at each one independently.



Unidentified Participant - *Credit Suisse - Analyst*

Just one more if I could, on the buybacks, is there anything that moved that \$400 million for the year higher, whether it be lack of M&A or anything that you see that would move that number up?

Chris Lafond - *Gartner Inc - EVP and CFO*

We will continue to look, as we always do, at all uses of cash. As we talked about at the beginning of this year, we feel very strongly that with our current cash position, the strength in our business, and the continued growth in our business, as well as our balance sheet, that at least \$400 million makes sense, and we'll look at that as we go through the rest of the year.

And I just wanted to come back and circle back on the question that the basic shares outstanding at the end of the quarter were 90.2 million, but we will clarify the weighted shares outstanding as of the end of the quarter.

Operator

Jeffrey Silber, BMO Capital Markets.

Jeffrey Silber - *BMO Capital Markets - Analyst*

In prior quarters you called out some trends in your government business. I was wondering, could we do that for this quarter?

Gene Hall - *Gartner Inc - CEO*

Our public-sector business overall grew at high single-digit rates. In terms of the US federal government, there's really no change in the situation we've talked about for the past few quarters.

Jeffrey Silber - *BMO Capital Markets - Analyst*

And how about governments abroad?

Gene Hall - *Gartner Inc - CEO*

Again, same thing. I think if you look at the public sector overall, it's pretty much what we've -- there's no change.

Jeffrey Silber - *BMO Capital Markets - Analyst*

I just wanted to circle back to the Software Advice acquisition, I'm not sure if you answered this question about your go-to market strategy. Is this going to be sold under a separate sales force, are you going to keep the name, are you going to change the name, any color there would be great.

Gene Hall - *Gartner Inc - CEO*

They have a different sales force. It's a different distribution channel, and in terms of the name, we're deciding how we're going to handle branding. For now we have retained Software Advice, but we'll figure in the future -- we're still determining what we're going to do in the future.



Jeffrey Silber - *BMO Capital Markets - Analyst*

On more on that, you had mentioned that the price you paid was reasonable based on other deals. Are you looking on a revenue multiple, a price per employee multiple, I'm just curious what metrics you used to make that statement.

Chris Lafond - *Gartner Inc - EVP and CFO*

When we look at transactions, depending on the transaction, we look at multiple -- we look at a variety of different valuation multiples, we do look at revenue, we do look at earnings, we do look at cash flow, we look at a variety of them, and growth rate and other things. So we're looking at all those when we look at valuation and feel very comfortable that this is a very good valuation, both for our business and for shareholders.

Operator

Jeff Meuler, Baird.

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

First, on the Software Advice acquisition, and I guess more on the small business, medium-sized business market opportunity, should we view this as kind of a platform acquisition that you use to attack that opportunity or should we view it more as the first of several potential acquisitions as you increase and we focus on that part of the market?

Gene Hall - *Gartner Inc - CEO*

Software Advice, we think, is the market leader in doing the kind of work we do with small businesses, and so we see that as a core acquisition.

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

And then, on consulting, I get that contract optimization's lumpy and that you have a lot of the upside in the quarter but the backlog was also strong. Can you talk about where the demand for -- what types of services you have the strongest demand for? Any geographies, anything along those lines in terms of what's driving the strength in the backlog?

Chris Lafond - *Gartner Inc - EVP and CFO*

If you look at the strength of the backlog, it was pretty balanced, actually, geographically, so we had really good strength around the world, and so from that perspective, very balanced. As you know, we're very focused on the kinds of activities that we do in our core consulting and benchmark businesses, and we saw real strength across the portfolio. I wouldn't say there's any specific place that drove that. It was just a very nicely balanced performance across the consulting business.

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

And then I think you talked about the research contract value outlook a little bit differently in terms of the language that you used this quarter versus last quarter, I think Gene said expect to accelerate in 2014. Just to be clear, are we still talking about, you expect it to be in the 13% to 14% range for 2014? Or are you saying you expect it to accelerate further from here, so maybe the range is now 14% to 15%, or it's just 14%, or how should I interpret that?

Chris Lafond - *Gartner Inc - EVP and CFO*

Now, as we sit here today, I think we're still reflecting what we talked about on the last call, which is we still expect to be in the 13% to 14% range, we've accelerated to 13% and we still believe that we have the opportunity to get to that 14% range this year.

Operator

Joseph Foresi, Janney.

Joseph Foresi - *Janney Montgomery Scott - Analyst*

I guess what I'm trying to focus in on, or what I had a question on was sort of what changed and drove the uptick in the quarter? Consulting seems to be more discretionary. It seems like that picked up. It sounds like Europe got a little bit better and there's really no change on a government business. So was this more execution, or to the prior question, is this economically driven and over the economy getting better, is this changes in IT? I'm just trying to get a feel for sort of what you would point to.

Gene Hall - *Gartner Inc - CEO*

Again, it's not the economy getting better. It's basically, I think, the fact that technology is becoming more important and so people need help with that -- technology changes, and it's also our execution. Let me just comment on consulting specifically. As many of you know, our strategy in consulting has always been to build a cadre of managing partners. We've been working on that, and I think one of the things that has really -- as we would analyze results for Q1 and the strong bookings there. It's really being driven by this strategy of having managed partners to drive that business, and so that's an example of our operational changes are really driving the improvement.

Joseph Foresi - *Janney Montgomery Scott - Analyst*

And then on the contract value uptick to maybe the 13% to 14% range, that kind of, either holding or improving in the back half the year, is that still based on sales force productivity and some of the new hires coming on as we talked about at the Analyst Day?

Gene Hall - *Gartner Inc - CEO*

It's really no change from Analyst Day which is, we're assuming we have flat sales productivity. It doesn't improve, and if you just look at, with flat sales productivity, we don't have an improving set of productivity, we still get an acceleration in our contract value growth rate.

Joseph Foresi - *Janney Montgomery Scott - Analyst*

And can I assume that the sales productivity is still higher for some of the -- I think you talked about some of the new hires that sales force productivity had been ahead of what you were expecting?

Gene Hall - *Gartner Inc - CEO*

We've been very focused on improving the performance of new hires. In fact, and we track it very closely, and the performance of new hires is improving.

Joseph Foresi - *Janney Montgomery Scott - Analyst*

And then the last question from me is just on the pricing front. Was it easier to get prices this year than in prior years or is it the same sort of environment that you've seen before?

Chris Lafond - *Gartner Inc - EVP and CFO*

I would say the same, as we've talked about repeatedly, we put that 3% to 6% in place, we've been able to do that every year. I wouldn't say there's any dramatic difference this year versus last year.

Operator

Andre Benjamin, Goldman Sachs.

Andre Benjamin - *Goldman Sachs - Analyst*

My first question is do you have any updated thoughts on your long-term leverage target? Is there still a willingness to increase leverage 3 times or so? Or has that changed with the business environment, and if it hasn't changed, any timeframe on how you're thinking about that given that it's been a view you've held for a while?

Chris Lafond - *Gartner Inc - EVP and CFO*

As we've talked about many times, we feel very comfortable that this company could easily handle on an ongoing basis 2 to 3 times debt to EBITDA on an ongoing basis. And could handle above that for certain transactions that make sense because we know that with our cash flow-generating ability they'll come down pretty quickly. So no change in terms of how we think about the long-term leverage that we can handle and that we would like to get to.

As we talked about at Investor Day, the acceleration in share repurchase, as well as the acquisition pipeline we feel we have, will help get us there, and we don't have a specific timeframe but we're going to continue to work through the year and execute as we have in Q1. We'll be able to provide updates as we go through the year.

Andre Benjamin - *Goldman Sachs - Analyst*

On the productivity front, I know you've called out some areas in particular in the past that you've had some challenges, like Europe. Any update, in particular, on progress in the areas that you've called out in the past? Have you seen those progress or is it just more of the same given the economy hasn't changed much?

Gene Hall - *Gartner Inc - CEO*

I talked about the public-sector earlier, where, in essence, we've seen no change. I'd say in other things we're seeing modest improvement as we focus operationally.

Operator

Jerry Herman, Stifel.

Jerry Herman - *Stifel Nicolaus - Analyst*

Gene, you referenced better retention in the sales force. Could you give us some metrics on that in terms of how much it has, in fact, improved. And also, as part of that question, you referenced your onboarding process, or getting the newer sales people productive more quickly. Can you talk about their retention rates and those cohorts?

Gene Hall - *Gartner Inc - CEO*

We've been very focused on hiring people that are a good fit with Gartner because we know if we have -- they'll be more successful, they'll stay longer, and it's a win-win for everybody. Our retention has been improving modestly over the last two to three years. So this isn't just -- it's part of a trend, and it's, every year it's got a little bit better.

We're staying on a same trend with getting a little bit better each year. And so it's an important metric, and I think it's getting better because we're -- we as an institution keep get better at being able to hire people that are a really good fit with our kind of environment.

Jerry Herman - *Stifel Nicolaus - Analyst*

And just a question about Software Advice, I know there have been a lot of them today for a small business, but it seemed like that business model would inherently have lower margins than your core research product. In fact, it almost seems like it better resembles the consulting model. Am I missing something there or should we -- does it, in fact, look more like a consulting model?

Chris Lafond - *Gartner Inc - EVP and CFO*

It does not look like a consulting model. We don't think about it as a consulting model at all and we think over the long term it will have very attractive margins.

Jerry Herman - *Stifel Nicolaus - Analyst*

And [tie into] research?

Chris Lafond - *Gartner Inc - EVP and CFO*

When you look at that business, obviously we're making some investments now, and we will see if that business scales. We will be able to give you more insight as we get farther along that path, but we certainly do not expect it to be a consulting model. We expect it to be more like a research business and we'll be able to come back to you as we move ahead here.

Operator

Gary Bisbee, RBC Capital Markets.

Gary Bisbee - *RBC Capital Markets - Analyst*

Just one quick one on, Chris, your comments around the financials for this acquisition, you lost me on part of it. Can you just repeat what you said about, there was some performance bonus or something that you were accruing, but if some numbers weren't hit -- what I missed was what the magnitude of that was, number one. Number two, what line on the P&L you said that would flow through.

Chris Lafond - *Gartner Inc - EVP and CFO*

Sure. Let me just go back and share with you what I talked about there. So when you look at what we did, there were some amounts that we have held back until certain employment conditions are met, and the amounts -- those amounts will be accrued ratably and expensed over the service period of those employees. So over a couple of year period, which is the appropriate accounting for this particular transaction. We anticipate that just under \$17 million will accrue to the 2014 P&L for that amount, and then there will be some in 2015, as well.

A little bit higher, and a little bit into 2016 just because of the timing of the transaction. And if those conditions are not met, we won't pay those out, and will reverse those charges, but we're going to be accruing them and then the cash will go out the door when they hit those particular -- (multiple speakers). It will all be in the line called acquisition integration charges, so you'll see it in that line item.

Gary Bisbee - *RBC Capital Markets - Analyst*

So help me understand that a little more. It sounds to me like it's compensation, rather than something that would be excluded from the normalized or adjusted earnings and EBITDA.

Chris Lafond - *Gartner Inc - EVP and CFO*

No, actually, this just happens to be the accounting treatment for the transaction, so it's all part of the purchase price. How we decided to protect ourselves and to protect against either not achieving the kind of results we thought we'd achieve, we held these amounts back and from an accounting perspective, it's treated this way. It is not compensation expense, it's part of the deal in the transaction. From an accounting perspective, we treat it as if it was compensation in the P&L, however, that's not what it is in terms of the deal itself.

Gary Bisbee - *RBC Capital Markets - Analyst*

So, but you treat it as if it's comp but it's in the line your excluding. So that last statement didn't make sense to me.

Chris Lafond - *Gartner Inc - EVP and CFO*

It is in the acquisition integration line because it is a deal cost. From an accounting perspective we are required to treat it the way we're treating it and ratably expense it over the period of performance, which is over a two-year period.

Operator

Jeff Silber, BMO Capital Markets.

Jeffrey Silber - *BMO Capital Markets - Analyst*

Sorry, just to follow up on that, so just to clarify. This is going to be a cost in addition to the \$102 million that I see on your cash flow statement for the first quarter?

Chris Lafond - *Gartner Inc - EVP and CFO*

Correct. So we paid out \$102 million There's an escrow amount that's held back and then there's this holdback as well, so there's holdback amounts that have not been paid out yet in cash.

Jeffrey Silber - *BMO Capital Markets - Analyst*

And can you just, again, clarify what are the total holdback amounts, both in escrow and this holdback that you're talking about?

Chris Lafond - *Gartner Inc - EVP and CFO*

Approximately \$32 million in total.

Jeffrey Silber - *BMO Capital Markets - Analyst*

So if I were looking at the total deal price, in theory it's \$102 million that you've already paid out, and then another \$32 million on top of it, potentially.

Chris Lafond - *Gartner Inc - EVP and CFO*

Right.

Operator

I'll now turn the call back over to Brian Shipman for your closing remarks.

Chris Lafond - *Gartner Inc - EVP and CFO*

This is Chris. Just one thing to clarify. There was a couple of questions on the share count so just for your modeling, where we ended Q1 was basic shares outstanding of about 90.2 million, and then fully diluted is about 91.7 million. So that's where we are as of Q1 ending, as I said, we fully expect by the end of the year to be below 90 million fully diluted shares outstanding.

Brian Shipman - *Gartner Inc - Group VP, IR*

Thank you everyone for being with us on today's Q1 2014 earnings call. If you have any further questions, please don't hesitate to contact us. We'll speak to you again on our 2Q conference call in early August. Thank you.

Operator

And ladies and gentlemen, and this concludes our presentation. You may now disconnect. Enjoy your day.



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