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Gartner, Inc. (IT)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by. And welcome to the Gartner Second Quarter 2021 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there'll be a question-and-answer session. [Operator Instructions] Please be advised that today's call may be recorded. [Operator Instructions]

I'd now like to hand the call over to David Cohen, Gartner's GVP of Investor Relations. Please go ahead.

David Cohen
Group Vice President-Investor Relations, Gartner, Inc.

Good morning, everyone. We appreciate you joining us today for Gartner's second quarter 2021 earnings call and hope you are well. With me on the call today are Gene Hall, Chief Executive Officer and Craig Safian, Chief Financial Officer. This call will include a discussion of the second quarter 2021 financial results and Gartner's updated outlook for 2021 as disclosed in today's earnings release and earnings supplement both posted on our website investor.gartner.com. Following comments by Gene and Craig, we will open up the call for your questions. We ask that you limit your questions to one and a follow-up.

On the call, unless stated otherwise, all references to EBITDA are for adjusted EBITDA with the adjustments as described in our earnings release. All growth rates in Gene's comments are FX-neutral, unless stated otherwise. Reconciliations for all non-GAAP numbers we use are available in the Investor Relations section of the gartner.com website. Finally, all contract values and associated growth rates we discuss are based on 2021 foreign exchange rates, unless stated otherwise. As set forth in more detail in today's earnings release, 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 2020 Annual Report on Form 10-K and Quarterly Reports on Form 10-Q, as well as in other filings with the SEC. I encourage all of you to review the risk factors listed in these documents.

Now, I will turn the call over to Gartner's Chief Executive Officer, Gene Hall.

Eugene A. Hall

Chief Executive Officer & Director, Gartner, Inc.

Good morning and thanks for joining us. Gartner's positive momentum continued in the second quarter of 2021. We again delivered strong results across contract value, revenue, EBITDA and free cash flow. We significantly increased the pace of our buybacks. Total company revenues were up 16% with strength in all three business segments and Research achieving our expectations. We continue to see growth opportunities across industries, geographies and every size enterprise. Research is our largest and most profitable segment. Our Research segment serves executives and their teams across all major enterprise functions in every industry around the world. Our market opportunity is vast across all sectors, sizes, and geographies.

Total contract value growth increased to 11%, with both the GTS and GBS accelerating in the quarter. This was driven by strength in both retention and new business. Global Technology Sales, or GTS, serves leaders and their teams within IT. For Q2, GTS contract value growth accelerated to 9% and we have CV growth in all of our top 10 countries. GTS drove strong growth across virtually all industries, including manufacturing, services and tech and telecom, and we expect the GTS contract value growth to continue accelerating, returning to double digit growth in future.

Global Business Sales, or GBS, serves leaders and their teams beyond IT. This includes HR, supply chain, finance, marketing, sales, legal and more. GBS again accelerated delivering outstanding contract value growth of 18%. All practices contributed to our growth and our HR, finance, sales and supply chain practices each exceeded 20% contract value growth. So, across our entire Research business, we're seeing the results of a sustained focus, a consistent execution of proven practices. We continue to have a vast market opportunity and our Research business is well-positioned as we continue to deliver a long term, sustained double-digit growth.

Turning to Conferences, for the second quarter 2021, Conferences revenues were $58 million, again exceeding our expectations. As many of you know, during 2020 we were unable to hold in-person conferences. To address this situation, we created virtual conferences to deliver extraordinarily valuable insights to our audiences. We continue to operationally prepare for some in-person conferences in the second half of the year, if conditions allow.

Gartner Consulting is the extension of Gartner Research and helps clients execute their most strategic initiatives through deeper, extended, project-based work. Consulting revenues were up 4% in Q2. We had strength in our labor-based business with labor-based revenue up 20% over this time last year. Contract optimization revenue was down from a record high last year. Overall, Consulting continues to be an important complement to our IT Research business. To ensure we keep pace with our accelerating growth rates, we're rapidly growing our recruiting capacity.

Our [ph] hurry is (00:05:25) accelerating. Even in today's tough labor market, candidates see Gartner as a great place for a long term career. They know we have an incredible impact on our clients, that we're a sales driven growth company and that our growth provides among the best promotion and professional development opportunities for all our associates. With strong revenues and continued disciplined cost management, EBITDA exceeded expectations. Strong EBITDA combined with effective cash management resulted in strong free cash flow. Our priorities for cash flow continue to be strategic tuck-in acquisitions like the small one we did this quarter and share repurchases.

Summarizing, Q2 was another strong quarter with strength in all three business segments and Research exceeding our expectations. We delivered strong results across contract value, revenue, EBITDA and free cash flow. Looking ahead, we are well-positioned for a long term, sustained double digit growth. We have a vast addressable market. We have an attractive recurring revenue business model, with strong contribution margins. We expect to deliver modest EBITDA margin expansion going forward from a normalized 2021. We generate a significant free cash flow in excess of net income, which we'll continue to deploy through share repurchases and strategic tuck-in acquisitions.

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

Craig Warren Safian

Executive Vice President & Chief Financial Officer, Gartner, Inc.

Thank you, Gene, and good morning. Second quarter results were excellent, with strength in contract value growth, revenue, EBITDA and free cash flow. We are increasing our 2021 guidance to reflect our strong Q2 performance.

Second quarter revenue was $1.2 billion, up 20% year-over-year as reported and 16% FX-neutral. In addition, total contribution margin was 70%, up more than 300 basis points versus the prior year. EBITDA was $355 million, up 85% year-over-year and up 75% FX-neutral. Adjusted EPS was $2.24. Free cash flow in the quarter was $563 million. Free cash flow includes $150 million from insurance proceeds related to cancelled 2020 conferences.

Research revenue in the second quarter grew 15% year-over-year as reported and 11% on an FX-neutral basis. We saw strong retention and new business in the quarter. Second quarter Research contribution margin was 74%, up about 170 basis points versus 2020. Contribution margins reflect both, improved operational effectiveness, continued avoidance of travel expenses, and a lower than planned head count. However, some of the margin improvement compared to historical levels is temporary and will reverse as we resume normal travel and increase spending to support growth. Total contract value grew 11% FX-neutral year-over-year to $3.8 billion at June 30th. Quarterly net contract value increase, or NCVI, was $114 million, significantly better than the pandemic lows in the second quarter of last year and a new record high for second quarter NCVI. Quarterly NCVI is a helpful way to measure contract value performance in the quarter even though there is notable seasonality in this metric.

Global Technology Sales contract value at the end of the second quarter was $3 billion, up 9% versus the prior year. GTS CV increased $75 million from the first quarter. The selling environment continued to improve in the second quarter. By industry, CV growth was led by technology, manufacturing and services. Wallet retention for GTS was 101% for the quarter, up about 110 basis points year-over-year. Wallet retention isn't yet fully back to normal because it's a rolling four-quarter measure. GTS new business was up 38% versus last year with strength in new logos and continued improvement in upsell with existing clients. Our regular full set of metrics can be found in our earnings supplement.

Global Business Sales contract value was $770 million at the end of the second quarter, up 18% year-over-year which is above the high end of our medium term outlook of 12% to 16%. GBS CV increased $39 million from the first quarter. Broad based CV growth was led by the healthcare and technology industries. All of our practices including marketing deliver year-over-year and sequential CV growth; HR, finance, sales and supply chain each grew 20% or more year-over-year. Wallet retention for GBS was 110% for the quarter, up more than 950 basis points year-over-year. GBS new business was up 76% over last year led by very strong growth across the full portfolio. As with GTS, our regular full set of GBS metrics can be found in our earnings supplement.

Conferences revenue for the second quarter was $58 million compared to no revenue in the year ago quarter. Contribution margin in the quarter was 73%, driven by a strong top line performance. We held 13 virtual conferences in the quarter. We also held a number of virtual Evanta meetings.

Second quarter Consulting revenues increased by 9% year-over-year to $106 million. On an FX-neutral basis, revenues were up 4%. Consulting contribution margin was 40% in the second quarter, up almost 600 basis points versus the prior year quarter. Labor based revenues were $86 million, up 25% versus Q2 of last year and up 20% on an FX-neutral basis. Labor based billable head count of 740 was down 7%. Utilization was 70%, up more than 1,100 basis points year-over-year. Backlog at June 30th was $108 million, up 7% year-over-year on an FX-neutral basis after another strong bookings quarter. Our contract optimization business was down 31% on a reported basis versus the prior year quarter and down 33% FX-neutral. The prior year period was the highest ever revenue quarter for contract optimization, and as we have detailed in the past, this part of the Consulting segment is highly variable.

Consolidated cost of services increased 9% year-over-year and 6% FX-neutral in the second quarter. Cost of services increased due to the reinstatement of annual merit increases and to support growth in the business. SG&A decreased 1% year-over-year and 4% FX-neutral in the second quarter. Compared with the prior year period, SG&A declined due to lower severance and conference-related expenses partially offset by higher personnel costs. E&E remains close to zero. Operating expenses were lower than planned in part because net head count growth was below our targets. While our rate of hiring continues to ramp up, turnover remains modestly above normal levels due to tighter labor market conditions. As Gene said, we're rapidly growing our recruiting capacity to keep pace with our accelerating growth rates. EBITDA for the second quarter was $355 million, up 85% year-over-year on a reported basis and up 75% FX-neutral. Second quarter EBITDA again reflected revenue above the high end and cost towards the low end of our expectations.

Depreciation in the quarter was up about $3 million versus 2020, reflecting real estate and software which went into service since the second quarter of last year. Net interest expense excluding deferred financing costs in the quarter was $26 million, roughly flat versus the second quarter of 2020. The Q2 adjusted tax rate, which we use for the calculation of adjusted net income, was 29.9% for the quarter. The tax rate for the items used to adjust net income was 24.6% in the quarter. Adjusted EPS in Q2 was $2.24. The weighted average fully diluted share count for the second quarter was 86.6 million shares. We exited the second quarter with 85.1 million fully diluted shares.

Operating cash flow for the quarter was $575 million, up 68% compared to last year. Q2 operating cash flow includes $150 million of proceeds from insurance related to 2020 conference cancellations. Excluding the insurance proceeds, operating cash flow improved by 24% versus the prior year quarter. Cash flow strength continues to be driven by EBITDA growth and improved collections. CapEx for the quarter was $12 million, down 44% year-over-year. Lower CapEx is largely a function of lower real estate investments. Free cash flow for the quarter was $563 million; which was up about 75% versus the prior year. Excluding the insurance proceeds, free cash flow improved by 28% versus the prior year quarter. Free cash flow growth continues to be an important part of our business model with modest capital expenditure needs and upfront client payments. Free cash flow as a percent of revenue or free cash flow margin was 27% on a rolling four-quarter basis. Excluding the insurance proceeds, free cash flow was 23% of revenue continuing the improvement we've been making over the past few years. Free cash flow was well in excess of both GAAP and adjusted net income.

At the end of the second quarter, we had $796 million of cash. During the quarter, we issued $600 million of new eight-year senior unsecured notes with the 3.625% coupon. The proceeds from this new issuance to repay $100 million of the existing Term Loan A, the balance is available for general corporate purposes including share repurchases. Our June 30th debt balance was $2.5 billion. At the end of the second quarter, we had about $1 billion of revolver capacity. Our reported gross debt to trailing 12-month EBITDA was about 2.3 times. Our expected free cash flow generation and excess cash remaining on the balance sheet provide ample liquidity and cash to deliver on our capital allocation strategy of share repurchases and strategic tuck-in M&A. During the quarter, we made a small acquisition with net cash paid at closing of $23 million.

Year-to-date, we have repurchased more than $1 billion in stock including $685 million during the second quarter. In July, the board increased our share repurchase authorization for the third time this year adding another $800 million. As of August 1st, we have more than $1 billion available for share repurchases. We expect the board will continue to refresh the repurchase authorization as needed. As we continue to repurchase shares, we expect our capital base will shrink. This is accretive to earnings per share and combined with growing profits also delivers increasing returns on invested capital over time.

We are updating our full year guidance to reflect Q2 performance and an improved and increased outlook for the remainder of the year. For Research, the strong start to the year in CV performance and improvements to non-subscription revenue are contributing to higher than previously expected Research revenue.

For Conferences, our guidance is still based on being virtual for the full year. With the uptick in COVID and shifting government directives, there is much more uncertainty around our ability to run in-person conferences during the balance of the year. We continue to operationally plan for some in-person conferences. Our updated guidance reflects some additional cancellation related costs for Conferences where we have been planning to run in-person but may need to cancel. If we are able to run in-person conferences, we expect incremental upside to both our revenue and profitability for 2021. For expenses, we have reinstated benefits which were either cancelled or deferred in 2020. This includes our annual merit increase which took effect April 1st. We are investing in expanding our recruiting capacity, drive additional hiring across the business. The additional hiring will continue into 2022 and beyond to support current and future growth. Our current plan is to increase quota-bearing head count in the mid-single digits for GTS and low-double digits for GBS by the end of 2021. Additionally, we continue to invest in a number of programs with a focus on improving sales productivity.

As you know, travel expenses were close to zero from April 2020 through June 2021. Our current plans continue to assume a ramp-up in travel-related expenses over the course of the rest of this year weighed more to the fourth quarter. If travel restrictions remain in place for longer than we've assumed, we'd see expense savings.

For our revenue guidance, we now expect Research revenue of at least $4 billion, which is growth of 11%. We still expect Conferences revenue of at least $170 million, which is a growth of 41% (sic) [42%] (00:18:04). We still expect Consulting revenue of at least $400 million, which is a growth of 6%. The result is an outlook for consolidated revenue of at least $4.57 billion, which is a growth of 11%. Based on current foreign exchange rates and business mix, the consolidated growth includes an FX benefit of about 200 basis points. The year-over-year FX benefit was more pronounced in the first half of the year. With the ongoing business momentum we are seeing, we will continue to restore our growth spending as we move through the year. We now expect full year adjusted EBITDA of at least $1.16 billion, which is an increase of about 42% versus 2020 and reflects reported margins of 25.4%.

We expect a reasonable baseline for thinking about the margins going forward is around 18% to 19%, consistent with our comments last quarter. We expect our full year 2021 adjusted net interest expense to be $113 million. Looking out to 2022 as the balance sheet stands today, we expect interest expense to be around $115 million. We expect an adjusted tax rate of around 22% for 2021. We now expect 2021 adjusted EPS of at least $7.60. For 2021, we now expect free cash flow of at least $1.13 billion. This includes the $150 million of insurance proceeds received in the second quarter this year. All of the details of our full year guidance are included on our Investor Relations site.

Turning to the second half of the year, for Research, we have more visibility into revenue the farther we get into the year. This is because the NCVI earlier in the year has more of an effect on the full year revenue. Seasonally, Conferences and Consulting are also both typically later in Q3. Finally, at the start of 2021, there was a lot of uncertainty in the world and we began with a prudently conservative plan. More than halfway through the year and with less macro uncertainty, there is a lower likelihood of the kind of upside we've seen in the past few quarters. As a result, we expect reported numbers to be closer to our guidance than earlier in the year. Any upside is more likely to come from lower cost than higher revenue. For Q3, we expect to deliver at least $250 million of EBITDA. We also expect a tax rate for the quarter in the high-20s.

Looking out over the medium term, our financial model and expectations are unchanged. With 12% to 16% Research CV growth, we will deliver double digit revenue growth. With gross margin expansion, sales costs growing in line with CV growth over time and G&A leverage, we can modestly expand margins from a normalized 2021 level of around 18% to 19%. We can grow free cash flow at least as fast as EBITDA because of our modest CapEx needs and the benefits of our clients paying us upfront. We will repurchase shares over time which will lower the share count. We have strong first half with momentum across the business. We have meaningfully updated our outlook for 2021 to reflect the stronger demand environment and our enhanced visibility. We are restoring certain expenses and investing to ensure we are well-positioned to continue our momentum. We repurchased more than $1 billion worth of stock this year and remain committed to returning excess capital to our shareholders.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Gary Bisbee with BofA Securities. Your line is open.

Gary E. Bisbee
Analyst, BofA Securities, Inc.

Q

Hey guys, good morning, and congratulations on another strong result. I guess, I wanted to dig a little more into the cost. The trend all year has been revenue ahead of your plan and cost a bit below or at the low end. What's really keeping you from accelerating investment? Is it the inability to hire? You talked about that investing there that being a little more difficult. Is it in part that you don't need more sales to deliver to the target this year given how strong productivity has been or there're other factors? I guess, in particular, I'm interested in labor market tightness and sort of how long you think it'll take to get the hiring that you've been [ph] targeting on (00:22:23). Thank you.

Eugene A. Hall
Chief Executive Officer & Director, Gartner, Inc.

A

Hey, Gary. It's Gene. So, we came into this year with a lot of sales capacity that we've built up over 2019. And so, to your point that you mentioned in your question, we actually have a lot of sales capacity and you're seeing that in our sales results. And so, the reason we've been relatively slow to ramp-up our sales hiring – our net sales hiring, has been we felt like we have plenty of capacity and plenty of opportunity and productivity and we still do. Having said that, as I mentioned earlier in my results, we're now at the point where we think it's time to sort of ramp-up that capacity. And so we've been aggressively building our recruiting capability, building our pipeline of candidates and we'd expect to increase the targeting as we go through the year to position us very well for next year and beyond.

Craig Warren Safian
Executive Vice President & Chief Financial Officer, Gartner, Inc.

A

And Gary, the other thing I would just add, good morning, is as the world has started to reopen, we've had fits and starts with that as well. And so we did have plans to have more travel and that hasn't panned out given the situation in the world. We had plans to reopen facilities. A lot of those have just been pushed that further into the year as well. So it's really a combination on the head count side that Gene just highlighted as well as some other large expense buckets that have just continued to be pushed out into the back half of the year.

Gary E. Bisbee
Analyst, BofA Securities, Inc.

Q

Okay. And then just on that note, the quick follow-up the 18% to 19% medium term margin target, if I backed into it right, it appears like the second half is above that whereas last quarter you were talking about it moving down to that level. Is that just delays in some of these costs like travel coming back that you've just cited or opening offices or is that the inability to maybe hire as quickly as you want also part of what's going on there?

Craig Warren Safian
Executive Vice President & Chief Financial Officer, Gartner, Inc.

A

Yeah. It's all three of those things, Gary, I would say. So things getting pushed out further into the year including the ramp up in hiring that Gene just talked about. And so, let let's pretend that we didn't hire all of our needs until

December 1, that's obviously not going to happen, but low burden on the 2021 P&L, full year burden on the 2022 P&L; and so our outlook, in terms of margin for the next year is really unchanged from the last quarter. This year changed just because again we continue to push out certain expenses further and further into the back half of the year.

Gary E. Bisbee
Analyst, BofA Securities, Inc.

Q

Great. Thank you.

Operator: Our next question comes from Jeff Meuler with Baird. Your line is open.

Jeffrey P. Meuler
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Thank you. I noticed that GBS sales head count has been back to sequential growth. GTS has not. I guess what I'm wondering is, is that a function of the GBS metrics inflecting earlier and growth being stronger? And therefore, you kicked the hiring into gear sooner there or is it more of a challenge in GTS because it's harder to retain individuals with tech domain selling experience? And if it's the latter, just any thoughts on if the comp packages are appropriate or need to be adjusted. Thanks.

Eugene A. Hall
Chief Executive Officer & Director, Gartner, Inc.

A

Yeah. Hey, Jeff. So I'd say, the biggest issue is the first that you started with, which is with the faster growth in GBS, the rapid acceleration, we felt more of a need to get our net hiring up sooner than we have with GTS. Having said that, as I mentioned in my remarks, turnover is modestly higher and it affects the people that are in, or parts of our business that are technology-oriented, like software engineers even as well as our GTS sales force. And while that's modestly higher, that's only a piece of it. I think a greater piece is just kind of like, what I said in the earlier question, about the timing of when we – the capacity we have today and the time of when we chose to have recruiting start back up again. We're a great place to work. Our sales people know that and really love being here and of course, we're a great place to attract new talents as well.

Jeffrey P. Meuler
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. And then not that I'd expect you to adjust your GBS medium term guidance because you had one quarter above the range, but I guess how are you thinking about it and is there some reason why there is like a cyclical lift in the current trends? Because, I guess, as I look at it the growth sounds broad-based. The comps aren't that easy and the historical experience from GTS has, on organic constant currency basis, it accelerated coming out of the financial crisis to a level and then it remained at that level kind of throughout the expansion. So just any thoughts on GBS; and if there's, I guess, upside potential or why not.

Craig Warren Safian
Executive Vice President & Chief Financial Officer, Gartner, Inc.

A

Good morning, Jeff, and thanks for the question. Yeah. I think, in terms of the way we think about the business over the medium term, unchanged. And so, again we believe that over the medium term, we can grow both GTS and GBS in that 12% to 16% range. Obviously GBS is performing exceptionally well. We've seen it accelerate. Even last year the acceleration started and it has continued through the first half of the year. And [indiscernible] (00:27:51) been a really nice combination of improvements and retention which you can see in our key metrics as well as great new business growth across the board, okay? So it's not any one practice. It's actually, as you alluded to, broad-based from an industry perspective and from a practice perspective. And so we remain bullish on GBS. We remain bullish on GTS as well. And over the medium term, again we believe we can grow both in that 12% to 16% range.

Jeffrey P. Meuler
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Thank you both.

Operator: Our next question comes from George Tong with Goldman Sachs. Your line is open.

George K. Tong
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Thanks. Good morning. The sales force productivity or NCVI for GBS stepped up to $141,000 which came ahead of GTS for the first time ever. Can you elaborate on what drove the increase and whether you expect GBS productivity to step back down to be below GTS levels over the near term?

Eugene A. Hall
Chief Executive Officer & Director, Gartner, Inc.

A

Yeah. Hey, George. The thing that drives our productivity in both sales forces is, what you've heard before, which is our recruiting capability, the training programs we have, the tools we have in the process design. And so the thing that's driving productivity is as the market has gotten – as the recession has come a little bit better, those combination of factors, the recruiting training tools and process affect both businesses. And that's what you're seeing drive the productivity improvement and so over time, we expect both productivity improvement in both sales forces.

George K. Tong
Analyst, Goldman Sachs & Co. LLC

Q

And on the second part of the question, what drove GBS to come ahead of GTS for the first time? And when would you expect that productivity to flip over the near term back to GBS being below GTS?

Eugene A. Hall
Chief Executive Officer & Director, Gartner, Inc.

A

We don't think about it as one's going to be higher than the other. We expect both will actually have improvements over time, and there is one meaningful difference between GBS and GTS and that is that we have a higher number of what we call business developers which are salespeople that don't have any existing accounts. GTS has a much larger installed base. And so we have a large number of what we call account executives, whose job is to sell more business to those existing clients. In GTS, we also have the business developers, but in GBS we have a much higher number of business developers compared to account executives than we do at GTS. That's part of the thing that impacts sales productivity with GBS, both now and over time.

George K. Tong
Analyst, Goldman Sachs & Co. LLC

Q

Got it. That's helpful. And then secondly, you increased your EBITDA margins for the full year to 25.4% at the midpoint. What expectations for second half margins are you embedding into your guidance and how should 2022 margins compare with the second half margins?

Craig Warren Safian
Executive Vice President & Chief Financial Officer, Gartner, Inc.

A

Good morning, George. Thanks for the question. Obviously, the second half margins are lower than what we've run through the first half and what the full year implies. Yet, as Gary highlighted as well, it's a little bit higher than the 18% to 19% that we've guided, or at least preliminarily guided around how to think about a normalized margin for this year. And there's really one primary reason for that and it's the deferral on the pushing out of spending that we expect to come in sooner, just happening a little bit later over the course of 2021 but also assuming we bear the full burden of that as the business continues to accelerate into 2022. And so a little bit higher than the 18% to 19% is the expectation for the second half of the year, but again that's largely because we've pushed out and deferred certain expenses to later in this year, but will have a full impact on the 2022 P&L.

George K. Tong
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Very helpful. Thank you.

Operator: Our next question comes from Toni Kaplan with Morgan Stanley. Your line is open.

Toni M. Kaplan
Analyst, Morgan Stanley & Co. LLC

Q

Thank you so much. I was hoping you could talk about what you're hearing from clients in terms of appetite for in-person conferences. I know you'd talked about your operationally planning on running some of them later this year and that will be upside to the guidance, but just what's the demand that you're hearing from clients and has the delta variant impacted that at all?

Eugene A. Hall
Chief Executive Officer & Director, Gartner, Inc.

A

Hey, Toni. Our in-person conferences remain usually popular with our clients. Clients are, I'd say, quite enthusiastic about returning to those in-person conferences and are looking forward to it. As we sit here today, I'd say our registrations for the conferences in the US haven't been affected very much by the delta variant. That could change over time if things go on, but the sentiment as of, just right now in terms of registrations things, hasn't changed very much. Outside of the US, I'd say there's more concern about it. And so it's not the same around the world. Having said that, even though there's a concern about the delta variant, the kind of underlying demand there even the clients that are concerned about the delta variant in terms of attending a conference, if we can address that, are wildly enthusiastic about conferences and really want to return back to them. And so over time, we'd expect, when it's safe to do so, to be introducing in-person conferences to meet that demand.

Toni M. Kaplan
Analyst, Morgan Stanley & Co. LLC

Q

That's great. And you've repurchased more than $1 billion of stock this year. Just any updates to capital allocation priorities and on strategic tuck-ins? I think you did a small one this quarter. So just give us a sense of what the optimal strategic tuck-in looks like right now at this point?

Thanks.

Craig Warren Safian
Executive Vice President & Chief Financial Officer, Gartner, Inc.

A

Good morning, Toni. I'll start out and then flip it over to Gene on the M&A strategy. You're right. We've repurchased over $1 billion worth of our stock through the first half of this year. As we've always highlighted, we have two priorities from a capital allocation perspective and they're not [ph] stacked to prioritize; it's 1A and 1B (00:34:23), I would characterize it as, which is return of capital to our shareholders through our buyback programs and strategic value enhancing M&A which is largely going to be in the small and medium tuck-in size. As we look forward, those remain the two priorities. Given what we see in the market, clearly in the first half of this year we've put a bias or priority around returning capital through our buyback programs, but as we move forward we have ample free cash flow, ample cash on balance sheet, ample balance sheet flexibility for it to be enhanced. So we can do buybacks and strategic tuck-in M&A as opposed to it being an overstatement. We just happened to put a strong bias towards buybacks through the first half of the year. And I'll flip it to Gene to talk about the M&A side.

Eugene A. Hall
Chief Executive Officer & Director, Gartner, Inc.

A

Yeah, Toni. So over time in general, our acquisitions have been focused on additions to our capabilities in one way or another. So sometimes they've been actual acquisitions to get to talent. Other times, it's been product extensions which we've used. And so I think – you could think about it as ways to improve our capabilities either in direct-people sense or in a product-offering sense.

Toni M. Kaplan
Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

Operator: Our next question comes from Andrew Nicholas with William Blair. Your line is open.

Andrew Nicholas
Analyst, William Blair & Co. LLC

Q

Hi. Good morning. I was hoping you could touch on the level of client engagement you've seen the past quarter or two and how that compares to pre-pandemic levels? Is it still elevated relative to pre-COVID? And if so, how important do you think that is to what I think is record client retention metrics you posted this quarter? Just trying to get a sense for how much of this could be more of a temporary phenomenon given the current environment?

Eugene A. Hall
Chief Executive Officer & Director, Gartner, Inc.

A

You know, Andrew, client engagement is really important in our business. When clients buy our services, they do it to get value out of it. And when they get the value is they engage with us. And so client engagement is up substantially compared to 2019. It's about the same as it was in 2020 and that's partially, as you said, due to the environment. There's a lot of uncertainty, but it's also due to the fact that we spend a lot of our energy thinking of ways that we can actually stimulate that engagement because again we know when we get more engagement, our clients get more value out of our services. And so the two things are related.

Andrew Nicholas
Analyst, William Blair & Co. LLC

Q

Got it. Makes sense. And then for my follow-up, it's been a several quarters in a row now of a pretty sizable upside in terms of your guidance, or at least, relative to your at least methodology. And so I'm just wondering, given now that it seems to be a bit more stable of an operating environment than the past 12 months to 18 months, if you're considering or how you're thinking about your approach to guidance and whether you'll consider potentially reverting back to the more traditional bracketed approach at some point, whether it's later this year or early next? Thanks.

Craig Warren Safian
Executive Vice President & Chief Financial Officer, Gartner, Inc.
A

Good morning, Andrew. Great question. We actually shifted our guidance methodology to the at least pre-pandemic. And I don't see us slipping back. I think as you alluded to obviously, there's been a lot of uncertainty in the world and we've been trying to, since the beginning of the pandemic, plan thoughtfully; plan prudently and even when we entered this year, I would say, plan conservatively as well. As the world has stabilized and we've got a heck of a lot more visibility into how the business is performing, we are still comfortable with the guidance methodology that we have. That said I'd reiterate what I said in my prepared remarks earlier around expected variability on that guidance moving forward. We would expect much less variability, probably more variability on the expense side than on the revenue side, but we are comfortable with the way that we guide now and the current methodology that we use.

Andrew Nicholas
Analyst, William Blair & Co. LLC
Q

Got it. Thank you.

Operator: Our next question comes from Jeff Silber with BMO Capital Markets. Your line is open.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.
Q

Thank you so much. You noted in your prepared remarks about slightly higher than expected turnover from, I believe, it was your sales force. Where are these folks going? Are they going to competitors? Are they going out on their own, going to other industries? Any color would be great.

Craig Warren Safian
Executive Vice President & Chief Financial Officer, Gartner, Inc.
A

Hey, Jeff. As I mentioned, turnover across the business is modestly up and the turnover is going to same places that it's always gone which is the – we are known as a company that has great recruiting training programs, and so there's people like to recruit from us, try to recruit from us and they're going to the same place they've always gone which tends to be the technology industry.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.
Q

Okay. Great. That's helpful. And you mentioned in your guidance that it includes, you're planning from some in-person destinations but the guidance only – on the Conference side, excuse me. The guidance only assumes virtual for Conference revenue. Can you remind us what the delta would be just for us for modeling purposes, if you shift from virtual to in-person?

Craig Warren Safian
Executive Vice President & Chief Financial Officer, Gartner, Inc.
A

Jeff, it's – and part of the reason why we've guided this way is, there's difference, vary on conference-by-conference basis. So it's very hard or near impossible to answer that question in terms of building your model. And I think the way to think about it is, with our current guide, it is virtual-only. That is the best numbers to plug in right now. And as we said, if we are able to run some in-person conferences in the balance of the year, it would be upside to those numbers, but it will depend on the timing, the location and everything else and it will be done on a – and decisions will be made on a conference-by-conference basis.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.

Q

All right. If I could sneak in one quick one; I'm sorry. You mentioned that the guidance does include some additional cancellation-related costs. Can you quantify those for us?

Craig Warren Safian
Executive Vice President & Chief Financial Officer, Gartner, Inc.

A

Yeah sure. It's probably low-double digits millions in terms of the potential cancellation cost. It's hard to quantify that right now. Some of them are contractual. Some of them will be sunk costs that go into the conference pre-cancellation decision, but it's in the lower-double digit millions is a kind of contemplation.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.

Q

Okay. Great. Thank you so much.

Operator: [Operator Instructions] Our next question comes from Hamzah Mazari with Jefferies. Your line is open.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Hi. This is Mario Cortellacci filling in for Hamzah. Just kind of going back to the delta variant; I'm just wondering how you're thinking about that and considering opening your in-person conferences. Is your decision clearly based more around government guidelines or is it just strictly more prudent on Gartner's part? And just making sure that these events are safe or if there's no government restrictions you guys, because you have the demand in place, you'll feel more comfortable doing it?

Eugene A. Hall
Chief Executive Officer & Director, Gartner, Inc.

A

Yeah, Mario. And so as I mentioned, the strength that we have is that our clients actually really appreciate the value of in-person conferences and we'd like to get back to them. Having said that, what we're going to do and any – before we hold any in-person conference, we're certainly going to follow any government guidelines that are relevant. So where the CDC or the relevant agencies in other countries have said, you shouldn't have large gatherings in this sort of circumstance, even if it's not a regulation, we're going to follow those guidelines. And then the third thing is we, on a regular basis, survey our clients to see how they feel about it as well and so we want to reflect their sentiment as well. Even if there were no government guidelines, but our client sentiment was it's not a safe thing to do, then we certainly wouldn't follow that as well. And of course, we use finally our own assessment. And if we think even if the guidelines are okay and even if the clients want to do it, we don't think it's safe. We wouldn't hold them as well. And so there's kind of – those are the factors that go into the decision making in terms of whether we hold an in-person conference or not.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Got it. And then just from my follow-up, could you talk about – when you're looking at the GTS sales force productivity, I guess, what are the biggest levers that you can pull to get back to pre-pandemic levels? You talked about some of the levers for GBS and it being broad and that they're all contributing. But is there one bigger lever that you can pull in GTS? And then, also, could you just compare what the tenure is for the GTS sales force today versus pre-pandemic? And then how much of that tenure can help add to productivity?

Eugene A. Hall
Chief Executive Officer & Director, Gartner, Inc.

A

Yeah. So the first part it's the factors that I missed earlier which is the things that impact productivity are really our recruiting program, making sure we recruit the best people, making sure we bring them on board that they're trained to sell the Gartner kinds of products, that we equip them with great tools and that we have the best processes. We're constantly improving those things, and so over time we expect those will drive productivity improvements. In terms of tenure compared to where we were in 2019, our tenure is on average higher because we've slowed hiring and so with a lower proportion of new people from our slowed hiring, the average tenure has gone up over time.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Any way to help quantify or give us a sense for how much that can help contribute to productivity?

Eugene A. Hall
Chief Executive Officer & Director, Gartner, Inc.

A

Yeah. I can't quantify it for you. Again, we track the numbers but we don't – those aren't things we talk about publicly. And so let's leave it at the tenure is higher.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Understood. Thank you.

Operator: There're no further questions. I like to turn the call back over to Gene Hall for any closing remarks.

Eugene A. Hall
Chief Executive Officer & Director, Gartner, Inc.

Well, summarizing today's call, Q2 was another strong quarter with strength in all three business segments and Research exceeding our expectations. We delivered strong results across contract value, revenue, EBITDA and free cash flow. GTS contract value growth accelerated to 9% and GBS contract value growth accelerated to 18%. We're accelerating hiring across our business to keep pace with this growth. Looking ahead, we are well-positioned for a long term sustained double digit growth. We have a vast addressable market. We have an attractive recurring revenue business model with strong contribution margins. We expect to deliver a modest EBITDA margin expansion going forward from a normalized 2021. We generate significant free cash flow in excess of net income which we'll continue to deploy through share repurchases and strategic tuck-in acquisitions.

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

Operator: This concludes the program. You may now disconnect. Everyone, have a great day.