

GARTNER INC
Form 10-Q
May 03, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period from to

**Commission File Number 1-14443
Gartner, Inc.**

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

04-3099750
(I.R.S. Employer
Identification Number)

P.O. Box 10212
56 Top Gallant Road
Stamford, CT

06902-7700
(Zip Code)

(Address of principal executive offices)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of April 23, 2007, 104,041,570 shares of the registrant's common shares were outstanding.

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Table of Contents**PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS****GARTNER, INC.**Condensed Consolidated Balance Sheets
(Unaudited, in thousands)

	March 31, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	\$ 91,094	\$ 67,801
Fees receivable, net	309,748	328,383
Deferred commissions	41,841	46,822
Prepaid expenses and other current assets	57,084	41,027
Total current assets	499,767	484,033
Property, equipment and leasehold improvements, net	58,757	59,715
Goodwill	409,161	408,545
Intangible assets, net	5,224	5,978
Other assets	84,523	81,522
Total Assets	\$ 1,057,432	\$ 1,039,793
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 141,742	\$ 208,002
Deferred revenues	390,870	375,881
Current portion of long-term debt	234,000	220,000
Total current liabilities	766,612	803,883
Long-term debt	171,000	150,000
Other liabilities	84,392	59,592
Total Liabilities	1,022,004	1,013,475
Stockholders Equity		
Preferred stock		
Common stock	78	78
Additional paid-in capital	544,845	544,686
Unearned compensation, net	(1,692)	(2,208)
Accumulated other comprehensive income, net	13,842	13,097
Accumulated earnings	257,196	249,004
Treasury stock, at cost	(778,841)	(778,339)
Total Stockholders Equity	35,428	26,318
Total Liabilities and Stockholders Equity	\$ 1,057,432	\$ 1,039,793

See the accompanying notes to the condensed consolidated financial statements.

Table of Contents**GARTNER, INC.**Condensed Consolidated Statements of Operations
(Unaudited, in thousands, except per share data)

	Three Months Ended March 31,	
	2007	2006
Revenues:		
Research	\$ 158,800	\$ 137,092
Consulting	76,267	75,893
Events	26,927	14,495
Other	2,203	3,449
Total revenues	264,197	230,929
Costs and expenses:		
Cost of services and product development	123,713	105,349
Selling, general and administrative	115,746	99,467
Depreciation	5,735	5,660
Amortization of intangibles	529	3,383
META integration charges		1,450
Total costs and expenses	245,723	215,309
Operating income	18,474	15,620
Interest expense, net	(6,263)	(4,363)
Other expense, net	(38)	(694)
Income before income taxes	12,173	10,563
Provision for income taxes	3,981	2,793
Net income	\$ 8,192	\$ 7,770
Income per common share:		
Basic	\$ 0.08	\$ 0.07
Diluted	\$ 0.08	\$ 0.07
Weighted average shares outstanding:		
Basic	103,521	113,769
Diluted	108,263	115,798

See the accompanying notes to the condensed consolidated financial statements.

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GARTNER, INC.
Condensed Consolidated Statements of Cash Flows
(Unaudited, in thousands)

	Three Months Ended March 31,	
	2007	2006
<i>Operating activities:</i>		
Net income	\$ 8,192	\$ 7,770
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of intangibles	6,264	9,043
Stock compensation expense	5,566	2,546
Excess tax benefits from stock-based compensation	(3,535)	(1,400)
Deferred taxes	(1,117)	(737)
Amortization and writeoff of debt issue costs	693	201
Changes in assets and liabilities:		
Fees receivable, net	19,511	36,421
Deferred commissions	5,071	7,308
Prepaid expenses and other current assets	(15,874)	(5,454)
Other assets	(2,467)	146
Deferred revenues	13,011	23,550
Accounts payable, accrued, and other liabilities	(35,537)	(73,289)
<i>Cash (used) provided by operating activities</i>	(222)	6,105
<i>Investing activities:</i>		
Additions to property, equipment and leasehold improvements	(4,777)	(3,356)
Other investing activities, net		(139)
<i>Cash used in investing activities</i>	(4,777)	(3,495)
<i>Financing activities:</i>		
Proceeds from interest rate swap	1,167	
Proceeds from stock issued for stock plans	11,984	11,894
Proceeds from debt issuance	405,000	
Payments for debt issuance costs	(1,257)	
Payments on debt	(370,000)	(3,333)
Purchases of treasury stock	(23,001)	(17,184)
Excess tax benefits from stock-based compensation	3,535	1,400
<i>Cash provided (used) in financing activities</i>	27,428	(7,223)
Net increase (decrease) in cash and cash equivalents	22,429	(4,613)
Effects of exchange rates on cash and cash equivalents	864	(29)
Cash and cash equivalents, beginning of period	67,801	70,282
Cash and cash equivalents, end of period	\$ 91,094	\$ 65,640

See the accompanying notes to the condensed consolidated financial statements.

Table of Contents**GARTNER, INC.**

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1 Basis of Presentation

These interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and should be read in conjunction with the consolidated financial statements and related notes of Gartner, Inc. (Gartner or the Company) filed in its Annual Report on Form 10-K for the year ended December 31, 2006.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of operating revenues and expenses. These estimates are based on management's knowledge and judgments. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of financial position, results of operations and cash flows at the dates and for the periods presented have been included. The results of operations for the three months ended March 31, 2007 may not be indicative of the results of operations for the remainder of 2007. Certain prior year amounts have been reclassified to conform to the current year presentation. Sales tax collected from customers remitted to governmental authorities is presented on a net basis in the Consolidated Statements of Operations.

Note 2 Comprehensive Income

The components of comprehensive income for the three months ended March 31, 2007 and 2006 are as follows (in thousands):

	Three Months Ended March 31,	
	2007	2006
Net income:	\$ 8,192	\$ 7,770
Other comprehensive income, net of tax:		
Foreign currency translation adjustments	765	272
Unrealized loss on interest rate swap	(1,085)	1,257
Realized gain on interest rate swap (a)	1,033	
Amortization of pension unrealized loss	32	
Other comprehensive income	745	1,529
Comprehensive income	\$ 8,937	\$ 9,299

(a) Net of approximately \$0.1 million reclassified to earnings in the first quarter of 2007.

Note 3 Computations of Income per Share of Common Stock

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

	Three Months Ended March 31,	
	2007	2006

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Numerator:

Net income used for calculating basic and diluted income per share	\$ 8,192	\$ 7,770
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Denominator:

Weighted average number of common shares used in the calculation of basic income per share	103,521	113,769
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Common stock equivalents associated with stock-based compensation plans	4,742	2,029
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Shares used in the calculation of diluted income per share	108,263	115,798
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Basic income per share	\$ 0.08	\$ 0.07
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Diluted income per share	\$ 0.08	\$ 0.07
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For the three months ended March 31, 2007 and 2006, 0.5 million and 1.3 million options and stock-settled stock appreciation rights, respectively, were not included in the computation of diluted income per share because the effect would have been anti-dilutive.

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The Company grants stock-based compensation awards as an incentive for employees and directors to contribute to the Company's long-term success. The Company's awards include stock options, stock-settled stock appreciation rights, restricted stock, service- and performance-based restricted stock units, and common stock equivalents.

The Company accounts for stock-based compensation in accordance with Statement of Financial Accounting Standards 123(R), Share-Based Payment (SFAS No. 123(R)), as interpreted by SEC Staff Accounting Bulletin No. 107 (SAB No. 107). Under SFAS No. 123(R), stock-based compensation expense is based on the fair value of the award on the date of grant, which is recognized over the related service period, net of estimated forfeitures. The service period is the period over which the related service is performed, which is generally the same as the vesting period. All of the Company's stock-based compensation awards are classified as equity awards in accordance with SFAS No. 123(R).

During the first quarter of 2007, the Company recognized \$5.6 million of pre-tax stock compensation expense under SFAS No. 123(R), with \$2.6 million recorded in Cost of services and product development expense and \$3.0 million recorded in Selling, general and administrative expense in the Condensed Consolidated Statement of Operations. In the first quarter of 2006, the Company recognized \$2.5 million of pre-tax stock compensation expense under SFAS No. 123(R), with \$1.4 million recorded in Cost of services and product development expense and \$1.1 million recorded in Selling, general and administrative expense.

As of March 31, 2007, the Company had \$55.3 million of total unrecognized stock-based compensation cost, which is expected to be recognized as stock-based compensation expense over the remaining weighted-average service period of approximately 2.7 years. For the three months ended March 31, 2007, excess tax benefits realized from the exercise of stock-based compensation awards was \$3.5 million. At the present time, the Company issues treasury shares upon the exercise or settlement of stock-based compensation awards.

Stock Options and Stock Appreciation Rights

A summary of the changes in stock options outstanding during the three months ended March 31, 2007 follows:

	Options in millions	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Outstanding at December 31, 2006	12.8	\$ 11.10	5.17 years
Granted			
Forfeited or expired	(0.1)	11.43	nm
Exercised (1)	(1.0)	11.70	nm
Outstanding at March 31, 2007 (2)	11.7	\$ 11.05	5.05 years
Vested and exercisable at March 31, 2007 (2)	8.2	\$ 10.95	4.65 years

nm=not meaningful

(1) Options exercised during the first quarter of 2007 had an intrinsic value of

\$10.7 million.
The Company received approximately \$12.0 million in cash from stock option exercises in the first quarter of 2007.

- (2) At March 31, 2007, options outstanding and options vested and exercisable had aggregate intrinsic values of \$151.4 million and \$106.4 million, respectively.

A summary of the changes in stock-settled stock appreciation rights (SARs) outstanding during the three months ended March 31, 2007 follows:

	SARs in millions	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term
Outstanding at December 31, 2006	1.22	\$ 14.48	\$6.02	6.38 years
Granted (1)	0.6	21.82	7.99	7.00 years
Forfeited or expired				
Exercised				
SARs outstanding at March 31, 2007 (2)	1.8	\$ 16.99	\$6.66	6.39 years
Vested and exercisable at March 31, 2007		\$	\$	

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(1) SARs generally vest ratably over a four-year service period and expire in seven years.

(2) At March 31, 2007, SARs outstanding had an aggregate intrinsic value of \$12.4 million.

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

	Three Months Ended	
	March 31,	
	2007	2006
Expected dividend yield (1)	0%	0%
Expected stock price volatility (2)	33%	40%
Risk-free interest rate (3)	4.7%	4.7%
Expected life in years (4)	4.8	4.8

(1) The dividend yield assumption is based on the history and expectation of the Company's dividend payouts. Historically, Gartner has not paid dividends on its common stock.

(2) Expected stock price volatility was based on both historical Gartner common stock prices and implied

volatility from publicly traded options in Gartner common stock.

- (3) The risk-free interest rate is based on the yield of a U.S. treasury bond with a similar maturity of the expected life of the award.
- (4) The expected life in years was based on the simplified calculation provided for in SAB No. 107. The simplified method determines the expected life in years based on the vesting period and contractual terms as set forth when the award is made.

Restricted Stock, Restricted Stock Units, and Common Stock Equivalents

The fair value of restricted stock, restricted stock units (RSUs), and common stock equivalents (CSEs) is determined on the date of grant based on the market price of the Company's common stock. The fair value of these awards is recognized as compensation expense as follows: (i) restricted stock awards generally vest based on the achievement of a market condition and are expensed on a straight-line basis over three years; (ii) service-based RSUs vest ratably over four years and are expensed on a straight-line basis over four years; (iii) performance-based RSUs are subject to both performance and service conditions, vest ratably over four years, and are expensed on an accelerated basis as required by SFAS No. 123(R); and (iv) CSEs vest immediately and are recorded as expense on the date of grant.

A summary of the changes in restricted stock, restricted stock units, and common stock equivalents during the three months ended March 31, 2007, is presented in the table below:

Restricted Stock	Weighted-Average Grant Date Fair Value	Restricted Stock Units (RSUs)	Weighted-Average Grant Date Fair Value	Common Stock Equivalents (CSEs)	Weighted-Average Grant Date Fair Value

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Nonvested at December 31, 2006	511,000	\$8.81	1,521,620	\$14.13		\$
Granted (1), (2)			992,768	21.85	4,527	24.30
Vested or settled (2)			(1,225)	13.75	(4,527)	24.30
Forfeited			(13,325)	13.75		
Nonvested at March 31, 2007 (3), (4)	511,000	\$8.81	2,499,838	\$17.20		\$

(1) Included in the 992,768 RSUs granted were 481,007 service-based RSUs awarded to non-executive staff and 511,761 shares of performance-based RSUs awarded to executives. The performance-based RSUs are subject to a performance condition tied to an annual increase in the Company's subscription-based contract value for 2007. With respect to the performance condition, the 511,761 performance-based RSUs granted represent the target amount, and the number of RSUs that will ultimately vest will be between 0% and 200% of the target amount depending on which performance level is achieved. If the minimum performance condition is not

met, the performance-based RSUs will expire, and any compensation expense already recorded will be reversed.

- (2) Fees paid to directors are paid in CSEs. These vest immediately and are convertible into common shares when the director leaves the Board of Directors.

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- (3) Vesting of 500,000 shares of the restricted stock is subject to a market condition, as follows:
- (i) 300,000 shares when the Company's common stock trades at an average price of \$20 or more for sixty consecutive trading days,
 - (ii) 100,000 shares when the Company's common stock trades at an average price of \$25 or more for sixty consecutive trading days, and
 - (iii) 100,000 shares when the Company's common stock trades at an average price of \$30 or more for sixty consecutive trading days.
- (4) The weighted-average remaining contractual term of the restricted stock units is 1.9 years. The restricted stock has no defined contractual term.

Note 5 Segment Information

The Company manages its business in three reportable segments: Research, Consulting and Events. Research consists primarily of subscription-based research products, access to research inquiry, as well as peer networking services and membership programs. Consulting consists primarily of consulting, measurement engagements, and strategic advisory

services. Events consists of various symposia, conferences, and exhibitions.

The Company evaluates reportable segment performance and allocates resources based on gross contribution margin. Gross contribution is defined as operating income excluding certain Cost of services and product development and selling, general and administrative expenses, depreciation, META integration charges, amortization of intangibles, and Other charges. Certain costs included in consolidated Cost of services and product development are not allocated to segment expense, primarily web maintenance and customer relationship database costs, and certain bonus and fringe charges. The accounting policies used by the reportable segments are the same as those used by the Company.

The Company does not identify or allocate assets, including capital expenditures, by operating segment. Accordingly, assets are not reported by segment because the information is not available and is not reviewed in the evaluation of segment performance or in making decisions in the allocation of resources.

The following tables present information about the Company's reportable segments (in thousands). The Other column includes certain revenues and other expenses unallocated to reportable segments, expenses allocated to operations that do not meet the segment reporting quantitative threshold, and other charges. There are no inter-segment revenues:

	Research	Consulting	Events	Other	Consolidated
Three Months Ended March 31, 2007:					
Revenues	\$ 158,800	\$ 76,267	\$ 26,927	\$ 2,203	\$ 264,197
Gross contribution	99,302	28,036	14,171	1,652	143,161
Corporate and other expenses					(124,687)
Operating income					\$ 18,474

	Research	Consulting	Events	Other	Consolidated
Three Months Ended March 31, 2006:					
Revenues	\$ 137,092	\$ 75,893	\$ 14,495	\$ 3,449	\$ 230,929
Gross contribution	84,487	33,826	6,427	2,813	127,553
Corporate and other expenses					(111,933)
Operating income					\$ 15,620

Note 6 Goodwill and Intangible Assets

Changes in the carrying amount of goodwill, by reporting segment, for the three months ended March 31, 2007, are as follows:

	Balance December 31, 2006	Currency Translation Adjustments	Balance March 31, 2007
Research	\$ 282,467	\$ 553	\$ 283,020
Consulting	87,666	47	87,713
Events	36,330	16	36,346
Other	2,082		2,082
Total goodwill	\$ 408,545	\$ 616	\$ 409,161

The following table presents the Company's intangible assets subject to amortization (in thousands):

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March 31, 2007

	Customer Relationships	Other	Total
Gross cost	\$ 7,700	\$ 1,035	\$ 8,735
Accumulated amortization	(3,080)	(431)	(3,511)
Net	\$ 4,620	\$ 604	\$ 5,224

December 31, 2006

	Customer Relationships	Other	Total
Gross cost	\$ 7,700	\$ 1,265	\$ 8,965
Accumulated amortization			