

# UConn Graduate Student Managed Fund

# Gartner®

## Analyst Report

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April 7, 2015



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Sector: Info. Tech.	Industry: IT & Consulting Services	Date: 10/28/2014
Current Price: 83.31	Target Range: \$93-\$116	Recommendation: BUY

### **Executive Summary**

- We are re-issuing a “BUY” recommendation for Gartner stock with a current target price of USD \$103 which gives us a 24% upside from the current price of \$83.31. Our purchase price was \$77.88 on October 28<sup>th</sup>, 2014, which has produced a 7% unrealized return to date. Gartner does not pay a dividend.
- Gartner is the market leader with IT research and advisory with no clear direct competitor of magnitude. Their large stable of world-class technology analysts provide objective advice to IT buyers and related professionals.
- There are three segments; research, consulting, and events. All are complementary, but research is the core.
- Global IT spend growth is modest, however, IT is critical to compete as time goes on and it becomes further integrated in executive decisions.

<b>Key Statistics</b>	
Market Cap.	7.32 B
Beta	0.97
ROE	70%
ROA	10%
P/E - TTM	38.4
P/E - Forward	26.6
Dividend Yield	N/A
Net Income Growth (3 yr)	10.3%

Data Source: ValueLine, Morningstar, Yahoo!



## **Business Description**

Gartner is an IT research and advisory company which has approximately 6,700 employees and almost 10,000 enterprise clients in 90 countries (Appendix 7: Geographic Revenue Breakdown). Common clients include IT buyers and professionals from all levels: Chief Information Officer (CIO) to technician. Also, Gartner is used by supply chain professionals, digital marketers, and investors in the IT industry.

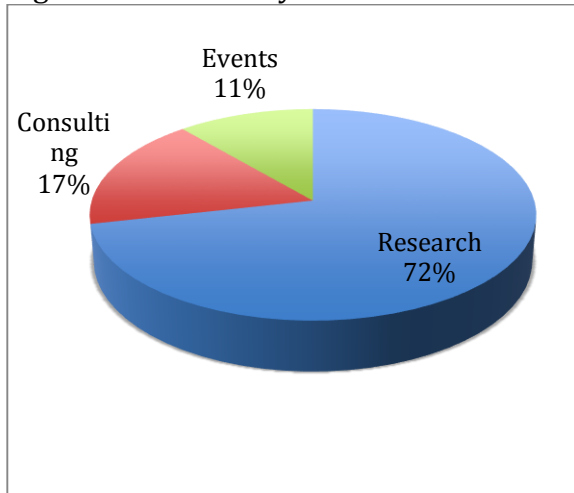
There are three unique but complementary operating segments; research, consulting, and events.

**Research** is the core of the company and accounts for 72% of revenues. There are over 1,000 analysts who write about software, hardware, and technology trends. The analysts are experts in their field, and provide objective opinions through a thoughtful methodology. Sales are subscription based and are billed up front with revenue recognized over the term.

**Consulting** accounts for 17% of the revenue. There are over 400 consultants, and engagements often consist of assisting organizations select appropriate technology. Furthermore, they do not assist in the implementation of the technology, such as other consulting firms like Accenture. Also, they provide contract review services in which they give clients insight into negotiating better terms with IT vendors.

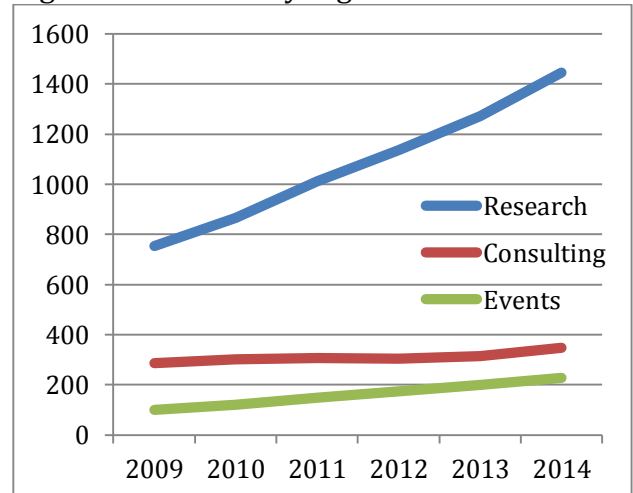
**Events** account for 11% of revenue. A typical event brings together IT executives and thought leaders as guest speakers, Gartner's analysts, IT vendors, and technology users as attendees. There are over 60 events a year with the annual Symposium/ITExpo as the flagship event.

Figure 1: Revenue by event



Source: Company Data

Figure 2: Revenue by segment



Source: Bloomberg



## Industry Overview and Competitive Position

Global IT spend is an indicator of the demand for IT research, consulting, and related services. Total worldwide spend in 2014 was \$3.7 trillion, which includes; telecom services, IT services, enterprise software, data center systems, and devices. Spend is predicted to grow at approximately 3% per year between 2015-2018.

The total addressable market according to Gartner currently stands at \$58 billion, or 110,000 US enterprise customers that have IT spend large enough to substantiate a subscription to Gartner. Currently with 10,000 enterprise clients, this represents only a 9% penetration rate. Considering that Gartner is the market leader this suggests a highly fragmented market.

There is a lot of competition, and given the intangible nature of the product and market fragmentation there are not significant barriers to entry. Often free advice is found online. However, expert, comprehensive, and objective advice at the product level in IT is rare and valuable.

Often consulting companies will have a research arm, like McKinsey. A competitor that has a similar business model to Gartner is Forrester Research (FORR), however, their primary products do not focus on information technology products but analyze industries and markets. Often financial information service companies like Moody's, FactSet, and Bloomberg are labeled as competitors but these are poor comparisons and is a function of Gartner's space not yet finding a unique classification.

Therefore there is no clear competitor with the scale and focus of Gartner. The quality and breadth of their products have created a positive

feedback loop between a strong reputation and more customers.

Figure 3: Competitor Comparison

	IT	FORR
Market Cap:	7.33B	654.10M
Employees:	6,758	1,351
Qtrly Rev Growth (yoy):	0.12	0.04
Revenue (ttm):	2.02B	312.06M
Gross Margin (ttm):	0.61	0.60
EBITDA (ttm):	339.24M	31.53M
Operating Margin (ttm):	0.15	0.06
Net Income (ttm):	183.77M	10.86M
EPS (ttm):	2.03	0.57
P/E (ttm):	41.23	63.58
PEG (5 yr expected):	2.22	2.76
P/S (ttm):	3.62	2.10

Source: Yahoo! Finance



## Financial Trend Analysis

### Profitability

Sales continue to grow at a double digit pace. Both gross and EBITDA profit margins are strong. The highest contribution margin comes from the research division as the incremental cost for each additional research client is small.

Figure 4: Profitability and margins

	2012	2013	2014	CAGR
Sales	1,615.8	1,784.2	2,021.4	11.8%
Gross Profit	956.7	1,070.7	1,223.5	13.1%
Margin	59.2%	60.0%	60.5%	
EBITDA	274.2	309.7	325.0	8.9%
Margin	17.0%	17.4%	16.1%	
Net Income	165.90	182.80	183.77	5.2%
Margin	10.3%	10.2%	9.1%	

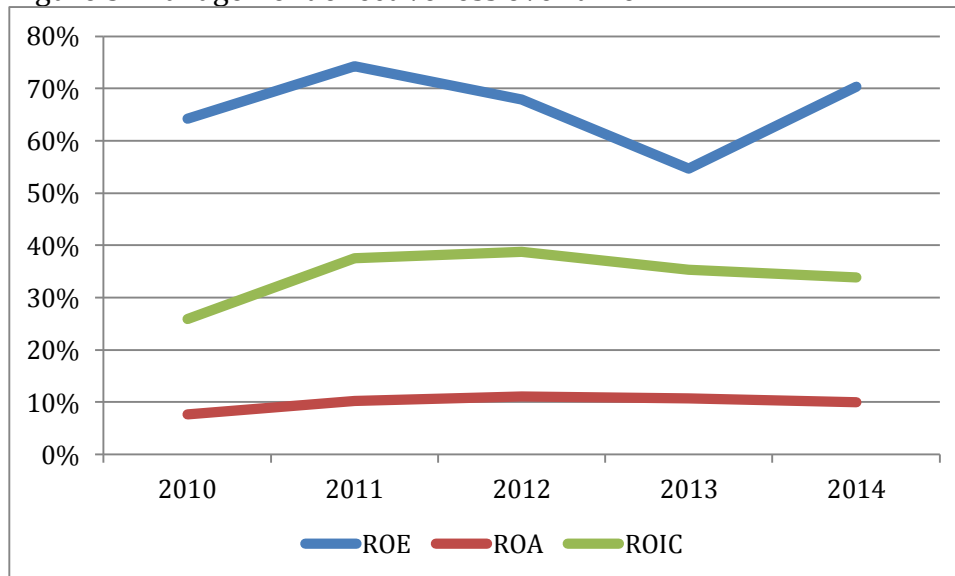
Source: Company Data

Research, consulting, and events gross margins are 69%, 34%, and 49% respectively.

### Management Effectiveness

ROE, ROA, and ROIC are all strong and relatively consistent, particularly ROE and ROIC. As Gartner makes an effort to take on more debt ROE should further increase.

Figure 5: Management effectiveness over time



Source: Bloomberg



## **Investment Summary**

**Market leader** – Gartner has the reputation as being the best source of objective, and expert opinion in their field

**Untapped market** – With only a 9% market penetration there is a clear path to growth with adding new clients, adding new “seats” with current clients, and upgrading existing subscriptions. Market opportunity is not the governor on growth, rather it is building out an experience sales team. Though they have been able to grow the sales force headcount by 15% a year and have a high retention rate, with so many new hires it is a challenge to have sales team units in every category to be led or balanced with experienced reps for optimum service and sales.

**Complementary Segments** – Research, consulting, and events allow for cross-selling and leverage Gartner’s market leading position and reputation.

**Financially strong** – There is little debt, operating cash flow to net income averages 150%, net working capital is negative from upfront payments of subscriptions, and there is a large untapped credit facility. Stock repurchases and strategic acquisition have been priority uses of cash.

**Major trends/Relevance** – Global IT spend is growing modestly around 3% a year, however, winners and losers in different verticals will be influenced by a company’s ability to leverage information technology. The CIO has become more influential in overall enterprise planning.

### **Possible investment risks**

1. Consulting revenue is non-recurring and can have down periods.
2. Events business can be disrupted from unforeseen circumstance (i.e. sudden decrease in travel to particular city because of emergency event).
3. Trading at a high P/E multiply, must continue to grow at projected trajectory to substantiate valuation
4. Loss of reputation due to independence or objectivity being undermined.



## **Historical Price Trend**

Gartner's stock has appreciated at a 5 year CAGR of 32%, and has grown 22% in the last 12 months. During the short SMF holding period, just over 5 months, the stock has grown 7%, edging out the market's 4.8% in the same time period.

Figure 6: Historical stock price



Source: Yahoo! Finance

## **Valuation**

The price target range is \$93 to \$116. This was determined with DCF analysis with a range of 4%-5% as a terminal value in the perpetuity growth model after 5 years of high growth. The midpoint of 4.5% represents a price target of \$103, which is an implied upside of 24% from recent (4/6/15) opening day price of \$83.31. Assumptions are detailed in the appendix.

From a multiples standpoint valuation is on the high side. At initial entry point IT was trading at 34.5x earnings, it has since increased to a P/E of 38.4x. These are high relative to the market. However, is well below peer groups 52x and Forrester Research's 56x. Most EV multiples are in line or better than the peer group.

Overall, the value is substantiated with the DCF analysis and high confidence in executing on the projected growth.





## **CSR**

Gartner generally ranks the same or slightly below peers in the information services sub-industry across CSR categories. With near average scores in an industry with a relatively low environmental impact, it was a reasonable selection for the portfolio.

Furthermore, Gartner has a Green IT vendor report in which they rank other vendors by their stewardship towards the planet. Allowing clients to weigh environmental friendliness in their vendor choice will inevitably

shift some IT spend towards higher CSR companies, leveraging Gartner's impact beyond its own practices.

<b>CSR Scores</b>	<b>Gartner</b>	<b>Average</b>
ESG Disclosure	12.81	15.7
Human Rights	0	0
Business Ethics	1	1
Equal Opportunity	0	1
Emission Reduction	0	0
Environmental Disclosure	Unavailable	19.12

Figure 7, Source: Bloomberg



# Appendices

## Appendix 1: DCF

### Discounted Cash Flow Analysis for Gartner

Figures in millions, except per share

	Historical year ending December 31,			Projected year ending December 31,					2014-2019 CAGR
	2012	2013	2014	2015	2016	2017	2018	2019	
Sales	\$1,615.8	\$1,784.2	\$2,021.4	\$2,261.2	\$2,529.3	\$2,829.3	\$3,164.8	\$3,540.1	11.9%
Cost of goods sold	659.1	713.5	797.9	892.6	998.4	1,116.8	1,249.3	1,397.4	
Gross Profit	956.7	1,070.7	1,223.5	1,368.6	1,530.9	1,712.5	1,915.5	2,142.7	11.9%
SG&A	682.5	761.0	898.5	974.9	1,090.5	1,219.8	1,364.5	1,526.3	
EBITDA	274.2	309.7	325.0	393.7	440.4	492.6	551.1	616.4	13.7%
EBITDA Margin	17.0%	17.4%	16.1%	17.4%	17.4%	17.4%	17.4%	17.4%	
Less: Depreciation	(25.4)	(29.0)	(31.2)	(37.1)	(42.5)	(48.6)	(55.6)	(63.6)	
Less: Amortization	(4.4)	(5.4)	(8.2)	(8.2)	(6.3)	(4.5)	(2.6)	(0.7)	
EBIT	244.6	275.4	285.7	348.6	391.8	439.7	493.0	552.3	14.1%
Less: Taxes @ 33.1%	(81.0)	(91.2)	(94.6)	(115.4)	(129.7)	(145.6)	(163.2)	(182.8)	
Tax-effected EBIT	163.7	184.3	191.2	233.2	262.1	294.2	329.8	369.5	14.1%
Plus: Depreciation and amortization		34.4	39.4	45.3	48.8	53.1	58.2	64.3	
Less: Capital expenditures		(36.5)	(38.5)	(44.7)	(49.9)	(55.9)	(62.5)	(69.9)	
Less: Additions to intangibles		5.7	(24.6)	(9.4)	(9.4)	(9.4)	(9.4)	(9.4)	
(Increase)/decrease in working capital		77.9	33.6	55.0	61.5	68.8	77.0	86.1	
<b>Unlevered Free Cash Flow</b>		<b>\$265.8</b>	<b>\$201.1</b>	<b>\$279.4</b>	<b>\$313.1</b>	<b>\$350.8</b>	<b>\$393.1</b>	<b>\$440.6</b>	<b>17.0%</b>
<b>Operating Assumptions</b>									
Sales growth	NA	10.4%	13.3%	11.9%	11.9%	11.9%	11.9%	11.9%	
Cost of goods sold (as a % sales)	40.8%	40.0%	39.5%	39.5%	39.5%	39.5%	39.5%	39.5%	
SG&A (as a % sales)	42.2%	42.7%	44.4%	43.1%	43.1%	43.1%	43.1%	43.1%	
<b>Capital Expenditure Assumptions</b>									
CapEx (as a % sales)	NA	2.0%	1.9%	2.0%	2.0%	2.0%	2.0%	2.0%	
Depreciation (as a % of CapEx)	NA	79.4%	81.0%	83.0%	85.0%	87.0%	89.0%	91.0%	
Additions to Intangibles (\$ amount)	NA	(\$5.7)	\$24.6	\$9.4	\$9.4	\$9.4	\$9.4	\$9.4	
Amortization (\$ amount)	NA	5.4	8.2	8.2	6.3	4.5	2.6	0.7	

Perpetuity Growth Method	
Weighted average cost of capital:	8.5%
Net present value of free cash flow	\$1,374.8
Terminal growth rate	4.0%
Terminal value	\$10,182.2
Present value of the terminal value	6,771.6
Enterprise value	\$8,146.4
Less: Net debt*	19.7
Equity value	\$8,166.1
Diluted shares:	87,522
<b>Equity Value Per Share</b>	<b>\$93.30</b>

EBITDA Multiple Method	
Weighted average cost of capital:	8.5%
Net present value of free cash flow	\$1,374.8
Terminal multiple	19.0x
Terminal value	\$11,712.1
Present value of the terminal value	7,789.0
Enterprise value	\$9,163.8
Less: Net debt*	19.7
Equity value	\$9,183.5
Diluted shares:	87,522
<b>Equity Value Per Share</b>	<b>\$104.93</b>

Implied EBITDA Terminal Multiple	
Terminal year unlevered free cash flow	\$440.6
Weighted average cost of capital	8.5%
Growth rate of free cash flow after terminal year	4.0%
Terminal year EBITDA	\$616.4
<b>Implied EBITDA Terminal Multiple:</b>	<b>16.5x</b>

Implied Perpetuity Growth Rate	
Terminal year EBITDA	\$616.4
Weighted average cost of capital	8.5%
Multiple	19.0x
Terminal year unlevered free cash flow	\$440.6
<b>Implied Growth Rate:</b>	<b>4.6%</b>



## Appendix 2: Income Statement

Consolidated Statements of Operations (USD \$)  In Thousands, except Per Share data, unless otherwise specified	12 Months Ended			%	CAGR
	Dec. 31, 2012	Dec. 31, 2013	Dec. 31, 2014		
<b>Revenues:</b>					
Research	\$1,137,147	\$1,271,011	\$1,445,338	72%	13%
Consulting	304,893	314,257	348,396	17%	7%
Events	173,768	198,945	227,707	11%	14%
Total revenues	1,615,808	1,784,213	2,021,441	100%	12%
<b>Costs and expenses:</b>					
Cost of services and product development	659,067	713,484	797,933	39%	10%
Selling, general and administrative	678,843	760,458	876,067	43%	14%
<b>EBITDA</b>					
Depreciation	25,369	28,996	31,186	2%	11%
Amortization of intangibles	4,402	5,446	8,226	0%	37%
Acquisition and integration charges	2,420	337	21,867	1%	201%
<b>EBIT</b>					
Total costs and expenses	1,370,101	1,508,721	1,735,279	86%	13%
Operating income	245,707	275,492	286,162	14%	8%
Interest income	1,046	1,551	1,413	0%	16%
Interest expense	-9,905	-10,388	-12,300	-1%	11%
Other expense, net	-1,252	-216	-592	0%	-31%
<b>EBT</b>					
Income before income taxes	235,596	266,439	274,683	14%	8%
Provision for income taxes	69,693	83,638	90,917	4%	14%
Net income	\$165,903	\$182,801	\$183,766	9%	5%
<b>Net income per share:</b>					
Basic (in Dollars per share)	\$1.78	\$1.97	\$2.06		8%
Diluted (in Dollars per share)	\$1.73	\$1.93	\$2.03		8%
<b>Weighted average shares outstanding:</b>					
Basic (in shares)	93,444	93,015	89,337		-2%
Diluted (in shares)	95,842	94,830	90,719		-3%

[1] The Company repurchased 5.9 million, 3.4 million, and 2.7

Source: Company Data (10k)



### Appendix 3: Balance Sheet

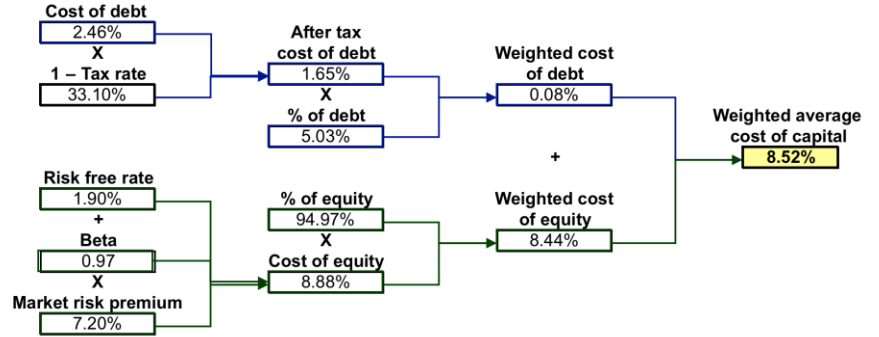
<b>Consolidated Balance Sheets (USD \$)</b>	<b>Dec. 31, 2013</b>	<b>Dec. 31, 2014</b>	<b>% assets</b>	<b>yoy%</b>
<b>In Thousands, unless otherwise specified</b>				
<b>Current assets:</b>				
Cash and cash equivalents	\$423,990	\$365,302	19%	-14%
Fees receivable, net of allowances of \$6,700 and \$7,000 respectively	490,923	552,107	29%	12%
Deferred commissions	106,287	115,381	6%	9%
Prepaid expenses and other current assets	63,682	63,868	3%	0%
<b>Total current assets</b>	<b>1,084,882</b>	<b>1,096,658</b>	<b>58%</b>	<b>1%</b>
Property, equipment and leasehold improvements, net	91,759	97,990	5%	7%
Goodwill	519,203	586,665	31%	13%
Intangible assets, net	6,107	30,689	2%	403%
Other assets	81,631	92,349	5%	13%
<b>Total Assets</b>	<b>1,783,582</b>	<b>1,904,351</b>	<b>100%</b>	<b>7%</b>
<b>Current liabilities:</b>				
Accounts payable and accrued liabilities	325,059	353,761	19%	9%
Deferred revenues	766,114	841,457	44%	10%
Current portion of long-term debt	68,750	20,000	1%	-71%
<b>Total current liabilities</b>	<b>1,159,923</b>	<b>1,215,218</b>	<b>64%</b>	<b>5%</b>
Long-term debt	136,250	385,000	20%	183%
Other liabilities	126,093	142,962	8%	13%
<b>Total Liabilities</b>	<b>1,422,266</b>	<b>1,743,180</b>	<b>92%</b>	<b>23%</b>
<b>Preferred stock:</b>				
\$.01 par value, authorized 5,000,000 shares; none issued or outstanding	0	0	0%	0%
<b>Common stock:</b>				
\$.0005 par value, authorized 250,000,000	78	78	0%	0%
Additional paid-in capital	718,644	764,433	40%	6%
Accumulated other comprehensive (loss) income, net	8,345	-21,170	-1%	-354%
Accumulated earnings	1,091,283	1,275,049	67%	17%
Treasury stock, at cost, 68,713,890 and 64,268,863 common shares, respectively	-1,457,034	-1,857,219	-98%	27%
<b>Total Stockholders' Equity</b>	<b>361,316</b>	<b>161,171</b>	<b>8%</b>	<b>-55%</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$1,783,582</b>	<b>\$1,904,351</b>	<b>1</b>	



## Appendix 4: WACC & WACC Sensitivity

### Weighted Average Cost of Capital for Gartner

<b>Cost of debt:</b>			
Cost of debt	2.46%		
Marginal tax rate	33.10%		
After-tax cost of debt	1.65%		
<b>Cost of equity:</b>			
Risk free rate <sup>(1)</sup>	1.90%		
Beta	0.97	tbd	
Market risk premium	7.20%		
Cost of equity	8.88%		
<b>Percentage of capital:</b>			
Total debt	\$385.0	5.03%	
Market value of equity	7,270.0	94.97%	tbd
Total capital	\$7,655.0	100.00%	
<b>Weighted average cost of capital:</b>			<b>8.52%</b>



### WACC Sensitivity Analysis

Beta	WACC
0.65	6.32%
0.70	6.66%
0.75	7.00%
0.80	7.34%
0.85	7.68%
0.90	8.03%
0.95	8.37%
1.00	8.71%
1.05	9.05%
1.10	9.39%
1.15	9.73%
1.20	10.08%
1.25	10.42%
1.30	10.76%
1.35	11.10%

		Market risk premium					
		6.75%	6.90%	7.05%	7.20%	7.35%	7.50%
Beta	0.80	7.00%	7.11%	7.23%	7.34%	7.46%	7.57%
	0.85	7.32%	7.44%	7.56%	7.68%	7.80%	7.93%
	0.90	7.64%	7.77%	7.90%	8.03%	8.15%	8.28%
	0.95	7.96%	8.10%	8.23%	8.37%	8.50%	8.64%
	1.00	8.28%	8.42%	8.57%	8.71%	8.85%	8.99%
	1.05	8.60%	8.75%	8.90%	9.05%	9.20%	9.35%
	1.10	8.92%	9.08%	9.24%	9.39%	9.55%	9.71%
1.15	9.24%	9.41%	9.57%	9.73%	9.90%	10.06%	
1.20	9.56%	9.73%	9.91%	10.08%	10.25%	10.42%	
1.25	9.88%	10.06%	10.24%	10.42%	10.60%	10.77%	



### Appendix 5: Management Effectiveness Data Table

	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
ROE	64%	74%	68%	55%	70%
ROA	8%	10%	11%	11%	10%
ROIC	26%	38%	39%	35%	34%

### Appendix 6: Price Sensitivity



## Stock Price Sensitivity Analysis for Gartner

### Perpetuity Growth Method

		<u>Weighted average cost of capital</u>						
		7.50%	7.75%	8.00%	8.25%	8.50%	8.75%	9.00%
<b>Terminal growth rate</b>	3.00%	\$81.21	\$76.83	\$72.89	\$69.32	\$66.08	\$63.12	\$60.41
	3.25%	\$85.35	\$80.50	\$76.16	\$72.25	\$68.72	\$65.51	\$62.58
	3.50%	\$90.01	\$84.60	\$79.79	\$75.49	\$71.63	\$68.13	\$64.95
	3.75%	\$95.28	\$89.21	\$83.85	\$79.09	\$74.84	\$71.01	\$67.54
	4.00%	\$101.31	\$94.44	\$88.42	\$83.12	\$78.41	\$74.19	\$70.39
	4.25%	\$108.27	\$100.41	\$93.60	\$87.65	\$82.39	\$77.72	\$73.55
	4.50%	\$116.39	\$107.31	\$99.52	\$92.78	\$86.88	\$81.67	\$77.05
	4.75%	\$125.98	\$115.35	\$106.35	\$98.64	\$91.96	\$86.12	\$80.96
	5.00%	\$137.49	\$124.85	\$114.32	\$105.41	\$97.78	\$91.16	\$85.37
	5.25%	\$151.56	\$136.26	\$123.74	\$113.31	\$104.48	\$96.92	\$90.36
	5.50%	\$169.15	\$150.20	\$135.04	\$122.64	\$112.30	\$103.56	\$96.07
	5.75%	\$191.77	\$167.63	\$148.85	\$133.83	\$121.55	\$111.31	\$102.65

### EBITDA Multiple Method

		<u>Weighted average cost of capital</u>						
		7.50%	7.75%	8.00%	8.25%	8.50%	8.75%	9.00%
<b>Terminal multiple</b>	15.00x	\$87.39	\$86.44	\$85.51	\$84.59	\$83.68	\$82.78	\$81.90
	15.25x	\$88.62	\$87.66	\$86.71	\$85.77	\$84.85	\$83.94	\$83.04
	15.50x	\$89.84	\$88.87	\$87.91	\$86.96	\$86.02	\$85.10	\$84.19
	15.75x	\$91.07	\$90.08	\$89.10	\$88.14	\$87.19	\$86.26	\$85.33
	16.00x	\$92.30	\$91.29	\$90.30	\$89.33	\$88.36	\$87.41	\$86.48
	16.25x	\$93.52	\$92.51	\$91.50	\$90.51	\$89.54	\$88.57	\$87.62
	16.50x	\$94.75	\$93.72	\$92.70	\$91.70	\$90.71	\$89.73	\$88.77
	16.75x	\$95.98	\$94.93	\$93.90	\$92.88	\$91.88	\$90.89	\$89.91
	17.00x	\$97.20	\$96.14	\$95.10	\$94.07	\$93.05	\$92.04	\$91.05

### Appendix 7: Geographic revenue breakdown



