Large Call Buy in Gartner After Earnings Retreat

Ticker/Price: IT ($150.5)

Analysis:

Gartner (IT) with a large trade on 2/11 that bought 5000 June $150 Calls to open for $8, a $4M trade in a name that sees very little options activity and becomes the only meaningful open interest in the name and comes on a day it presented at a Goldman Sachs Conference. IT shares have been a bit more range-bound since 2018 and rallied off weakness in Q4 2019 before stalling right near a previous high from 2018, though shares traded up above $170 in July 2019 before a sharp sell-off. IT shares have pulled back the last two weeks to a 38.2% Fibonacci retracement and to just above the rising 89 week MA while trying to form a weekly hammer above the rising 55 week MA. The $13.5B company operates as a research and advisory company that aims to provide indispensable advice and insights to business leaders while operating a model targeting double digit revenue, EPS and FCF growth. In 2017 it made one of its larger acquisitions with a $2.6B deal for CEB. It sees a massive market opportunity of more than $180B for its services and contract value has a long-term CAGR of 16%. It operates in three main segments of Research, Operating, and Consulting. Research, a recurring subscription revenue business, is 60% of its business. Gartner is a reference seat where you have read-only access to everything, think in the range of about $20,000 per year. For about $40,000 a year, you get that plus the ability to talk to a research analyst whenever you like. And then as you move up the executive chain, it has higher level premium offerings for like Chief Information Officers, where you'll have a dedicated service person who often will have been a former CIO in their previous career.. Those products can range from $100,000 per year up to about $150,000 per year. EBITDA margins at 16.1% are currently a low watermark and looking to improve which will be driven by better sales productivity. It reported results on 2/4 beating estimates and raising the FY20 EPS outlook Analysts have an average target of $160 and short interest at 2.3% of the float has fallen sharply the last 18 months and down 36% Q/Q. Gartner does not see a lot of Analyst coverage, initiated at Hold with a $178 target at Jefferies in November, RW Baird last week raising its target to $170. BAML rates shares Buy with a $170 target, citing disappointing revenue growth outlook, as the run-off of non-core and less profitable revenue within the Marketing practice is exacerbated by an expectation for slower non-subscription sales and a bit more challenging operating environments in select markets (China, Germany, India). Aligning cost growth more closely to revenues is a positive development that should lead to improving profit growth and hopefully less volatile financial results. And, with the stock down and FCF forecasts up modestly, valuation (P/FCF) is a bit more attractive (in-line with the peer group vs. historical premium). Free cash flow generation improved in 2019, and the 2020 outlook calls for double digit Y/Y growth. The improvement is driven by both declining acquisition/integration charges, and some improvement in working capital and moderation of capital spending. The stronger cash flow positions Gartner to accelerate share repurchases or other investments in 2020. Valuation now looks attractive to information services peers with its organic growth among the highest. Hedge Fund ownership fell 9.15% in Q3 filings, Select Equity reducing a concentrated position, while Atlanta Capital and Melvin Capital added to positions as did Polen Capital who holds IT as its 14th largest position, a $820M stake. BAMCO and Bares Capital are also top notable concentrated holders.

Hawk Vision:

Hawk's Perspective: IT is a consistent compounder, a high quality company where the bar is reset for 2020 and has notable investors, my guess is Melvin Capital bought these calls. I see it as a good name to own at these levels.

Confidence Ranking: $$