EPAM Systems, Inc.
Form 10-Q
November 09, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

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: 001-35418

EPAM SYSTEMS, INC.
(Exact Name of Registrant as Specified in its Charter)

| | |
|---|---|
| Delaware<br>(State or other jurisdiction of incorporation or organization) | 223536104<br>(I.R.S. Employer Identification No.) |
| 41 University Drive, Suite 202<br>Newtown, Pennsylvania | 18940 |
| (Address of principal executive offices) | (Zip code) |

267-759-9000
(Registrant's telephone number, including area code)

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 x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

| | |
|---|---|
| Large accelerated filer x | Accelerated filer ¨ |

Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Title of Each Class | Outstanding as of October 31, 2016 |
| --- | --- |
| Common Stock, par value $0.001 per share | 51,035,929 shares |

EPAM SYSTEMS, INC.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (Unaudited)
EPAM SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(US Dollars in thousands, except share and per share data)

| | As of September 30, 2016 | As of December 31, 2015 |
|---|---|---|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | $330,627 | $199,449 |
| Time deposits | — | 30,181 |
| Accounts receivable, net of allowance of $2,301 and $1,729, respectively | 187,833 | 174,617 |
| Unbilled revenues | 82,360 | 95,808 |
| Prepaid and other current assets | 32,205 | 14,344 |
| Employee loans, net of allowance of $0 and $0, respectively | 2,698 | 2,689 |
| Deferred tax assets | — | 11,847 |
| Total current assets | 635,723 | 528,935 |
| Property and equipment, net | 70,284 | 60,499 |
| Restricted cash | 236 | 238 |
| Employee loans, net of allowance of $0 and $0, respectively | 3,283 | 3,649 |
| Intangible assets, net | 53,867 | 46,860 |
| Goodwill | 111,722 | 115,930 |
| Deferred tax assets | 26,598 | 18,312 |
| Other long-term assets | 7,486 | 4,113 |
| Total assets | $909,199 | $778,536 |
| | | |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable | $4,661 | $2,576 |
| Accrued expenses and other liabilities | 34,856 | 60,749 |
| Deferred revenue | 3,685 | 3,047 |
| Due to employees | 34,894 | 26,703 |
| Deferred compensation due to employees | 4,035 | 5,364 |
| Contingent consideration | 800 | — |
| Taxes payable | 39,499 | 29,472 |
| Total current liabilities | 122,430 | 127,911 |
| Long-term debt | 33,062 | 35,000 |
| Deferred tax liabilities | 3,327 | 2,402 |
| Other long-term liabilities | 268 | — |
| Total liabilities | 159,087 | 165,313 |
| Commitments and contingencies (Note 9) | | |
| Stockholders' equity | | |
| Common stock, $0.001 par value; 160,000,000 authorized; 51,035,509 and 50,177,044 shares issued, 51,016,500 and 50,166,537 shares outstanding at September 30, 2016 and December 31, 2015, respectively | 50 | 49 |

| | | |
|---|---|---|
| Additional paid-in capital | 363,154 | 303,363 |
| Retained earnings | 419,557 | 345,054 |
| Treasury stock | (170 ) | (93 ) |
| Accumulated other comprehensive loss | (32,479 ) | (35,150 ) |
| Total stockholders’ equity | 750,112 | 613,223 |
| Total liabilities and stockholders’ equity | $909,199 | $778,536 |

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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EPAM SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(Unaudited)
(US Dollars in thousands, except share and per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Revenues | $298,293 | $236,049 | $846,607 | $653,875 |
| Operating expenses: | | | | |
| Cost of revenues (exclusive of depreciation and amortization) | 190,797 | 148,479 | 538,960 | 408,622 |
| Selling, general and administrative expenses | 67,491 | 55,431 | 193,226 | 158,345 |
| Depreciation and amortization expense | 5,925 | 4,393 | 17,150 | 12,496 |
| Other operating expenses/(income), net | 178 | (30) | 958 | 210 |
| Income from operations | 33,902 | 27,776 | 96,313 | 74,202 |
| Interest and other income, net | 1,067 | 865 | 3,416 | 3,322 |
| Foreign exchange (loss)/gain | (1,728) | 32 | (5,313) | (6,187) |
| Income before provision for income taxes | 33,241 | 28,673 | 94,416 | 71,337 |
| Provision for income taxes | 7,067 | 5,800 | 19,913 | 14,519 |
| Net income | $26,174 | $22,873 | $74,503 | $56,818 |
| Foreign currency translation adjustments | 358 | (8,341) | 2,671 | (7,397) |
| Comprehensive income | $26,532 | $14,532 | $77,174 | $49,421 |
| | | | | |
| Net income per share: | | | | |
| Basic | $0.51 | $0.47 | $1.48 | $1.17 |
| Diluted | $0.49 | $0.44 | $1.40 | $1.10 |
| Shares used in calculation of net income per share: | | | | |
| Basic | 51,131 | 49,043 | 50,172 | 48,506 |
| Diluted | 53,864 | 52,344 | 53,159 | 51,755 |

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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EPAM SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| (US Dollars in thousands) | Nine Months Ended September 30, 2016 | 2015 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $74,503 | $56,818 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 17,150 | 12,496 |
| Bad debt expense | 1,690 | 910 |
| Deferred taxes | (11) | 535 |
| Stock-based compensation expense | 37,520 | 33,350 |
| Excess tax benefit on stock-based compensation plans | (4,769) | (3,118) |
| Other | 1,834 | 2,358 |
| Changes in operating assets and liabilities: | | |
| (Increase)/decrease in operating assets: | | |
| Accounts receivable | (14,801) | (3,575) |
| Unbilled revenues | 15,633 | (49,110) |
| Prepaid expenses and other assets | (630) | 29 |
| Increase/(decrease) in operating liabilities: | | |
| Accounts payable | 2,011 | 8,128 |
| Accrued expenses and other liabilities | (26,942) | 10,844 |
| Deferred revenues | 540 | (607) |
| Due to employees | 8,047 | 4,295 |
| Taxes payable | (609) | (8,799) |
| Net cash provided by operating activities | 111,166 | 64,554 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (19,981) | (9,533) |
| Payment for construction of corporate facilities | — | (4,671) |
| Employee housing loans issued | (1,361) | (1,993) |
| Proceeds from repayments of employee housing loans | 1,597 | 1,611 |
| Decrease/(increase) in restricted cash and time deposits, net | 30,001 | (29,947) |
| Increase in other long-term assets, net | (2,660) | (988) |
| Proceeds from foreign currency derivatives | 104 | — |
| Payments for foreign currency derivatives | (91) | — |
| Acquisition of businesses, net of cash acquired | (4,499) | (27,654) |
| Net cash provided by/(used in) investing activities | 3,110 | (73,175) |
| Cash flows from financing activities: | | |
| Proceeds from stock option exercises | 15,850 | 17,607 |
| Excess tax benefit on stock-based compensation plans | 4,769 | 3,118 |
| Proceeds from debt (Note 5) | 20,000 | 15,000 |
| Repayment of debt (Note 5) | (22,096) | — |
| Proceeds from government grants | 135 | — |
| Acquisition of business, deferred consideration | (2,260) | (30,274) |
| Net cash provided by/(used in) financing activities | 16,398 | 5,451 |
| Effect of exchange rate changes on cash and cash equivalents | 504 | (2,921) |
| Net increase/(decrease) in cash and cash equivalents | 131,178 | (6,091) |
| Cash and cash equivalents, beginning of period | 199,449 | 220,534 |

| | | |
|---|---|---|
| Cash and cash equivalents, end of period | $330,627 | $214,443 |

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(US Dollars in thousands, except share and per share data)

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

EPAM Systems, Inc. (the "Company" or "EPAM") is a global provider of software product engineering, technology consulting and digital expertise to clients located around the world, primarily in North America, Europe, Asia and the CIS region. The Company has expertise in various industries, including software and hi-tech, financial services, media and entertainment, travel and hospitality, retail and distribution, and life sciences and healthcare.

The Company is incorporated in Delaware with headquarters in Newtown, PA. EPAM serves clients worldwide utilizing an award-winning global delivery platform and its locations in over 25 countries across North America, Europe, Asia and Australia.

Basis of Presentation —The accompanying unaudited condensed consolidated financial statements of EPAM have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") and Article 10 of Regulation S-X under the Securities Exchange Act of 1934, as amended. The condensed consolidated financial statements include the financial statements of EPAM Systems, Inc. and its subsidiaries with all intercompany balances and transactions eliminated.

These unaudited condensed consolidated financial statements and accompanying notes should be read in conjunction with the Company's audited consolidated financial statements and the notes thereto for the year ended December 31, 2015 included in its Annual Report on Form 10-K. The preparation of these condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in these condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates, and such differences may be material to the condensed consolidated financial statements.

Operating results for the interim periods are not necessarily indicative of results that may be expected to occur for the entire year. In our opinion, all adjustments considered necessary for a fair presentation of the accompanying unaudited condensed consolidated financial statements have been included, and all adjustments are of a normal and recurring nature.

Reclassification — During the first quarter of 2016, the Company revised the classification of certain health insurance premium and other employee fringe benefit expenses between the cost of revenues and selling, general and administrative expenses line items on the condensed consolidated statements of income and comprehensive income. The effect of this reclassification had no impact on total income from operations for the three and nine months ended September 30, 2016.

Revenue Recognition — The Company recognizes revenue when the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the sales price is fixed or determinable; and (4) collectability is reasonably assured. Determining whether and when some of these criteria have been satisfied often involves assumptions and judgments that can have a significant impact on the timing and amount of revenue reported.

The Company derives its revenues from a variety of service offerings, which represent specific competencies of its IT professionals. Contracts for these services have different terms and conditions based on the scope, deliverables, and complexity of the engagement, which require management to make judgments and estimates in determining the appropriate revenue recognition. Fees for these contracts may be in the form of time-and-materials or fixed-price arrangements. If there is an uncertainty about the project completion or receipt of payment for the services, revenue is deferred until the uncertainty is sufficiently resolved. At the time revenue is recognized, the Company provides for any contractual deductions and reduces the revenue accordingly. The Company reports gross reimbursable "out-of-pocket" expenses incurred as both revenues and cost of revenues in the condensed consolidated statements of income and comprehensive income.

The Company defers amounts billed to its clients for revenues not yet earned. Such amounts are anticipated to be recorded as revenues when services are performed in subsequent periods. Unbilled revenue is recorded when services have been provided but billed subsequent to the period end in accordance with the contract terms.

Fair Value of Financial Instruments — The Company makes assumptions about fair values of its financial assets and liabilities in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 820, “Fair Value Measurement”, and utilizes the following fair value hierarchy in determining inputs used for valuation:
Level 1 — Quoted prices for identical assets or liabilities in active markets.

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Level 2 — Inputs other than quoted prices within Level 1 that are observable either directly or indirectly, including quoted prices in markets that are not active, quoted prices in active markets for similar assets or liabilities, and observable inputs other than quoted prices such as interest rates or yield curves.
Level 3 — Unobservable inputs reflecting our view about the assumptions that market participants would use in pricing the asset or liability.
Where the fair values of financial assets and liabilities recorded in the condensed consolidated balance sheets cannot be derived from an active market, they are determined using a variety of valuation techniques. These valuation techniques include a net present value technique, comparison to similar instruments with market observable inputs, option pricing models and other relevant valuation models. To the extent possible, observable market data is used as inputs into these models but when it is not feasible, a degree of judgment is required to establish fair values.
The Company’s contingent liabilities measured at fair value on a recurring basis are comprised of performance-based awards issued to certain former owners of acquired businesses in exchange for future services and cash settled restricted stock units issued to employees.
Performance-based awards issued to certain former owners of acquired businesses are valued using significant inputs that are not observable in the market, which are defined as Level 3 inputs according to fair value measurement accounting. The Company believes its estimates and assumptions are reasonable, however, there is significant judgment involved.
Cash settled restricted stock units issued to employees are valued using the price of the Company's stock, a significant input that is observable in the market, which is defined as Level 1 input according to fair value measurement accounting.
These changes in fair value could cause a material impact to, and volatility in the Company’s operating results. See Note 4 for disclosures related to fair value.
Employee Loans — The Company issues employee housing loans in Belarus, relocation loans to assist employees with relocation needs in connection with intra-company transfers and loans for the purchase of automobiles in India. There are no loans issued to principal officers, directors, and their affiliates. The Company intends to hold all employee loans until their maturity. Interest income is reported using the effective interest method. Where applicable, loan origination fees, net of direct origination costs, are deferred and recognized in interest income over the life of the loan. On a quarterly basis, the Company reviews the aging of its loan portfolio and evaluates the ability of employees to repay their debt on schedule. Factors considered in the review include historical payment experience, reasons for payment delays and shortfalls, if any, as well as probability of collecting scheduled principal and interest payments. Since the initiation of the loan program there have not been material past due or non-accrual employee loans or write offs related to loan losses and, therefore, the Company determined that no allowance for loan losses is required.
Employee Housing Loans — In 2012, the Board of Directors of the Company approved the Employee Housing Program (the “Housing Program”), which provides employees with loans to purchase housing in Belarus. The housing is sold directly to employees by independent third parties. The Housing Program was designed as a retention mechanism for the Company’s employees in Belarus and is available to full-time qualified employees who have been with the Company for at least three years. The aggregate maximum lending limit of the program is $10,000, with individual loans not exceeding $50. Loans issued under the Housing Program are denominated in U.S. dollars with a 5-year term and an interest rate of 7.5%.
The housing loans are measured using the Level 3 inputs within the fair value hierarchy because they are valued using significant unobservable inputs. These housing loans are measured at fair value upon initial recognition through the market approach under ASC Topic 820, “Fair Value Measurement” and subsequently carried at amortized cost less allowance for loan losses, if any. Any difference between the carrying value and the fair value of a loan upon initial recognition is charged to expense.
Employee Loans, Other — The Company issues short-term, non-interest bearing relocation loans to employees who have relocated within the company. In addition, the Company has in the past issued and may issue in the future a small number of interest bearing loans to employees for the purchase of automobiles. Such loans are issued to qualified employees with certain conditions attached. Due to the short term duration of these employee loans and high certainty of repayment, their carrying amount is a reasonable estimate of their fair value.

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Business Combinations — The Company accounts for its business combinations using the acquisition accounting method, which requires it to determine the fair value of net assets acquired and the related goodwill and other intangible assets in accordance with the FASB ASC Topic 805, "Business Combinations." The Company identifies and attributes fair values and estimated lives to the intangible assets acquired and allocates the total cost of an acquisition to the underlying net assets based on their respective estimated fair values. Determining the fair value of assets acquired and liabilities assumed requires management's judgment and involves the use of significant estimates, including projections of future cash inflows and outflows, discount rates, asset lives and market multiples. There are different valuation models for each component, the selection of which requires considerable judgment. These determinations will affect the amount of amortization expense recognized in future periods. The Company bases its fair value estimates on assumptions it believes are reasonable, but recognizes that the assumptions are inherently uncertain.

If initial accounting for the business combination has not been completed by the end of the reporting period in which the business combination occurs, provisional amounts are reported for which the accounting is incomplete, with retrospective adjustment made to such provisional amounts during the measurement period to present new information about facts and circumstances that existed as of the acquisition date.

All acquisition-related costs, other than the costs to issue debt or equity securities, are accounted for as expenses in the period in which they are incurred. Changes in fair value of contingent consideration arrangements that are not measurement period adjustments are recognized in earnings. Payments to settle contingent consideration, if any, are reflected in cash flows from financing activities and the changes in fair value are reflected in cash flows from operating activities in the Company's condensed consolidated statements of cash flows.

The acquired assets typically consist of customer relationships, trade names, non-competition agreements, and workforce and as a result, a substantial portion of the purchase price is usually allocated to goodwill and other intangible assets.

Goodwill and Other Intangible Assets — Goodwill and intangible assets that have indefinite useful lives are accounted for in accordance with FASB ASC 350, "Intangibles - Goodwill and Other." The Company conducts its evaluation of goodwill impairment at the reporting unit level on an annual basis during its fourth quarter, and more frequently if events or circumstances indicate that the carrying value of a reporting unit exceeds its fair value. A reporting unit is an operating segment or one level below. The Company does not have intangible assets that have indefinite useful lives.

Intangible assets that have finite useful lives are amortized over their estimated useful lives on a straight-line basis. When facts and circumstances indicate potential impairment of amortizable intangible assets, the Company evaluates the recoverability of the asset's carrying value, using estimates of future cash flows over the remaining asset life. The estimates of future cash flows attributable to intangible assets require significant judgment based on the Company's historical and anticipated results. Any impairment loss is measured by the excess of carrying value over fair value.

Stock-Based Compensation — The Company recognizes the cost of its stock-based incentive awards based on the fair value of the award at the date of grant net of estimated forfeitures. The cost is expensed evenly over the service period. The service period is the period over which the employee performs the related services, which is normally the same as the vesting period. Over time, the forfeiture assumption is adjusted to the actual forfeiture rate and such change may affect the timing of the total amount of expense recognized over the vesting period. Equity-based awards that do not require future service are expensed immediately. Equity-based awards that do not meet the criteria for equity classification are recorded as liabilities and adjusted to fair value at the end of each reporting period.

Off-Balance Sheet Financial Instruments — The Company uses FASB ASC Topic 825, "Financial Instruments" to identify and disclose off-balance sheet financial instruments, which include credit instruments, such as commitments to make employee loans and related guarantees, standby letters of credit and certain guarantees issued under customer contracts. The face amount for these items represents the exposure to loss, before considering available collateral or the borrower's ability to repay. Loss contingencies arising from off-balance sheet financial instruments are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. The Company does not believe such matters exist that will have a material effect on the condensed consolidated financial statements.

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## 2. ACQUISITIONS

Strategic acquisitions allowed the Company to expand into desirable geographic locations, complement the existing vertical markets, increase revenue and create new service offerings.

NavigationArts — On July 10, 2015, the Company acquired all of the outstanding equity of NavigationArts, Inc. and its subsidiary, NavigationArts, LLC (collectively “NavigationArts”). The U.S.-based NavigationArts provides digital consulting, architecture and content solutions and is regarded as a leading user-experience agency. The acquisition of NavigationArts added approximately 90 design consultants to the Company’s headcount. In connection with the NavigationArts acquisition the Company paid $28,747 in cash consideration, of which $2,670 was placed in escrow for a period of 18 months as security for the indemnification obligations of the sellers under the terms of the stock purchase agreement. In the first quarter of 2016, the Company decided to make a 338(h)(10) election to treat the NavigationArts acquisition as an asset purchase for tax purposes. As a result, during the second quarter of 2016 the Company paid an additional $1,797 to the sellers of NavigationArts, as provided for in the stock purchase agreement.

AGS — On November 16, 2015, the Company acquired all of the outstanding equity of Alliance Consulting Global Holdings, Inc., including its wholly-owned direct and indirect subsidiaries Alliance Global Services, Inc., and Alliance Global Services, LLC, companies organized under the laws of USA, and Alliance Global Services IT India, a company organized under the laws of India (collectively, “AGS”). AGS provides software product development services and test automation solutions and has multiple locations in the United States and India. The acquisition of AGS added 1,151 IT professionals to the Company’s headcount in the United States and India. In connection with the AGS acquisition, the Company paid $51,717 as cash consideration, of which $5,000 was placed in escrow for a period of 15 months as security for the indemnification obligations of the sellers under the terms of the stock purchase agreement.

The following is a summary of the estimated fair values of the net assets acquired at the date of each respective acquisition as originally reported during the year 2015 and at September 30, 2016:

| | NavigationArts | | AGS | | Total | |
|---|---|---|---|---|---|---|
| | As Originally Reported | Final as of September 30, 2016 | As Originally Reported | As of September 30, 2016 | As Originally Reported | As of September 30, 2016 |
| Cash and cash equivalents | $1,317 | $ 1,317 | $1,727 | $ 1,727 | $3,044 | $ 3,044 |
| Accounts receivable and other current assets | 3,920 | 3,920 | 10,600 | 10,539 | 14,520 | 14,459 |
| Property and equipment and other long-term assets | 230 | 230 | 1,665 | 1,665 | 1,895 | 1,895 |
| Deferred tax assets | — | — | 4,996 | 4,996 | 4,996 | 4,996 |
| Acquired intangible assets | 1,500 | 2,800 | 10,000 | 22,700 | 11,500 | 25,500 |
| Goodwill | 23,822 | 23,794 | 33,815 | 25,078 | 57,637 | 48,872 |
| Total assets acquired | 30,789 | 32,061 | 62,803 | 66,705 | 93,592 | 98,766 |
| Accounts payable and accrued expenses | 871 | 871 | 3,087 | 2,676 | 3,958 | 3,547 |
| Bank loans and other long-term liabilities | — | — | — | 295 | — | 295 |
| Deferred revenue | 50 | 50 | 1,049 | 1,049 | 1,099 | 1,099 |
| Due to employees | 596 | 596 | 3,010 | 2,342 | 3,606 | 2,938 |
| Deferred tax liabilities | 525 | — | 3,800 | 8,626 | 4,325 | 8,626 |
| Total liabilities assumed | 2,042 | 1,517 | 10,946 | 14,988 | 12,988 | 16,505 |
| Net assets acquired | $28,747 | $ 30,544 | $51,857 | $ 51,717 | $80,604 | $ 82,261 |

As of September 30, 2016, the Company adjusted the preliminary purchase price allocations related to both NavigationArts and AGS. For NavigationArts, the adjustments reflect final balances related to the acquisition. Finalization of the purchase price allocation included adjustments to intangible assets to reflect the results of a final valuation report as well as certain adjustments made to goodwill and deferred tax liabilities as a result of the 338(h)(10) election to treat the NavigationArts acquisition as an asset purchase for tax purposes, increasing net assets acquired by $1,797.

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For AGS, recorded purchase price allocation amounts remain provisional and are based on the information that was available as of the acquisition date, updated as applicable for any changes identified through September 30, 2016, including adjustments based on a preliminary valuation analysis. As of September 30, 2016, the Company made adjustments to goodwill, intangible assets, deferred taxes and working capital, and reclassified certain liabilities out of accrued expenses into a separate category, resulting in a decrease of $140 to the net assets acquired. The fair values reflected for AGS are subject to change and such changes could be significant. The Company continues to gather and assess additional information necessary to finalize the estimated fair values of the net assets acquired.

The following table presents the estimated fair values and useful lives of intangible assets acquired from NavigationArts and AGS:

| | NavigationArts | | AGS | |
|---|---|---|---|---|
| | Weighted Average Useful Life (in years) | Amount | Weighted Average Useful Life (in years) | Amount |
| Customer relationships | 10 | $ 2,800 | 10 | $ 22,700 |
| Total | | $ 2,800 | | $ 22,700 |

As of September 30, 2016, NavigationArts and AGS have been significantly integrated into the Company and as such, it is not possible to precisely report their individual post-acquisition results of operations. Pro forma results of operations of these acquisitions for the period in which they occurred have not been presented because the effects of the acquisitions are not material to the Company’s consolidated results of operations, individually or in the aggregate.

## 3. GOODWILL

Goodwill by reportable segment was as follows:

| | North America | Europe | Total |
|---|---|---|---|
| Balance as of January 1, 2016 | $ 81,464 | $ 34,466 | $ 115,930 |
| NavigationArts purchase accounting adjustment (Note 2) | 2,030 | — | 2,030 |
| AGS purchase accounting adjustment (Note 2) | (8,737 ) | — | (8,737 ) |
| Other acquisitions | 2,404 | 177 | 2,581 |
| Other acquisitions purchase accounting adjustment | 204 | 87 | 291 |
| Effect of net foreign currency exchange rate changes | 111 | (484 ) | (373 ) |
| Balance as of September 30, 2016 | $ 77,476 | $ 34,246 | $ 111,722 |

There were no accumulated impairments losses in the North America or Europe operating segments as of September 30, 2016 or December 31, 2015.

## 4. FAIR VALUE MEASUREMENTS

As required by the guidance for fair value measurements, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Thus, assets and liabilities categorized as Level 3 may be measured at fair value using inputs that are observable (Levels 1 and 2) and unobservable (Level 3). Management’s assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of assets and liabilities and their placement within the fair value hierarchy levels.

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The following tables show the fair values of the Company's financial assets and liabilities measured at fair value as of September 30, 2016 and December 31, 2015:

| | As of September 30, 2016 | | | |
|---|---|---|---|---|
| | Balance | Level 1 | Level 2 | Level 3 |
| Cash and cash equivalents | $330,627 | $330,627 | $— | $— |
| Time deposits and restricted cash | 236 | — | 236 | — |
| Employee loans | 5,981 | — | — | 5,981 |
| Total assets measured at fair value | $336,844 | $330,627 | $236 | $5,981 |
| | | | | |
| Contingent consideration | $800 | $— | $— | $800 |
| Performance-based equity awards | 2,359 | — | — | 2,359 |
| Cash-settled restricted stock units | 1,676 | 1,676 | — | — |
| Total liabilities measured at fair value | $4,835 | $1,676 | $— | $3,159 |

| | As of December 31, 2015 | | | |
|---|---|---|---|---|
| | Balance | Level 1 | Level 2 | Level 3 |
| Cash and cash equivalents | $199,449 | $199,449 | $— | $— |
| Time deposits and restricted cash | 30,419 | — | 30,419 | — |
| Employee loans | 6,338 | — | — | 6,338 |
| Total assets measured at fair value | $236,206 | $199,449 | $30,419 | $6,338 |
| | | | | |
| Performance-based equity awards | $5,364 | $— | $— | $5,364 |
| Total liabilities measured at fair value | $5,364 | $— | $— | $5,364 |

As of September 30, 2016, the only financial liabilities related to acquisitions of businesses included performance-based equity awards and contingent consideration and as of December 31, 2015, the only financial liabilities related to acquisitions of businesses included performance-based equity awards.

A reconciliation of the beginning and ending balances of acquisition-related contractual contingent liabilities using significant unobservable inputs (Level 3) for the nine months ended September 30, 2016, is as follows:

| | Amount |
|---|---|
| Contractual contingent liabilities at January 1, 2016 | $5,364 |
| Acquisition date fair value of contractual contingent liabilities - Other acquisitions | 800 |
| Liability-classified stock-based awards | 3,861 |
| Changes in fair value of contractual contingent liabilities included in earnings | 1,089 |
| Settlements of contractual contingent liabilities — stock | (7,955 ) |
| Contractual contingent liabilities at September 30, 2016 | $3,159 |

There were no transfers in or out of Level 3 from other levels in the fair value hierarchy during the three and nine months ended September 30, 2016 and 2015. Changes in the values of these financial liabilities, if any, are typically included in selling, general and administrative expenses on the Company's unaudited condensed consolidated statements of income and comprehensive income.

5. DEBT

On September 12, 2014, the Company entered into a credit facility (the "2014 Credit Facility") with PNC Bank, National Association; Santander Bank, N.A; and Silicon Valley Bank (collectively the "Lenders") to replace its former revolving loan agreement. The 2014 Credit Facility provides for a borrowing capacity of $100,000, with potential to increase the credit facility up to $200,000 if certain conditions are met. The 2014 Credit Facility matures on September 12, 2019.

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Borrowings under the 2014 Credit Facility may be denominated in U.S. dollars or, up to a maximum of $50,000 in British pounds sterling, Canadian dollars, euros or Swiss francs (or other currencies as may be approved by the Lenders). Borrowings under the 2014 Credit Facility bear interest at either a base rate or Euro-rate plus a margin based on the Company’s leverage ratio. Base rate is equal to the highest of (a) the Federal Funds Open Rate, plus 0.5%, (b) the Prime Rate, and (c) the Daily LIBOR Rate, plus 1.0%.

The 2014 Credit Facility is collateralized with: (a) all tangible and intangible assets of the Company, and its U.S.-based subsidiaries including all accounts, general intangibles, intellectual property rights and equipment; and (b) all of the outstanding shares of capital stock and other equity interests in U.S.-based subsidiaries of the Company, and 65.0% of the outstanding shares of capital stock and other equity interests in certain of the Company's foreign subsidiaries. The 2014 Credit Facility includes customary business and financial covenants and restricts the Company's ability to make or pay dividends (other than certain intercompany dividends) unless no potential or actual event of default has occurred or would be triggered. As of September 30, 2016, the Company was in compliance with all covenants contained in the 2014 Credit Facility.

As of September 30, 2016, the outstanding debt of the Company under the 2014 Credit Facility was $33,076, including accrued interest, and is subject to a LIBOR-based interest rate, which resets regularly at issuance, based on lending terms. In addition, the Company has a $942 unused irrevocable standby letter of credit associated with its insurance program that was issued under the 2014 Credit Facility.

As of September 30, 2016, the borrowing capacity of the Company under the 2014 Credit Facility was reduced to $66,058.

## 6. INCOME TAXES

The Company’s worldwide effective tax rate for the three months ended September 30, 2016 and 2015 was 21.3% and 20.2%, respectively, and 21.1% and 20.4% during the nine months ended September 30, 2016 and 2015, respectively. The slight change in the worldwide effective tax rate for three and nine months ended September 30, 2016 was primarily due to changes in the overall geographic mix of our estimated taxable income for the current year.

Our Belarus subsidiary is eligible for certain income tax holiday benefits granted by the local government for its export activities conducted within the High Tech Park. Income tax holidays are effective for 15 years starting from 2006. Other subsidiaries of the Company are primarily taxed at the jurisdictions’ statutory rate some of which are lower than U.S. federal statutory rates.

## 7. STOCK-BASED COMPENSATION

The following costs related to the Company’s stock compensation plans were included in the condensed consolidated statements of income and comprehensive income:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Cost of revenues | $4,518 | $3,622 | $12,600 | $9,871 |
| Selling, general and administrative expenses - Acquisition related | 3,890 | 4,542 | 9,870 | 13,985 |
| Selling, general and administrative expenses - All other | 5,418 | 3,799 | 15,050 | 9,494 |
| Total | $13,826 | $11,963 | $37,520 | $33,350 |

### Equity Plans

2012 Non-Employee Directors Compensation Plan — On January 11, 2012, the Company approved the 2012 Non-Employee Directors Compensation Plan (“2012 Directors Plan”) to be used to issue equity awards to its non-employee directors. The Company authorized 600,000 shares of common stock to be reserved for issuance under the plan. The 2012 Directors Plan will expire after 10 years and is administered by the Company’s Board of Directors. As of September 30, 2016, 547,560 shares remained available for issuance under the 2012 Directors Plan.

2015 Long-Term Incentive Plan — On June 11, 2015, the Company's stockholders approved the 2015 Long Term Incentive Plan (“2015 Plan”) to be used to issue equity awards to company personnel. As of September 30, 2016, 5,963,453 shares remained available for issuance under the 2015 Plan. All of the stock option awards issued pursuant

to the 2015 Plan expire 10 years from the date of grant.

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2012 Long-Term Incentive Plan — On January 11, 2012, the Company approved the 2012 Long-Term Incentive Plan ("2012 Plan") to be used to issue equity grants to company personnel. In June 2015, the 2012 Plan was discontinued; however, outstanding awards remain subject to the terms of the 2012 Plan and any shares that are subject to an award that was previously granted under the 2012 Plan and that expire or terminate for any reason prior to exercise will become available for issuance under the 2015 Plan. All of the stock option awards issued pursuant to the 2012 Plan expire 10 years from the date of grant.

2006 Stock Option Plan — Effective May 31, 2006, the Board of Directors of the Company adopted the 2006 Stock Option Plan (the "2006 Plan") to grant stock options to directors, employees, and certain independent contractors. In January 2012, the 2006 Plan was discontinued; however, outstanding awards remain subject to the terms of the 2006 Plan and any shares that are subject to an option award that was previously granted under the 2006 Plan and that expire or terminate for any reason prior to exercise will become available for issuance under the 2015 Plan. All of the awards issued pursuant to the 2006 Plan expire 10 years from the date of grant.

Stock Options

Stock option activity under the Company's plans is set forth below:

| | Number of Options | Weighted Average Exercise Price | Aggregate Intrinsic Value |
|---|---|---|---|
| Options outstanding at January 1, 2016 | 7,450,914 | $ 34.07 | $331,938 |
| Options granted | 296,692 | 70.56 | (371 ) |
| Options exercised | (807,677 ) | 19.93 | (39,883 ) |
| Options forfeited/cancelled | (186,234 ) | 47.04 | (4,147 ) |
| Options outstanding at September 30, 2016 | 6,753,695 | $ 37.01 | $218,144 |
| | | | |
| Options vested and exercisable at September 30, 2016 | 3,428,390 | $ 25.74 | $149,375 |
| Options expected to vest | 3,149,286 | $ 48.25 | $66,324 |

As of September 30, 2016, total remaining unrecognized compensation expense related to unvested stock options, net of forfeitures was approximately $50,882. The expense is expected to be recognized over a weighted-average period of 1.7 years.

As of September 30, 2016, the weighted average remaining contractual term was 6.2 years for fully vested and exercisable outstanding options and 8.0 years for outstanding options expected to vest.

As of September 30, 2016, a total of 15,663 shares underlying options exercised through September 30, 2016, were in transfer with the Company's transfer agent.

There were no material changes with respect to the assumptions used in the Black-Scholes option valuation model during the nine months ended September 30, 2016, as compared with the assumptions disclosed in Note 13 to the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

Restricted Stock and Restricted Stock Units

The Company grants awards of restricted stock to non-employee directors under the Company's 2012 Directors Plan and restricted stock units ("RSUs") to Company personnel under the Company's 2015 Plan (and prior to its approval, under the 2012 Plan). In addition, the Company has issued in the past, and may issue in the future its equity securities to compensate employees of acquired businesses for future services. Equity-based awards granted in connection with acquisitions of businesses are generally issued in the form of service-based awards (dependent on continuing employment only) and performance-based awards, which are granted and vest only if certain specified performance conditions are met. The awards issued in connection with acquisitions of businesses are subject to the terms and conditions contained in the applicable award agreement and acquisition documents with typical vesting period of three years, with 33.3% of the awards granted vesting in equal installments on the first, second and third anniversaries of the grant.

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Service-Based Awards

The table below summarizes activity related to the Company's equity-classified and liability-classified service-based awards for the nine months ended September 30, 2016.

| | Equity-Classified Restricted Stock | | Equity-Classified Equity-Settled Restricted Stock Units | | Liability-Classified Cash-Settled Restricted Stock Units | |
|---|---|---|---|---|---|---|
| | Number of Shares | Weighted Average Grant Date Fair Value Per Share | Number of Shares | Weighted Average Grant Date Fair Value Per Share | Number of Shares | Weighted Average Grant Date Fair Value Per Share |
| Unvested service-based awards outstanding at January 1, 2016 | 306,839 | $ 41.14 | 149,272 | $ 57.55 | — | $ — |
| Awards granted | 6,510 | 73.00 | 403,580 | 70.46 | 207,586 | 70.53 |
| Awards vested | (128,180) | 41.52 | (39,612 ) | 55.02 | — | — |
| Awards forfeited/cancelled | (2,035 ) | 44.55 | (20,753 ) | 70.98 | (2,287 ) | 70.52 |
| Unvested service-based awards outstanding at September 30, 2016 | 183,134 | $ 41.97 | 492,487 | $ 67.77 | 205,299 | $ 70.53 |

As of September 30, 2016, the aggregate unrecognized compensation expense for all outstanding service-based restricted stock was $5,184. This expense is expected to be recognized over the next 1.1 years using the weighted average method.

As of September 30, 2016, the aggregate unrecognized compensation expense for all outstanding service-based equity-classified RSUs was $27,841. This expense is expected to be recognized over the next 2.2 years using the weighted average method.

As of September 30, 2016, the aggregate unrecognized compensation expense for all outstanding service-based liability-classified RSUs was $11,205. This expense is expected to be recognized over the next 2.3 years using the weighted average method.

Performance -Based Awards

Summarized activity related to the Company's performance-based awards for the nine months ended September 30, 2016, was as follows:

| | Equity-Classified Restricted Stock | | Liability-Classified Restricted Stock | | Equity-Classified Equity-Settled Restricted Stock Units | |
|---|---|---|---|---|---|---|
| | Number of Shares | Weighted Average Grant Date Fair Value Per Share | Number of Shares | Weighted Average Grant Date Fair Value Per Share | Number of Shares | Weighted Average Grant Date Fair Value Per Share |
| Unvested performance-based awards outstanding at January 1, 2016 | 22,090 | $ 37.52 | 211,206 | $ 39.65 | 14,000 | $ 70.22 |
| Awards granted | — | — | — | — | — | — |

| | | | | | | |
|---|---|---|---|---|---|---|
| Awards vested | (6,784 ) | 36.57 | (105,604 ) | 40.44 | (4,666 ) | 70.22 |
| Awards forfeited/cancelled | (6,467 ) | 36.85 | — | — | (4,667 ) | 70.22 |
| Unvested performance-based awards outstanding at September 30, 2016 | 8,839 | $ 38.74 | 105,602 | $ 38.86 | 4,667 | $ 70.22 |

As of September 30, 2016, the aggregate unrecognized compensation expense for all outstanding performance-based equity-classified restricted stock was $214. This expense is expected to be recognized over the next 1.1 years using the weighted average method.

As of September 30, 2016, the aggregate unrecognized compensation expense for all outstanding performance-based liability-classified restricted stock was $4,960. This expense is expected to be recognized over the next 1.0 year using the weighted average method.

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As of September 30, 2016, the aggregate unrecognized compensation expense for all outstanding performance-based equity-classified RSUs was $553. This expense is expected to be recognized over the next 1.4 years using the weighted average method.

## 8. EARNINGS PER SHARE

Basic earnings per share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the potentially dilutive securities had been issued. Potentially dilutive securities include outstanding stock options, unvested restricted stock and unvested equity-settled RSUs. The dilutive effect of potentially dilutive securities is reflected in diluted earnings per share by application of the treasury stock method.

The following table sets forth the computation of basic and diluted earnings per share of common stock as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Numerator for basic and diluted earnings per share: | | | | |
| Net income | $26,174 | $22,873 | $74,503 | $56,818 |
| Numerator for basic and diluted earnings per share | $26,174 | $22,873 | $74,503 | $56,818 |
| | | | | |
| Denominator for basic and diluted earnings per share: | | | | |
| Weighted average basic common shares outstanding | 51,131 | 49,043 | 50,172 | 48,506 |
| Effect of dilutive securities: | | | | |
| Stock options, RSUs and restricted stock awards | 2,733 | 3,301 | 2,987 | 3,249 |
| Denominator for diluted earnings per share | 53,864 | 52,344 | 53,159 | 51,755 |
| | | | | |
| Net income per share: | | | | |
| Basic | $0.51 | $0.47 | $1.48 | $1.17 |
| Diluted | $0.49 | $0.44 | $1.40 | $1.10 |

During the three and nine months ended September 30, 2016, a total of 2,357 and 2,324 shares underlying equity-based awards, respectively, were outstanding but were not included in the computation of diluted earnings per share because the effect was anti-dilutive. During the three and nine months ended September 30, 2015, a total of 2,143 and 1,456 shares underlying equity-based awards, respectively, were outstanding but were not included in the computation of diluted earnings per share because the effect was anti-dilutive.

## 9. COMMITMENTS AND CONTINGENCIES

Indemnification Obligations — In the normal course of business, the Company is a party to a variety of agreements under which it may be obligated to indemnify the other party for certain matters. These obligations typically arise in contracts where the Company customarily agrees to hold the other party harmless against losses arising from a breach of representations or covenants for certain matters such as title to assets and intellectual property rights associated with certain arrangements. The duration of these indemnifications varies, and in certain cases, is indefinite.

The Company is unable to reasonably estimate the maximum potential amount of future payments under these or similar agreements due to the unique facts and circumstances of each agreement and the fact that certain indemnifications provide for no limitation to the maximum potential future payments under the indemnification. Management is not aware of any such matters that would have a material effect on the condensed consolidated financial statements of the Company.

Litigation — From time to time, the Company is involved in litigation, claims or other contingencies. Management is not aware of any such matters that would have a material effect on the condensed consolidated financial statements of the Company.

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10. SEGMENT INFORMATION

The Company determines its reporting segments and reports segment information in accordance with the management approach, which designates internal reporting used by management to make operating decisions and assess performance as the source of the Company’s reportable segments.

The Company manages its business primarily based on the geographic managerial responsibility for its client base. As managerial responsibility for a particular client relationship generally correlates with the client’s geographic location, there is a high degree of similarity between client locations and the geographic boundaries of the Company’s reportable segments. In some cases, managerial responsibility for a particular client is assigned to a management team in another region and is usually based on the strength of the relationship between client executives and particular members of EPAM’s senior management team. In such cases, the client’s activity would be reported through the management team’s reportable segment.

The Company’s reportable segments are North America, Europe, Russia and Other. The revenues in the Other segment represented less than 1% of total segment revenues in 2014 and 2015 due to the ending of certain customer relationships and contractual changes with other clients. As no substantial clients remained in the segment, during the first quarter of 2016, the Company shifted managerial responsibility for the remaining clients to the Russia segment. This change does not represent a change in the Company's existing segments but rather a movement in responsibility for several clients that represent less than 1% of total segment revenue.

The Company’s Chief Operating Decision Maker (“CODM”) evaluates performance and allocates resources based on the segment's revenues and operating profit. Segment operating profit is defined as income from operations before unallocated costs. Generally, operating expenses for each reportable segment have similar characteristics and are subject to similar factors, pressures and challenges. Expenses included in segment operating profit consist principally of direct selling and delivery costs as well as an allocation of certain shared services expenses. Certain expenses are not allocated to specific segments, as management does not believe these expenses are either directly attributable to any specific segment or controllable at the segment level. Such “unallocated” expenses are deducted against the Company’s total income from operations and are not allocated to individual segments in internal management reports used by the CODM.

Revenues from external customers and operating profit/(loss), before unallocated expenses, for the North America, Europe, Russia and Other reportable segments for the three and nine months ended September 30, 2016 and 2015, were as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Segment revenues: | | | | |
| North America | $161,655 | $121,746 | $466,255 | $330,228 |
| Europe | 126,265 | 103,514 | 349,834 | 292,826 |
| Russia | 10,434 | 9,707 | 31,056 | 27,432 |
| Other | — | 1,207 | — | 3,951 |
| Total segment revenues | $298,354 | $236,174 | $847,145 | $654,437 |
| Segment operating profit/(loss): | | | | |
| North America | $34,699 | $28,906 | $103,693 | $78,720 |
| Europe | 19,548 | 17,021 | 49,793 | 49,031 |
| Russia | 1,208 | 1,626 | 5,244 | 3,095 |
| Other | — | 168 | — | (12 ) |
| Total segment operating profit | $55,455 | $47,721 | $158,730 | $130,834 |

Intersegment transactions were excluded from the above on the basis that they are neither included into the measure of a segment’s profit and loss by the CODM, nor provided to the CODM on a regular basis.

During the three and nine months ended September 30, 2016, revenues from one customer, UBS AG, were $35,142 and $107,381, respectively, and accounted for more than 10% of total revenues. During the three and nine months

ended September 30, 2015, revenues from one customer, UBS AG, were $32,960 and $95,826, respectively, and accounted for more than 10% of total revenues. Revenues from this customer included reimbursable expenses and were included in the Company's Europe segment in the periods indicated.

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Trade accounts receivable and unbilled revenues are generally dispersed across our clients in proportion to their revenues. As of September 30, 2016, billed and unbilled trade receivables from one customer, UBS AG, individually exceeded 10% and accounted for 10.3% and 10.7% of our total billed and unbilled trade receivables, respectively.
Reconciliation of segment revenues to consolidated revenues and segment operating profit to consolidated income before provision for income taxes is presented below:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Total segment revenues | $298,354 | $236,174 | $847,145 | $654,437 |
| Less: Other income | (61 ) | (125 | | |