

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

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

FORM 10-Q

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 223536104  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

41 University Drive, Suite 202 18940  
Newtown, Pennsylvania  
(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  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  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  Accelerated filer  Non-accelerated filer  Smaller reporting company

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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

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

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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

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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		Nine Months Ended	
	September 30,		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 Weighted Average Useful Life (in years)	Amount	AGS 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	—	—	—	—	—	—

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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, 2016		Nine Months Ended September 30, 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		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 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		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Total segment revenues	\$298,354	\$236,174	\$847,145	\$654,437
Less: Other income	(61 )	(125 )	(538 )	(562 )
Revenues	\$298,293	\$236,049	\$846,607	\$653,875
Total segment operating profit:	\$55,455	\$47,721	\$158,730	\$130,834
Unallocated amounts:				
Other income	(61 )	(125 )	(538 )	(562 )
Stock-based compensation expense	(13,826 )	(11,963 )	(37,520 )	(33,350 )
Non-corporate taxes	(1,588 )	(1,120 )	(4,105 )	(2,858 )
Professional fees	(1,470 )	(1,572 )	(5,656 )	(5,423 )
Depreciation and amortization	(2,027 )	(1,312 )	(6,294 )	(3,919 )
Bank charges	(370 )	(340 )	(1,097 )	(1,021 )
One-time charges	(7 )	—	(314 )	—
Other corporate expenses	(2,204 )	(3,513 )	(6,893 )	(9,499 )
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

## Geographic Area Information

Long-lived assets include property and equipment, net of accumulated depreciation and amortization, and management has determined that it is not practical to allocate these assets by segment since such assets are used interchangeably among the segments. Geographical information about the Company's long-lived assets based on physical location of the assets was as follows:

	As of	As of
	September	December
	30,	31,
	2016	2015
Belarus	\$ 44,942	\$ 44,879
Ukraine	5,735	4,487
Russia	4,851	2,084
Hungary	3,945	2,485
United States	2,685	1,969
Poland	2,135	1,088
China	1,715	514
India	1,594	1,099
Other	2,682	1,894
Total	\$ 70,284	\$ 60,499

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Information about the Company's revenues by client location is as follows:

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
United States	\$153,818	\$110,191	\$435,258	\$299,606
United Kingdom	43,535	41,324	131,541	121,312
Switzerland	31,550	28,370	94,771	81,654
Canada	14,526	14,695	45,400	40,394
Germany	12,325	10,378	30,694	26,216
Russia	9,833	9,469	29,269	26,526
Sweden	6,256	3,020	16,204	7,479
Hong Kong	4,839	5,758	15,684	17,030
Netherlands	4,302	2,630	10,014	6,984
Belgium	2,676	2,154	7,329	5,307
China	2,050	276	2,757	411
Spain	1,821	334	2,635	513
Ireland	1,315	1,554	3,795	4,374
Italy	1,103	602	2,732	1,695
Other locations	5,185	2,417	9,793	7,398
Reimbursable expenses and other revenues	3,159	2,877	8,731	6,976
Revenues	\$298,293	\$236,049	\$846,607	\$653,875

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11. RECENT ACCOUNTING PRONOUNCEMENTS

In October 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. The amendment in this update allows recognition of current and deferred income taxes for an intra-entity asset transfer, other than inventory, when the transfer occurs, which was prohibited before and required recognition only when the asset was sold to an outside party. This amendment should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The amendment in this update is effective on a modified retrospective basis for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company is currently evaluating the impact this new standard will have on its condensed consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force). The amendments in this update reduces diversity in eight areas where the FASB does not provide clear or specific guidance in classifying certain cash receipts and payments. The ASU currently applies to our contingent consideration payments made after a business combination. It requires us to show payments made soon after the acquisition to settle the contingent liability under investing activities section, those payments not made soon after the acquisition under the financing activity section in the amount of a liability recognized at the acquisition date (including measurement-period adjustments) and any excess under operating activities section. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. As the Company reports its cash flow activity related to contingent consideration consistent with the new ASU, the adoption of this guidance will have no effect on our consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which requires measurement and recognition of expected credit losses for financial assets held. The new standard will be effective on January 1, 2020. The adoption of this standard is not expected to have a material impact on the Company's financial position or results of operations.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which impacts virtually all aspects of an entity's revenue recognition. The ASU introduces a new five-step revenue recognition model in which an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. In July 2015, the FASB deferred the effective date until the annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017. This standard will be effective beginning in the first quarter of 2018. In March 2016, the FASB issued Accounting Standards Update No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which finalized proposed ASU 2015-290 of the same name and clarifies the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606), which clarifies multiple aspects of identifying performance obligations and accounting for licenses of intellectual property. In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which provides clarifying guidance in a few narrow areas and adds some practical expedients to the guidance. The Company is currently evaluating the impact this new standard will have on its condensed consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which amends Accounting Standards Codification (“ASC”) Topic 718, Compensation - Stock Compensation. The amendments in this update simplify the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash

flows. The amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The Company is currently evaluating the impact this new standard will have on its condensed consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). Under the new guidance, a lessee will be required to recognize assets and liabilities for leases greater than 1 year, regardless of whether they were previously accounted for as capital or operating leases. This update is effective for public companies for fiscal years beginning after December 15, 2018 with early adoption permitted. The Company is currently evaluating the impact of adopting this standard as well as the timing of when it will adopt this ASU.



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In November 2015, the Financial Accounting Standards Board (FASB) issued ASU 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. The amendment requires deferred tax liabilities and assets, along with any related valuation allowance, be classified as noncurrent on the balance sheet. Effective April 1, 2016, the Company early adopted ASU No. 2015-17 on a prospective basis, which resulted in the reclassification of current deferred tax assets to non-current deferred income tax assets on its condensed consolidated balance sheet. No prior periods were retrospectively adjusted.

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. The amendments in this update require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The update eliminates the current requirement to retrospectively adjust provisional amounts recognized at the acquisition date. The amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The implementation of this standard did not have a material effect on the Company's condensed consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The update guides presentation of debt issuance costs and requires the related debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. The amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The implementation of this standard did not have a material effect on the Company's condensed consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810): Amendments to the Consolidations Analysis, which changes the guidance for evaluating whether to consolidate certain legal entities. Specifically, the amendments modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities ("VIEs") or voting interest entities. The amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The implementation of this standard did not have a material effect on the Company's condensed consolidated financial statements.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

You should read the following discussion and analysis of our financial condition and results of operations together with our Annual Report on Form 10-K for the year ended December 31, 2015 and the unaudited condensed consolidated financial statements and the related notes included elsewhere in this quarterly report. In addition to historical information, this discussion contains forward-looking statements that involve risks, uncertainties and assumptions that could cause actual results to differ materially from management's expectations. Factors that could cause such differences are discussed in the

sections entitled "Forward-Looking Statements" in this item and "Part II. Item 1A. Risk Factors." We assume no obligation to update any of these forward-looking statements.

In this quarterly report, "EPAM," "EPAM Systems, Inc.," the "Company," "we," "us" and "our" refer to EPAM Systems, Inc. its consolidated subsidiaries.

**Executive Summary**

We are a leading global provider of product development and software engineering solutions offering specialized technological services to many of the world's leading organizations. Our clients depend on us to solve their complex technical challenges and rely on our expertise in core engineering, advanced technology, digital engagement and intelligent enterprise development. We are continuously venturing into new industries to expand our core industry client base in software and technology, financial services, media and entertainment, travel and hospitality, retail and distribution, and life sciences and healthcare. Our teams of developers, architects, strategists, engineers, designers, and product experts have the capabilities and skill sets to deliver business results.

Our global delivery model and centralized support functions, combined with the benefits of scale from the shared use of fixed-cost resources, enhance our productivity levels and enable us to better manage the efficiency of our global operations. As a result, we have created a delivery base whereby our applications, tools, methodologies and infrastructure allow us to seamlessly deliver services and solutions from our delivery centers to global clients across

all geographies, further strengthening our relationships with them.

Through increased specialization in focused verticals and a continued emphasis on strategic partnerships, we are leveraging our roots in software engineering to grow as a recognized brand in software development and end-to-end digital transformation services for our clients.

#### Year-to-Date 2016 Developments and Trends

During the first nine months of 2016, our revenues were \$846.6 million, an increase of approximately 29.5% over \$653.9 million reported for the same period a year ago. Our performance remained strong across our key verticals, including the Life Sciences and Healthcare vertical showing growth of 48.5% during the first nine months of 2016 as compared to the first nine months of 2015.

We seek to grow revenues by continually expanding the scope and size of our engagements with existing customers, as well as by growing our customer base through business development efforts and strategic acquisitions. During the first nine months of 2016, we focused on continuing to develop our existing business, both geographically and across industry verticals. As we enter new geographies through acquisitions and organic growth, we continue to seek to expand our service offerings and industry expertise in those new locations.

We are committed to maintaining and continuing to diversify a well-balanced portfolio of clients. During the first nine months of 2016, our top five and top ten customers accounted for 29.3% and 39.3% of consolidated revenues, compared to 33.5% and 44.4% during the first nine months of 2015, respectively.

On June 23, 2016, the U.K. held a referendum in which voters approved an exit from the E.U. (referred to as “Brexit”). As a result, it is anticipated that the U.K. government will negotiate the terms of the U.K.’s withdrawal from the E.U. after Parliamentary approval. The Brexit vote resulted in immediate stock market and foreign currency exchange rate volatility and uncertainty, and it remains to be determined what impact the U.K.’s exit from the E.U. will have on other operational areas including immigration. We have a significant operating presence in the U.K., with approximately 16% of the Company’s revenues in the first nine months of 2016 coming from U.K. clients. We are monitoring the developments relating to Brexit, but the related uncertainty may affect our customers’ operations and may result in new operational and financial challenges for us.

#### Summary of Results of Operations

The following table presents a summary of our results of operations for the three and nine months ended September 30, 2016 and 2015:

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	Three Months				Nine Months					
	Ended		Increase		Ended		Increase			
	September 30,		Dollars	Percentage	September 30,		Dollars	Percentage		
	2016	2015			2016	2015				
	(in thousands, except percentages)									
Revenues	\$298,293	\$236,049	\$62,244	26.4	%	\$846,607	\$653,875	\$192,732	29.5	%
Income from operations	33,902	27,776	6,126	22.1	%	96,313	74,202	22,111	29.8	%
Net income	26,174	22,873	3,301	14.4	%	74,503	56,818	17,685	31.1	%

The key highlights of our consolidated results for the three and nine months ended September 30, 2016, as compared to the corresponding periods of 2015, were as follows:

Our North American geography had the greatest impact on revenue growth, growing \$43.5 million and \$140.7 million during the three and nine months ended September 30, 2016, or 34.8% and 41.4% over the corresponding period of 2015;

Revenue increased in all our key verticals and in particular within the Media and Entertainment vertical, which grew \$14.2 million during the third quarter of 2016 over the corresponding period of 2015. During the first nine months of 2016, the largest growth was noted in the Financial Services vertical, which grew \$40.2 million over the corresponding period of 2015;

Income from operations grew by 22.1% and 29.8% during the three and nine months ended September 30, 2016, compared with the corresponding periods of 2015 as we continued our aggressive growth;

Net income increased by 14.4% during the third quarter of 2016 compared with the corresponding period of 2015. On a year-to-date basis, net income increased by 31.1% over the corresponding period of 2015. Expressed as a percentage of revenues, net income was 8.8% during both the three and nine months ended September 30, 2016, compared with 9.7% and 8.7% in the corresponding periods of 2015.

The operating results in any period are not necessarily indicative of the results that may be expected for any future period.

#### Effects of Inflation

Economies in CIS countries, particularly Belarus, Russia and Ukraine, have periodically experienced high rates of inflation. Periods of higher inflation may slow economic growth in those countries and as a result decrease demand for our services, and negatively impact the business of our existing clients. Inflation is likely to increase some of our expenses, which may reduce our profitability, as we may not be able to pass these increases on to our clients. Generally, our largest expense that could be impacted by inflation is wages. We do not rely on borrowed funds for operations in those locations; therefore, increases in interest rates typical for inflationary environments do not currently pose a risk to our business.

Ukraine has been experiencing political and economic turmoil severely impacting the Ukrainian economy. The Ukrainian currency has been weakened and the negative outlook in the Ukrainian economy continues. We have not experienced a significant impact from the inflation in Ukraine and do not have clients located in Ukraine.

Inflation in Russia increased in late 2014 due to weakening of the Russian ruble and decreasing oil prices. Inflation in Russia remained steady during 2015 with some decline observed during 2016. Our operations in Russia have not been significantly affected by local inflation; however, we have noted some impact from inflation on our clients in Russia. Belarus experienced hyperinflation in the past and may experience high levels of inflation in the future. We have not seen a significant impact from the inflation in Belarus as our largest expense there, wages, is denominated in U.S. dollars in order to provide stability in our business and for our employees. We do not have significant clients located in Belarus and in the first nine months of 2016, we had approximately \$1.3 million, or 0.1%, of our revenues denominated in Belarusian rubles. The functional currency for financial reporting purposes in Belarus is US dollars. Other locations where we have clients or perform services are not experiencing significant inflation and our business is not materially impacted by inflation in those locations.

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## Results of Operations

The following table sets forth a summary of our consolidated results of operations for the periods indicated. This information should be read together with our unaudited condensed consolidated financial statements and related notes included elsewhere in this quarterly report. The operating results in any period are not necessarily indicative of the results that may be expected for any future period.

	Three Months Ended		Increase/(Decrease)		Nine Months Ended		Increase/(Decrease)			
	September 30, 2016	2015	Dollars	Percentage	September 30, 2016	2015	Dollars	Percentage		
	(in thousands, except percentages)									
Revenues	\$298,293	\$236,049	\$62,244	26.4	%	\$846,607	\$653,875	\$192,732	29.5	%
Operating expenses:										
Cost of revenues										
(exclusive of depreciation and amortization) <sup>(1)</sup>	190,797	148,479	42,318	28.5	%	538,960	408,622	130,338	31.9	%
Selling, general and administrative expenses <sup>(2)</sup>	67,491	55,431	12,060	21.8	%	193,226	158,345	34,881	22.0	%
Depreciation and amortization expense	5,925	4,393	1,532	34.9	%	17,150	12,496	4,654	37.2	%
Other operating expenses, net	178	(30)	208	(693.3)	%	958	210	748	356.2	%
Income from operations	33,902	27,776	6,126	22.1	%	96,313	74,202	22,111	29.8	%
Interest and other income, net	1,067	865	202	23.4	%	3,416	3,322	94	2.8	%
Foreign exchange (loss)/gain	(1,728)	) 32	(1,760)	(5,500.0)	%	(5,313)	) (6,187)	) 874	(14.1)	%
Income before provision for income taxes	33,241	28,673	4,568	15.9	%	94,416	71,337	23,079	32.4	%
Provision for income taxes	7,067	5,800	1,267	21.8	%	19,913	14,519	5,394	37.2	%
Net income	\$26,174	\$22,873	\$3,301	14.4	%	\$74,503	\$56,818	\$17,685	31.1	%

Includes \$4,518 and \$3,622 of stock-based compensation expense for the three months ended September 30, 2016 (1) and 2015, respectively, and \$12,600 and \$9,871 of stock-based compensation expense for the nine months ended September 30, 2016 and 2015, respectively;

Includes \$9,308 and \$8,341 of stock-based compensation expense for the three months ended September 30, 2016 (2) and 2015, respectively, and \$24,920 and \$23,479 of stock-based compensation expense for the nine months ended September 30, 2016 and 2015, respectively.

Three and Nine Months Ended September 30, 2016 Compared to the Three and Nine Months Ended September 30, 2015

## Revenues

During the three and nine months ended September 30, 2016, our revenues grew 26.4% and 29.5% over the corresponding periods in 2015, to \$298.3 million and \$846.6 million in total revenues. This growth is mainly attributable to our ability to retain and increase the level of services we provide to our existing customers including our top and long-term clients. We continue targeting new customers and expanding our presence in various verticals, both organically and through acquisitions.

Our largest contributor to consolidated revenue in terms of geography is North America, which accounted for 56.4% and 56.8% of consolidated revenues during the three and nine months ended September 30, 2016, an increase of 3.5% and 4.8% over the corresponding periods in 2015. During the three and nine months ended September 30, 2016,

revenues in North America grew \$43.5 million and \$140.7 million, or 34.8% and 41.4%, over the same periods last year.

Revenues from all major verticals in North America grew during the three and nine months ended September 30, 2016 compared with the same periods last year. This result is partly attributed to continuing strong performance by our existing top clients in the North America's top performing Software and Hi-Tech vertical. Revenues from the Software and Hi-Tech vertical in North America increased by \$12.6 million and \$33.9 million for the three and nine months ended September 30, 2016 compared with the same periods last year. During the three and nine months ended September 30, 2016, significant revenue growth rate in North America was noted in the Financial Services vertical, showing an increase of 104.7% and 112.1%, over the corresponding periods of 2015.

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In our European geography, the Financial Services vertical contributed the most to revenue growth and accounted for 38.3% and 44.7% of overall revenue growth in this geography during the three and nine months ended September 30, 2016, compared to the same periods in 2015. During the three and nine months ended September 30, 2016, revenues from the Financial Services vertical in Europe increased by \$6.7 million and \$21.4 million, or 15.1% and 16.6%, over the corresponding periods of 2015. The Financial Services vertical remained our largest vertical on a consolidated basis with the majority of its revenue, \$51.3 million and \$150.5 million for the three and nine months ended September 30, 2016, coming from the European geography. Continued solid performance of the Financial Services vertical was attributable to an increased demand for our services and ongoing relationships with existing customers located in Europe. In particular, 5.0% and 6.6% of consolidated revenue growth during the three and nine months ended September 30, 2016, was attributable to increased business from our top customer located in Switzerland. Revenues in the CIS geography increased by \$0.1 million, or 0.6%, during the three months ended September 30, 2016 as compared to the corresponding period of 2015 and increased by \$1.3 million, or 4.2% on a year-to-date basis as compared to the same period of 2015. In our CIS geography, the Financial Services vertical contributed the most revenue with \$6.5 million and \$18.6 million or 59.0% and 56.8% of total revenue in this geography during the three and nine months ended September 30, 2016, respectively. The CIS region overall has been impacted by macroeconomic instability and significant foreign currency fluctuations in Russia and other CIS countries had a negative impact on the revenues from those locations causing unsteady revenue trends.

During the third quarter of 2016, revenues from the APAC region increased by \$0.8 million, or 13.8%, over the corresponding period of 2015 and increased by \$1.1 million, or 6.2%, on a year-to-date basis as compared to the same period of 2015. In our APAC region, the Financial Services vertical contributed the most revenue with \$4.1 million and \$13.5 million or 59.6% and 72.8% of total revenue in this geography during the three and nine months ended September 30, 2016, respectively. We have focused on diversifying our business in this region beyond banking and financial services to other key verticals, including retail, consumer, media and entertainment markets. During 2016, we have established new clients in the Travel and Consumer vertical in the APAC region, which accounted for 26.1% and 17.0% of total revenue in this geography during the three and nine months ended September 30, 2016, respectively.

**Cost of Revenues (Exclusive of Depreciation and Amortization)**

During the three months ended September 30, 2016, cost of revenues (exclusive of depreciation and amortization) was \$190.8 million representing an increase of 28.5% over the corresponding period of 2015. As a percentage of revenues, cost of revenues (exclusive of depreciation and amortization) increased by 1.1% over the corresponding period of 2015 to 64.0% of consolidated revenues.

The increase in cost of revenues (exclusive of depreciation and amortization) in the third quarter of 2016 was primarily driven by a \$41.3 million increase in compensation costs for revenue producing delivery personnel, including an increase in stock-based compensation expense of \$0.9 million. The increase was mainly attributable to a 36.3% growth in the average number of delivery professionals in the quarter, resulting from organic growth as well as personnel additions from our strategic acquisitions.

During the nine months ended September 30, 2016, cost of revenues (exclusive of depreciation and amortization) was \$539.0 million representing an increase of 31.9% over the corresponding period of 2015. As a percentage of revenues, cost of revenues (exclusive of depreciation and amortization) increased by 1.2% over the corresponding period of 2015 to 63.7% of consolidated revenues.

The increase in cost of revenues (exclusive of depreciation and amortization) in the first nine months of 2016 was primarily driven by a \$125.3 million increase in personnel-related costs, including an increase in stock-based compensation expense of \$2.7 million. The total increase in personnel-related costs was primarily attributable to a 35.8% growth in the average number of delivery professionals in 2016 to date, resulting from organic growth as well as personnel additions from our strategic acquisitions.

Table of Contents**Selling, General and Administrative Expenses**

We continued to invest in key areas including sales, infrastructure, industry expertise, and other functions supporting global operations and our growth. During the three months ended September 30, 2016, selling, general and administrative expenses were \$67.5 million representing an increase of 21.8% over the corresponding period of 2015. As a percentage of revenues, selling, general and administrative expenses decreased 0.9% over the corresponding period of 2015, to 22.6% of consolidated revenues. The increase in selling, general and administrative expenses during the three months ended September 30, 2016, compared to the same period of 2015, was primarily driven by a \$5.1 million increase in personnel-related costs, which includes salaries and stock-based compensation expense. Of these personnel-related costs, stock-based compensation expense comprised \$1.0 million of the increase during the three months ended September 30, 2016, compared to the same period of 2015.

During the nine months ended September 30, 2016, selling, general and administrative expenses were \$193.2 million representing an increase of 22.0% over the corresponding period of 2015. As a percentage of revenues, selling, general and administrative expenses decreased 1.4% over the corresponding period of 2015, to 22.8% of consolidated revenues. The increase in selling, general and administrative expenses during the nine months ended September 30, 2016, compared to the same period of 2015, was primarily driven by a \$12.8 million increase in personnel-related costs, which includes salaries and stock-based compensation expense. Of these personnel-related costs, stock-based compensation expense comprised \$1.4 million of the increase during the nine months ended September 30, 2016, compared to the same period of 2015.

Our selling, general and administrative expenses have increased primarily as a result of our expanding operations, acquisitions, and the hiring of a number of senior managers to support our sustainable growth. During the three and nine months ended September 30, 2016, we experienced a 31.9% and 27.3% growth in the average non-production headcount as compared to the same periods of 2015. In addition, we have issued stock to sellers and/or personnel in connection with our business acquisitions and have been recognizing stock-based compensation expense in the periods after the closing of these acquisitions as part of selling, general and administrative expenses. Such stock-based compensation expense related to acquisitions comprised 41.8% and 39.6% of total selling, general and administrative stock-based compensation expense for the three and nine months ended September 30, 2016, and 54.5% and 59.6% in the same periods of 2015.

**Depreciation and Amortization Expense**

During the three and nine months ended September 30, 2016, depreciation and amortization expense was \$5.9 million and \$17.2 million, as compared to \$4.4 million and \$12.5 million in the corresponding periods last year. Expressed as a percentage of revenues, depreciation and amortization expense increased 0.1% during both the three and nine months ended September 30, 2016 as compared with the corresponding periods of 2015. The increase in depreciation and amortization expense is primarily due to the increase in purchases of computer equipment to support headcount growth, accompanied by increased amortization of new intangible assets purchased during 2015. We purchased \$2.8 million of intangible assets as part of our NavigationArts acquisition and \$22.7 million of intangible assets as part of our AGS acquisition in 2015.

**Interest and Other Income, Net**

Net interest and other income was \$1.1 million and \$3.4 million during the three and nine months ended September 30, 2016 representing an increase of \$0.2 million and \$0.1 million compared to the corresponding periods last year. The increase was primarily impacted by more interest received on cash accounts in Belarus and more interest earned on employee housing loans.

**Provision for Income Taxes**

The provision for income taxes was \$7.1 million during the three months ended September 30, 2016, representing an increase from \$5.8 million during the three months ended September 30, 2015. The effective income tax rate was 21.3% for the three months ended September 30, 2016 and 20.2% for the three months ended September 30, 2015. The provision for income taxes was \$19.9 million during the nine months ended September 30, 2016, representing an increase from \$14.5 million during the nine months ended September 30, 2015. The effective income tax rate was 21.1% for the nine months ended September 30, 2016 and 20.4% for the nine months ended September 30, 2015.





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## Results by Business Segment

Our reportable segments are based on managerial responsibility for a particular client. Because 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 our reportable segments. In some specific cases, however, managerial responsibility for a particular client is assigned to a management team in another region, usually based on the strength of the relationship between client executives and particular members of our senior management team. In such cases, the client's activity would be reported through the management team's reportable segment.

Our 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, we shifted managerial responsibility for the remaining clients to the Russia segment. This change does not represent a change in our existing segments but rather a movement in responsibility for several clients that represent less than 1% of total segment revenue.

Each segment engages in business activities that generate revenues and incur expenses. Separate financial information is available for each segment and it is used on a regular basis by our chief executive officer, who is also our chief operating decision maker ("CODM"), in determining how to allocate resources and evaluate performance based on segment revenues and operating profit. Segment operating profit is defined as income from operations before unallocated costs. Generally, operating expenses for each operating 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. These shared expenses include Delivery, Recruitment and Development, Sales and Marketing, and support functions such as IT, Finance, Legal, and Human Resources. Generally, shared expenses are allocated based on measurable drivers of expense, e.g., recorded hours or headcount. Certain expenses, such as stock based compensation expense, 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 clients and segment operating profit, 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
	(in thousands)			
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
North America Segment				

During the three months ended September 30, 2016, revenues for the North America segment increased \$39.9 million, or 32.8%, over the corresponding period in 2015 and segment operating profits increased \$5.8 million, or 20.0%, as compared to the same period last year. During the three months ended September 30, 2016, revenues from our North America segment were 54.2% of total segment revenues, which increased from the 51.5% of total segment revenues in the corresponding period of 2015. As a percentage of North America segment revenues, the North America segment's operating profit was 21.5% during the three months ended September 30, 2016 and 23.7% in the same period of 2015.

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During the nine months ended September 30, 2016, revenues for the North America segment increased \$136.0 million, or 41.2%, over the corresponding period in 2015 and segment operating profits increased \$25.0 million, or 31.7%, as compared to the same period last year. During the nine months ended September 30, 2016, revenues from our North America segment were 55.0% of total segment revenues, which increased from the 50.5% of total segment revenues in the corresponding period of 2015. As a percentage of North America segment revenues, the North America segment's operating profit was 22.2% during the nine months ended September 30, 2016 and 23.8% in the same period of 2015.

The increase in revenues during the three and nine months ended September 30, 2016 was driven by continued expansion of existing customer relationships and by revenues from new clients. During the first nine months of 2016, operating results of the North America operating segment were impacted from our 2015 acquisitions of AGS and NavigationArts, which mainly generate revenues in North America.

Europe Segment

During the three months ended September 30, 2016, revenues from our Europe segment were 42.3% of total segment revenues and represented an increase of \$22.8 million, or 22.0%, over the corresponding period of 2015. During the three months ended September 30, 2016, segment operating profits increased \$2.5 million, or 14.8%, as compared to the same period of 2015, to \$19.5 million of operating profit.

During the nine months ended September 30, 2016, revenues from our Europe segment were 41.3% of total segment revenues and represented an increase of \$57.0 million, or 19.5%, over the corresponding period of 2015. During the nine months ended September 30, 2016, segment operating profits increased \$0.8 million, or 1.6%, as compared to the same period of 2015, to \$49.8 million of operating profit.

Europe continues to be a growing segment in our portfolio with several top European-based clients primarily in the banking and financial services sector. Our Europe segment includes the business in the APAC region, which is managed by the same management team. We have gained several new clients in various industries in the APAC region during the three and nine months ended September 30, 2016, compared with the corresponding period of 2015. We expect that many of our new and existing customers in other business verticals will use our services in that region resulting in possible revenue and operating profit increases for the Europe segment.

Russia and Other Segments

During the three months ended September 30, 2016, revenues from our Russia segment were 3.5% of total segment revenues and represented an increase of \$0.7 million, or 7.5%, compared to the corresponding period of 2015. During the three months ended September 30, 2016, operating profit of the Russia segment decreased \$0.4 million, or 25.7%, as compared to the same period of 2015, to \$1.2 million.

During the nine months ended September 30, 2016, revenues from our Russia operating segment increased \$3.6 million, or 13.2%, and operating profits increased \$2.1 million, or 69.4%, as compared to the same period of 2015. During the three and nine months ended September 30, 2016, no substantial clients remained in the Other segment due to the ending of certain customer relationships and contractual changes with other clients, and as a result we shifted managerial responsibility for the remaining clients to the Russia segment. This change does not represent a change in our existing segments but rather a movement in responsibility for several clients that represent less than 1% of total segment revenue.

Revenues and operating profits in the Russia and Other segments are subject to volatility resulting from revenue recognition delays related to finalizing budgets for certain arrangements with major customers in those segments causing instability between revenues and associated profits. Also, since 2014, the United States and the European Union have imposed and expanded sanctions targeting Russian government and government-controlled interests and certain government officials. While this has not directly impacted our business in Russia, the sanctions aggravated the overall Russian economy and negatively influenced the business of our major clients in the region, decreasing demand for our services. Additionally, strong foreign currency fluctuations in 2015 and 2016 further destabilized the economic situation in the regions that are included in these segments and negatively impacted our business in Russia and other CIS countries during 2015 and 2016.



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## Liquidity and Capital Resources

## Capital Resources

At September 30, 2016, our principal sources of liquidity were cash and cash equivalents totaling \$330.6 million and \$66.1 million of available borrowings under our revolving line of credit.

As of September 30, 2016, \$274.9 million of our total cash and cash equivalents were held outside the United States. Of this amount, \$132.3 million was held in U.S. dollar denominated accounts in Belarus, including deposits that accrued interest at an average interest rate of 3.2% during the first nine months of 2016. As of September 30, 2016, a balance of \$31.7 million U.S. dollars is kept in an unrestricted account in our Cyprus entity's bank in the United Kingdom. Our subsidiaries in the CIS or APAC regions do not maintain significant balances denominated in currencies other than U.S. dollars.

The cash and cash equivalents held at locations outside of the United States are for future operating expenses and we have no intention of repatriating those funds. However, as a result of various factors such as any global or regional instability or changes in tax laws in place for a specific time period, we may later decide to repatriate some or all of our funds to the United States. If we decide to remit funds to the United States in the form of dividends, \$274.9 million would be subject to foreign withholding taxes, of which \$262.0 million would also be subject to U.S. corporate income tax. We believe that our available cash and cash equivalents held in the United States and cash flow to be generated from domestic operations will be adequate to satisfy our domestic liquidity needs in the foreseeable future. Our ability to expand and grow our business in accordance with current plans and to meet our long-term capital requirements will depend on many factors, including the rate, if any, at which our cash flows increase, our continued intent not to repatriate earnings from outside of the U.S. and the availability of public and private debt and equity financing. To the extent we pursue one or more significant strategic acquisitions, we may incur debt or sell additional equity to finance those acquisitions.

On September 12, 2014, we established a revolving credit facility with PNC Bank, National Association; Santander Bank, N.A; and Silicon Valley Bank. This credit facility consists of a \$100.0 million revolving line of credit, with a maturity date of September 12, 2019. There is potential to increase the credit facility up to \$200.0 million if certain conditions are met. Borrowings under the credit facility may be denominated in United States Dollars or, up to a maximum of \$50.0 million in British pounds sterling, Canadian dollars, euros or Swiss francs (or other currencies as may be approved by the lenders). As of September 30, 2016, we had outstanding debt of \$33.1 million, including accrued interest, and \$0.9 million of an unused irrevocable letter of credit under the 2014 Credit Facility, with the balance of the credit line of \$66.1 million remaining available for use.

## Cash Flows

The following table summarizes our cash flows for the periods indicated:

	Nine Months Ended	
	September 30,	
	2016	2015
	(in thousands)	
Condensed Consolidated Statements of Cash Flow Data:		
Net cash provided by operating activities	\$ 111,166	\$ 64,554
Net cash provided by/(used in) investing activities	3,110	(73,175 )
Net cash provided by 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

## Operating Activities

Net cash provided by operating activities during the nine months ended September 30, 2016 increased by \$46.6 million, compared to the corresponding period of 2015. This increase in operating cash flows for the first nine months of 2016 as compared to the same period in 2015 is mainly attributable to an increase in collected revenue, which is partially offset by an increase in payroll, bonuses, taxes and office related expenses.



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Investing Activities

Net cash provided by investing activities during the nine months ended September 30, 2016 was \$3.1 million and consisted primarily of a matured \$30 million interest bearing time deposit set up by our Cyprus entity in the United Kingdom during the nine months ended September 30, 2015. Upon maturity in March 2016, these funds were placed back into cash and cash equivalents. Significant fluctuations between the two periods were also caused by \$27.7 million spent on acquisitions during the nine months ended September 30, 2015 compared to only \$4.5 million spent during the same period of the current year. In both periods, investing activities included expenditures on property, plant and equipment to support our growth and geographic expansion, with total purchases of \$20.0 million and \$9.5 million during the nine months ended September 30, 2016 and 2015, respectively.

Financing Activities

Net cash provided by financing activities during the nine months ended September 30, 2016 was \$16.4 million, and included \$15.9 million of proceeds from stock option exercises and \$2.1 million net outflow from borrowings, mainly under the 2014 Credit Facility. Net cash provided by financing activities during the nine months ended September 30, 2015 was \$5.5 million, and consisted mainly of \$30.3 million in payments of deferred consideration related to acquisitions, offset by \$17.6 million of proceeds from stock option exercises and \$15.0 million of proceeds from borrowings.

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## Contractual Obligations and Future Capital Requirements

## Contractual Obligations

As of September 30, 2016, our fixed and determinable contractual obligations were as follows:

	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
	(in thousands)				
Long-term debt obligations	\$33,194	\$137	\$33,055	\$2	\$—
Operating lease obligations	86,092	28,589	36,630	12,919	7,954
Capital lease obligations	97	87	10	—	—
	\$119,383	\$28,813	\$69,695	\$12,921	\$7,954

## Letter of credit

As of September 30, 2016, we had an irrevocable standby letter of credit in the amount \$0.9 million under the 2014 Credit Facility, which is required to secure commitments for certain insurance policies. The letter of credit expires on April 27, 2017 with a possibility of automatic extension for an additional period of one year from the present or any future expiration date. No amounts were outstanding against this letter of credit during the three and nine months ended September 30, 2016.

## Future Capital Requirements

We believe that our existing cash and cash equivalents combined with our expected cash flow from operations will be sufficient to meet our projected operating and capital expenditure requirements for at least the next twelve months and that we possess the financial flexibility to execute our strategic objectives, including the ability to make acquisitions and strategic investments in the foreseeable future. Our ability to generate cash, however, is subject to our performance, general economic conditions, industry trends and other factors. To the extent that existing cash and cash equivalents and operating cash flow are insufficient to fund our future activities and requirements, we may need to raise additional funds through public or private equity or debt financing. If we issue equity securities in order to raise additional funds, substantial dilution to existing stockholders may occur. If we raise cash through the issuance of additional indebtedness, we may be subject to additional contractual restrictions on our business. There is no assurance that we would be able to raise additional funds on favorable terms or at all.

## Off-Balance Sheet Commitments and Arrangements

We do not have any obligations under guarantee contracts or other contractual arrangements that would constitute off-balance sheet arrangements other than as disclosed in Note 9 and Note 5 of our financial statements in “Part I. Item 1. Financial Statements (Unaudited).” We have not entered into any transactions with unconsolidated entities whereby we have financial guarantees, subordinated retained interests, derivative instruments, or other contingent arrangements that expose us to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to us, or engages in leasing, hedging, or research and development services with us.



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### Critical Accounting Policies

**Revenue Recognition** — We recognize revenue when realized or realizable and earned, which is when the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred; the sales price is fixed or determinable; and 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 we report. If there is an uncertainty about the project completion or receipt of payment for the services, revenues are deferred until the uncertainty is sufficiently resolved. At the time revenues are recognized, we provide for any contractual deductions and reduce revenues accordingly. We defer amounts billed to our clients for revenues not yet earned. Such amounts are anticipated to be recorded as revenues as services are performed in subsequent periods. Unbilled revenues represent services provided which are billed subsequent to the period end in accordance with the contract terms.

We derive our revenues from a variety of service offerings, which represent specific competencies of our 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 appropriate revenue recognition. Fees for these contracts may be in the form of time-and-materials or fixed-price arrangements.

We report gross reimbursable “out-of-pocket” expenses incurred as both revenues and cost of revenues in the condensed consolidated statements of income and comprehensive income.

**Fair Value of Financial Instruments** — We make significant assumptions about fair values of our financial assets and liabilities and we utilize the following fair value hierarchy, prescribed by authoritative guidance, in forming those assumptions:

Level 1 — Quoted prices for identical assets or liabilities in active markets.

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.

Our contingent liabilities measured at fair value on a recurring basis consist 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. We believe our estimates and assumptions are reasonable, however, there is significant judgment involved. As of September 30, 2016, the significant portion of our contingent liabilities measured at fair value on a recurring basis has been settled and, therefore, uncertainty associated with the earnout assumptions has been significantly curtailed along with the risk of causing a material impact to, and volatility in our operating results.

Cash settled restricted stock units issued to employees are valued using the price of our stock, a significant input that is observable in the market, which is defined as Level 1 input according to fair value measurement accounting.

**Business Combinations** — We account for our business combinations using the acquisition accounting method, which requires us to determine the fair value of net assets acquired, including related goodwill and other intangible assets.

We identify and attribute fair values and estimated lives to the intangible assets acquired and allocate 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. We base our fair value estimates on assumptions we believe are reasonable, but recognize that the assumptions are inherently uncertain.

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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 expense 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 our condensed consolidated statements of cash flows.

Our acquisitions usually do not have significant amounts of tangible assets, as the principal assets typically acquired are customer relationships, trade names, non-competition agreements, and workforce. As a result, a substantial portion of the purchase price is 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”. We conduct the evaluation of goodwill impairment at the reporting unit level on an annual basis during the 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. We do 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, we evaluate 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 our historical and anticipated results. Any impairment loss is measured by the excess of carrying value over fair value.

Stock-Based Compensation — Equity-based compensation cost relating to the issuance of stock-based awards to employees is based on the fair value of the award at the date of grant, which is expensed evenly over the requisite service period, net of estimated forfeitures. The forfeiture assumption is ultimately adjusted to the actual forfeiture rate. Therefore, changes in the forfeiture assumptions may affect the timing of the total amount of expense recognized over the vesting period. The service period is the period over which the employee performs the related services, which is normally the same as 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 in liabilities and adjusted to fair value at the end of each reporting period.

Recent Accounting Pronouncements

See Note 11 to our unaudited condensed consolidated financial statements in “Part I. Item 1. Financial Statements (Unaudited)” for additional information.

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### Forward-Looking Statements

This quarterly report on Form 10-Q contains estimates and forward-looking statements, principally in “Part I. Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Part II. Item 1A. Risk Factors.” Our estimates and forward-looking statements are mainly based on our current expectations and estimates of future events and trends, which affect or may affect our businesses and operations. Although we believe that these estimates and forward-looking statements are based upon reasonable assumptions, they are subject to several risks and uncertainties and are made in light of information currently available to us. Important factors, in addition to the factors described in this quarterly report, may adversely affect our results as indicated in forward-looking statements. You should read this quarterly report and the documents that we have filed as exhibits hereto completely and with the understanding that our actual future results may be materially different from what we expect. The words “may,” “will,” “should,” “could,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “predict,” “intend,” “potential,” “might,” “would,” “could,” and “may” and other negative of these terms or other comparable terminology and similar words are intended to identify estimates and forward-looking statements. Estimates and forward-looking statements speak only as of the date they were made, and, except to the extent required by law, we undertake no obligation to update, to revise or to review any estimate and/or forward-looking statement because of new information, future events or other factors. Estimates and forward-looking statements involve risks and uncertainties and are not guarantees of future performance. As a result of the risks and uncertainties described above, the estimates and forward-looking statements discussed in this quarterly report might not occur and our future results, level of activity, performance or achievements may differ materially from those expressed in these forward-looking statements due to, including, but not limited to, the factors mentioned above, and the differences may be material and adverse. Because of these uncertainties, you should not place undue reliance on these forward-looking statements.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to certain market risks in the ordinary course of our business. These risks result primarily from changes in foreign currency exchange rates and interest rates, and concentration of credit risks. In addition, our international operations are subject to risks related to differing economic conditions, changes in political climate, differing tax structures, and other regulations and restrictions.

#### Concentration of Credit and Other Credit Risks

Financial instruments that potentially subject us to significant concentrations of credit risk consist primarily of employee loans receivable, cash and cash equivalents, trade accounts receivable and unbilled revenues.

At September 30, 2016, loans issued to employees were \$6.0 million, or 0.7% of our total assets. These loans potentially expose us to a risk of non-payment and loss. Repayment of these loans is primarily dependent on the personal income of borrowers obtained through their employment with EPAM and may be adversely affected by macroeconomic changes, such as currency devaluation and inflation. Given a large demand for the program among our employees and its advantages as compared to alternative methods of financing available on the market, we expect the borrowers to fulfill their obligations.

We maintain our cash and cash equivalents and short-term investments with financial institutions. We believe that our credit policies reflect normal industry terms and business risk. We do not anticipate non-performance by the counterparties. We hold a significant balance of cash in banks in the CIS countries where banking and other financial systems generally do not meet the banking standards of more developed markets and bank deposits made by corporate entities in the CIS region are not insured. As of September 30, 2016, \$160.2 million of total cash was held in CIS countries, with \$132.4 million of that in Belarus. The CIS banking sector remains subject to periodic instability and the transparency of the banking sector lags behind international standards. Particularly in Belarus, a banking crisis, bankruptcy or insolvency of banks that process or hold our funds, may result in the loss of our deposits or adversely affect our ability to complete banking transactions in the CIS region, which could materially adversely affect our business and financial condition. Cash in other CIS locations is used for short-term operational needs and cash balances in those banks move with the needs of the entities.

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.

During the three and nine months ended September 30, 2016, our top five customers accounted for 28.0% and 29.3% of our total revenues, and our top ten customers accounted for 37.6% and 39.3% of our total revenues. During the three and nine months ended September 30, 2015, our top five customers accounted for 31.9% and 33.5% of our total revenues, and our top ten customers accounted for 42.9% and 44.4% of our total revenues.

During the three and nine months ended September 30, 2016, revenues from one customer, UBS AG, were \$34.9 million and \$106.2 million, 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 \$32.7 million and \$95.3 million, respectively, and accounted for more than 10% of total revenues. Indicated revenues do not include reimbursable expenses.

Historically, credit losses and write-offs of trade accounts receivable balances have not been material to our condensed consolidated financial statements.

#### Interest Rate Risk

Our exposure to market risk is mainly influenced by the changes in interest rates received on our cash and cash equivalent deposits and paid on any outstanding balance on our revolving line of credit, which is subject to a variety of rates depending on the type and timing of funds borrowed.

As of September 30, 2016 the outstanding borrowings under our 2014 Credit Facility were \$33.1 million. The interest rate for this debt is based on LIBOR, which resets regularly at issuance, based on lending terms. We do not believe we are exposed to material direct risks associated with changes in interest rates related to this borrowing.

We offer interest-bearing loans in Belarus under our Employee Housing Program and charge an interest rate on these loans. These loans are financed with available funds of our Belarusian subsidiary and the interest rate charged is nominal and determined by us. We do not believe that employee loans issued under our Employee Housing Program expose us to significant interest rate risks.

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We have not been exposed to material risks due to changes in market interest rates and we do not use derivative financial instruments to hedge our risk of interest rate volatility. However, our future interest expense may increase and interest income may fall due to changes in market interest rates.

Foreign Exchange Risk

Our condensed consolidated financial statements are reported in U.S. dollars; however, our business is conducted in various currencies. Outside of the United States, we operate primarily through wholly-owned subsidiaries in Canada, Europe, Asia, and the CIS and CEE regions and generate a significant portion of our revenues in currencies other than the U.S. dollar, principally, euros, British pounds sterling, Canadian dollars, Swiss francs and Russian rubles. We incur expenditures in non-U.S. dollar currencies, principally in Hungarian forints, Russian rubles, Polish zlotys, Swiss francs, British pounds sterling, Indian rupees and China yuan renminbi (“CNY”) associated with our delivery centers located in the CEE, Europe, Mexico and APAC regions.

Our international operations expose us to foreign currency exchange rate changes that could impact translations of foreign denominated assets and liabilities into U.S. dollars and future earnings and cash flows from transactions denominated in different currencies. We are exposed to fluctuations in foreign currency exchange rates primarily on accounts receivable and unbilled revenues from sales in these foreign currencies and cash outflows for expenditures in foreign currencies. Our results of operations can be affected if any of the currencies, which we use materially in our business, appreciate or depreciate against the U.S. dollar. Our exchange rate risk primarily arises from our foreign currency revenues and expenses, however, our exposure to currency exchange rate changes is diversified due to the variety of countries and currencies in which we conduct business.

Management supplements results reported in accordance with United States generally accepted accounting principles, referred to as GAAP, with non-GAAP financial measures. Management believes these measures help illustrate underlying trends in our business and uses the measures to establish budgets and operational goals, communicated internally and externally, for managing our business and evaluating its performance. When important to management’s analysis, operating results are compared on the basis of “constant currency”, which is a non-GAAP financial measure. This measure excludes the effect of foreign currency exchange rate fluctuations by translating the current period revenues and expenses into U.S. dollars at the weighted average exchange rates of the prior period of comparison. Based on our results of operations for the third quarter of 2016, if currencies were not impacted by foreign exchange fluctuations and results were evaluated on a constant currency basis using rates from the third quarter in 2015, our consolidated revenue would have been higher by 1.8%. Revenue in the third quarter of 2016 compared on a constant currency basis to the third quarter of 2015 was negatively impacted the most by the British pound sterling and slightly positively impacted by the Russian ruble and Canadian dollar. If compared on the same constant currency basis, our net income would have been higher by 5.2% as the impact from the currency declines also had a favorable impact on the expenses at our offshore delivery centers. Net income in the third quarter of 2016 compared on a constant currency basis to the third quarter of 2015 was impacted positively by the Russian ruble, Canadian dollar and Polish zloty and was offset by the negative impact from the British pounds sterling. The euro did not have a significant impact on the revenue or net income for the third quarter of 2016 compared on a constant currency basis to the third quarter of 2015. To the extent that we need to convert U.S. dollars into foreign currencies for our operations, appreciation of such foreign currencies against the U.S. dollar would adversely affect the amount of such foreign currencies we receive from the conversion. Changes in the currency exchange rates resulted in our reporting a net foreign currency exchange loss of \$1.7 million and gain of \$0.1 million during the three months ended September 30, 2016 and 2015, respectively. During the nine months ended September 30, 2016 and 2015, total net foreign currency exchange losses were \$5.4 million and \$6.1 million, respectively. The decrease in net foreign exchange loss in the first nine months of 2016 compared to the same period of 2015 was primarily attributable to stabilization in exchange rates of the Russian ruble, euro and Canadian dollar against the U.S. dollar in the periods indicated. This loss is included in our condensed consolidated statements of income and comprehensive income.

Foreign currency translation adjustments from translating financial statements of our foreign subsidiaries from functional currency to the U.S. dollars are recorded as a separate component of stockholders’ equity or included in the condensed consolidated statements of income and comprehensive income if local currencies of our foreign subsidiaries differ from their functional currencies. As of September 30, 2016, approximately 24.9% of our total net

assets were subject to foreign currency translation exposure, as compared to 25.3% as of September 30, 2015. During the nine months ended September 30, 2016 and 2015, net income generated by foreign subsidiaries for which the functional currency was not U.S. dollars was 53.8% and 59.7%, respectively.

During the three months ended September 30, 2016 and 2015, we recorded \$0.4 million of translation gains and \$8.3 million of translation losses in each respective period within our condensed consolidated statements of income and comprehensive income, and \$2.7 million of translation gains and \$7.4 million of translation losses for the year-to-date periods in 2016 and 2015, respectively.

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During the periods presented, our condensed consolidated statements of income and comprehensive income were not materially affected by gains or losses arising from translating financial statements of our foreign subsidiaries from functional currency to U.S. dollars.

On June 23, 2016, the U.K. held a referendum in which voters approved an exit from the E.U. (referred to as “Brexit”). As a result, it is anticipated that the U.K. government will negotiate the terms of the U.K.’s withdrawal from the E.U, after Parliamentary approval. The Brexit vote resulted in immediate stock market and foreign currency exchange rate volatility and uncertainty and, as a result, we are monitoring the developments relating to Brexit as we have a significant operating presence in the U.K. and collect revenues and incur expenses in currencies that may be affected.

Item 4. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Based on management’s evaluation, with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as of the end of the period covered by this report, our CEO and CFO have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), are effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting during the quarter ended September 30, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in litigation and claims arising out of our operations in the normal course of business. We are not currently a party to any material legal proceeding. In addition, we are not aware of any material legal or governmental proceedings against us, or contemplated to be brought against us.

Item 1A. Risk Factors

There have been no material changes with respect to the risk factors disclosed in “Part I. Item 1A.Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.



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Item 6. Exhibits

Exhibit Number	Description
10.1	Amended Non-Employee Director Compensation Policy
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 9, 2016  
EPAM SYSTEMS, INC.

By: /s/ Arkadiy Dobkin  
Name: Arkadiy Dobkin  
Title: Chairman, Chief Executive Officer and President  
(principal executive officer)

By: /s/ Anthony J. Conte  
Name: Anthony J. Conte  
Title: Senior Vice President, Chief Financial Officer and Treasurer  
(principal financial officer and principal accounting officer)