EPAM Systems, Inc.
Form 10-Q
November 13, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2012

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 incorporation or organization)	**(I.R.S. Employer Identification No.)**
41 University Drive, Suite 202	
Newtown, Pennsylvania	**18940**
(Address of principal executive offices)	**(Zip code)**

267-759-9000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes xNo ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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

Title of Each Class	Outstanding as of November 7, 2012
Common Stock, par value $0.001 per share	43,525,140 shares

EPAM SYSTEMS, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

EPAM SYSTEMS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	As of September 30, 2012	As of December 31, 2011
	(in thousands, except share and per share data)	
Assets		
Current assets		
Cash and cash equivalents	$ 105,885	$ 88,796
Accounts receivable, net of allowance of $2,355 and $2,250, respectively	67,867	59,472
Unbilled revenues	44,342	24,475
Prepaid and other current assets	13,270	6,436
Time deposits	1,545	
Restricted cash, current	948	
Deferred tax assets, current	3,815	4,384
Total current assets	237,672	183,563
Property and equipment, net	52,948	35,482
Restricted cash, long-term	674	2,582
Intangible assets, net	6,014	1,251
Goodwill	11,305	8,169
Deferred tax assets, long-term	3,529	1,875
Other long-term assets	578	2,691
Total assets	**$ 312,720**	**$ 235,613**
Liabilities		
Current liabilities		
Accounts payable	$ 2,558	$ 2,714
Accrued expenses	13,485	24,782
Deferred revenue	3,847	6,949
Due to employees	12,137	8,234
Taxes payable	12,802	8,712
Deferred tax liabilities, current	1,243	1,736
Total current liabilities	46,072	53,127
Taxes payable, long-term	1,228	1,204
Deferred tax liabilities, long-term	269	283
Total liabilities	**47,569**	**54,614**
Commitments and contingencies (Note 9)		
Preferred stock, $.001 par value; 0 and 5,000,000 authorized at September 30, 2012 and December 31, 2011; 0 and 2,054,935 Series A-1 convertible redeemable preferred stock issued and outstanding at September 30, 2012 and December 31, 2011; $.001 par value 0 and 945,114 authorized at September 30, 2012 and December 31, 2011, 0 and 384,804 Series A-2 convertible redeemable preferred stock issued and		85,940

outstanding at September 30, 2012 and December 31, 2011		
Stockholders equity		
Common stock, $.001 par value; 160,000,000 authorized; 44,677,738 and 18,914,616 shares issued, 43,395,364 and 17,158,904 shares outstanding at September 30, 2012 and December 31, 2011, respectively	43	17
Preferred stock, $.001 par value; 0 and 290,277 authorized Series A-3 convertible preferred stock issued and outstanding at September 30, 2012 and December 31, 2011, respectively		
Additional paid-in capital	164,443	40,020
Retained earnings	113,993	74,508
Treasury stock	(11,666)	(15,972)
Accumulated other comprehensive loss	(1,662)	(3,514)
Total stockholders equity	**265,151**	**95,059**
Total liabilities and stockholders equity	**$ 312,720**	**$ 235,613**

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)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in thousands, except share and per share data)			
Revenues	**$ 110,078**	**$ 86,423**	**$ 308,261**	**$ 239,401**
Operating expenses:				
Cost of revenues (exclusive of depreciation and amortization)	69,099	51,627	193,077	145,948
Selling, general and administrative expenses	21,153	15,822	59,491	46,420
Depreciation and amortization expense	3,040	2,083	7,674	5,732
Goodwill impairment loss				1,697
Other operating expenses, net	50		669	23
Income from operations	**16,736**	**16,891**	**47,350**	**39,581**
Interest and other income, net	486	385	1,422	1,000
Foreign exchange loss	(635)	(2,301)	(1,949)	(3,138)
Income before provision for income taxes	**16,587**	**14,975**	**46,823**	**37,443**
Provision for income taxes	2,522	1,025	7,338	5,474
Net Income	**$ 14,065**	**$ 13,950**	**$ 39,485**	**$ 31,969**
Comprehensive income (Note 10)	**$ 16,769**	**$ 12,130**	**$ 41,337**	**$ 31,568**
Accretion of preferred stock				$ (17,563)
Net income allocated to participating securities		$ (7,822)	$ (3,259)	$ (12,010)
Net income/(loss) available for common stockholders	$ 14,065	$ 6,128	$ 36,226	$ 2,396
Net income/(loss) per share of common stock:				
Basic (common)	$ 0.33	$ 0.36	$ 0.93	$ 0.14
Basic (puttable common)		$ 0.36		$ 0.40
Diluted (common)	$ 0.30	$ 0.33	$ 0.85	$ 0.14
Diluted (puttable common)		$ 0.33		$ 0.37
Shares used in calculation of net income per share of common stock:				
Basic (common)	42,952	17,124	38,990	17,078
Basic (puttable common)		18		44
Diluted (common)	46,501	20,656	42,729	20,156
Diluted (puttable common)		18		44

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)

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in thousands)	
Cash flows from operating activities:		
Net income	$ 39,485	$ 31,969
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,674	5,732
Bad debt expense	465	361
Deferred taxes	(374)	71
Stock-based compensation	5,369	2,154
Goodwill impairment loss (Note 4)		1,697
Excess tax benefits on stock-based compensation plans	(1,635)	
Non-cash stock charge (Note 2)	640	
Other	(30)	517
Change in operating assets and liabilities:		
Accounts receivable	(6,083)	(9,920)
Unbilled revenues	(19,424)	(9,903)
Prepaid expenses and other assets	1,243	19
Accounts payable	(2,098)	(437)
Accrued expenses and other liabilities	(11,318)	770
Deferred revenue	(3,387)	(1,097)
Due to employees	3,571	4,412
Taxes payable	(1,358)	1,809
Net cash provided by operating activities	12,740	28,154
Cash flows from investing activities:		
Purchases of property and equipment	(10,317)	(12,852)
Payment for construction of corporate facilities	(13,416)	(710)
Decrease/(increase) in restricted cash and other long-term assets, net	(640)	
Acquisition of business, net of cash acquired (Note 3)	(6,990)	
Net cash used in investing activities	(31,363)	(13,562)
Cash flows from financing activities:		
Net proceeds from issuance of common stock in initial public offering	32,364	
Costs related to stock issue	(1,766)	(1,175)
Proceeds related to stock options exercises	2,495	72
Excess tax benefit on stock-based compensation plans	1,635	
Proceeds related to line of credit		5,000
Repayment related to line of credit		(5,000)
Repurchase of common stock	(61)	
Net cash provided by/(used in) financing activities	34,667	(1,103)
Effect of exchange rate changes on cash and cash equivalents	1,045	(94)

Net increase in cash and cash equivalents	17,089	13,395
Cash and cash equivalents, beginning of period	88,796	54,004
Cash and cash equivalents, end of period	$ 105,885	$ 67,399

Summary of non-cash investing and financing transactions:

Accretion of Series A-2 convertible redeemable preferred stock was $0 for the nine months ended September 30, 2012 and $17,563 for the nine months ended September 30, 2011.

Total incurred but not paid costs related to stock issue were $0 for the nine months ended September 30, 2012 and $341 for the nine months ended September 30, 2011.

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

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EPAM SYSTEMS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(US DOLLAR AMOUNTS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

1. BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements of EPAM Systems, Inc. (the Company or EPAM) have been prepared in accordance with generally accepted accounting principles in the United States and Article 10 of Regulation S-X under the Securities and Exchange Act of 1934, as amended. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements (and notes thereto) for the year ended December 31, 2011. In the Company s 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. Operating results for the interim periods are not necessarily indicative of results that may be expected to occur for the entire year.

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, as well as revenues and expenses during the reporting period. The Company bases its estimates and judgments on historical experience, knowledge of current conditions and its beliefs of what could occur in the future, given available information. Actual results could differ from those estimates, and such differences may be material to the financial statements.

Emerging growth company status In April 2012, several weeks after EPAM s initial public offering in February 2012, President Obama signed into law the Jumpstart Our Business Startups Act of 2012 (the JOBS Act). The JOBS Act contains provisions that relax certain requirements for emerging growth companies that otherwise apply to larger public companies. For as long as a company retains emerging growth company status, which may be until the fiscal year-end after the fifth anniversary of its initial public offering, it will not be required to (1) provide an auditor s attestation report on its management s assessment of the effectiveness of its internal control over financial reporting, otherwise required by Section 404(b) of the Sarbanes-Oxley Act of 2002, (2) comply with any new or revised financial accounting standard applicable to public companies until such standard is also applicable to private companies, (3) comply with certain new requirements adopted by the Public Company Accounting Oversight Board, (4) provide certain disclosure regarding executive compensation required of larger public companies or (5) hold shareholder advisory votes on matters relating to executive compensation.

EPAM is classified as an emerging growth company under the JOBS Act and is eligible to take advantage of the accommodations described above for as long as it retains this status. However, EPAM has elected not to take advantage of the transition period described in (2) above, which is the exemption provided in Section 7(a)(2)(B) of the Securities Act of 1933 and Section 13(a) of the Securities Exchange Act of 1934 (in each case as amended by the JOBS Act) for complying with new or revised financial accounting standards. EPAM will therefore comply with new or revised financial accounting standards to the same extent that a non-emerging growth company is required to comply with such standards.

2. PREFERRED AND COMMON STOCK

On January 19, 2012, the Company effected an 8-to-1 stock split of the Company s common stock, on which date the number of authorized common and preferred stock was increased to 160,000,000 and 40,000,000 shares, respectively. All shares of common stock, options to purchase common stock and per share information presented in the consolidated financial statements have been adjusted to reflect the stock split on a retroactive basis for all periods presented. There was no change in the par value of the Company s common stock. The ratio by which the then outstanding shares of Series A-1 Preferred, Series A-2 Preferred and Series A-3 Preferred Stock were convertible into shares of common stock was adjusted to reflect the effects of the common stock split, such that each share of preferred stock was convertible into eight shares of common stock.

In February 2012, the Company completed an initial public offering of 6,900,000 shares of its common stock, which included 900,000 shares of common stock sold by the Company pursuant to an over-allotment option granted to the underwriters, which were sold at a price to the public of $12.00 per share. The offering commenced on February 7, 2012 and closed on February 13, 2012. Of the 6,900,000 shares of common stock sold, the Company issued and sold 2,900,000 shares of common stock and its selling stockholders sold 4,000,000 shares of common stock, resulting in gross proceeds to the Company of $34,800 and $28,969 in net proceeds after deducting underwriting discounts and commissions of $2,436 and offering expenses of $3,395. The Company did not receive any proceeds from the sale of common stock by the selling stockholders.

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Upon the closing of the initial public offering, all outstanding Series-A1 and Series-A2 convertible redeemable preferred stock, and Series A3 convertible preferred stock were converted into a total of 21,840,128 shares of common stock, as shown in the table below.

	Conversion Shares
Series A-1 Convertible Redeemable Preferred Stock	16,439,480
Series A-2 Convertible Redeemable Preferred Stock	3,078,432
Series A-3 Convertible Preferred Stock	2,322,216
Total	21,840,128

On August 20, 2010, the Company entered into an agreement with Instant Information Inc. to issue shares of common stock to Instant Information Inc. as consideration for the acquisition of the assets of Instant Information Inc. subject to achievement of certain financial milestones or upon the completion of an initial public offering by the Company. A total of 53,336 shares of common stock were issued to Instant Information Inc. upon completion of the Company s initial public offering for an aggregate value of $640, which was expensed during the first quarter of 2012.

On May 25, 2012, the Company issued a total of 434,546 shares of common stock in connection with the acquisition of Thoughtcorp, Inc. (Note 3).

3. ACQUISITIONS

Thoughtcorp, Inc. On May 23, 2012, the Company acquired substantially all of the assets and assumed certain liabilities of Thoughtcorp, Inc., a Toronto-based software solutions provider (Thoughtcorp). The acquisition is intended to expand the Company s geographic footprint within North America, and complement its global delivery capabilities with expertise in areas such as Agile Development, Enterprise Mobility and Business Intelligence. In addition, Thoughtcorp brings significant telecommunications expertise, and is also expected to expand and enhance the Company s offering within the Financial and Retail verticals.

The purchase price was comprised of approximately $7,497 paid in cash and 217,274 shares of common stock with a fair value of $3,607 at the acquisition date. Half of these shares were placed in escrow for a period of 18 months as a security for the indemnification obligations of the sellers under the asset purchase agreement. Additionally, the Company issued to the sellers 217,272 shares of non-vested (restricted) common stock contingent on their continued employment with the Company (Note 12). These shares have an estimated value of $3,607 and will be recorded as stock-based compensation expense over an associated service period of two years. A deferred tax asset has been recognized for the tax effect of the fair value of the portion of the shares that were placed in escrow.

The purchase price was allocated to the assets acquired based on their related fair values, as follows:

Cash and cash equivalents	$ 1,111
Trade receivables and other current assets	2,484
Property and equipment	92
Deferred tax asset	1,348
Acquired intangible assets	5,296
Goodwill	2,935
Total assets acquired	13,266
Accounts payable and accrued expenses	461
Assumed shareholder and director loans	1,290
Deferred revenue and other liabilities	411
Total liabilities assumed	2,162

Net assets acquired	$ 11,104

The Company performed a valuation analysis to determine the fair values of certain intangible assets of Thoughtcorp as of the acquisition date. As part of the valuation process, the excess earnings method was used to determine the value of customer relationships. Fair values of trade name and non-competition agreements were determined using the relief from royalty and discounted earnings methods, respectively. The Company expects approximately $9,580 of tax goodwill. Of this amount 75% is deductible at 7% per annum on a declining basis.

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

	May 23, 2012	Weighted Average Useful Life (in years)
Customer relationships	$ 2,810	15
Trade names	2,014	5
Non-competition agreements	472	5
Total	$ 5,296	

The above estimated fair values of the assets acquired and liabilities assumed are provisional and based on information available as of the acquisition date to estimate the fair values of the assets acquired and liabilities assumed. The Company believes such information provides a reasonable basis for estimating the fair values but the Company is waiting for additional information necessary to finalize those amounts, particularly with respect to the estimated fair values of intangible assets and deferred income taxes. Thus, the provisional measurements of fair value reflected are subject to change. Such changes could be significant. The Company expects to finalize the valuation and complete the purchase price allocation as soon as practicable but no later than one year from the Thoughtcorp acquisition date.

Included in consolidated statements of income for the three and nine months ended September 30, 2012 are $2,793 and $3,886 of revenues, respectively, and $199 and $185 of net losses of the acquiree, respectively.

Total acquisition-related post-combination compensation expense recognized for the three and nine month ended September 30, 2012 was $516 and $736, respectively, and is presented within selling, general and administrative expenses. Total acquisition-related costs were $9 and $375 and are presented within selling, general and administrative expenses for the three and nine months ended September 30, 2012, respectively.

Pro forma results of operations for the Thoughtcorp acquisition completed during the nine months ended September 30, 2012 have not been presented because the effects of the acquisition were not material to the Company s consolidated results of operations.

4. GOODWILL

Changes in goodwill for the nine months ended September 30, 2012 are as follows:

	North America	EU	Russia	Other	Total
Balance as of January 1, 2012					
Goodwill	$ 2,286	$ 2,864	$ 3,019	$ 1,697	$ 9,866
Accumulated impairment losses				(1,697)	(1,697)
	2,286	2,864	3,019		8,169
Acquisition of Thoughtcorp, Inc. (Note 3).	2,935				2,935
Effect of net foreign currency exchange rate changes	103		98		201
Balance as of September 30, 2012					
Goodwill	5,324	2,864	3,117	1,697	13,002
Accumulated impairment losses				(1,697)	(1,697)
	$ 5,324	$ 2,864	$ 3,117		$ 11,305

As part of the Thoughtcorp acquisition, substantially all of the employees of the acquiree accepted employment with the Company. The Company believes the amount of goodwill resulting from the allocation of purchase price to acquire Thoughtcorp is attributable to the workforce of the acquired business. All of the goodwill was allocated to the Company s Canadian operations and is presented within North America.

The Company values goodwill at fair value on a non-recurring basis. When testing for impairment, the Company first compares the fair value of its reporting units to the recorded values. Valuation methods used to determine fair value are based on the analysis of the discounted future cash flows that a reporting unit is expected to generate (Income Approach). These valuations are considered Level 3 measurements under FASB ASC Topic 820. The Company utilizes estimates to determine the fair value of the reporting units such as future cash flows, growth rates, capital requirements, effective tax rates and projected margins, among other factors. Estimates utilized in the future evaluations of goodwill for impairment could differ from estimates used in the current period calculations. If the carrying amount of the reporting units exceeds its fair value, goodwill is considered potentially impaired and a second step is performed to measure the amount of impairment loss.

As a result of an operating loss in the Other reporting unit for the three months ended June 30, 2011, the Company performed a goodwill impairment test. In assessing impairment in accordance with Accounting Standards Codification, (ASC) No. 350, Intangibles-Goodwill and Other, the Company determined that the fair value of the Other reporting unit, based on the total of the expected future discounted cash flows directly related to the reporting unit, was below the carrying value of the reporting unit. The Company completed the second step of the goodwill impairment test, resulting in an impairment charge of $1,697. The Company completed its annual impairment testing in the fourth quarter of fiscal 2011 and found no indication of goodwill impairment for its North America, EU, or Russia reporting units.

5. RESTRICTED CASH AND TIME DEPOSITS

Restricted cash and time deposits consist of the following:

	September 30, 2012	December 31, 2011
Time deposits	$ 1,545	$
Short-term security deposits under client contracts	948	
Long-term deposits under employee loan programs	380	393
Long-term security deposits under client contracts	187	2,082
Long-term security deposits under operating leases	107	107
Total	$ 3,167	$ 2,582

Included in time deposits as of September 30, 2012, were bank deposits of $548 and $997 with maturities of three and twelve months, respectively, which earned an interest rate of 2.55% and 2.95%, respectively. The Company doesn t intend to withdraw the deposits prior to their maturity dates.

At September 30, 2012, and December 31, 2011, short-term and long-term security deposits under client contracts included fixed amounts placed in respect of letters of credit and a bank guarantee intended to secure appropriate performance under respective contracts. The Company estimates the probability of non-performance under the contracts as remote, therefore, no provision for losses has been created in respect of these amounts as of September 30, 2012, and December 31, 2011.

Also included in restricted cash as of September 30, 2012 and December 31, 2011, were deposits of $380 and $393, respectively, placed in connection with certain employee loan programs (Note 9).

Restricted cash and time deposits are considered Level 2 measurements under FASB ASC Topic 820. Fair values of Level 2 measurements are determined by analyzing quoted prices for similar assets in an active market, quoted prices for identical or similar assets in markets that are not active, inputs other than quoted prices that are observable and market-corroborated inputs which are derived principally from or corroborated by observable market data. The carrying values of restricted cash and time deposits approximated their fair values as of September 30, 2012, and December 31, 2011.

6. LONG-TERM DEBT

Revolving Line of Credit In November 2006, the Company entered into a revolving credit loan and security agreement (collectively the Credit Facility or Facility) with a bank (the Bank). The Credit Facility is comprised of a five year revolving line of credit pursuant to which the Company can borrow up to $7,000 at any point in time based on borrowing availability, as defined, at LIBOR plus 1.25%. In September 2010, the Company extended the term of the Facility through October 15, 2013. On July 25, 2011, the Company and the Bank agreed to amend the Facility to increase the borrowing capacity to $30,000. The maximum borrowing availability under the Facility is based upon a percentage of eligible accounts receivable and cash in US Dollars. As of September 30, 2012 and December 31, 2011, the Company s borrowing availability was $25,736 and $30,000, respectively.

The Facility is collateralized by 85% of US trade receivables, as defined, and US Dollar cash representing the lesser of (a) available cash on hand, and (b) $10,000, $5,000 and $0 for the periods ended December 31, 2011, 2012 and 2013, respectively. The Facility contains affirmative and negative covenants, including financial and coverage ratios. As of September 30, 2012 and December 31, 2011, the Company had no outstanding borrowing under the Facility and was in compliance with all debt covenants as of those dates.

7. INCOME TAXES

The Company s worldwide effective tax rate was 15.2% and 15.7%, and 6.8% and 14.6% for the three and nine months ended September 30, 2012 and 2011, respectively. The increase in the Company s worldwide effective tax rate in the third quarter of 2012 and nine months ended September 30, 2012, as compared to the same periods of 2011, was primarily due to (a) the movement of a portion of the Company s pre-tax income from countries with lower statutory tax rates such as Belarus and Hungary; and (b) the increase in certain unfavorable permanent tax differences in high-taxed jurisdictions in 2012.

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8. EARNINGS PER SHARE

Basic EPS is computed by dividing the net income applicable to common stockholders for the period by the weighted average number of shares of common stock outstanding during the same period. The Company s Series A-1 Preferred, Series A-2 Preferred, and Series A-3 Preferred Stock, that had been outstanding and convertible into common stock until February 13, 2012, and its puttable common stock were considered participating securities since these securities had non-forfeitable rights to dividends or dividend equivalents during the contractual period and thus required the two-class method of computing EPS. When calculating diluted EPS, the numerator is computed by adding back the undistributed earnings allocated to the participating securities in arriving at the basic EPS and then reallocating such undistributed earnings among the Company s common stock, participating securities and the potential common shares that result from the assumed exercise of all dilutive options. The denominator is increased to include the number of additional common shares that would have been outstanding had the options been issued.

No preferred stock was outstanding as of September 30, 2012, as a result of the Company s initial public offering on February 13, 2012 when all convertible preferred stock was converted into common stock.

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

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in thousands, except share and per share data)			
Numerator for common earnings per share:				
Net income	$ 14,065	$ 13,950	$ 39,485	$ 31,969
Accretion of preferred stock				(17,563)
Net income allocated to participating securities		(7,822)	(3,259)	(12,010)
Numerator for basic (common) earnings per share	14,065	6,128	36,226	2,396
Effect on income available from reallocation of options		650	263	4,515
Numerator for diluted (common) earnings per share	$ 14,065	$ 6,778	$ 36,489	$ 6,911
Numerator for (puttable common) earnings per share:				
Net income allocated to basic (puttable common)		6		17
Effect on income available from reallocation of options		(1)		(1)
Numerator for diluted (puttable common) earnings per share		5		16
Denominator for basic (common) earnings per share:				
Weighted average common shares outstanding	42,952	17,124	38,990	17,078
Effect of dilutive securities:				
Stock options	3,549	3,532	3,739	3,078
Denominator for diluted (common) earnings per share	46,501	20,656	42,729	20,156
Denominator for basic and diluted (puttable common) earnings per share:				
Weighted average puttable common shares outstanding		18		44
Earnings per share:				
Basic (common)	$ 0.33	$ 0.36	$ 0.93	$ 0.14
Basic (puttable common)		$ 0.36		$ 0.40
Diluted (common)	$ 0.30	$ 0.33	$ 0.85	$ 0.14
Diluted (puttable common)		$ 0.33		$ 0.37

Anti-dilutive options not included in the calculation	1,953	600	1,582	600

9. COMMITMENTS AND CONTINGENCIES

Employee Loan Program Beginning in third quarter of 2006, the Company started to guarantee bank loans for certain of its key employees. Under the conditions of the guarantees, the Company is required to maintain a security deposit of 30% of the value of loans outstanding at each reporting date. While the program has been discontinued, total commitment of the Company under these guarantees remains at $580 as of September 30, 2012. The Company estimates a probability of material losses under the program as remote, therefore, no provision for losses was recognized for the three and nine months ended September 30, 2012.

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Construction in progress On December 7, 2011, the Company entered into an agreement with IDEAB Project Eesti AS for approximately $17,209 for the construction of a 14,071 square meter office building within the High Technologies Park in Minsk, Belarus. During the third quarter of 2012, total expected construction cost was increased to approximately $18,538. The building is expected to be operational in the first half of 2013. As of September 30, 2012, total outstanding commitment of the Company was $4,445.

Corporate Facilities In June 2012, the Company entered into an agreement for the construction of 12 corporate apartments located within the High Technology Zone in Minsk, Belarus. During the third quarter of 2012, the agreement was amended and the number of apartments was increased to 26. As of September 30, 2012, total construction cost is estimated at $1,030. The Company s outstanding commitment at September 30, 2012 was approximately $759. The construction is expected to be completed in 2013. The Company intends to use the apartments for general business purposes.

Employee Housing Program In the third quarter of 2012, the Board of Directors of the Company approved the Employee Housing Program (the Housing Program), which assists employees in purchasing housing in Belarus. The Company does not bear any market risk as the housing will be sold directly to employees by independent third parties. As part of the Housing Program, the Company will extend financing to employees up to an aggregate amount of $10,000. The loans will be issued in U.S. Dollars with a 5 year term and bear an interest rate of 7.5% which is below the market interest rate in Belarus. The Housing Program was designed to be a retention mechanism for the Company s employees in Belarus and will be available to full-time employees who have been with the Company for at least three years. As of September 30, 2012, the Company s total outstanding commitment under the Housing Program was $0.

10. COMPREHENSIVE INCOME

The components of accumulated other comprehensive income as of September 30, 2012 and December 31, 2011 were as follows:

	September 30, 2012	December 31, 2011
Foreign currency translation adjustments	$ (1,662)	$ (3,514)
Total accumulated other comprehensive income	$ (1,662)	$ (3,514)

The components of comprehensive income for the three and nine months ended September 30, 2012 and 2011 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Comprehensive income:				
Net income	$ 14,065	$ 13,950	$ 39,485	$ 31,969
Foreign currency translation adjustments	2,704	(1,820)	1,852	(401)
Total comprehensive income	$ 16,769	$ 12,130	$ 41,337	$ 31,568

11. OPERATING SEGMENTS

The Company s reportable segments are: North America, Europe, Russia and Other. This determination is based on the unique business practices and market specifics of each region and that each region engages in business activities from which it earns revenues and incurs expenses. The Company s Chief Operating Decision Maker (CODM) evaluates the Company s performance and allocates resources 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. Certain expenses are not specifically allocated to specific segments as management does not believe it is practical to allocate such costs to individual segments because they are not directly attributable to any specific segment. Further, stock based compensation expense is not allocated to individual segments in internal management reports used by the CODM. Accordingly, this expense is separately disclosed as unallocated and adjusted only against the Company s total income from operations.

Revenues from external customers 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, 2012 and 2011, were as follows:

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	Three Months Ended September 30, 2012	2011	Nine Months Ended September 30, 2012	2011
Total segment revenues:				
North America	$ 52,767	$ 39,000	$ 142,333	$ 109,390
Europe	42,505	32,035	123,160	87,804
Russia	11,688	11,934	30,943	32,787
Other	3,115	3,443	11,786	9,210
Total segment revenues	$ 110,075	$ 86,412	$ 308,222	$ 239,191
Segment operating profit:				
North America	$ 10,450	$ 8,855	$ 30,616	$ 25,812
Europe	8,798	6,919	24,461	17,697
Russia	1,680	3,507	3,498	7,156
Other	1,230	1,336	4,550	1,383
Total segment operating profit	$ 22,158	$ 20,617	$ 63,125	$ 52,048

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.

Reconciliation of segment revenues and operating profit to consolidated income from operations is presented below:

	Three Months Ended September 30, 2012	2011	Nine Months Ended September 30, 2012	2011
Total segment revenues	$ 110,075	$ 86,412	$ 308,222	$ $239,191
Unallocated revenue	3	11	39	210
Revenues	$ 110,078	$ 86,423	$ 308,261	$ 239,401
Total Segment operating profit:	$ 22,158	$ 20,617	$ 63,125	$ 52,048
Unallocated amounts:				
Other revenues	3	11	39	210
Stock-based compensation expense	(2,046)	(785)	(5,369)	(2,154)
Stock charge (Note 2)			(640)	
Non-corporate taxes	(391)	(584)	(1,630)	(2,179)
Professional fees	(493)	(812)	(1,811)	(2,193)
Depreciation and amortization	(448)	(192)	(756)	(668)
Bank charges	(278)	(200)	(823)	(529)
Goodwill impairment loss (Note 4)				(1,697)
Other corporate expenses	(1,769)	(1,164)	(4,785)	(3,257)
Income from operations	$ 16,736	$ 16,891	$ 47,350	$ 39,581

Geographic Area Information

Management has determined that it is not practical to allocate identifiable assets by segment since such assets are used interchangeably amongst the segments. Geographical information about the Company s long-lived assets based on physical location of the assets was as follows:

	As of September 30, 2012	As of December 31, 2011
Belarus	$ 40,435	$ 26,001
Ukraine	5,105	4,314
Russia	3,021	2,011
United States	2,012	1,445
Hungary	1,742	1,108
Other	633	603
Total	$ 52,948	$ 35,482

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Long-lived assets include property and equipment, net of accumulated depreciation and amortization.

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

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
United States	$ 50,365	$ 41,775	$ 145,629	$ 118,419
United Kingdom	25,651	19,307	70,777	50,267
Russia	10,554	11,229	29,045	31,041
Switzerland	8,496	3,781	21,438	11,153
Germany	4,325	1,947	11,766	5,029
Canada	3,270	609	5,816	882
Kazakhstan	2,967	1,946	6,300	5,600
Ukraine	181	661	4,556	1,506
Sweden	1,006	1,221	3,478	3,958
Netherlands	750	925	2,408	3,189
Other locations	1,120	1,516	2,862	4,045
Reimbursable expenses and other revenues	1,393	1,506	4,186	4,312
Revenues	$ 110,078	$ 86,423	$ 308,261	$ 239,401

Revenues by client location differ from the segment information above, which is not solely based on the geographic location of the clients but rather is based on managerial responsibility for a particular client regardless of where the client is located.

Service Offering Information

Information about the Company s revenues by service offering is as follows:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Service Offering				
Software development	$ 73,894	$ 56,580	$ 206,045	$ 157,025
Application testing services	22,001	17,859	61,297	48,523
Application maintenance and support	8,806	7,101	25,775	20,502
Infrastructure services	3,213	2,299	8,965	6,353
Licensing	771	1,078	1,993	2,686
Reimbursable expenses and other revenues	1,393	1,506	4,186	4,312
Revenues	$ 110,078	$ 86,423	$ 308,261	$ 239,401

12. STOCK-BASED COMPENSATION

The following costs related to the Company s stock compensation plans are included in the unaudited consolidated statements of income:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011

Cost of revenues	$ 1,036	$ 417	$ 2,486	$ 947
Selling, general and administrative	1,010	368	2,883	1,207
Total	$ 2,046	$ 785	$ 5,369	$ 2,154

On January 16, 2012, the Company issued 194,800 shares of non-vested (restricted) common stock to Mr. Robb, President of EU Operations and Executive Vice President. These restricted shares vested 25% on January 16, 2012, and are scheduled to vest 25% on each of January 1, 2013, 2014, and 2015. On termination of Mr. Robb s service to the Company with Cause or without Good Reason (in each case, as defined in the award agreement), any unvested restricted shares will be forfeited. In addition, under the restricted stock award agreement, Mr. Robb is subject to perpetual confidentiality and non-disclosure obligations as well as non- competition and employee and customer non-solicitation obligations that survive for a period of 12 months after the termination of his service to the Company. Fair market value of these restricted shares on the date of grant was $2,338. The stock-based compensation charge related to the shares granted for the three and nine months ended September 30, 2012, was $146 and $1,023, respectively.

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On May 25, 2012, the Company issued 217,272 shares of non-vested stock (restricted) common stock in connection with the acquisition of Thoughtcorp (Note 3). The shares vest 50% on each of the first and second anniversaries of the Closing Date. Upon termination of the Sellers services to the Company with Cause or without Good Reason (in each case, as defined in the escrow agreement), any unvested shares will be forfeited. Fair value of these shares on the date of grant was $3,607. The stock-based compensation charge related to the shares granted for the three and nine months ended September 30, 2012, was $451 and $645, respectively.

2012 Non-Employee Directors Compensation Plan On January 11, 2012 the Company approved the 2012 Non-Employee Directors Compensation Plan (2012 Directors Plan), which will be used to issue equity grants 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 ten years and will be administered by the Company s board of directors.

On January 18, 2012, the Company issued 11,764 shares of non-vested (restricted) common stock to its non-employee directors. The shares will vest and become non-forfeitable 25% on each of the first four anniversaries of the grant date. On termination of service from the Board at any time, a portion of restricted shares shall vest as of the date of such termination on a pro rata basis, determined by the number of days that the participant served on the Board from the grant date through the date of such termination. Fair market value of these restricted shares on the date of grant was $141. The stock-based compensation charge related to the shares granted for the three and nine months ended September 30, 2012, was $9 and $25, respectively.

On April 5, 2012, the Company granted 7,092 shares of non-vested (restricted) stock to its non-employee directors under the 2012 Non-Employee Director Compensation Plan. The restricted stock vests and becomes 100% non-forfeitable on the first anniversary of the grant date. Upon termination of service from the Board at any time, a portion of the restricted stock shall vest as of the date of such termination on a pro rata basis for the number of days that the participant served on the Board from the grant date through the date of such termination. The fair market value of the restricted stock on date of grant was $150. The stock-based compensation charge related to the shares granted for the three and nine months ended September 30, 2012, was $37 and $73, respectively.

2012 Long-Term Incentive Plan On January 11, 2012 the Company approved the 2012 Long-Term Incentive Plan (2012 Plan), which will be used to issue equity grants to employees. The Company authorized 9,246,800 shares of common stock to be reserved for issuance under the plan. This is in addition to 733,808 shares that remained available for issuance under the 2006 Plan as of January 11, 2012 and which are available for issuance under the 2012 Plan. In addition, up to 6,595,136 shares that are subject to outstanding awards as of January 1, 2012, under the 2006 Plan and that expire or terminate for any reason prior to exercise or that would otherwise return to the 2006 Plan s share reserve will be available for awards to be granted under the 2012 Plan.

During the nine months ended September 30, 2012, the Company issued 1,443,810 options to purchase common stock under the 2012 Plan with an aggregate grant date fair value of $10,870.

As of September 30, 2012, a total of 8,705,393 shares remained available for issuance under the 2012 Plan.

2006 Stock Option Plan Effective May 31, 2006, the Board of Directors of the Company adopted the 2006 Stock Option Plan (the 2006 Plan). The Company s stock option plan permitted the granting of options to directors, employees, and certain independent contractors. The Compensation Committee of the Board of Directors generally had the authority to select individuals who are to receive options and to specify the terms and conditions of each option so granted, including the number of shares covered by the option, the exercise price, vesting provisions, and the overall option term. In January 2012, the 2006 Plan was discontinued; however, a total of 857,808 shares remain available for issuance under the 2012 Plan as of September 30, 2012. All of the options issued pursuant to the 2006 Plan expire ten years from the date of grant.

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

	Number of Options	Weighted Average	Aggregate Intrinsic Value
Options outstanding at December 31, 2011	**6,595,136**	**$ 4.65**	**$ 48,447**
Options granted	1,443,810	16.80	3,090
Options exercised	(831,957)	3.74	(12,646)
Options forfeited/cancelled	(168,595)	10.68	(1,393)

Options outstanding at September 30, 2012	**7,038,394**	**$ 7.11**	**$ 83,264**
Options vested and exercisable at September 30, 2012	3,794,531	$ 3.32	$ 59,271
Options expected to vest	3,026,253	$ 11.40	$ 22,818

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The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model. The Company recognizes the fair value of each option as compensation expense ratably using the straight-line method over the service period (generally the vesting period). Additionally, the Company estimates forfeitures at the time of grant and revises those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses a combination of historical data and other factors to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest.

As of September 30, 2012, total unrecognized compensation cost related to non-vested share-based compensation awards was $19,166. That cost is expected to be recognized over the next 2 years using the weighted average method.

Summary of restricted stock activity as of September 30, 2012, and changes during the nine months then ended is presented below:

	Number of Shares	Weighted Average Grant Date Fair Value Per Share
Unvested restricted stock outstanding at January 1, 2012		$
Restricted stock granted	430,928	14.47
Restricted stock vested	(48,700)	12.00
Unvested restricted stock outstanding at September 30, 2012	382,228	$ 14.78

13. RECENT ACCOUNTING PRONOUNCEMENTS

In May 2011, the Financial Accounting Standard Board (FASB) issued Accounting Standards Update (ASU or Update) No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS which is intended to create consistency between U.S. GAAP and International Financial Reporting Standards (IFRS). The amendments include clarification on the application of certain existing fair value measurement guidance and expanded disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. This guidance was effective prospectively for public entities for interim and annual reporting periods beginning after December 15, 2011, with early adoption by public entities prohibited. The adoption of this standard did not have a material effect on the Company s financial condition, results of operations and cash flows.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income which requires comprehensive income to be reported in either a single statement or in two consecutive statements reporting net income and other comprehensive income. The amendment does not change what items are reported in other comprehensive income. Additionally, in December 2011, the FASB issued ASU No. 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 which indefinitely defers the requirement in ASU No. 2011-05 to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. During the deferral period, the existing requirements in U.S. GAAP for the presentation of reclassification adjustments must continue to be followed. These standards were effective for interim and annual financial periods beginning after December 15, 2011 and are to be applied retrospectively, with early adoption permitted. As these standards impact presentation requirements only, the adoption of this guidance did not have a material effect on the Company s financial condition, results of operations and cash flows.

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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, 2011 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 and 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. and its consolidated subsidiaries.

Executive Summary

We are a leading global IT services provider focused on complex software product development services, software engineering and vertically-oriented custom development solutions. Since our inception in 1993, we have been serving independent software vendors, or ISVs, and technology companies. The foundation we have built serving ISVs and technology companies has enabled us to differentiate ourselves in the market for software engineering skills and technology capabilities. Our work with these clients exposes us to their customers challenges across a variety of industry verticals. This has enabled us to develop vertical-specific domain expertise and grow our business in multiple industry verticals, including Banking and Financial Services, Business Information and Media, Travel and Hospitality and Retail and Consumer.

Our delivery centers in Belarus, Ukraine, Russia, Hungary, Kazakhstan and Poland are strategically located in centers of software engineering talent and educational excellence across Central and Eastern Europe (CEE) or the Commonwealth of Independent States (the CIS). Our applications, tools, methodologies and infrastructure allow us to seamlessly deliver services and solutions from our delivery centers to global clients, thereby further strengthening our relationships with them. We also have client management locations in the United States, Canada, the United Kingdom, Germany, Sweden, Russia, Switzerland and Kazakhstan.

Our clients primarily consist of Forbes Global 2000 corporations located in North America, Europe and the CIS. Our focus on delivering quality to our clients is reflected by an average of 89.0% and 76.1% of our revenues during the nine months ended September 30, 2012 coming from clients that had used our services for at least one and two years, respectively.

Summary of Results of Operations and Non-GAAP Financial Measures

The following tables present a summary of our results of operations for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012		2011		2012		2011	
	(in thousands, except percentages)				(in thousands, except percentages)			
Revenues	$ 110,078	100.0%	$ 86,423	100.0%	$ 308,261	100.0%	$ 239,401	100.0%
Income from operations	16,736	15.2	16,891	19.5	47,350	15.4	39,581	16.5
Net income	$ 14,065	12.8	13,950	16.1	39,485	12.8	31,969	13.4

The key drivers of our revenue growth during the three and nine months ended September 30, 2012 as compared to the three and nine months ended September 30, 2011 were as follows:

- Broad based revenue growth from clients in most of our key verticals, and in particular within Banking and Financial Services, Retail and Consumer, and ISV and Technology. The third quarter and year-to-date results were further improved by the growth in the Other vertical primarily related to revenues generated from two governmental tax agency projects located in the CIS;

- Continued penetration of the European market where we experienced revenue growth of $12.8 million, or 45.8%, and $36.1 million, or 47.5% during the three and nine months ended September 30, 2012, respectively;

Strong revenue contribution from our top clients. Revenues attributable to our top ten clients as of September 30, 2012 increased by $ 32.2 million during the nine months ended September 30, 2012 as compared to 2011 as we continued to leverage long-term relationships to generate repeat revenue and expand existing revenue streams; and

Completion of a strategic acquisition of Thoughtcorp, Inc. (Thoughtcorp) in the second quarter of 2012, which contributed another $3.9 million in revenues to our year-to-date results.

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In our quarterly earnings press releases and conference calls, we discuss two key measures that are not calculated according to generally accepted accounting principles (GAAP). The first non-GAAP measure is income from operations, as reported on our consolidated and condensed statements of income and comprehensive income, excluding certain expenses and benefits, which we refer to as non-GAAP income from operations . The second measure calculates non-GAAP income from operations as a percentage of reported revenues, which we refer to as non-GAAP operating margin . We believe that these non-GAAP measures help illustrate underlying trends in our business, and we use these measures to establish budgets and operational goals (communicated internally and externally), manage our business, and evaluate our performance. We also believe these measures help investors compare our operating performance with our results in prior periods and compare our operating results with those of similar companies. We exclude certain expenses and benefits from non-GAAP income from operations that we believe are not reflective of these underlying business trends and are not useful measures in determining our operational performance and overall business strategy. Because our reported non-GAAP financial measures are not calculated according to GAAP, these measures are not comparable to GAAP and may not be comparable to similarly described non-GAAP measures reported by other companies within our industry. Consequently, our non-GAAP financial measures should not be evaluated in isolation from or supplant comparable GAAP measures, but, rather, should be considered together with our consolidated and condensed financial statements, which are prepared according to GAAP. The following table presents a reconciliation of income from operations as reported on our consolidated and condensed statements of income and comprehensive income to non-GAAP income from operations and non-GAAP operating margin for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands, except percentages)			
Revenues	$ 110,078	$ 86,423	$ 308,261	$ 239,401
GAAP Income from operations	16,736	16,891	47,350	39,581
Stock-based compensation(1)	2,046	785	5,369	2,154
One-time charges			584	
Goodwill impairment				1,697
Amortization of purchased intangible assets	431	191	711	639
M&A costs	(13)	282	374	492
Non-GAAP Income from operations	$ 19,200	$ 18,149	$ 54,388	$ 44,563
GAAP Operating margin	15.2%	19.5%	15.4%	16.5%
Effect of the adjustments detailed above	2.2	1.5	2.2	2.1
Non-GAAP Operating margin	17.4%	21.0%	17.6%	18.6%

(1) Cost of revenue includes stock-based compensation expense of $1,036 and $2,486 for the three months and nine months ended September 30, 2012, and $417 and $947 for the same periods in 2011, respectively. Selling, general and administrative expenses include stock-based compensation expense of $1,010 and $2,883 for the three and nine months ended September 30, 2012, and $368 and $1,207 for the same periods of 2011, respectively.

Income from operations decreased 0.9% during the three months ended September 30, 2012. However, on a year-to-date basis income from operations grew 19.6%. Operating margins were 15.2% and 15.4% during the three and nine months ended September 30, 2012, compared to 19.5% and 16.5% during the same periods in 2011, respectively. As a percentage of revenues, cost of revenue increased by 2.9% and 1.7% during the three and nine months ended September 30, 2012, including the impact of a 0.5% and 0.4% increase in stock-based compensation expense during the same periods, respectively. This reduction in operating margins was partly offset by an improvement in selling, general and administrative expenses. As a percentage of revenues, selling, general and administrative expenses increased by 0.9% during the third quarter of 2012 over the same period of 2011 primarily due to an increase of 0.5% in the stock-based compensation expense as a percentage of revenues. On a year-to-date basis, selling, general and administrative expenses remained relatively flat with a 0.1% decrease as compared to 2011. The operating results in any period are not necessarily indicative of the results that may be expected for any future period.

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Recent developments

On February 13, 2012, we completed our initial public offering of 6,900,000 shares of our common stock, which included 900,000 shares of our common stock sold by us pursuant to an over-allotment option granted to the underwriters, sold at a price to the public of $12.00 per share. Of the 6,900,000 shares of common stock sold, we issued and sold 2,900,000 shares of common stock and our selling stockholders sold 4,000,000 shares of common stock, resulting in gross proceeds to us of $34.8 million, and $29.0 million in net proceeds to us after deducting underwriting discounts and commissions of $2.4 million and offering expenses of $3.4 million. We did not receive any proceeds from the sale of common stock by the selling stockholders.

In April 2012, several weeks after EPAM s initial public offering in February 2012, President Obama signed into law the Jumpstart Our Business Startups Act of 2012 (the JOBS Act). The JOBS Act contains provisions that relax certain requirements for emerging growth companies that otherwise apply to larger public companies. For as long as a company retains emerging growth company status, which may be until the fiscal year-end after the fifth anniversary of its initial public offering, it will not be required to (1) provide an auditor s attestation report on its management s assessment of the effectiveness of its internal control over financial reporting, otherwise required by Section 404(b) of the Sarbanes-Oxley Act of 2002, (2) comply with any new or revised financial accounting standard applicable to public companies until such standard is also applicable to private companies, (3) comply with certain new requirements adopted by the Public Company Accounting Oversight Board, (4) provide certain disclosure regarding executive compensation required of larger public companies or (5) hold shareholder advisory votes on matters relating to executive compensation.

We are classified as an emerging growth company under the JOBS Act, and are eligible to take advantage of the accommodations described above for as long as we retain this status. However, we have elected not to take advantage of the transition period described in (2) above, which is the exemption provided in Section 7(a)(2)(B) of the Securities Act of 1933 and Section 13(a) of the Securities Exchange Act of 1934 (in each case as amended by the JOBS Act) for complying with new or revised financial accounting standards. We will therefore comply with new or revised financial accounting standards to the same extent that a non-emerging growth company is required to comply with such standards.

We expect to take advantage of the exemption from complying with the auditor attestation requirement of Section 404(b) of the Sarbanes-Oxley Act of 2002. Our board of directors has not yet determined whether to take advantage of the accommodations relating to executive compensation disclosure and advisory voting.

On May 25, 2012 we completed the acquisition of Thoughtcorp, a Canadian company with a 17-year history of successfully delivering high-value IT solutions and complex software applications to some of Canada s most prominent companies within the Telecommunication, Financial and Retail segments. With the Thoughtcorp acquisition we have strengthened our Financial and Retail verticals, and have gained significant telecommunications expertise with a highly skilled and experienced employee base. The acquisition also expands our North American geographic footprint and complements our global delivery capabilities with expertise in areas important for us, such as Agile Development, Enterprise Mobility and Business Intelligence. We expect to continue to seek opportunities to deepen our industry expertise and technology capabilities necessary to deliver complex mission-critical solutions as part of our ongoing growth strategy.

Critical Accounting Policies and Significant Judgments and Estimates

We have identified the accounting policies which are critical to understanding our business and our results of operations. Management believes that there have been no significant changes during the nine months ended September 30, 2012 to the items disclosed in our summary of critical accounting policies, significant judgments and estimates in Management s Discussion and Analysis of Financial Conditions and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2011, other than those described below.

Earnings per Share

Basic EPS is computed by dividing the net income applicable to common stockholders for the period by the weighted average number of shares of common stock outstanding during the same period. Our Series A-1 Preferred, Series A-2 Preferred, and Series A-3 Preferred Stock, that had been outstanding and convertible into common stock until February 13, 2012 (the date of our IPO), and our puttable common stock were considered participating securities since these securities had non-forfeitable rights to dividends or dividend equivalents during the contractual period and thus required the two-class method of computing EPS. When calculating diluted EPS, the numerator is computed by adding back the undistributed earnings allocated to the participating securities in arriving at the basic EPS and then reallocating such undistributed earnings among our common stock, participating securities and the potential common shares that result from the assumed exercise of all dilutive options. The denominator is increased to include the number of additional common shares that would have been outstanding had the options been issued.

No preferred stock was outstanding as of September 30, 2012, as a result of our initial public offering on February 13, 2012 when all convertible preferred stock was converted into common stock.

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Change in Presentation of Certain Financial Information

As part of our discussion and analysis, we analyze revenues by vertical. Prior to the third quarter of 2012, certain individually insignificant customers pertaining to acquired operations were aggregated for the purposes of presenting revenue by vertical. Effective third quarter of 2012, we have individually reassigned these customers to corresponding verticals. We believe this change is preferable as it allows us to more effectively analyze our verticals by aligning presentation of existing and acquired customers using a standardized approach. This change does not result in any adjustments to our previously issued financial statements. This change was applied retrospectively beginning on January 1, 2011 as presented in the table below:

	Nine Months Ended September 30, 2011			
	As Previously Reported		After Reclassification	
	(in thousands, except percentages)			
Vertical				
ISVs and Technology	$ 63,977	26.7%	$ 63,751	26.6%
Banking and Financial Services	53,801	22.5	53,770	22.5
Business Information and Media	46,622	19.5	47,993	20.0
Travel and Hospitality	28,618	12.0	28,308	11.8
Retail and Consumer	20,539	8.6	20,689	8.6
Other verticals	21,532	8.9	20,578	8.7
Reimbursable expenses and other revenues	4,312	1.8	4,312	1.8
Revenues	$ 239,401	100.0%	$ 239,401	100.0%

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Results of Operations

Three and Nine Months Ended September 30, 2012 Compared to the Three and Nine Months Ended September 30, 2011

The following table presents the components of net income included in our consolidated condensed statements of income and comprehensive income:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in thousands)			
Revenues	**$ 110,078**	**$ 86,423**	**$ 308,261**	**$ 239,401**
Operating expenses:				
Cost of revenues (exclusive of depreciation and amortization)	69,099	51,627	193,077	145,948
Selling, general and administrative expenses	21,153	15,822	59,491	46,420
Depreciation and amortization expense	3,040	2,083	7,674	5,732
Goodwill impairment loss				1,697
Other operating expenses, net	50		669	23
Income from operations	**16,736**	**16,891**	**47,350**	**39,581**
Interest and other income, net	486	385	1,422	1,000
Foreign exchange gain/ (loss)	(635)	(2,301)	(1,949)	(3,138)
Income before provision for income taxes	**16,587**	**14,975**	**46,823**	**37,443**
Provision for income taxes	2,522	1,025	7,338	5,474
Net Income	**$ 14,065**	**$ 13,950**	**$ 39,485**	**$ 31,969**

Revenues

Revenues totaled $110.1 million for the third quarter and $308.3 million for the first nine months of 2012, compared with $86.4 million and $239.4 million generated during the same periods last year, respectively. Quarter and year-to-date results improved primarily due to continued demand for our services from existing customers, the acquisition of Thoughtcorp and approximately $9.0 million and $15.2 million in revenues from new clients in the third quarter and first nine months of 2012, respectively. Revenues were derived primarily from providing software development services to our clients. We discuss below the breakdown of our revenues by service offering, vertical, client location, contract type and client concentration. Revenues consist of IT services revenues and reimbursable expenses and other revenues, which primarily include travel and entertainment costs that are chargeable to clients.

Revenues by Vertical

The foundation we have built with ISVs and technology companies has enabled us to leverage our strong domain knowledge and industry-specific knowledge capabilities to become a premier IT services provider to a range of additional verticals such as Banking and Financial Services, Business Information and Media, Travel and Hospitality and Retail and Consumer.

The following table sets forth revenues by vertical by amount and as a percentage of our revenues for the periods indicated:

	Three Months Ended September 30, 2012		Three Months Ended September 30, 2011		Nine Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
	(in thousands, except percentages)							
Vertical								
ISVs and Technology	$ 30,365	27.6%	$ 22,791	26.4%	$ 80,657	26.2%	$ 63,751	26.6%

Banking and Financial Services	29,659	26.9	19,825	22.9	75,978	24.6	53,770	22.5
Business Information and Media	15,366	14.0	15,916	18.4	47,937	15.6	47,993	20.0
Travel and Hospitality	9,211	8.4	10,805	12.5	30,749	10.0	28,308	11.8
Retail and Consumer	13,525	12.3	8,191	9.5	38,242	12.4	20,689	8.6
Other verticals	10,559	9.5	7,389	8.6	30,512	9.8	20,578	8.7
Reimbursable expenses and other revenues	1,393	1.3	1,506	1.7	4,186	1.4	4,312	1.8
Revenues	$ 110,078	100.0%	$ 86,423	100.0%	$ 308,261	100.0%	$ 239,401	100.0%

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Revenues by Client Location

Our revenues are sourced from three geographic markets: North America, Europe and the CIS. We present our revenues by client location based on the location of the specific client site that we serve, irrespective of the location of the headquarters of the client or the location of the delivery center where the work is performed. As such, revenues by client location differ from the segment information in our unaudited condensed consolidated financial statements included elsewhere in this quarterly report, which information is not solely based on the geographic location of the clients but rather is based on managerial responsibility for a particular client regardless of client location. The following table sets forth revenues by client location by amount and as a percentage of our revenues for the periods indicated:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012		2011		2012		2011	
	(in thousands, except percentages)							
Client Location								
North America	**$ 53,687**	**48.7%**	**$ 42,384**	**49.1%**	**$ 150,837**	**48.9%**	**$ 119,301**	**49.9%**
Europe	**40,726**	**37.0**	**27,938**	**32.3**	**112,050**	**36.3**	**75,951**	**31.7**
United Kingdom	25,651	23.3	19,307	22.3	71,437	23.2	50,267	21.0
Other	15,075	13.7	8,631	10.0	40,613	13.1	25,684	10.7
CIS	**14,272**	**13.0**	**14,595**	**16.9**	**41,188**	**13.4**	**39,837**	**16.6**
Russia	10,583	9.6	11,229	13.0	29,074	9.4	31,041	13.0
Other	3,689	3.4	3,366	3.9	12,114	4.0	8,796	3.6
Reimbursable expenses and other revenues	1,393	1.3	1,506	1.7	4,186	1.4	4,312	1.8
Revenues	$ 110,078	100.0%	$ 86,423	100.0%	$ 308,261	100.0%	$ 239,401	100.0%

Revenues by Service Offering

Software development includes software product development, custom application development services and enterprise application platform services, and has historically represented, and we expect to continue to represent, the substantial majority of our business. The following table sets forth revenues by service offering by amount and as a percentage of our revenues for the periods indicated:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012		2011		2012		2011	
	(in thousands, except percentages)							
Service Offering								
Software development	$ 73,894	67.1%	$ 56,580	65.5%	$ 206,045	66.8%	$ 157,025	65.5%
Application testing services	22,001	20.0	17,859	20.7	61,297	19.9	48,523	20.3
Application maintenance and support	8,806	8.0	7,101	8.2	25,775	8.4	20,502	8.6
Infrastructure services	3,213	2.9	2,299	2.7	8,965	2.9	6,353	2.7
Licensing	771	0.7	1,078	1.2	1,993	0.6	2,686	1.1
Reimbursable expenses and other revenues	1,393	1.3	1,506	1.7	4,186	1.4	4,312	1.8
Revenues	$ 110,078	100.0%	$ 86,423	100.0%	$ 308,261	100.0%	$ 239,401	100.0%

Revenues by Contract Type

Our services are performed under both time-and-material and fixed-price arrangements. Our engagement models depend on the type of services provided to a client, the mix and locations of professionals involved and the business outcomes our clients seek to achieve. Historically, the majority of our revenues have been generated under time-and-material contracts. Under time-and-material

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contracts, we are compensated for actual time incurred by our IT professionals at negotiated hourly, daily or monthly rates. Fixed-price contracts require us to perform services throughout the contractual period and we are paid in installments on pre-agreed intervals. We expect time-and-material arrangements to continue to comprise the majority of our revenues in the future.

The following table sets forth revenues by contract type by amount and as a percentage of our revenues for the periods indicated:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012		2011		2012		2011	
	(in thousands, except percentages)							
Contract Type								
Time-and-material	$ 93,087	84.5%	$ 75,207	87.1%	$ 265,280	86.1%	$ 208,031	86.9%
Fixed-price	14,827	13.5	8,633	10.0	36,802	11.9	24,373	10.2
Licensing	771	0.7	1,077	1.2	1,993	0.6	2,685	1.1
Reimbursable expenses and other revenues	1,393	1.3	1,506					