EPAM Systems, Inc.
Form 10-Q
August 06, 2018

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 June 30, 2018

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 (State or other jurisdiction of incorporation or organization)	22-3536104 (I.R.S. Employer Identification No.)
41 University Drive, Suite 202 Newtown, Pennsylvania (Address of principal executive offices)	18940 (Zip code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	¨

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

Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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 July 31, 2018
Common Stock, par value $0.001 per share	53,781,973 shares

EPAM SYSTEMS, INC.

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

	As of June 30, 2018	As of December 31, 2017
Assets		
Current assets		
Cash and cash equivalents	$584,081	$582,585
Accounts receivable, net of allowance of $2,790 and $1,186, respectively	283,001	265,639
Unbilled revenues	123,434	86,500
Prepaid and other current assets, net of allowance of $42 and $45, respectively	31,919	23,196
Employee loans, current, net of allowance of $0 and $0, respectively	2,084	2,113
Total current assets	1,024,519	960,033
Property and equipment, net	98,450	86,419
Employee loans, noncurrent, net of allowance of $0 and $0, respectively	1,669	2,097
Intangible assets, net	55,201	44,511
Goodwill	144,667	119,531
Deferred tax assets	54,805	24,974
Other noncurrent assets, net of allowance of $130 and $140, respectively	12,884	12,691
Total assets	$1,392,195	$1,250,256
Liabilities		
Current liabilities		
Accounts payable	$6,727	$5,574
Accrued expenses and other current liabilities	72,443	89,812
Due to employees	50,374	38,757
Deferred compensation due to employees	4,338	5,964
Taxes payable	47,529	40,860
Total current liabilities	181,411	180,967
Long-term debt	25,020	25,033
Taxes payable, noncurrent	56,540	59,874
Other noncurrent liabilities	16,421	9,435
Total liabilities	279,392	275,309
Commitments and contingencies (Note 11)		
Stockholders' equity		
Common stock, $0.001 par value; 160,000,000 authorized; 53,705,002 and 53,003,420 shares issued, 53,685,267 and 52,983,685 shares outstanding at June 30, 2018 and December 31, 2017, respectively	54	53
Additional paid-in capital	511,131	473,874
Retained earnings	633,950	518,820
Treasury stock	(177)	(177)
Accumulated other comprehensive loss	(32,155)	(17,623)

Total stockholders’ equity	1,112,803	974,947
Total liabilities and stockholders’ equity	$1,392,195	$1,250,256

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)
(In thousands, except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues	$445,647	$ 348,977	$869,795	$673,628
Operating expenses:				
Cost of revenues (exclusive of depreciation and amortization)	289,175	220,132	566,809	427,862
Selling, general and administrative expenses	91,843	80,419	179,620	158,872
Depreciation and amortization expense	8,962	7,020	17,138	13,692
Other operating expenses, net	1,430	724	3,294	1,554
Income from operations	54,237	40,682	102,934	71,648
Interest and other income, net	1,052	802	501	1,386
Foreign exchange gain/(loss)	1,830	1,562	1,583	(1,393)
Income before provision for/(benefit from) income taxes	57,119	43,046	105,018	71,641
Provision for/(benefit from) income taxes	6,864	5,687	(9,655)	10,641
Net income	$50,255	$ 37,359	$114,673	$61,000
Foreign currency translation adjustments, net of tax	(15,834)	4,551	(12,525)	10,937
Unrealized net loss on cash-flow hedging instruments, net of tax	(2,076)	—	(2,007)	—
Comprehensive income	$32,345	$ 41,910	$100,141	$71,937
Net income per share:				
Basic	$0.94	$ 0.72	$2.15	$1.19
Diluted	$0.89	$ 0.68	$2.03	$1.12
Shares used in calculation of net income per share:				
Basic	53,517,124	51,899,416	53,299,038	51,431,353
Diluted	56,587,009	54,848,619	56,414,986	54,371,284

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)
(In thousands)

	Six Months Ended June 30, 2018	2017
Cash flows from operating activities:		
Net income	$114,673	$61,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	17,138	13,692
Bad debt expense	1,529	102
Deferred taxes	(27,581)	(766)
Stock-based compensation expense	31,406	28,703
Other	(2,099)	(1,550)
Changes in operating assets and liabilities:		
(Increase)/decrease in operating assets:		
Accounts receivable	(15,051)	(4,630)
Unbilled revenues	(35,334)	(44,133)
Prepaid expenses and other assets	(4,495)	973
Increase/(decrease) in operating liabilities:		
Accounts payable	1,008	518
Accrued expenses and other liabilities	(15,861)	(3,333)
Due to employees	1,351	4,549
Taxes payable	105	4,208
Net cash provided by operating activities	66,789	59,333
Cash flows from investing activities:		
Purchases of property and equipment	(19,303)	(11,441)
Employee housing loans issued	(214)	(512)
Proceeds from repayments of employee housing loans	919	1,315
Decrease in time deposits, net	418	13
Acquisition of businesses, net of cash acquired	(50,264)	(6,810)
Other investing activities, net	130	(190)
Net cash used in investing activities	(68,314)	(17,625)
Cash flows from financing activities:		
Proceeds from stock option exercises	22,368	37,757
Payments of withholding taxes related to net share settlements of restricted stock units	(6,696)	(2,702)
Proceeds from debt (Note 6)	—	25,000
Repayment of debt (Note 6)	(3,478)	(25,059)
Other financing activities, net	(603)	(864)
Net cash provided by financing activities	11,591	34,132
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(7,645)	5,912
Net increase in cash, cash equivalents and restricted cash	2,421	81,752
Cash, cash equivalents and restricted cash, beginning of period	582,855	364,664
Cash, cash equivalents and restricted cash, end of period	$585,276	$446,416

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

The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the condensed consolidated balance sheets:

	As of June 30, 2018	As of December 31, 2017
Balance sheet classification		
Cash and cash equivalents	$584,081	$582,585
Restricted cash in Prepaid and other current assets	—	91
Restricted cash in Other noncurrent assets	1,195	179
Total restricted cash	1,195	270
Total cash, cash equivalents and restricted cash	$585,276	$582,855

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)
(In thousands, except share and per share data)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

EPAM Systems, Inc. (the “Company” or “EPAM”) is a leading global provider of digital platform engineering and software development services to clients located around the world, primarily in North America, Europe, Asia and Australia. The Company has expertise in various industries, including software and hi-tech, financial services, business information and media, travel and hospitality, retail and distribution and life sciences and healthcare. The Company is incorporated in Delaware and headquartered in Newtown, PA.

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, 2017 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 management’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.

Adoption of New Accounting Standards

Unless otherwise discussed below, the adoption of new accounting standards did not have an impact on the Company’s consolidated financial position, results of operations, and cash flows.

Revenue Recognition — Effective January 1, 2018, the Company adopted the new accounting standard ASU 2014-09, Revenue from Contracts with Customers (Topic 606) as amended using the modified retrospective method. The standard effectively replaced previously existing revenue recognition guidance (Topic 605) and requires entities to recognize revenue to depict the transfer of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services as well as requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments.

The following table summarizes the cumulative effect of adopting Topic 606 using the modified retrospective method of adoption as of January 1, 2018:

	Balance as of December 31, 2017	Adjustments Due to Topic 606	Balance as of January 1, 2018
Balance Sheet			
Assets			
Unbilled revenues	$86,500	$ (78)	$86,422
Deferred tax assets	$24,974	$ (173)	$24,801
Liabilities			
Accrued expenses and other current liabilities	$89,812	$ (708)	$89,104
Stockholders’ equity			
Retained earnings	$518,820	$ 457	$519,277

The Company applied a practical expedient to aggregate the effect of all contract modifications that occurred before the adoption date.

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See Note 7 “Revenues” in the condensed consolidated interim financial statements for additional information regarding revenues.

Restricted cash and restricted cash equivalents — Effective January 1, 2018, the Company adopted Accounting Standard Update (“ASU”) No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash which requires the Company to include in its cash and cash equivalents balances presented in the statements of cash flows amounts that are deemed to be restricted in nature. As a result of the adoption, the Company restated its condensed consolidated statements of cash flows for all of the prior periods presented. The impact of adoption on the Company’s condensed consolidated statement of cash flows was as follows for the six months ended June 30, 2017:

	As Reported	Restated	Effect
Cash flows from operating activities:			
Changes in operating assets and liabilities:			
Prepaid expenses and other assets	$736	$973	$237
Net cash provided by operating activities	$59,096	$59,333	$237
Cash flows from investing activities:			
Decrease in restricted cash and time deposits, net	$94	$13	$(81)
Acquisition of businesses, net of cash acquired	$(6,840)	$(6,810)	$30
Net cash used in investing activities	$(17,574)	$(17,625)	$(51)
Effect of exchange rate changes on cash, cash equivalents, and restricted cash	$5,822	$5,912	$90
Net increase in cash, cash equivalents and restricted cash	$81,476	$81,752	$276
Cash, cash equivalents and restricted cash, beginning of period	362,025	364,664	2,639
Cash, cash equivalents and restricted cash, end of period	$443,501	$446,416	$2,915

Derivatives and Hedging — Effective April 1, 2018, the Company early-adopted ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The new guidance is intended to simplify and amend hedge accounting and reporting to better align and disclose the economic results of an entity’s risk management activities in its financial statements. The ASU makes more financial and non-financial hedging strategies eligible for hedge accounting. It also changes how companies assess hedge effectiveness and amends the presentation and disclosure requirements by eliminating the requirement to separately measure and report hedge ineffectiveness and generally requires companies, for qualifying hedges, to present the entire change in the fair value of a hedging instrument in the same income statement line as the hedged item. The guidance also eases documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. The guidance requires entities to apply the amended presentation and disclosure guidance prospectively as of the period of adoption. The adoption of this guidance did not have any effect on the consolidated financial results.

The Company enters into derivative financial instruments to manage exposure to fluctuations in certain foreign currencies. During 2018, for accounting purposes, these foreign currency forward contracts became designated as hedges, as defined under FASB ASC Topic 815, Derivatives and Hedging. The Company measures these foreign currency derivative contracts at fair value on a recurring basis utilizing Level 2 inputs. The Company records changes in the fair value of these hedges in accumulated other comprehensive income/(loss) in our consolidated balance sheet until the forecasted transaction occurs. When the forecasted transaction occurs, the related gain or loss on the cash flow hedge is reclassified to the same line item in the statement of income as the forecasted transaction is recorded. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, the Company reclassifies the gain or loss on the underlying hedge from accumulated other comprehensive income/(loss) to foreign exchange gain/(loss) in the consolidated statement of income. The cash flow impact of derivatives identified as hedging instruments is reflected as cash flows from operating activities. The cash flow impact of derivatives not identified as hedging instruments is reflected as cash flows from investing activities.

Pending Accounting Standards

From time to time, new accounting pronouncements are issued by the FASB or other standards-setting bodies that the Company will adopt according to the various timetables the FASB specifies. Unless otherwise discussed below, the

Company believes the impact of recently issued standards that are not yet effective will not have a material impact on its consolidated financial position, results of operations and cash flows upon adoption.

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Leases — Effective January 1, 2019, the Company will be required to adopt the new guidance of ASC Topic 842, Leases (Topic 842) (with early adoption permitted effective January 1, 2018). This amendment supersedes previous accounting guidance (Topic 840) and requires all leases, with the exception of leases with a term of twelve months or less, to be recorded on the balance sheet as lease assets and lease liabilities. The standard allows for two methods of adoption to recognize and measure leases: retrospectively to each prior period presented in the financial statements with the cumulative effect of initially applying the guidance recognized at the beginning of the earliest comparative period presented or retrospectively at the beginning of the period of adoption with the cumulative effect of initially applying the guidance recognized at the beginning of the period in which the guidance is first applied. The adoption methods both include a number of optional practical expedients that entities may elect to apply. These practical expedients relate to the identification and classification of leases that commenced before the effective date, initial direct costs for leases that commenced before the effective date, and the ability to use hindsight in evaluating lessee options to extend or terminate a lease or to purchase the underlying asset. An entity that elects to apply the practical expedients will, in effect, continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP. The transition guidance in Topic 842 also provides specific guidance for the amounts previously recognized in accordance with the business combinations guidance for leases. The Company has developed a transition plan, which includes making necessary changes to policies, processes, internal controls and system enhancements to generate the information necessary to comply with the new standard. The Company expects the new guidance will have a material impact on its consolidated balance sheet for the addition of right-of-use assets and lease liabilities principally due to its office space leases. EPAM does not expect the new guidance to have a material impact on its consolidated statement of income and comprehensive income or its consolidated statement of cash flows. The Company expects to adopt this standard on January 1, 2019 using the method of adoption whereby the cumulative effect of adoption is recognized at the beginning of the period of adoption.

Measurement of Credit Losses on Financial Instruments — Effective January 1, 2020, the Company will be required to adopt the amended guidance of ASC Topic 326, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, (with early adoption permitted effective January 1, 2019.) The amendments in this update change how companies measure and recognize credit impairment for many financial assets. The new expected credit loss model will require companies to immediately recognize an estimate of credit losses expected to occur over the remaining life of the financial assets (including trade receivables) that are in the scope of the update. The update also made amendments to the current impairment model for held-to-maturity and available-for-sale debt securities and certain guarantees. Entities are required to adopt the standard using a modified-retrospective approach through a cumulative effect adjustment to retained earnings as of the beginning of the period of adoption. The Company has not yet completed its assessment of the impact of the new guidance on its consolidated financial statements or concluded on when it will adopt the standard.

2. ACQUISITIONS

Continuum — On March 15, 2018, the Company acquired all of the outstanding equity of Continuum Innovation LLC together with its subsidiaries, ("Continuum") to enhance the Company's consulting capabilities as well as its digital and service design practices. Continuum, headquartered in Boston with offices located in Milan, Seoul, and Shanghai, focuses on four practices including strategy, physical and digital design, technology and its Made Real Lab. The acquisition of Continuum added approximately 125 design consultants to the Company's headcount.

In connection with the Continuum acquisition, the Company paid \$52,515 as cash consideration, of which \$5,410 was placed in escrow for a period of 9 to 15 months as security for the indemnification obligations of the sellers under the terms of the equity purchase agreement. Furthermore, subject to attainment of specified performance targets in the 12 months after the acquisition, the Company will make a cash earnout payment with a maximum amount payable of \$3,135. The Company recorded \$2,400 related to this earnout payment as contingent consideration (Note 4 "Fair Value Measurements").

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The following table summarizes the preliminary fair values of the assets acquired and liabilities assumed in connection with the acquisition of Continuum as originally reported and as adjusted as of June 30, 2018:

	As Originally Reported	As Adjusted
Cash and cash equivalents	$ 2,251	$ 2,251
Accounts receivable	6,676	6,676
Unbilled revenues	2,463	2,463
Prepaid and other current assets	942	936
Goodwill	29,805	26,293
Intangible assets	16,600	14,850
Property and equipment and other noncurrent assets	8,902	8,902
Total assets acquired	$ 67,639	$ 62,371
Accounts payable, accrued expenses and other current liabilities	$ 2,991	$ 2,745
Due to employees	1,001	1,001
Long-term debt (Note 6)	3,220	3,220
Other noncurrent liabilities	5,412	490
Total liabilities assumed	$ 12,624	$ 7,456
Net assets acquired	$ 55,015	$ 54,915

During the three months ended June 30, 2018, the Company updated the valuation of intangible assets acquired which resulted in an adjustment of initially recognized intangible assets and their useful lives as well as in recognition of an additional intangible asset in the form of a favorable lease. The Company removed a liability associated with an initially recognized unfavorable lease, which was classified as other noncurrent liabilities. These adjustments as well as the revaluation of contingent consideration resulted in a corresponding decrease in the value of acquired goodwill. The Company recorded $26 of amortization and $41 of rent expense during the three months ended June 30, 2018 that would have been recognized in a prior period if the adjustments to the preliminary amounts had been recognized as of the acquisition date. The Company is gathering additional information necessary to finalize the estimated fair values of the assets acquired and liabilities assumed. The fair values reflected are subject to change and 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 acquisition date.

The following table presents the estimated fair values and useful lives of intangible assets acquired in connection with the acquisition of Continuum:

	Continuum	
	Weighted Average Useful Life (in years)	Amount
Favorable lease	11.9	$5,900
Customer relationships	6.6	5,800
Contract royalties	8	1,900
Trade names	5	1,250
Total		$14,850

The goodwill recognized as a result of the Continuum acquisition is attributable primarily to strategic and synergistic opportunities related to the consulting business, the assembled workforce of Continuum and other factors. The goodwill is expected to be deductible for income tax purposes.

Revenues generated by Continuum totaled $8,470 and $10,224 during the three and six months ended June 30, 2018. Pro forma results of operations have not been presented because the effect of the Continuum acquisition on the Company’s condensed consolidated financial statements was not material.

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3. GOODWILL

Goodwill by reportable segment was as follows:

	North America	Europe	Total
Balance as of December 31, 2017	$77,290	$42,241	$119,531
Continuum acquisition (Note 2)	26,293	—	26,293
Effect of net foreign currency exchange rate changes	(285)	(872)	(1,157)
Balance as of June 30, 2018	$103,298	$41,369	$144,667

There were no accumulated impairment losses in the North America or Europe reportable segments as of June 30, 2018 or December 31, 2017.

4. FAIR VALUE MEASUREMENTS

The Company carries certain liabilities at fair value on a recurring basis on its consolidated balance sheets. The following table shows the fair values of the Company's financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2018:

	As of June 30, 2018			
	Balance	Level 1	Level 2	Level 3
Foreign exchange derivative assets	$84	$ —	$84	$—
Total assets measured at fair value on a recurring basis	$84	$ —	$84	$—
Contingent consideration	$2,400	$ —	$—	$2,400
Foreign exchange derivative liabilities	2,690	$ —	2,690	$—
Total liabilities measured at fair value on a recurring basis	$5,090	$ —	$2,690	$2,400

The Company had no material financial assets or liabilities measured at fair value on a recurring basis as of December 31, 2017.

As of June 30, 2018, contingent consideration included amounts payable in cash in connection with the acquisition of Continuum (Note 2 "Acquisitions"). The fair value of the contingent consideration is based on the expected future payments to be made to the sellers of the acquired business in accordance with the provisions outlined in the purchase agreement. In determining fair value, the Company considered a variety of factors, including future performance of the acquired businesses using financial projections developed by the Company and market risk assumptions that were derived for revenue growth and earnings before interest and taxes. The Company estimated future payments using the earnout formula and performance targets specified in the purchase agreement and adjusted those estimates to reflect the probability of their achievement. Those future payments were then discounted to present value using a rate based on the weighted-average cost of capital of guideline companies. The Company believes its estimates and assumptions are reasonable; however, there is significant judgment involved. Changes in financial projections, market risk assumptions, discount rates or probability assumptions related to achieving the various earnout criteria would result in a change in the fair value of the recorded contingent liability. Such changes, if any, are recorded within Interest and other income, net in the Company's consolidated statement of income and comprehensive income.

Our Level 2 foreign exchange derivatives are valued using pricing models and discounted cash flow methodologies based on observable foreign exchange data at the measurement date. See Note 5 for further information regarding the Company's derivative financial instruments.

A reconciliation of the beginning and ending balances of acquisition-related contractual contingent liabilities using significant unobservable inputs (Level 3) for the six months ended June 30, 2018 is as follows:

	Amount
Contractual contingent liabilities at December 31, 2017	$ —
Acquisition date fair value of contractual contingent liabilities — Continuum (Note 2)	2,400
Contractual contingent liabilities at June 30, 2018	$ 2,400

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Estimates of fair value of financial instruments not carried at fair value on a recurring basis on the Company's consolidated balance sheets are generally subjective in nature, and are determined as of a specific point in time based on the characteristics of the financial instruments and relevant market information. The Company uses the following methods to estimate the fair values of its financial instruments:

- for financial instruments that have quoted market prices, those quoted prices are used to estimate fair value;
- for financial instruments for which no quoted market prices are available, fair value is estimated using information obtained from independent third parties, or by discounting the expected cash flows using an estimated current market interest rate for the financial instrument;
- for financial instruments for which no quoted market prices are available and that have no defined maturity, have a remaining maturity of 360 days or less, or reprice frequently to a market rate, the Company assumes that the fair value of these instruments approximates their reported value, after taking into consideration any applicable credit risk.

The generally short duration of certain of the Company's assets and liabilities results in a number of assets and liabilities for which fair value equals or closely approximates the amount recorded on the Company's condensed consolidated balance sheets. These types of assets and liabilities which are reported on the Company's consolidated balance sheet include:

- cash and cash equivalents;
- time deposits and restricted cash;
- employee loans;
- borrowings under the Company's 2017 Credit Facility (Note 6 "Long-Term Debt").

The fair value of employee housing loans is estimated using information on the rates of return that market participants in Belarus would require when investing in unsecured U.S. dollar-denominated government bonds with similar maturities (a "risk-free rate"), after taking into consideration any applicable credit and liquidity risk.

The following tables present the reported amounts and estimated fair values of the financial assets and liabilities for which disclosure of fair value is required, as they would be categorized within the fair value hierarchy, as of the dates indicated:

			Fair Value Hierarchy		
	Balance	Estimated Fair Value	Level 1	Level 2	Level 3
June 30, 2018					
Financial Assets:					
Cash and cash equivalents	$584,081	$584,081	$584,081	$—	$—
Restricted cash	$1,195	$1,195	$1,195	$—	$—
Employee loans	$3,753	$3,753	$—	$—	$3,753
Financial Liabilities:					
Borrowings under the 2017 Credit Facility	$25,019	$25,019	$—	$25,019	$—

			Fair Value Hierarchy		
	Balance	Estimated Fair Value	Level 1	Level 2	Level 3
December 31, 2017					
Financial Assets:					
Cash and cash equivalents	$582,585	$582,585	$582,585	$—	$—
Time deposits and restricted cash	$673	$673	$—	$673	$—
Employee loans	$4,210	$4,210	$—	$—	$4,210
Financial Liabilities:					
Borrowings under the 2017 Credit Facility	$25,009	$25,009	$—	$25,009	$—

5. DERIVATIVE FINANCIAL INSTRUMENTS

The Company conducts a large portion of its operations in international markets that subject it to foreign currency fluctuations. To manage the risk of fluctuations in foreign currency exchange rates, during the six months ended June 30, 2018, the Company implemented a hedging program whereby it entered into a series of foreign exchange forward contracts with

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durations of twelve months or less that are designated as cash flow hedges of forecasted Russian ruble, Polish zloty and Indian rupee transactions.

The Company measures derivative instruments and hedging activities at fair value and recognizes them as either assets or liabilities in its consolidated balance sheets. Accounting for the gains and losses resulting from changes in fair value depends on the use of the derivative and whether it is designated and qualifies for hedge accounting. As of June 30, 2018, all of the Company's foreign exchange forward contracts were designated as hedges. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge, and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions.

Derivatives may give rise to credit risks from the possible non-performance by counterparties. The Company has limited its credit risk by entering into derivative transactions only with highly-rated financial institutions and by conducting an ongoing evaluation of the creditworthiness of the financial institutions with which the Company does business. There is no financial collateral (including cash collateral) required to be posted by the Company related to the foreign exchange forward contracts.

The fair value of derivative instruments on the Company's consolidated balance sheets as of June 30, 2018 and December 31, 2017 were as follows:

	Balance Sheet Location	As of June 30, 2018		As of December 31, 2017	
		Asset Derivatives	Liability Derivatives	Asset Derivatives	Liability Derivatives
Foreign exchange forward contracts - Designated as hedging instruments	Prepaid and other current assets	$84		$ —	
	Accrued expenses and other current liabilities		$ 2,690		$ —
Foreign exchange forward contracts - Not designated as hedging instruments	Prepaid and other current assets	$—		$ 114	
	Accrued expenses and other current liabilities		$ —		$ —

The Company records changes in the fair value of its cash flow hedges in accumulated other comprehensive income/(loss) in the consolidated balance sheet until the forecasted transaction occurs. When the forecasted transaction occurs, the Company reclassifies the related gain or loss on the cash flow hedge to cost of revenues (exclusive of depreciation and amortization). In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, the Company reclassifies the gain or loss on the related cash flow hedge from accumulated other comprehensive income/(loss) to foreign exchange gain/(loss) in the consolidated statement of income in that period. If the Company does not elect hedge accounting, or the contract does not qualify for hedge accounting treatment, the changes in fair value from period to period are recorded in foreign exchange gain/(loss) in the consolidated statement of income.

The changes in the fair value of foreign currency derivative instruments in our unaudited condensed consolidated statements of income and comprehensive income for the three and six months ended June 30, 2018 and 2017 were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Foreign exchange forward contracts - Designated as hedging instruments:				

Change in fair value recognized in accumulated other comprehensive loss	(2,696)	—	(2,606)	—
Net loss reclassified from accumulated other comprehensive loss into cost of revenues (exclusive of depreciation and amortization)	(937)	—	(937)	—
Foreign exchange forward contracts - Not designated as hedging instruments:				
Net gain recognized in foreign exchange gain/(loss)	—	20	44	159

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6. LONG-TERM DEBT

Revolving Line of Credit — On May 24, 2017, the Company entered into an unsecured credit facility (the "2017 Credit Facility") with PNC Bank, National Association; PNC Capital Markets LLC; Wells Fargo Bank, National Association; Santander Bank, N.A.; Fifth Third Bank and Citibank N.A. (collectively the "Lenders"). The 2017 Credit Facility provides for a borrowing capacity of $300,000, with potential to increase the credit facility up to $400,000 if certain conditions are met. The 2017 Credit Facility matures on May 24, 2022.

Borrowings under the 2017 Credit Facility may be denominated in U.S. dollars or up to a maximum of $100,000 equivalent in British pounds sterling, Canadian dollars, euros or Swiss francs or other currencies as may be approved by the administrative agent and the Lenders. Borrowings under the 2017 Credit Facility bear interest at either a base rate or Euro-rate plus a margin based on the Company's leverage ratio. The base rate is equal to the highest of (a) the Overnight Bank Funding Rate, plus 0.5%, (b) the Prime Rate, and (c) the Daily LIBOR Rate, plus 1.0%. As of June 30, 2018, the Company's outstanding borrowings are subject to a LIBOR-based interest rate which resets regularly at issuance, based on lending terms.

The 2017 Credit Facility includes customary business and financial covenants that may restrict the Company's ability to make or pay dividends (other than certain intercompany dividends) if a potential or an actual event of default has occurred or would be triggered. As of June 30, 2018, the Company was in compliance with all covenants contained in the 2017 Credit Facility.

The following table presents the outstanding debt and borrowing capacity of the Company under the 2017 Credit Facility:

	As of June 30, 2018	As of December 31, 2017
Outstanding debt	$25,000	$25,000
Interest rate	3.1 %	2.6 %
Irrevocable standby letters of credit	$343	$1,294
Available borrowing capacity	$274,657	$273,706
Current maximum borrowing capacity	$300,000	$300,000

As part of the acquisition of Continuum, the Company assumed $3,448 of long-term debt associated with a leased facility and payable to Continuum's landlord. The debt was payable in monthly installments through March 2029 and bore interest at a rate of 8% per annum. During March 2018, the Company paid $3,448 to settle this assumed long-term debt.

7. REVENUES

Adoption of ASC Topic 606, "Revenue from Contracts with Customers" and Change in Accounting Policies

Effective January 1, 2018, the Company adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) as amended. The Company adopted the new guidance using the modified retrospective method by recognizing the cumulative effect of adoption as an adjustment to retained earnings as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with Topic 605. The impact of adoption of the new guidance on the Company's consolidated financial statements as of January 1, 2018 are presented in Note 1 "Summary of Significant Accounting Policies."

The Company recognizes revenues when control of goods or services is passed to a customer in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. Such control may be transferred over time or at a point in time depending on satisfaction of obligations stipulated by the contract. Consideration expected to be received may consist of both fixed and variable components and is allocated to each separately identifiable performance obligation based on the performance obligation's relative standalone selling price. Variable consideration is usually presented in the form of cash incentives or credits. Determining the estimated amount of such variable consideration involves assumptions and judgment that can have an impact on the amount of revenue reported.

The Company derives its revenues from a variety of service offerings, which represent specific competencies of its IT professionals. Fees for these contracts may be in the form of time-and-materials or fixed-price arrangements. The majority of the Company’s revenues are generated under time-and-material contracts which are billed using hourly, daily or monthly rates to determine the amounts to be charged directly to the client. The Company applies a practical expedient and revenue related to time-and-material contracts is recognized based on the Company’s right to invoice for services performed.

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Fixed-price contracts include maintenance and support arrangements, which may exceed one year in duration, as well as application development arrangements. Maintenance and support arrangements generally relate to the provision of ongoing services. Revenues for such agreements are recognized ratably over the expected service period. Application development arrangements are accounted for using input or output methods for measuring the progress towards satisfaction of the performance obligation. Input methods are used only when there is a direct correlation between hours incurred and the end product delivered. Assumptions, risks and uncertainties inherent in the estimates used to measure progress could affect the amount of revenues, receivables and deferred revenues at each reporting period.
Revenues from licenses which have significant stand-alone functionality are recognized at a point in time when control of the license is transferred to the customer. Revenues from licenses which do not have stand-alone functionality are recognized over time.
If there is an uncertainty about the receipt of payment for the services, revenue is deferred until the uncertainty is sufficiently resolved. The Company applies a practical expedient and does not assess the existence of a significant financing component if the period between when the Company transfers the service to a customer and when the customer pays for that service is one year or less.
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 following tables summarize the impacts of changes in accounting policies after adoption of Topic 606 on the Company's condensed consolidated financial statements for the three and six months ended June 30, 2018, which primarily resulted from deferring the timing of revenue recognition for contracts that were previously recognized on a cash basis and recognizing revenues from certain license agreements at a point-in-time rather than over time:

	As of June 30, 2018		
	As Reported	Balances Without Adoption of Topic 606	Effect of Change Higher/(Lower)
Balance Sheet			
Liabilities			
Accrued expenses and other current liabilities	$72,443	$72,426	$ 17
Other noncurrent liabilities	16,421	16,424	(3)
Stockholders' equity			
Retained earnings	$633,950	$633,964	$ (14)

	Three Months Ended June 30, 2018			Six Months Ended June 30, 2018		
	As Reported	Balances Without Adoption of Topic 606	Effect of Change Higher/(Lower)	As Reported	Balances Without Adoption of Topic 606	Effect of Change Higher/(Lower)
Income Statement						
Revenues	$445,647	$444,951	$ 696	$869,795	$869,812	$ (17)
Income from operations	$54,237	$53,541	$ 696	$102,934	$102,951	$ (17)
Provision for/(benefit from) income taxes	$6,864	$6,728	$ 136	$(9,655)	$(9,652)	$ (3)
Net income	$50,255	$49,695	$ 560	$114,673	$114,687	$ (14)

Disaggregation of Revenues
The following tables show the disaggregation of the Company's revenues by major client location, including a reconciliation of the disaggregated revenue with the reportable segments (Note 12 "Segment Information") for the three and six months ended June 30, 2018:

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	Three Months Ended June 30, 2018					
Reportable Segments	North America	Europe	Russia	Total Segment Revenue	Other Income Included in Segment Revenues	Consolidated Revenues
Client Locations						
North America	$250,273	$14,177	$14	$264,464	$ (13)	$ 264,451
Europe	3,086	146,998	—	150,084	(280)	149,804
CIS	2,089	28	17,294	19,411	—	19,411
APAC	1,655	10,292	72	12,019	(38)	11,981
Revenues	$257,103	$171,495	$17,380	$445,978	$ (331)	$ 445,647

	Six Months Ended June 30, 2018					
Reportable Segments	North America	Europe	Russia	Total Segment Revenue	Other Income Included in Segment Revenues	Consolidated Revenues
Client Locations						
North America	$476,343	$27,538	$29	$503,910	$ (13)	$ 503,897
Europe	5,826	297,478	42	303,346	(457)	302,889
CIS	4,092	91	37,008	41,191	—	41,191
APAC	2,038	19,731	87	21,856	(38)	21,818
Revenues	$488,299	$344,838	$37,166	$870,303	$ (508)	$ 869,795

The following tables show the disaggregation of the Company's revenues by industry vertical, including a reconciliation of the disaggregated revenue with the reportable segments (Note 12 "Segment Information") for the three and six months ended June 30, 2018:

	Three Months Ended June 30, 2018					
Reportable Segments	North America	Europe	Russia	Total Segment Revenue	Other Income Included in Segment Revenues	Consolidated Revenues
Industry Vertical						
Financial Services	$26,732	$62,496	$14,091	$103,319	$ (331)	$ 102,988
Travel & Consumer	47,104	52,120	1,792	101,016	—	101,016
Software & Hi-Tech	64,536	19,857	624	85,017	—	85,017
Business Information & Media	59,532	18,117	—	77,649	—	77,649
Life Sciences & Healthcare	32,876	5,649	—	38,525	—	