EPAM Q1 FY21
Earnings Prepared Remarks

David Straube, Head of Investor Relations

Thank you, operator, and good morning, everyone. By now, you should have received your copy of the earnings release for the Company's first quarter 2021 results. If you have not, a copy is available on EPAM.com in the investor section.

With me on today are Arkadiy Dobkin, CEO and President, and Jason Peterson, Chief Financial Officer.

I would like to remind those listening that some of the comments made on today's call may contain forward-looking statements. These statements are subject to risk and uncertainties as described in the Company's earnings release and SEC filings.

Additionally, all references to reported results that are non-GAAP measures have been reconciled to the comparable GAAP measures and are available in our quarterly earnings materials located in the investors section of our website.

Arkadiy Dobkin, President and CEO

Thank you, David. Good morning everyone and thank you for joining us today.

Before I begin my summary of the quarter, I want to acknowledge that the past month has been a stark reminder that we are still amid a deadly and very much global pandemic and that we must continue to be united in our efforts against COVID. As we have done over the last year, we will do everything possible to support our people on the ground and the communities in which they live and work.

Now, turning to our results… for the first quarter we delivered $781 million in revenues, reflecting growth of 20% year-over-year as reported and 18% in constant currency and Non-GAAP earnings per share of $1.81, a 27% increase over the same quarter in 2020.

The strong revenue growth, combined with a greater level of profitability, enabled us to continue to investing at higher levels across the business.

Since we last talked mid-February, we have seen a meaningful increase in demand across our business, with a notable acceleration occurring in the second half of the quarter. Demand for our core services is very robust as clients double down on digital transformation and innovation journeys.

Increasingly, they turn to EPAM to help not only build new platforms, but also to conceive new digital products and services as well as modernize and transform their technology strategy and delivery models. The digitization trends are driving increased interest in business strategy, new types of engagement platforms, cloud migration and modernization efforts, data engineering & data analytics engagements, and, in turn, Machine Learning & AI applications.

From an industry perspective, we are experiencing this dynamic most notably in Life Sciences & Healthcare, Financial Services, Insurance, CPG, Retail and Telecommunications. Today we are focusing on building a stronger vertical expertise to leverage even more effectively our market leading capabilities in core engineering, data and cloud.

In result, while we still have much more work to do to continue building our integrated consulting propositions under the EPAM Continuum brand, with our increasing depth in vertical domains, we are already realizing the promise of delivering increasingly differentiated offerings to our global enterprise customers.

As an example - with EPAM's help, Equifax is creating a platform for developing modern, cloud-based applications, products, and services and bringing their data offerings to a new generation of consumers. It is a critical part of a multi-year cloud- and data-driven transformation for Equifax, where we are working together to build a Google Cloud Platform based data “fabric” that enables Equifax to organize its disparate, legacy data sources into a single, seamless structure while keeping all critical governing and separation measures in place. Also, worth mentioning that while rewriting Equifax’s legacy systems to be cloud native would normally take years, EPAM successfully assisted in transforming Equifax’s mainframe applications in less than one year.

This is only one example, which is repeating across most of the markets and verticals we serve, from Financial Services to rebounding interest in Retail and Travel platforms, and we believe it underscores the amount of technology led change that is pushing all industries into higher levels of activity. With all these dynamics in play today, and hopefully soon in a post-COVID environment, the number of business domains and processes which must be digitized is going to be rapidly increasing. Those market drivers, along with the opportunities in cloud modernization, composable architecture, data, ML/AI and cybersecurity will give us sizeable room for continued and sustainable growth.

To meet this growing demand, we also continue to focus on scaling up our talent. While 2020 challenged us to create reliable and secure remote operations, 2021 has presented an opportunity to leverage those investments in infrastructure, modern talent processes and tooling across the globe to explore ways in which we can activate broader talent markets and deploy a more diverse set of capabilities. The result is that our hiring and net headcount growth is accelerating.

For Q1 we welcomed approximately 2,300 net hires to EPAM, which included an increase of senior level hires coming to us with strong industry experience. Since the beginning of Q4 2020 more than 5,400 net additions have joined the company, representing the highest level of EPAMers we have added in two consecutive quarters.

While the shortage of technical and deep industry talent is a known industry issue, we are confident that our investments in that area, our elevating brand recognition and expanding employee career journey will continue to draw top talent to EPAM.

Also, part of EPAM's growth strategy is the expansion of our capabilities with very focused acquisition efforts. Recently we closed three acquisitions bringing to EPAM talent and experience in the areas of Salesforce, Business Intelligence and Security.

In April we announced the acquisition of PolSource - a Salesforce consultancy with talent concentration in the U.S., UK, & Poland, which will extend our Salesforce Services offerings and its global footprint, and provide a foundation for building additional expertise, IP and scale around Salesforce eco-system. This acquisition builds on our earlier acquisition of MuleSoft partner Ricston to advance our Salesforce API capabilities and to enable customers to leverage a multi cloud approach. We are already working closely with PolSource team to bring together a very different proposition for enterprise clients by joining our expanded consulting and global engineering offerings and to become one of the top global players in the Salesforce services space.

On Tuesday, we announced the acquisition of White-Hat – a niche cyber security consultancy based in Israel. White-Hat's expertise, methodologies, and team of talented professionals will enhance EPAM's cyber defense capabilities and help clients to further improve cyber protection within their platforms.

And lastly, we recently closed an acquisition of a boutique Data and Analytics consultancy firm with offices in Europe and Asia, serving customers across Retail, Consumer and Energy. This acquisition will bring a team of trusted advisors and experts

who provide the full spectrum of Data and Analytics consultancy, including strategy, advisory, data management, market leading accelerators, custom apps and end-to-end delivery across multi-vendor platforms and solutions.
We are pleased to have these three companies join EPAM.

In closing, we are encouraged about the road ahead. During the last twelve months we proved our leadership position within the digital segment of a very competitive Global IT Services market. The EPAM of today is a much more adaptable, diverse, and global company, with increasingly strong market offerings and all the necessary components for a scalable talent eco-system, which are required for growth as we think about EPAM becoming a $5 to $10 billion company.

With that let me hand the call over to Jason to provide more specifics in our Q1 results and an update to our 2021 business outlook.

Jason Peterson, Chief Financial Officer

Thank you, Ark, and good morning everyone.

We are pleased with our performance this quarter. As Ark mentioned, we delivered strong growth across a broad range of industry verticals and geographies.

In the first quarter, EPAM generated revenues of $780.8 million, a year-over-year increase of 19.9% on a reported basis and 17.8% in constant currency, reflecting a positive foreign-exchange impact of 210 basis points. Revenues came in higher than previously guided due to stronger demand in the second half of the quarter, combined with our ability to accelerate hiring in response to the improving demand environment.

Our industry vertical performance produced strong sequential growth across the majority of the portfolio, driven by a higher level of revenues from both new work at existing clients and new customer relationships established over the last 12 months.

Looking at the year-over-year performance across our industry verticals…

- Life Sciences & Healthcare grew 31.6%. Growth in the quarter was driven by platform development to support new business models and data & analytics to drive deeper customer insights.
- Financial Services grew 28.3%, with growth coming from traditional banking, insurance, and to a lesser degree, wealth management. Growth was driven by our client's need to transform beyond digital banking to modernize core processes and applications, leveraging the cloud.
- Software & Hi-Tech grew 20.7% in the quarter.
- Travel & Consumer grew 16.3%, driven by strong growth from our Consumer clients, along with solid and improving performance within Retail.
- Business Information & Media delivered 6.5% growth in the quarter. Growth in the quarter reflected a tougher comparison with the same quarter last year, with several clients having experienced substantial growth in the first half of 2020 with revenues from those programs generally plateauing late last year.
- And finally, our Emerging Verticals delivered 23.6% growth, driven by clients in Telecommunications, Automotive and Materials.

From a geographic perspective:

- North America, our largest region representing 60.2% of our Q1 revenues, grew 20.6% year-over-year or 19.9% in constant currency.
- Europe, representing 33.2% of our Q1 revenues, grew 16.3% year-over-year or 10.9% in constant currency.
- CIS, representing 3.9% of our Q1 revenues, grew 21.2% year-over-year and 28.2% in constant currency.
- And finally, APAC grew 53.9% year-over-year or 48.4% in constant currency and now represents 2.7% of our revenues. Growth in the quarter was driven primarily by clients in Financial Services. Additionally, the shutdown of economic activity in the region in March 2020 produced a beneficial year-over-year comparison.

In Q1, revenue growth across the portfolio was more diverse than in previous quarters, with our top 20 clients growing 12.1% while clients outside our top 20 grew 25.9%. Additionally, we saw good growth with both existing and new clients.

Moving Down the Income Statement.

Our GAAP Gross Margin for the quarter was 33.5%, compared to 34.9% in Q1 of last year. Non-GAAP Gross Margin for the quarter was 34.9%, compared to 35.5% for the same quarter last year. The lower gross margin in the quarter was primarily the result of Q1 2021 having one less available day of capacity than Q1 2020. Additionally, we are beginning to see some degree of elevated labor costs in certain geographies.

GAAP SG&A was 17.5% of revenue compared to 19.2% in Q1 of last year, and Non-GAAP SG&A came in at 15.5% of revenue compared to 17.6% in the same period last year. Our SG&A continues to reflect a lower level of corporate spend, which we believe will tick up as we progress throughout the year.

GAAP income from operations was $107.3 million or 13.7% of revenue in the quarter compared to $87.5 million or 13.4% of revenue in Q1 of last year.

Non-GAAP income from operations was $136.9 million or 17.5% of revenue in the quarter compared to $105.3 million or 16.2% of revenue in Q1 of last year.

Our GAAP effective tax rate for the quarter came in at 5.1%, which includes a lower-than expected level of excess tax benefits related to stock-based compensation. Our Non-GAAP effective tax rate, which excludes excess tax benefits, was 22.7%.

Diluted earnings per share on a GAAP basis was $1.86. Non-GAAP diluted EPS was $1.81 reflecting a 26.6% increase over the same quarter in 2020.

In Q1, there were approximately 58.8 million diluted shares outstanding.

Turning to our cash flow and balance sheet.

Cash flow from operations for Q1 was $12.8 million, compared to $63.3 million in the same quarter of 2020. Free cash flow was $1.6 million, compared to $34.2 million in the same quarter last year. The lower level of cash flow in the quarter was the result of timing of payments related to our annual variable compensation programs returning to more historic norms. Additionally, income tax payments were higher compared to the same quarter in 2020.

We ended the quarter with $1.37 billion in cash and cash equivalents.

In Q1 DSO was 67 days and compares to 64 days in Q4 2020 and 76 days in the same quarter last year. We believe we can continue managing DSO levels in the upper 60’s.

Moving on to a few operational metrics.

We ended the quarter with more than 38,800 Engineers, Designers and Consultants, a year-over-year increase of 17.3% and a sequential increase of 5.7%. Our total headcount for Q1 was 43,450 employees.

Utilization was 81.4% compared to 79.5% in Q1 of last year and 77.9% in Q4 2020.

Now let's turn to guidance.

We continue to see strong demand across a broad range of our offerings. Due to elevated demand across the portfolio, combined with improvements in staffing capacity, we are raising our revenue and EPS outlook for 2021.

As we mentioned during our last earnings call, throughout 2021 we will be investing at elevated levels across the business to support growing demand, and we will continue our expansion into new geographies underpinning our long-term growth objectives and goal of becoming both a larger an increasingly global EPAM.

Starting with our full year outlook:

- Revenue growth <u>will now be</u> at least 29.0% on a reported basis and, in constant currency terms, <u>will now be</u> at least 28.0% after factoring in an approximate 1.0% favorable foreign exchange impact. We <u>now expect</u> approximately 200 basis points of revenue contribution to come from acquisitions we closed in the last 12 months.

- We expect GAAP Income from Operations <u>to continue to be</u> in the range of 13.5% to 14.5% and Non-GAAP Income from Operations <u>to continue to be</u> in the range of 16.5% to 17.5%. As mentioned earlier, our Income from Operations reflects a higher level of investment in the planned expansion of our capabilities and geographies in 2021.

- We expect our GAAP Effective Tax Rate to continue to be approximately 12% and our Non-GAAP Effective Tax Rate, which excludes excess tax benefits related to stock-based compensation, to continue to be approximately 23%.

- For Earnings Per Share, we expect GAAP diluted EPS will now be in the range of $7.09 to $7.31 for the full year, and Non-GAAP diluted EPS will now be in the range of $7.54 to $7.76 for the full year.

- We expect weighted average share count of 59.0 million fully diluted shares outstanding.

For Q2 of 2021 we expect:

- Revenues to be in the range of $853 to $861 million producing a year-over-year growth rate of approximately 35.5% at the midpoint of the range. We expect the favorable impact of FX on revenue growth to be approximately 3.0%. Lastly, We now expect approximately 250 basis points of revenue contribution to come from acquisitions we closed in the last 12 months.

- For the second quarter, we expect GAAP Income from Operations to be in the range of 13.5% to 14.5% and Non-GAAP Income from Operations to be in the range of 16.5% to 17.5%.

- We expect our GAAP Effective Tax Rate to be approximately 11.0% and our Non-GAAP Effective Tax Rate, which excludes excess tax benefits related to stock-based compensation, to be approximately 23.0%.

- For Earnings per Share, we expect GAAP diluted EPS to be in the range of $1.76 to $1.83 for the quarter, and Non-GAAP diluted EPS to be in the range of $1.88 to $1.95 for the quarter.
- We expect a weighted average share count of 59.0 million diluted shares outstanding.

Finally, a few key assumptions that support our GAAP to Non-GAAP measurements:

- Stock-based compensation expense is expected to be approximately $21.8 million in Q2, $21.5 million in Q3 and $21.2 million in Q4.
- Amortization of intangibles is expected to be approximately $3.1 million for each of the remaining quarters.
- The impact of foreign exchange is expected to be approximately a $1.5 million-dollar loss for each of the remaining quarters.
- Tax effect of Non-GAAP adjustments is expected to be around $5.7 million in Q2 and approximately $5.5 million in each remaining quarter.
- And finally, we expect excess tax benefits to be around $14.2 million in Q2, $10.2 million in Q3 and $8.6 million in Q4. In summary, we are pleased with the high-quality results we delivered in the quarter, which combined with the broad based strength we see across the business, provides support for strong 2021 performance.

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