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LXFT - Q2 2016 Luxoft Holding Inc Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to the Luxoft Holdings Inc call on financial results for the quarter and six months ended September 30, 2015.

(Operator Instructions)

As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Alina Plaia, Vice President and Investor Relations Officer. Thank you, you may begin.

Alina Plaia - *Luxoft Holding, Inc. - VP of IR*

Thank you, Melissa. Hello everyone, and good to have you on this earnings call. Today, we are discussing Luxoft's financial and operating results for the three and six months ended September 30, 2016. We hope that by now you've had a chance to review our earnings release, which is located along with the updated investor materials on our website, Luxoft.com investor center. As always, we are running a webcast at the same time with the call.

On the line with me today, I have three speakers: Dmitry Loschinin, the President and Chief Executive Officer; Alwin Bakkenes, CEO of Pelagicore, who is now in charge of Luxoft's digital cockpit practice; and Roman Yakushkin, our CFO.

Before we begin, Safe Harbor rule. Some of our comments in our call today may be deemed forward-looking statements. This includes our business and financial outlook, answers to some of your questions or comments, and forecasts with respect to future vertical and account growth and development of our high potential accounts. Such statements are subject to risks and uncertainties, as described in the Company's earnings release, and other filings with the SEC.

As you know we follow US GAAP accounting rules in our financials, and at the same time we always reference certain non-GAAP measures that we believe are relevant for better understanding of our business dynamic by the market. You can now find a reconciliation of our GAAP to non-GAAP measures, including for the metrics used in the outlook in the back of our earnings release, along with the other schedules.

In a moment Dmitry Loschinin will give you an overview of the past six months. Alwin will speak about his background and the expertise that his company brought to Luxoft, including around digital cockpit. And finally, Roman Yakushkin will give you all other financial information for the first half of the year.

Now, I would like to pass the call to Dmitry Loschinin. Dmitry, please go ahead.

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

Hello, everyone. Good to have you on the call. We are pleased to share with you financial results from our second quarter and the first six months of the year, marked by consistent top line growth supporting a good outlook for the rest of this financial year, as previously guided.

Our top line in the first six months of FY17 delivered about 21% year-over-year growth, or 22% in constant currency terms. 15% of the growth for this period was purely organic. This year is clearly is a challenging year for every segment of the economy, and the IT services industry is not an exception.

However, we believe there is successful execution on the resolutions we made earlier this year. We are steadily implementing strategic improvements to reinforce our position on the market, and to solidify our business model. For nearly a decade have been actively aiming to get exposure to the budget pockets of our clients that are highly leveraged, that must have technological innovation, regulatory, and compliance [oboes].

Basically there's no discretionary budget that are less volatile by nature regardless of market. Thus, despite the uncertainty in our business environment, in the broad sense, we feel that our growth is resilient, and reiterate at least 20% year-over-year top line growth for the full year, as well is a soft target of $1 billion by March 31, 2018.

We're pleased to note a significant decline in our top client concentration, in line with what we have been promising to the market. Top line account concentration declined about 7.5% to 26% of the total. Top 2, 3, 5 and 10 concentrations are down about 6% across the board for the first six months of the year. Please note that this measurable concentration decline comes on the back of healthy top line growth, consistent with our outlook.

It is our goal to continue on this trajectory until no single client exists 15% of the revenues at the most. We expect to be there by 2020. Growth of the business outside of Deutsche and UBS for the first six months of the year comprised about 37% year-over-year.

We have three new names in our top 10 accounts list, since for the first half of the year, versus same period of last year. One from automotive, it's actually an OEM, one from financial services, European bank that we have spoken about many times, and one new name that only appeared this quarter from healthcare and that healthcare group.

This quarter we added a total of seven HPAs, three from automotive tools with our well-known European OEMs and Tier 1 supplier that has been our client for years but not has been on the HPA list. Two from healthcare, and two from telecom. This brings the total count of HPAs to 47.

The HPA group continues to comprise about 20% of our overall revenues, and grows a little over 100% annually. This dynamic provides substantial routes to our future growth, and allows us to diversify our revenues and continue reducing client and financial vertical concentration.

INSYS update, perhaps you remember that in July of this year, we have purchased a US-based IT technology consultant, and IT management firm, called INSYS. The company has two business lines that are very complementary to Luxoft's business, healthcare, pharmaceutical and telecom.

Core services focus around advanced predictive analytics business intelligence and data warehousing, digital marketing, and enterprise information management. INSYS acquisition integration process is smoothly underway, according to a 30 point strategy around cross-sell opportunities within account portfolios of both companies, offering synergies in big data and analytics and DevOps. We are also realizing operational efficiencies by combining back-office functions.

Luxoft and INSYS management team are collaborating on various integration steps, and defining a strategy on further development, telecom and healthcare verticals. Acquisition of INSYS added at least four accounts to our HPA list, such as Verizon and United Healthcare Group. It also measurably boosted revenue growth at AT&T, who we have previously worked with. Lastly, we significantly increase our presence by nearly 500 people in North America, and immediately established a solid sales infrastructure in this part of the world.

Let me take you through the highlight of our vertical dynamic. Financial services. While the financial services vertical grew about 14% for the first six months of the year, on a year-over-year basis, outside of the top two accounts, the growth was 34%, all of which was organic.

Vertical concentration and the total revenue mix has declined significantly for such a short period of time, over 4%. It now comprises approximately 66% of the total revenues, and the projected concentration will continue to slowly decline for the next couple of years. Our top clients, Deutsche Bank and UBS, have been in the news a lot for the past several months. Their shares have been quite volatile, and that also triggered volatility in our stock.

Despite the news and daily noise, there is no fundamental shift in the way we engage with either of these banks. Within UBS, we are actually participating in digital engagements such as IBS [new], in creating a [cooperation] of dealership platform. Another transformational project there is a creation of One Wealth Management Platform, uniting back office and execution functions between Americas and Europe.

The new CIO that stepped in, as expected in September, is focusing on continued portfolio rationalization, simplification, and implementation the next digital banker services. We also still play an important role in the regulatory initiatives of the bank, focused on capital planning and stress testing, recovered resolution planning in line with Dodd-Frank and others. On the [dubious] side, we're looking at the same close of the year as previously guided, single-digit year-over-year decline.

In the upcoming quarters, we are hoping to expand in the areas of the Bank outside of capital markets such as treasury asset and wealth management, and global transactional banking. Some of that expansion is coming from the tailwind of consolidation, which is slowly starting a process that we referred to on the previous calls. It's logical to assume that the bank will be reducing its budget, including [fees] next year after the first quarter.

We believe that between the expansion opportunity that's in other areas of bank, and likely upcoming budget cuts, FX and IB in capital markets, we will still continue to retain substantial presence as one of the key vendors within Deutsche Bank. We still forecast the top two accounts being about flipped, as of the end of our fiscal year. We [DB] are contributing single-digit declines in UBS end of the year with single-digit growth. We forecast similar dynamic for the next year.

At the same time, we have solid growth coming into the financial services vertical from HPAs. European banks, and other financial services companies continue to generate consistent demand for IT services and technical consulting. The entire system of technology delivery today is being revised because of the pressure to move faster, be agile, and increase productivity of the workforce.

You are probably aware that around 80% of the work that we do across the entire Company is considered digital. For some of our financial services clients, that handle significant parts of the additional transformation and regulatory agenda, which envisages acceleration of the work in the risk governance and compliance areas, where the cost of failure is very high. Additional vendors are unable to pick up the pace, we believe, and that is why Luxoft has been enjoying the incoming demand from those areas.

Two of our European clients, both relatively new HPAs have been growing very well in the back of this trend, and I expect it to continue, with strong growth in the next several quarters. We're solidifying the relation with one of our older financial HPAs, that is on our top 10 client list. Recently, we were able to secure additional engagements with this bank, and now we will be serving this client on a more global level versus our previous status of a regional vendor. We will be working on a worldwide scale not in only software development services space, but also in consulting and other premium services.

Automotive. We're very encouraged to see persistent growth in the segment for the first six months, reflecting our expectations that we have share with you previously of 50% year-over-year growth and 125% growth outside of the top one client in the vertical, all of which is organic.

We expect to see this strong momentum to be reflected in the full FY17 results. We actually already have some good visibility into 2018, since software development cycles in auto are much longer than in other verticals. For the first six months, automotive vertical represented 13% of our revenues, up from 10% of the revenues a year ago.

One of the newest additions into our top 10 accounts is a luxury European OEM, which has been growing over 300% over the past year, and Luxoft is taking more strategic growth with this client. We hope to be able to speak about it with you next year.

The most popular areas of demand remain to be HMI and telematics projects, as well as engagement around the next generation IVA platforms. The market is quite favorable for this segment, and most of the budgets are ready to accommodate all of the new necessary developments that are coming into the vehicles three or four years from now.

For the past two quarters, we were able to add many new HPAs that includes OEMs and Tier 1 providers. We have been rapidly expanding with one of our newer HPAs, an European-based automotive supplier, one of the leading Tier 1 in the autonomous driving space. This class products, including various sensors, camera equipment, and various radars focus on improving performance of the vehicle and facilitate intuitive driving. Luxoft computer vision and our timing know-how really impressed the customer, and currently we're embarking on several wide scale engagements.

Just recently we have completed acquisition of a small but strategically important company, Pelagicore, a Swedish provider of software platform and services for in-vehicle infotainment, IVI, and human-machine interface, HMI development. This allowed us to reinforce Luxoft as a leader and end-to-end provider to IVI and HMI development used for the global automotive and Tier 1 manufacturers. You will hear in a few minutes from Alwin Bakkenes, CEO of Pelagicore, who is now heading up the digital cockpit practice at Luxoft.

The telecom vertical has advanced over 60% year over year, driven by organic growth, and also by changes in the account base post INSYS acquisition. There's a massive, ongoing change in the industry, where large providers such as AT&T, which is our client, changes the way we're running the business and how they capture the end consumers.

INSYS and Luxoft are very excited to work with this common customer, which immediately entered our top 10 list for the quarter post acquisition. Over the past three months, in addition to ongoing engagements, we will focus on solutions delivered via our big data COE around artificial intelligence, IoT and has [real] testing.

We are very pleased to add healthcare and pharma to our list of core verticals businesses. As you are already aware, we entered these verticals since requiring INSYS, with whom we have many synergies. Data analytics capability being one of the most important ones, with focus on the payer provider space.

Healthcare now comprises 4% of Luxoft total revenue for the total year. Our sales and business leaders are working on rolling out the joint offering to the players within the segment, as well past on plans to realize substantial cross selling opportunities between our and INSYS customers.

On other fronts, we continue to expand our global presence, with an addition of the office in Malaysia, Penang. We're very excited to build our business in the Asia-Pacific region, and see great opportunities to serve our current clients from financial out and other verticals from that location.

For the first six months of the year, our productivity has increased to approximately $77,000 per engineer, the highest historical level for the period. Even at that budgetary and pricing environment, we can see this is a testament to our quality of delivery into the acute need for the solutions we are building. With this, I would like to pass the word to Alwin, who will explain the importance of IT competencies related to digital cockpit, speak about the overall trends, and how newly added Pelagicore is helping Luxoft to remain the strongest and best supplier in the space.

Alwin Bakkenes - *Pelagicore - CEO*

Thank you, very much, for the introduction, and welcome, everybody. Let me start by introducing Pelagicore to you, and explain also why we partnered up with Luxoft.

As most of you know, the automotive industry has struggled to keep pace with the highly innovative mobile industry, and delivering stunning user experience to its consumers, and car markers are making a transition from analog instruments, and purpose built infotainment systems to an all-digital user experience, with functionalities that bridge their mobile devices and in car user experiences. This is what we call the digital cockpit.

With roots in both open-source and the mobile industry, Pelagicore's mission has been to deliver stunning user experiences to the automotive industry, in line with next-generation mobile devices. Over the past years, Pelagicore developed a customer portfolio with thought-leading premium car makers, and enabled them to bring new experience to their customers. Pelagicore built a product portfolio that has been made available to the market under open-source licenses, which enables the development of very large developer ecosystem, and industry support for its solutions.

This combination of key industry expertise, a premium customer base, improvement solutions represents a very strong synergy to Luxoft, and that led to the acquisition. Luxoft adds global sales outreach, and a global agile delivery capacity, with complementary customer portfolio. And to ensure that we're able to fully capture these synergies, we've chosen to combine all expertise, solutions, and delivery capacity in this domain into the digital cockpit practice. Together, we can now provide a full range of solutions and services to enable car makers and Tier 1 suppliers to make a transition to digital user experiences.

The Pelagicore team consisted of seasoned professionals with a profound understanding of both the automotive industry, but also open-source based software development. For example, I myself held the position as the director of the infotainment, driver information and HFI department at Global Cars for approximately seven years before joining Pelagicore.

I've also served on the Board, and still do, on the Board of GENIVI Alliance, in support of the development of an open source-based infotainment platform. Our combined management team has held leadership positions with organization such as the Linux Foundation, the AllSeen Alliance, and with companies such as Nokia, Continental, Volvo, BMW and other leaders in their fields.

For the past few years, the automotive industry has been lagging behind in user experiences to the mobile industry. Many car makers, however, recognize that the digital user experience in the vehicle helps them connect their consumer to their brand. And especially as traditional brand differentiators such as driving dynamics and engine performance are becoming less relevant for consumers in the sharing economy, this has led to significant market growth for in-vehicle infotainment and digital instrument cluster markets. And analysis almost unanimously forecasts continued strong growth.

The Luxoft digital cockpit team provides a full reference act from pixel to silicon. Our team of experienced designers support car makers in developing unique interactive solutions for our future autonomous driving vehicles, and our technical team enables leading new silicon platforms to run the software platforms of the future, and to enable fast time to market and innovation.

For this we also provide a Linux-based platform with acute automotive suite HMI and application framework under open source licenses. This puts Luxoft in very unique position to be part of our customer design process, to support many innovation projects, and add the capacity to deploy natural products. This unique positioning of Luxoft in combination with our agile global delivery team enables us to support the automotive industry, with solutions and services that connect the consumers to the car makers brand, an area which is really key for any car maker to succeed in the sharing economy.

Let's review one case study of how we support our clients, such as one of our major premium car manufacturer customers, to deliver truly stunning user experience. Firstly, we have taken responsibility and delivered their HMS software directly with their designers, leading to a result that is truly stunning. It has an intuitive interaction, combined with high fidelity graphics and animation.

Our unique open-source solutions enable the development of an application ecosystem, making the vehicle platform a platform for innovation by content and services providers, and ensuring that the vehicle remains fresh and in line with the consumer's digital lifestyle. Finally, we strategically support this particular customer to build and retain in-house competence, and enable them to innovate and develop even better solutions, based on this platform going forward. Back to you, Dmitry.

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

Thank you, Alvin. Before I pass over to Roman, I would like to reiterate our optimistic outlook for the end of this, maintain and win financial year, and believe that during this challenging year of rebalancing and reinvestment into our business, we're positioning ourselves well within several verticals: financial services, auto, healthcare, and telecom. And as a leading provider of certain expertise related to data analytics in our teams, HMI, UI we're building up consultant expertise in several crucial platform architectures.

We're expanding our global presence, while remaining agile. We also believe our Company has a solid foundation, excellent execution skills, strong management, and in combination with the currently undertaken strategic initiatives, we are securing a steady growth of the company for years to come.

Given our current pipeline of business and the opportunities we see for Luxoft, (inaudible) we believe that we can accomplish our circle target of $1 billion by the end of our FY18. Roman, please go ahead.

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

Thank you, Dmitry. I hope everyone is doing well today. Let me guide you through our operational financial dynamic. For the sake of leaving as much time for the Q&A as possible, I will focus mainly on the six-month picture.

As Dmitry said, we are pleased with the momentum that Luxoft continues to carry in the separation of financial performance, despite a challenge macro environment and lot of uncertainty. Revenue for the first six months amounted to $374.5 million, compared to $309.6 million for the first six months of the prior year, which is 21% increase. Revenue in constant currency amounted to $378.3 million, as compared to $309.6 million for the first six months of the previous year. This corresponds to 22.2% increase year over year.

Revenue breakdown by geography for the first six months of the year was as follows: UK increased 5.7% year-over-year and amounted to 51.6% of the total. US increased 16.6% year-over-year to comprise 30.3% of the total revenue. Germany increased 38.4% to 14.2% of the total.

Russia decreased 6.5% to 4% of the total. Switzerland increased 100.8% to 4.6% of the total. The increase for Switzerland is attributable to UBS. Other geographies increased 53.6%, and now comprise 15.3% of the total. That includes rest of Europe, with 10.7%.

Revenue breakdown by verticals for the first six months: Financial services vertical amounted to 65.6% of total sales. That represents an increase of 13.5% year-over-year. Without the top two accounts, the growth was 34.5%.

Automotive and transport, 13% of total sales, an increase of 51.8% year-over-year. Ex-Harman, this vertical actually grew by 125%. Telecom comprised 7.7% of the total revenue, and an increase of 61.4% year-over-year.

Technology vertical. 5.6% of the total revenue and a decrease of 5.3% year-over-year. Travel and aviation vertical comprised 4% of total sales, and an increase of 7.4% year-over-year. If we excluded Boeing, the growth of the vertical would be 28.7% year-over-year.

Healthcare contributed 2.2%. Energy amounted to 1.6% of total sales, a decrease of 4.7% year-over-year. We're pleased to report that development for our HPAs organically and budget acquisitions brought our client concentration down dramatically. For the first six months, our top three accounts comprised of 54.4% of total revenue, which is a 6.5% year-over-year decrease.

Our top five accounts amounted to 60% of sales, representing 6.3% decrease year-over-year. Our top 10 accounts for the same period amounted to 70% of sales, which represents 5.3% decrease year over year.

The dynamic for our top three accounts, Deutsche Bank, UBS and Harman is as follows: For the first six months ended September 30, Deutsche Bank amounted to 25.9% of sales, down from 33.4% for the same period a year ago, representing 6% decrease on a year-over-year basis. At the same time, UBS grew by 29.1% to 22.1% from sales from 20.7% a year ago. For the first six months of FY17, Harman comprised to 6.4% of total revenue, it is 13.2% increase year-over-year.

Moving onto the profitability metrics. For the first six months, adjusted EBITDA amounted to $67.1 million versus $64.2 million in the first half a year ago, representing a 4.5% increase.

Our adjusted EBITDA margins at six months was 17.9% versus 20.7% in the first half last year. Our GAAP net income was $30.4 million for the first half of the year, in comparison with $37.6 million in the first half of the previous year, a 19.2% year-over-year decrease. Our GAAP net income margin the first six months was 8.1%, 410 basis points lower than in the first half of the last year.

Major factors affecting GAAP net income dynamics are as follows: One, additional share-based compensation expense, attributable to the growth in new existing staff retention motivation purposes. Two, amortization of intangible assets, related to our M&A activity. And three, acquisition-related costs.

Our non-GAAP net income was $48.9 million in the first half of the year, in comparison with $49.3 million last year, 0.8% decrease year-over-year. Our non-GAAP net income margin the first half was 13% versus 15.9% in the same period last year. In the second quarter, our non-GAAP net income was $27.8 million, versus $28.6 million in the year-ago quarter, and $21 million in the previous quarter ended June 30, 2016.

Currency breakdown. On the revenue side, US dollars 55%, Euros 30%, Great Britain pound 6%, Polish zloty 3%, ruble 2%, others 4%. And on the cost side, US dollars 47%, ruble 12%, Great Britain pound 9%, Polish zloty 13%, Romanian leu 9%, Euro 4%, Swiss franc 2%, and others 4%.

Our effective tax rate for the six months ended September 30 was 16.1%, same as in the second half of last year. We would like to remind you that our target rate for the year as a whole is between 15% and 16%.

Weighted average of diluted share count for the past quarter was 33.7 million shares, an increase of 0.1 million shares from the previous quarter. Our diluted EPS amounted to $0.48 per share, as compared to $0.42 per share in the previous quarter, and $0.67 in the second quarter a year ago. On a non-GAAP basis, our diluted EPS were $0.83 per share compared to $0.62 per share in the previous quarter and $0.84 in the second quarter of the last year.

Let's move on to the balance sheet. We have finished the six months with approximately $80.2 million in cash and cash equivalents. As on September 30, our trade receivables, including unbilled revenue, were approximately $177.8 million, compared to $134.1 million a year ago, and $147.1 million as of June 30, 2016. Unbilled revenues amounted to $15.2 million as of September 30, 2016, down from $19.6 million as of September 30 last year.

At the end of the second quarter, days sales outstanding, excluding unbilled and deferred revenues stood at 69 days, up by two days from 67 days in the previous quarter, and in the same quarter the previous year. Full DSO, including our unbilled and deferred revenues stood almost unchanged at 74 days, up by one day up from 73 days last quarter, and in the second quarter last year. For the first six months, DSO excluding unbilled and deferred revenues stood at 77 days.

Our CapEx level for the past six months has been at 2.7%. We usually capitalize and amortize expenses related to the workplaces, computers, furniture, et cetera. Therefore our CapEx usually grows in proportion with the headcount, and does not exceed 4% of the total revenues. In general, as you can see, we're not in a capital intensive business. Moving forward, we expect 4% figure to be maintained for at least for the mid term.

For the first six months of this financial year, our cash flow from operations was $48.2 million, or 12.9% of the revenue. Net cash of $64.7 million was used in investing activities, and $11.6 million of cash was used in financing activities. During the first half, our free cash flow was $41.8 million, which translates into 11.2% of revenue.

Luxoft is basically debt-free today. We ended second quarter with only $0.5 million in total debt, virtually the same as total borrowings at the end of the previous quarter of $0.6 million. We have finished the quarter with 11,900 personnel, of which 10,000 were IT professionals.

Attrition in the second quarter was 11.5%, slightly up from 10.9% as of June 30, 2016. Our annualized revenue per engineer is now $77,200, which represents a 1.2% year-over-year increase in productivity, or 1% increase on a sequential basis.

Before I conclude, we would like to leave you with an updated outlook for the full financial year ended March 31, 2017. We expect to continue delivering solid revenue growth.

We reiterate our guidance for the end of FY17, achieving at least $781 million in sales. That represents an increase of at least 20% year-over-year annuity terms. Adjusted EBITDA margin expectation remains unchanged as always, in the range between 17% and 19%.

We are leaving our non-GAAP EPS guidance unchanged, at least $2.85 per share. Diluted EPS on a GAAP basis is expected to be at least $1.65 per share, which is low from our previous guidance of $2.10. The EPS is based on estimated weighted average of 34 million diluted shares as of the end of financial year ended March 31, 2017. At this, we will open the lines looking forward to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Anil Doradla, William Blair.

Anil Doradla - *William Blair & Company - Analyst*

Good results, especially in the backdrop of what is going on, so good job. Dmitry and Roman, I had a couple questions. DB has taken a little bit deeper dip of roughly 6% year-over-year decline. Clearly you're having a lot of solid stuff going on, on the other hand. Can you share with us how we should be looking at the DB trajectory over the next several quarters? Can you give us some qualitative color? Then I had a follow-up.

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

There's nothing unexpected. We projected this decline on our last call. This year it should be the same trajectory, I guess. We have very stable volume of work, until the first quarter of next year. After that, it's really about what will be the budget decisions on the DB side.

On the positive note, we have started seeing the realization of vendor consolidation and the so-called tail vendor consolidation, where we are already, in the early stages, are grabbing pretty substantial work from those vendors who are on the exit list. We also entered a couple new, relatively new, areas for us, such as treasury and wealth management which are -- they have much less budgetary constraints than in traditional IB space. All in all, I believe that we are pretty confident that this year should not bring any major surprises. As for the next year, we're doing a lot of work to rebalance so we can compensate some of the potential budget cuts on the IB side with some of the new work coming from new areas.

Anil Doradla - *William Blair & Company - Analyst*

Very good. On UBS, switching to UBS, obviously much better growth there. The new CIO has come in and he has settled in. We have seen some mixed results from UBS with some of your peers. Can you highlight what's going on that front?

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

Again this year, we thinks it's been a pretty rough year within UBS, as the management was not in place and some other initiatives, and there were significant budget cuts across all domains. Going forward, it looks more optimistic that we saw three months ago. We see actually some really good momentum building up in some of the key areas where we have dominant play today. It's hard to say what will be the outlook for the upcoming years, but definitely, the trend is positive.

Anil Doradla - *William Blair & Company - Analyst*

Very good. Roman, if you don't mind me speaking -- sorry, go ahead.

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

I just wanted to say, again, between UBS and Deutsche, everything what we do there, actually with UBS we won a very large multi-year deal which is another four years ahead. That should save us from some of the volatility there, which is really good news. Our plan and our belief that between those two, we should be able to maintain flat revenue with some ups and downs, but as most of them represent pretty large opportunities and accounts and in most of them we are among the top-tier suppliers, strategic suppliers. Going forward, we believe we should maintain the level of the business we have today.

Anil Doradla - *William Blair & Company - Analyst*

That's good. Roman, if you don't mind me sneaking one in. Tick up in stock-based compensation, a little bit more here, so the GAAP, non-GAAP is different. Can you share with us when we're going to get back to some normalized levels, and what was the reason why we had a little tick up here? Thank you very much.

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

Basically, indeed there was a pickup of the stock-based compensation in the second quarter, which basically was not visible in the first quarter. That's largely attributable to two major factors. One is, we granted (inaudible) the new common measures which are obviously now playing a big role and basically lets us moving the Company to its goals.

Second, we also granted shares to the existing managers to increase further the motivation commitment and to align their goals for the Company goals for achieving these targets by 2020. That caused some divergence between non-GAAP and GAAP metrics, obviously. Going forward, we do not expect this divergence to continue to widen and rather see this gap to stay rather constant, or at least until the end of this current fiscal year.

Anil Doradla - *William Blair & Company - Analyst*

Great, and good job once again, guys, thank you.

Operator

Moshe Katri, Wedbush Securities.

Moshe Katri - *Wedbush Securities - Analyst*

Going back to some of the commentary that came in from Dmitry, just to confirm, Dmitry, you spoke about UBS and Deutsche Bank, you spoke about, you gave us some growth numbers for the end of the year, and you said you are looking for the same assumptions for next year. Are we talking about calendar year 2017 or FY18?

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

FY18.

Moshe Katri - *Wedbush Securities - Analyst*

Great. Are we also using the same pricing assumptions for both accounts?

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

Pretty much so. The pricing there is fixed, so we have, for both accounts, we have pretty much fixed pricing for the next few years.

Moshe Katri - *Wedbush Securities - Analyst*

Understood. I think it looks like the non-GAAP EBITDA margins were up year over year. Can you talk about some of the drivers here?

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

Moshe, it's Roman. Basically, I wouldn't say non-GAAP EBITDA margin was up year over year. Base ratio was down year-over-year basis, because it was 20.9% in the second quarter last year, and this quarter was 19.1%. But on the sequential basis, it is indeed higher, because in the first quarter this year it was 16.6%, so clearly we have some 2.5% increase here. That is basically due to some intensive cost measures from the Company side and also some additional basically revenue that was coming in the second quarter. Seasonally the second quarter is typically better than the first one.

Moshe Katri - *Wedbush Securities - Analyst*

Cost management, that's a pretty big uptick sequentially. Can you give us more color on that? Is that sustainable into the next few quarters?

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

Well we do believe so, so we do believe that we are able to achieve the guidance of 17% on a year-over-year basis. The 17% margin, so to stay within the 17% to 19% range and, yes, we will see how this third and fourth quarter will look like. Typically the third quarter is better in terms of the margins than the fourth quarter, whereby we have higher pressures coming from the taxation side, from the cost increases and so on, and so forth.

Moshe Katri - *Wedbush Securities - Analyst*

Okay. Last question, just going back to stock-based comp. We've obviously reset GAAP EPS numbers for the year. I think you said it has to do with two things, something related to M&A, incremental M&A expenses and on top of that, stock-based comp. Where are you expecting stock-based comp to be by the end of the year? I think for the first half, I think you have about $13 million. Where do you think that goes to at the end of the year?

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

Our expectation, as it stands today, it's about $28 million for the whole year.

Moshe Katri - *Wedbush Securities - Analyst*

Okay. Where do you think that normalizes looking into FY18, because again, this is a pretty substantial jump?

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

Yes, we believe it should be normalized, and as a proportion of revenue, we don't think that going forward, it will be -- it will take a bigger proportion than it does today.

Moshe Katri - *Wedbush Securities - Analyst*

All right, thanks.

Operator

Arvind Ramnani, Pacific Crest Securities.

Arvind Ramnani - *Pacific Crest Securities - Analyst*

A good quarter. It looks like the number of delivery professionals in the quarter was -- increased by about 526. How much of that growth came from the INSYS acquisition?

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

Yes, that was about between 400, 450 FT billable engineers coming from INSYS.

Arvind Ramnani - *Pacific Crest Securities - Analyst*

Organic growth was pretty minimal. Any underlying reasons for that?

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

Can you repeat the question, please?

Arvind Ramnani - *Pacific Crest Securities - Analyst*

Yes, the organic growth was pretty minimal, in terms of headcount increases. Are there any underlying reasons for the minimal growth in headcount?

THOMSON REUTERS

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

There was some growth. We also show here the average I believe, so that does not really translate on the entire net increase, but what happened in the previous quarter, due to some volatility in the project, we actually had a much bigger bench than usually we have. This quarter we have actually brought it back to normalized bench and increased utilization. I guess these are two factors that you see a relatively small net increase.

Arvind Ramnani - *Pacific Crest Securities - Analyst*

Great, and then what was growth at Credit Suisse, and what should we expect from this account for next year?

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

Credit Suisse is in a very good growth space, and we have very high hopes. Actually, we've done exceptionally well there, recognizing one of the strategic players and of the multiple initiatives going on, and Luxoft has been part of the more strategic ones. Again, we have started serving the account on a global scale. We believe that the growth will continue on the same pace, and maybe we should see some increase next year. We are very optimistic about Credit Suisse.

Arvind Ramnani - *Pacific Crest Securities - Analyst*

Really, at Credit Suisse, what's the nature of the work? Who are you displacing? Can you give us some more specific color on that account?

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

A lot of digital and wealth management, and this is probably one of the largest chunk of the work which we do there. We also helping them with typical stuff, that the direct space, they are going through the same transition as most of the other players. It's combination of digital and wealth management. Some of the work which we do there also helps optimize and rationalize their IB space. I would say it's maybe 60% wealth management, which is the key for Credit Suisse, and digital transformation there is one of the key initiatives there that the banks undertake.

Arvind Ramnani - *Pacific Crest Securities - Analyst*

Last question, at Credit Suisse are you displacing some of your competitors, or are you replacing, is it new work, are you replacing Credit Suisse employees? What's really going on?

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

Well, I think Credit Suisse is little bit late in the game, in terms of how much they outsource and the quality of the outsourcing or the sourcing partners. To your question, first, there's this change to back initiatives which are all the digital conversion. We have taken very important and pretty large role there and believe not many traditional competitors are in that spot. True, we are actually displacing or are taking some of the market share from legacy suppliers to Credit Suisse.

Arvind Ramnani - *Pacific Crest Securities - Analyst*

If I can squeeze one last one in. I realize, you probably do not have a lot of employees on H1B visas. Are you able to just quantify the number of, percentage of employees who are on H1B visas?

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

It's below 1% in the US. Among all of our employees it's below 1%, so it's not material. We're not exposed to any H1 visa constraints.

Arvind Ramnani - *Pacific Crest Securities - Analyst*

If there's any immigration outcome, immigration law, it really should not affect you guy, right?

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

We typically hire locally, and we have compared to our overall size, have a pretty strong presence in the US. We don't see necessity do this H1B and staff reallocation. There are enough skilled personnel which we can bring on work domestically.

Arvind Ramnani - *Pacific Crest Securities - Analyst*

Excellent. Thank you very much, and good luck for the remainder the year.

Operator

Steve Milunovich, UBS.

Steve Milunovich - *UBS - Analyst*

Great, thank you, good morning. You said 15% organic revenue growth. Was that for the quarter or for the half?

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

Half year.

Steve Milunovich - *UBS - Analyst*

How are you doing, Roman? What was it for the quarter?

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

For the quarter it's like 12%-plus, because of the INSYS addition.

Steve Milunovich - *UBS - Analyst*

Can you make some comments on what you expect in the pricing environment going forward? Utilization rates, wage rates, and what kind of hiring rate you're expecting going forward?

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

Wage again, as we are very diversified in terms of the geographies and our delivery geographies, we would expect to stay within the same, around 5% wage inflation has been historically the case for the Company. This is compensated by continuous increase of our average revenue per billable employee. As for the pricing environment, this is different, obviously, from industry to industry. We don't see it as anything major happening in our (inaudible) area. Good situation and position there.

In financial services, as we moved towards a solution business and a lot of what we sell comes in a solution form, we separate competitive from our current rates so we are beat against extension all of these big guys for some of niche players. I wouldn't say -- we always have to prove to fight procurement, but there is not really a big change compared to what we had a year ago.

Steve Milunovich - *UBS - Analyst*

All right. Dmitry, I think you have commented that you haven't had a huge marketing presence in financial services area the US, in terms of feet on the street. I was curious where we are now in terms of your selling presence in the US and what you think the prospect is for getting into other US banks?

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

Yes, we have got a few clients this year in the US and a couple showing pretty good dynamic at this stage, but there are still -- we have very interesting pipeline of new accounts coming our way. Still early to say, but we have invested heavily in building and growing our sales presence and our onset presence. Also, INSYS acquisition, even thought they have a relatively small financial services arm, they have a pretty good sales team. Combined I believe you shall see some of the progress starting next year from the banks in the US.

Steve Milunovich - *UBS - Analyst*

Okay. Finally, I was curious where we are in terms of taking some of your acquisitions up toward Luxoft's margins. INSYS of course is pretty recently but Symtavision and others you've done over time, how are those progressing?

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

Symtavision is a small acquisition and is not that much materials. It is fully integrated and they've actually expanded offering. With our global delivery, and it makes pretty good margins in ECU under-the-hood domain, so it is fully aligned. Excelian, if you remember, we acquired the company with lower single-digit EBITDA and this year they demonstrate pretty solid 14%-plus EBITDA so that's clearly a proof of the concept that we can really bring the efficiency of acquired businesses up.

For INSYS, is early to say. We just started the integration. The plans are similar to what we've been doing or what we've done with Excelian. So the company comes with single-digit efficiency and then we have this two-years plan to bring it to double-digit, and on the third year, bring close to our standard efficiency. Obviously, while doing the acquisition we have some negative impact on the overall Company performance. That's also the upside of that is we buy them relatively cheap.

Steve Milunovich - *UBS - Analyst*

Great, thank you very much.

Operator

Joseph Foresi, Cantor Fitzgerald.

Joseph Foresi - *Cantor Fitzgerald - Analyst*

I was wondering what gives you confidence in the FY outlook for the top clients? Is it the ultimate outlook dependent on how the budgets are set, or is there a base level? I think you might have mentioned a base level with UBS. I'm just trying to get a sense of the confidence and what it's dependent on for FY18.

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

There is a base level, as you say. There are also some multi-year engagements, which in the UBS case, about I would say 6% of the work. There's also some volume commitment. So a combination of those two and also seeing the way the pipeline builds for the next year gives us pretty good confidence in terms of UBS performance.

Deutsche is a bit of a wild card because they really will do some budget because -- and another one thing about UBS. UBS has made very substantial, very significant budget cuts this year. Going forward -- and we actually managed to overcome that with relatively modest damage on our end. So going forward, life should become easier there.

Deutsche is a bit of a wild card. They may go with some select down to 10% to 20% cost reduction, which they will have to execute just to align their budgets across and bring their run rate down. Still, we have opportunities to grow in the areas which are outside of our key domains. As I mentioned, wealth management, treasury, some of the retail bank. Then vendor consolidation should bring us some extra business.

Again, we still have time to build up the pipeline there, the work for the next year. That is pretty much what our thoughts are around these two accounts.

Joseph Foresi - *Cantor Fitzgerald - Analyst*

Okay. I wanted to understand the organic headcount growth slowdown. Is that linked to slower organic growth, or have you been moving employees off of either Deutsche Bank UBS to other businesses or other work?

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

Yes, we've been doing a lot of work of reallocation, as you can imagine. On that scale the reduction, the 5%, 10% reduction is pretty significant, so we've been reallocating and redistributing the work. Also at one point in time, we had a pretty significant bench. Now it's back to normal. Yes, that's pretty much the case, you are right.

Joseph Foresi - *Cantor Fitzgerald - Analyst*

Okay. Do think the reallocation is done? Will we expect to have headcount growth count to reaccelerate early next year, last next year? Just trying to get a sense.

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

It's already accelerating as we speak. We have a pretty decent pipeline of open (inaudible).

Joseph Foresi - *Cantor Fitzgerald - Analyst*

Okay. The last question for me, you've given some thoughts on the top two clients for FY18. Any thoughts on the overall organic growth rates and any thoughts on margins that you could share? Thanks.

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

That's pretty much to say we are in the center in the planning cycle. What we see, even if top two, they were together would show some decline, which combined would be a single-digit decline for top two still can balance if you have lots of opportunities outside of them. As we said, overall we have a very healthy dynamic. The growth dynamic all across the Company (inaudible) is leading the way. The pipeline and the book of work for the next year is already complete, so we are very confident in this line of business, and a very healthy growth there.

Also telco shows really some very good indication of the opportunity, but even in financial services, as we said, there two, three accounts on the very growth curve, but then outside of them we have another 70 accounts with whom we are in different stages, but they look quite promising. Again, the Company stays pretty confident that first of all, we will achieve the targets of this year, and also we believe that we should be able to achieve our soft target for next year to cross $1 billion.

Joseph Foresi - *Cantor Fitzgerald - Analyst*

Okay. Thank you.

Operator

Charles Brennan, Credit Suisse.

Charles Brennan - *Credit Suisse - Analyst*

I've got a couple, actually. The first is, can you give us a little bit more granularity around the margin performance during the period on a year-on-year basis? You've obviously added about $35 million to the top line, but none of that has dropped through to EBITDA. Does that mean all the revenue growth is coming at zero margin, or does that mean there's been significant margin weakness in the core business? I'm just trying to get a sense of how much of that is temporary, and how much of that is a structural margin change?

Maybe you can give us color on what you expect in Q3. Obviously last year, there were some one-offs that depressed the margin in Q3. Does that mean we should expect margins to grow for the next quarter? Then I have a follow-up on the share-based compensation.

Roman Yakushkin - *Luxoft Holding, Inc. - CFO*

Yes, regarding the margin, I think we have several factors. One is overall, if you compare 2016 financially, it was 2017 that across the board should expect some margin decline of about 200 basis points, so from top of the range 19% EBITDA to 17%. We have discussed it extensively in the last couple of quarters, saying that we added quite a bit to the R&D, and we spent quite a bit on the sales, on boosting our sales capabilities, also developing US and also adding quite a bit of presence to Asia-Pacific. That basically gives us some negative impact to the margin. That's one thing.

Second thing is, again, if you compare the margins of historical Luxoft and the recent acquisitions, that we had some negative impact. On the one hand, we obviously have positive impact to top line but on the other side of the coin, we have negative impact to the bottom line, and that, say, it's about 1.5% to 2%, just coming from the acquisitions today, as it stands. INSYS for example, is a recent acquisition. As Dmitry said, it has single-digit margins, which we are on the path to improve from bringing closer to Luxoft standard, but that will obviously take two, three years from now, in other words. Also, Excelian, again, to remind you, was also in single-digit margin. Now it's up to some 13%, 14% EBITDA. But again, they are still on the way to reach the margins that comparable to the historical Luxoft accounts.

Going forward, I wouldn't say the margin profile would change drastically. Again, I wouldn't sort of now share the details for the third quarter, fourth quarter, just would say that we are still committed to earn the non-GAAP EPS that we provided in our guidance. Also, we are committed to stay within 17%, 19%. Again, probably the lower range, so 17% is really our target. Again, if you see the breakdown between Q3, Q4, normally Q3 is better just because of the seasonality factors.

Charles Brennan - *Credit Suisse - Analyst*

Yes, okay. On the share-based compensation, can you just give us some insight into what the core targets are for both the senior and the middle managers? Is everyone focused on revenue growth, or is there any EBITDA margin and cash flow component to the targets? Just as a follow-up, I know you have given us some P&L guidance, but in terms of the share count, what does this level of share-based payments imply for the growth in share counts over next few years? Thanks.

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

Well basically, we have pretty much same targets for senior and line managers, which are aligned to our three-year goal to achieve the strategic targets that the Company set for FY20, and that basically translates into two major KPIs being revenue commitment, revenue growth, as well as EBITDA margin. Those two are those key KPIs that for most managers interest are aligned about. Regarding the share count, I think we're speaking somewhere in the range of 55 million shares, 54 million, 55 million shares. That's where our projections are based.

Charles Brennan - *Credit Suisse - Analyst*

Does that mean that we should be extrapolating issuance of something like 1.5 million to 2 million a year going forward, or was that just a one-year impact?

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

No, I think that's too many. I don't think we are going to be issuing that much. We're talking about a few hundred thousand shares maximum, not millions.

Charles Brennan - *Credit Suisse - Analyst*

Okay. Thank you.

Operator

Alexander Vengranovich, Otkritie Capital.

Alexander Vengranovich - *Otkritie Capital - Analyst*

I wanted to elaborate a little bit on the changes, your outlook for stock option plan and also the additional expenses related to the acquisition. What has changed towards your vision of that over the last quarter? Because a quarter ago, you gave different guidance on EPS, and then since this acquisition happened, you gave different guidance. Is anything unexpected -- was anything unexpected, which led to some increase of these expenses?

The second question, you already talked to your main clients regarding the implications of the US elections on your operations in the US? Do you think it will lead to any period of volatility like we've seen after Brexit? Thank you.

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

I will cover the stock option plan part. Basically what is changed in the second quarter which was not in the first quarter was obviously the addition of Pelagicore. It's also the pipeline of the M&A, which has widened, and now we have a few new takeover targets which will drive the acquisition-related expense upwards. That's one new thing.

Another new thing is basically the grant of the shares that we granted, that we gave to the managers, and that took place largely at the end of the quarter in September. Again, it wasn't visible in our previous guidance that we gave back in mid-August.

Operator

Ladies and gentlemen, we have come to the end of our time allowed for questions. I'd like turn the floor back to Management for any final remarks.

Dmitry Loschinin - *Luxoft Holding, Inc. - President and CEO*

I would like to thank everyone for joining our call and for your good questions. We will see many of you at the upcoming conferences that various leaders of our Company attend across the globe over the next three weeks. For the rest of you, wishing you and your family a great end of the year and happy and safe holiday season. Speak in February. Goodbye.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.
