Luxoft Holding, Inc. Third Quarter Fiscal 2018

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Operator: Greetings and welcome to the Luxoft Holdings, Inc. Third Quarter Fiscal 2018 conference call.

At this time, all participants are in a listen only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Tracy Krumme, Vice President of Investor Relations. Thank you. You may begin.

Ms. Tracy Krumme: Good morning, everyone. Thank you for joining us on Luxoft's Third Quarter Fiscal 2018 conference call. On the call with me today are Dmitry Loschinin, Chief Executive Officer and President, and Evgeny Fetisov, Chief Financial Officer.

Before we begin, I would like to note that we have provided a slide presentation to help guide our discussion. This presentation can be accessed on the webcast and on our website, Luxoft.com.

I would like to caution investors regarding forward-looking statements. Any statement made in today's presentation that are not based on historical fact are forward-looking statements. Such statements are based on certain estimates and expectations and are subject to a number of risks and uncertainties. Actual future results may vary materially from those expressed or implied by the forward-looking statements.

We encourage you to read the risks described in our 20F filing for the fiscal year ended March 31, 2017. Except to the extent required by applicable securities laws, we undertake no obligation to update or publicly revise any of the forward-looking statements that we make here today, whether as a result of new information, future events or otherwise.

Today's presentation will also include references to certain non-GAAP financial measures. We have reconciled the comparable GAAP and non-GAAP numbers in yesterday's press release as well as the supplemental tables in the back of the slide deck.

With that, I will now turn the line over to Dmitry. Dmitry, please go ahead.

Mr. Dmitry Loschinin: Thank you, Tracy. And thanks everyone for joining us today.

I'll begin today's call by sharing my perspective on the quarter and provide an update on the execution of our transformation plan and positioning Luxoft for long-term sustainable growth.

I'll begin on Slide 3. We had a solid quarter with results that were mostly in-line with our expectations. Our performance speaks to our ongoing progress driving diversified revenue and our expanding share in a number of attractive, high-growth markets.

In fact, this quarter we drove double-digit revenue growth across each of our business segments. Our success rebalancing our customer portfolio, through vertical and customer diversification, is demonstrated by our strong Q3 revenue growth of 26.5% year-over-year, excluding our top two accounts. This performance includes ongoing strong adoption of

advanced digital solutions which drove Digital Enterprise revenue growth of 20% year-over-year.

In our Financial Services business, we grew our top line 13%, and 49% outside of our top two accounts. This represents the 12th consecutive quarter of over 25% year-over-year revenue growth in Financial Services, excluding our top two accounts.

I believe this demonstrates both the breadth of our solutions portfolio and the significant growth opportunities that remain in this business.

We continue to be excited about our growth potential and market position in the Automotive business. In fact, we are seeing strong demand as autonomy drives increased industry investments in advanced technologies, aimed at improving user experiences and increasing the need for connected services, IT infrastructure and other solutions.

Automotive revenue was up 10% year-over-year, and up 38% in the 9 month period. We expect revenue in Q4 to accelerate and finish the year with an annual increase of more than 40%.

The growth of high performance accounts (or HPAs) remains a key component of our strategy. We added 4 HPAs this quarter, of which one was new and three were existing. The HPA revenue mix continues to perform in-line with our full year expectations of approximately $340 million or 37% of total revenue.

Our business transformation is centered on rebalancing our customer portfolio, reducing client concentration, and improving delivery scale in key global markets. We continue to execute on this component of our strategy.

During the quarter we opened a new delivery center in Berlin, the result of a strategic collaboration with a major German multination OEM, which we believe will attract new talent for next-generation, intelligent user experience for cars.

The level of interest and demand for these solutions is remarkably high given the disruptive shift expected to occur within the Automotive industry over the coming years and decades. This new delivery center and partnership emphasizes our strengthened role with leading OEMs and will position us to capitalize on what should be a long-term demand cycle.

With the addition of Berlin, we now have in total 39 delivery centers, up from 32 a year ago.

We continue to increase our presence in Asia Pacific, adding nearly 100 people in Q2 and Q3 to the Bangalore office following the opening. The decision-making cycle in APAC is much faster, more digitally-aligned and less regulatory. We expect to continue to quickly ramp our engineering headcount. We see a wide variety of attractive market opportunities to deliver IT services to financial institutions and other industries in Singapore, Australia, Malaysia and China from nearshore locations.

We are also building our expertise in cutting edge platforms in the digital space, such as cloud, blockchain, and artificial intelligence. We believe this will strengthen our competitive positioning and add significant value to customers.

We were chosen by Amazon Web Services (or AWS) as one of six IT and consulting services companies on their blockchain advisory list. As a result, we'll be collaborating with them to enable companies of their ecosystem to adopt blockchain and distributed ledger technologies. This marks the second time since 2016 we've been collaborated with AWS following our work on Internet of Things solutions.

We've recently received notable recognition from Gartner as an example of a large system integrator with Agile and DevOps capabilities. We received this industry accolade, while also being named a Top 15 Sourcing Standout by ISG, a leading global technology research and

advisory firm. In addition, Luxoft was among the leading providers in the Breakthrough 15 category in each of three major regions – the Americas, EMEA and Asia Pacific – according to their recent Global ISG Index™.

Evgeny will speak to this in greater detail, but we are revising our full-year guidance. This reflects lower revenue from two Fortune 10 telecom and healthcare clients.

We have spoken to the challenges these customers face and some of the low margin legacy engagements that we acquired with Insys and IntroPro. We've stated that we would be looking to ramp down these projects and replace with higher margin, value-accretive opportunities. While we scaled down the revenue as promised, we were not able to ramp new business fast enough to offset the cuts.

While we are disappointed to revise our guidance, we believe these actions position the Company more competitively in the long run.

I am confident that we are executing the right strategy to further build our long-term growth potential and deliver increasing value to our shareholders.

Turning to Slide 4 for an update on our revenue diversification and client concentration metrics.

In Q3, Financial Services accounted for 58% of revenue, down slightly from last year despite large declines from our top two accounts. This speaks to continued growth opportunities and the strength of this business outside DB and UBS.

As we make further inroads into the Automotive and Digital Enterprise markets, we expect this concentration to continue to decrease, just as it has over the last two years.

Looking at our revenue diversification by geography, APAC revenue increased 114% year-over-year and represent 5% of total sales.

Contributions from our top two accounts fell to 34% in the quarter compared to 41% last year as we further de-risk and diversify our top line. Top five customers were 46% compared to 53% in the prior year, down significantly from 71% three years ago. Our Top 10 customers accounted for 57% of revenues compared to 64% last year, and 80% three years ago.

In short, we have come a long way building a stronger and more diversified company and I am pleased with our success to date. This will remain a key focus of the entire executive team as we look to increase our share in attractive markets that are prone to digital disruption such as automotive and others.

Now moving to Slide 5 and a review of our top two accounts, Deutsche Bank and UBS.

On a combined basis, Q3 revenue from both clients was down 3% year-over-year and up 1% sequentially. As expected, we continue to see increased challenges at Deutsche Bank. This resulted in a year-over-year quarterly revenue decline of 10%, while revenue increased 1% sequentially.

We see less challenges at UBS. Q3 revenue was up 5% year-over-year. This reflects a growing demand for consulting services in digital and simplification, as well as successful implementation of a MiFidII-dominated agenda.

Looking at the nine-month period, combined revenue from both accounts was down 11% year-over-year, in line with our forecast.

Deutsche Bank was down 16% year-over-year and UBS was down 5% year-over-year for the nine months, in line with our initial guidance and plans.

We continue to face near-term headwinds, including ongoing insourcing at both clients. Deutsche Bank recently announced IT budget cuts of 20 to 30% to be implemented in the next year. Taking this into account, we believe we will see similar double-digit revenue declines from Deutsche Bank of approximately 20% and single digit declines from UBS in fiscal 2019.

That said, we believe both offer growth opportunities over the long term as our strategic partnership remains. Opportunities exist for solutions including information security, wealth management, simplification, and digital, to name a few. We have strong relationships, going back over 10 years, with both of these global financial institutions and continue to seek inroads among higher demand IT areas.

Turning to Slide 6 and a historical view of revenue contribution from HPA accounts over the last four fiscal years.

For the nine months, HPAs comprised 36% of our total revenue, in line with our full year guidance and up from 28% last year.

As we have previously stated, we believe HPAs provide attractive long-term growth opportunities as the relationship matures and their return is more than worth the additional near-term investment required to deepen the relationship. They are the cornerstone of our future top-line growth and an important component of our overall revenue rebalancing strategy.

I'd like to move to Slide 7 and discuss some highlights for each of our business segments.

Starting first with Financial Services, revenue was up 13% year-over-year. During the quarter, we secured strategic vendor status with an Australian multinational bank in the global markets and trading space.

Additionally, we had a large, strategic Murex and standard packages win from a large Dutch global banking and financial services company. What makes this win particularly gratifying is that this client has one of the largest Murex projects and we competed head-to-head with a large key competitor in a highly competitive Murex market.

This project is about decommissioning three or four large legacy software packages and migrating to Murex, which is a multi-year project that will involve most of the bank's capital markets IT.

We won because of our location strategy, our strong capabilities in Murex and other software packages, such as Calypso and ION, and our agility and responsiveness in meeting the client's needs.

We believe demand within the Financial Services industry will be driven by ongoing pressure to restore growth and improve profitability, industry-wide regulatory reforms, requirements to

increase transparency and manage risk exposure, and adoption of new technologies such as cloud and AI.

Turning to our Automotive segment. We delivered 10% year-over-year revenue growth in the third quarter. We anticipate much stronger growth from this segment in the fourth quarter with an anticipated over 40% year-over-year gain.

We recently participated in CES where we showcased a number of our advanced solutions for autonomous driving and our software applications. We were pleased to have a presence at this year's show as it seemed to revolve around advancements made within the car, relating to autonomous driving and the user experience, two areas where we are strong and actively collaborating with the leading OEMs and tier one suppliers.

There was a lot of interest and excitement surrounding our offerings and we left the show with lots of new leads.

One recent deployment worth highlighting and unveiled at CES by Daimler was the world premiere of an intuitive and intelligent multimedia system. It is a user experience that changes the game in terms of how a driver or passenger interacts with the car. It can be individualized

through the use of AI, creating an emotional connection between the vehicle, driver and passengers.

We took a principal role in this program, securing a strong position in the development of the future product, and are continuing to create and enhance the smart technology behind it.

As car makers strive to become software companies, we are forming partnerships to develop smart cloud solutions. Our connected mobility business unit supports this effort and is growing strongly. We recently won a project, from a major German car maker, to develop Alexa in the car based on Amazon's intelligent assistant, providing advanced speech control in the cloud.

We are also working with a major tier one to develop various autonomous driving system components.

Car makers are seeking deep partnerships with technology and service providers that can integrate a range of technologies into the vehicle architecture. As an independent service provider, that's what sets us apart.

Lastly, to our Digital Enterprise Line of Business. Digital transformation remains a major global investment priority across many of our markets given the expanding demand for advanced

digital transformation and emerging technology solutions where Luxoft today has a global leadership position. Revenues in our digital enterprise segment were up 20% in the third quarter.

During the third quarter we experienced broad-based demand for our digital capabilities with deployments/deals across the media and communications, healthcare and life sciences, energy and other industries.

We successfully closed a master services agreement with a global leading information services company specializing in legal, finance and healthcare sectors. We are excited about the partnership and look forward to growing with them in the years to come.

We also won a multi-year managed services project, in our media and communications segment, from one of the global leaders in the search engine technologies and online advertising. We are responsible for porting a light-weight cross-platform operating system for HTML apps to run on various Smart TVs, game consoles, OTT devices and any other future devices. This win demonstrates how we are highly valued and continue to stand out from the outsourcing crowd.

We developed, and continue to deliver new features for, a “Big Data” driven audience projection application for a large communications service provider or ‘CSP’. The application supplies an optimized media plan to effectively reach an advertisers’ target TV audience and has functionality for household level advertising.

This application gives the large CSP the ability to increase advertising revenue, drive enhanced targeted advertising, and improve the effectiveness of customer advertising campaigns.

Blockchain is now firmly established as one of the most dynamic and disruptive forces in the current technology landscape. Data and transactions can now be verified with certainty without the need for any centralized authority, giving rise to many different use cases across the enterprise.

At Luxoft, we have been investigating blockchain as a means of solving some of the age-old problems that have traditionally plagued across industries.

There are opportunities to streamline our client’s systems, particularly around data issues, including recording, reconciliation and sharing across distributed systems and multiple locations. Not only does it offer clients the potential to gain efficiencies in terms of costs and resourcing, but it is also opening up new business opportunities. We see growing interest from

our clients and are getting involved in the early stage discussion and moving into the deployment phase.

We are an early adapter, have a strong position and are a well-recognized leader in this space. Blockchain is becoming a main topic among our clients and is not just a buzzword but represents real opportunities.

We continue to enhance our differentiating position by increasing our end-to-end digital solutions and forming new partnerships, which allows our clients to create new product offerings and reduce operational cost.

In summary, we are focused on maintaining a high level of execution and building upon momentum across our business. Our strategy is working, and is demonstrated by the continued improvement in many key business metrics including: revenue diversity, HPA expansion and growth outside our top two accounts.

Today we have a clear pathway to capture increased market share in multiple verticals, including Digital Enterprise and Automotive. Our focus remains centered on strengthening our foundation for sustainable long-term growth.

Thanks for your attention. Now I'll turn it over to Evgeny.

Mr. Evgeny Fetisov: Thank you, Dmitry. Hello everyone and thank you for being on the call with us. I will go over some key numbers, provide additional color for our Q3 operational and financial results, and review our guidance.

If you turn to Slide 8, Luxoft delivered a healthy level of year-over-year and sequential revenue growth. Third quarter revenue of $236.6 million was up 14.3% year-over-year and 3.8% sequentially. While conditions at our top two accounts remain challenging, we have made strong progress diversifying our customer and revenue base. Revenue growth outside of these top two clients was 26.5% year-over-year.

Now let me give you the highlights of our third quarter financial performance. Adjusted EBITDA of $40 million was up 6.7% year-over-year and up 3.8% sequentially. Our adjusted EBITDA margin was 16.9%, down 122 basis points year-over year.

Gross margin was 39%, virtually flat sequentially and down 74 basis points from third quarter last year. This is in line with our message regarding company-wide gross margin at or about 37% for the remainder of the year and gradual improvement over next year.

GAAP net income was $20.6 million. Net income margin was 8.7% compared to 9% a year ago, and 8.1% last quarter. Non-GAAP net income was $30.5 million versus $27.9 million in the third quarter last year and $28.0 million last quarter.

Non-GAAP net income margin was 12.9% compared to 13.5% in third quarter last year, and compared to 12.3% in the previous quarter. Weighted average diluted share count was 34.1 million shares, up 20,000 shares from last quarter.

Diluted EPS amounted to $0.60 per share, as compared to $0.54 last quarter and $0.55 in the third quarter last year. On a non-GAAP basis, our diluted EPS was $0.89 per share compared to $0.82 per share last quarter and $0.82 in the third quarter last year.

Turning to Slide 9, during the third quarter, SG&A as a percentage of revenue was 26.8%, up slightly from 26.2% a year ago. Over the nine months, SG&A as a percentage of revenue was 26.7%, down 42 basis points from the same period last year.

SOP Expense as a % of revenue was 3.7% in the third quarter, unchanged from the third quarter last year, and in line with our expectation of annual SOP Expense less than $30 million and below 4% of revenue.

Let's move to Slide 10. Luxoft finished the quarter with $69.4 million in cash and cash equivalents with operating cash inflow of $23.7 million, or 10.0% of revenue, financing activities using $2.6 million of cash and net cash of $7.3 million used in investing activities.

The increase in DSOs is linked to a change in fiscal Q2 in the billing cycle of one of our top two accounts, which caused a growth of receivables.

While the receivables went down in Q3, as the transition to the new billing cycle and invoice processing is complete, it is not fully recognized in the Q3 number, which is an average of the beginning and end of the quarter number.

Q3 DSOs was 82 days, and Q4 should show improvement. Our cash capex at $7.3 million was flat from Q3 last year. We finished the quarter with 13,101 people, of which 11,055 were IT professionals, up 8.9% from 10,149 IT professionals one year ago.

Attrition in the quarter was 16.4%, up from 15.3% last quarter and up from 12.5% in the same period last year. The increased attrition rate is due to revenue portfolio rebalancing and getting rid of lower-margin projects.

Our annualized revenue per engineer continues to grow and is now $85,392, up 3.2% from $82,752 last quarter and up 4.5% from $81,705 one year ago.

Now to Slide 11. The change in the US corporate income tax rate has a positive impact on our tax expense. In the third quarter of the fiscal 2018 we recorded a one-time tax benefit of $2 million due to the revaluation of US deferred tax liabilities.

As a result our effective tax rate in the third quarter decreased by 9.1% from 16.8% to 7.7%, and in the nine-month period, it decreased 3.9%, from 15.7% to 11.8%.

On a long-term perspective we estimate that the reduction of the US tax rate will result in an approximate 1% decrease of Luxoft group effective tax rate. For 12 months we expect the impact will result in an approximately a three percentage point decrease in the group effective tax rate and estimate our full fiscal year 2018 effective tax rate to be in 12-13% range.

Finally, Slide 12. Looking ahead, as Dmitry mentioned, we expect our full-year results to be slightly impacted due to lower revenue from two large acquired telecom and healthcare clients. This is primarily the result of our de-emphasizing lower margin, non-core business and strategically aligning our resources with our expanding number of attractive, higher margin opportunities.

While this will impact our revenue generation this year, we believe it positions the company more competitively in the long term.

As a result, we are revising our guidance for the year ending March 31st, 2018. We now expect our full year fiscal 2018 revenue to be in the range of $900-905 million, down 2% from our previous guidance of $920 million. This represents an approximate 15% of year-over-year revenue growth.

We expect our adjusted EBITDA margin to be in the range of 15.0-15.2%, down from our previous 15.5-16.5%. The new guidance for non-GAAP Diluted EPS is $2.77 to $2.85 versus the previous guidance of at least $2.85.

Guidance for GAAP, diluted EPS remains unchanged at least $1.53. EPS is based on an estimated weighted average of 34.4 million diluted shares.

With this we are opening the lines and look forward to your questions.

Operator: Thank you. If you'd like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star,

two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key.

Our first question comes from the line of Arvind Ramnani with Keybanc Capital Markets. Please proceed with you question.

Mr. Arvind Ramnani: Hi. Yeah, thank you for taking my question. On the call, you--there were certainly several positives including, you know, new client sign-ups, uh, expanding your automotive capabilities, growth in HPs, uh, but then you had to lower your guidance. You know, can you help, uh, reconcile this positive commentary with the performance?

Mr. Dmitry Loschinin: Yeah, hi Arvind. So basically, uh, on the positive side, you know, we continued to grow our automotive line of business and some of the wins there, and it goes in line with our, uh, expectations. So pretty much you would expect the automotive to be 40+ percent year-over-year growth.

The performance of this quarter is a bit lumpy, but this is due to the longer project cycles, so we had a strong Q2 in automotive, uh, relatively weak Q3 and will be another strong quarter Q4. Just, you know, the way that the delivery is going.

So the major miss and the revenue, which resulted in our revision of the guidance is attributable to telecom and healthcare, and it's, uh, largely allocated to Q4, where on our two accounts, uh, inherited from the acquisition or acquired with Insys and IntroPro, they show, like, relatively poor performance.

One is, uh, announced some extra cuts. Uh, then that's a telecom client, and the end of the last year, so that basically results in us to downgrade the forecast for this client, and on the healthcare side, those are the largest clients off Insys. We've been doing restructuring over the low-margin business, anticipating to compensate that with a new business and new business development goals are slower.

Also due to some internal factors within the client, as it goes through a pretty significant transaction, the decision-making cycles are [unintelligible]. So that's pretty much kind of, uh, the main disappointment comes from the telecom and healthcare side, and this will be largely seen in our Q4.

Some of that is already seen in Q3, but it's a small number.

Mr. Arvind Ramnani: Good. And, uh, roughly about a year ago, you all had indicated that you were going to use most of '17 and some part of '18 as more of a transition period so you could, you know, clean up some of the accounts and get the much healthier kind of growth rate.

You know, kind of looking, and I know you're not issuing guidance, but kind of looking into calendar '18, is this a year we should still expect, like, sub-15% growth or do you think closer to 20% growth is-is kind of where we need to kind of reset our mindset?

Mr. Dmitry Loschinin: So on '19,and again what will be the [unintelligible] in our fiscal '19, both of our top two accounts, and especially DB, will continue to decline. Uh, and again, we reported that and we also talked about that during the call so that DB just announced the result of their calendar fiscal year, which are very disappointing, so they're going to reduce the IT budget further and we might expect some significant cuts for another one year.

And they are also pursuing this, uh, this insourcing agenda. So, uh, again, we have some positive there, but just to be on the conservative side, believe that DB performance next year will be similar to what we have this year, up to 20% decline.

And, uh, UBS, uh, is in better shape, but still they also do the insourcing agenda, as they believe the bank has outsourced a lot, much higher than most of the people on the street, so that

might happening. So these are two major factors there. So we still believe this, given our growth trajectory that the company will grow more than 10%, so double digit, excluding top two, we will grow 20% plus, for sure.

Mr. Arvind Ramnani: Great. And if I could squeeze one more in, you know, I appreciate the perspective on blockchain technology. You know, in terms of blockchain, what are you offering? You know, what are you selling? And-and also how has that impacted your pipeline?

Mr. Dmitry Loschinin: So blockchain is still early-stage technology, that the way we see it is developing in fiscal '18. Like fiscal '17, it was more buzzword than anything else. Fiscal '18, or calendar '18, or '17, which is more or less the same, it started to translate some significant POCs, so where clients started to test the technology and coming up with the use cases that will make a significant impact on the business.

Going forward, so in our fiscal '19, we already see a pretty significant deployment. Still, on the absolute numbers, we are not talking massive, massive amounts of money, but there are some of the deals that will relate to pretty substantial growth opportunity in the future. So right now, we are pursuing about ten blockchain deals.

We have won three just in the last quarter, and this is a pretty solid pipeline. Again, the way the technology is entering the market, it goes through the POC to improve business cases, and then to bring a large-scale deployment. So this we are yet to see, but we are very confident it is coming.

Mr. Arvind Ramnani: Great, thank you very much.

Mr. Dmitry Loschinin: Thank you, Arvind.

Operator: Thank you. Our next question comes from the line of Joseph Foresi with Cantor Fitzgerald. Please proceed with your question.

Mr. Joseph Foresi: Hi. So I think just kind of building on the first set of questions, do you feel like after the healthcare and telecom client issues that you're going to have over the next two quarters that you've accurately pruned your portfolio? In other words, do you think that those are the two problem clients that you have, and once those issues are resolved, uh, that the portfolio should perform as expected, excluding, obviously, the comments around DB and UBS?

Mr. Dmitry Loschinin: Yes, we are very confident that, uh, we are kind of, um, we have digested the business and transformed that to the level that is good enough for the future expansion

and growth, so we kind of exited some of the assets for contracts that were not a long-term sustainable or profitable for the company as well as establish ourselves in some of the growth opportunity markets, you know, for the future growth.

Speaking about healthcare, uh, there are two components of healthcare. The traditional healthcare and the Pharma side. So we actually, today, see more opportunities on the Pharma side because the way the industry evolves, it's more digital disruptive, I would say, and there are more moments on the kind of high class of the-of the work.

So we for sure see a pretty strong growth opportunity there. As for the traditional healthcare, it is still yet--and I believe this also reflects pretty much what our peers are doing in the industry. There are still certain questions to answer, but again combine those two segments provides a pretty decent growth opportunity.

As for the telecom, there is obviously an impact of our largest clients there that has been doing a lot of transformational efforts, you know, because the business has been going through the transformational thing participating in a pretty large position that they're going to make. So some of the major programs which basically were bringing new technology, digital technology, on board were significantly reduced.

But at the same time, we see some of the other things have started, so again, going forward, we believe that the next year for the client is going to be a growth year.

Mr. Joseph Foresi: Got it. And then you talk about these clients may be coming in at lower margins. It does that mean that we could get back to a kind of historical margin level quicker now that you've, uh, cleaned them out? And how are you redeploying the resources?

Mr. Dmitry Loschinin: So the margins are improving on that client. Still, we need to continue our investment, especially on the digital space, where our group--our margin trajectory is going to improve. We would not anticipate the margins to get back to the previous 17% level in the next year, but we will see some improvement there.

Mr. Joseph Foresi: Got it. And then the last one for me, uh, you talked about DB maybe being down another 20% next year. Having gone through a 20% cut already, how are you prepared to handle that type of revision from a workforce utilization perspective? And, you know, do you have enough demand outside of DB to redeploy people or will it take a couple of quarters? I'm just trying to get an idea sort of what the cadence will be associated with that. Thanks.

Mr. Dmitry Loschinin: Yeah, thank you. Well, uh, in absolute numbers, even though this is still the same 20%, in absolute numbers it's less impact, obviously, as DB went down quite

significantly during our fiscal '18, and I think we have already showed the ability to redistribute and really apply.

It comes with certain costs, so obviously all people that will be--and actually this is happening also now, in this quarter we have some of the ramp down from DB, and that impacts our performance, but it's already now planned.

And also, I want to mention that of the guidance that we provided for these top two accounts from the very beginning pretty much in line with what has happened there. So despite, you know, high volatility, a news company and was able to anticipate, you know, both the performance of the accounts and the top line and absorb and digest some of these cuts in our bottom line.

The real disappointment in terms of the numbers and where the main miss comes from is from the acquisitions, so that basically there's nobody to blame except ourselves. We definitely need to improve there, but we have a very strong lessons there.

Mr. Joseph Foresi: Thank you.

Operator: Thank you. Our next question comes from the line of Avishai Kantor with Cowen and Company. Please proceed with your question.

Mr. Avishai Kantor: Yes, good morning and thank you for taking my question. Regarding the new business opportunities at the large healthcare and telecom clients, any thoughts on the timeline? How long it will take to ramp up that business? And what are you doing with the account resources at this point?

Mr. Dmitry Loschinin: So again, if you talk about the telecom and the healthcare, we believe that we are kind of at the bottom, pretty much, of those two. So we don't really anticipate significant ramp-down for these accounts going forward, and we've been able to manage and reuse the skillset that works there in some of the other accounts.

And, also, in the absolute numbers it's not that much compared, for instance, to some of the DB ramp down. Um, so going forward, again, we still--so basically, if you look at the healthcare side, we've been ramping down low margin business or three minutes down, I would say, kind of careful not to destroy the relationship with the client. At the same time, keep aggressively working with some new business opportunities, which is our mainstream business.

And then, as I said, we have pretty solid success on the Pharma side, especially on the Pharma side. So going forward, I would say that we should expect, because we went from a relatively high base. Over the year, we trimmed down most of the accounts, so base is lower. Going forward, we will see a steady increase of the business there or we should see a steady increase of the business.

Mr. Avishai Kantor: And then in North America was up 8%. Is that totally a function of the telecom and healthcare clients? Anything else going on that has been impacting North America?

Mr. Dmitry Loschinin: Not just telecom, I would say across all of the businesses, we have some ways and means--I still need to understand where the number is coming from. Actually, if you look at the North America, then the percentage-wise it actually went down from 35 to 33.

Mr. Avishai Kantor: Yeah, I was just talking about the annual growth--the year-over-year growth rate.

Mr. Dmitry Loschinin: Yeah, it's hard to say for me. There are multiple factors. We've got some ways and means there, and there's an opportunity there, so you know it's really close.

Mr. Avishai Kantor: Thank you. Thank you for taking my questions.

Mr. Dmitry Loschinin: Thank you.

Operator: Thank you. Our next question comes from the line of Maggie Nolan with William Blair. Please proceed with your question.

Ms. Maggie Nolan: Hi, so last quarter, you talked about a slow-down in decision-making at the financial--some of your financial services clients. Obviously, I'm talking outside of the top two. Have you seen this decision-making process pick back up at all? Because it seems like that vertical ex-the top two seems to be accelerating over the course of the year.

Mr. Dmitry Loschinin: This year that's slowly normalizing and improving. We also report a couple significant wins in this space. One, which delivers a major win for Australian banks, and that was--which we've been working on this deal for the last nine months. Still, you know, if we talk about new business, then those cycles are pretty long.

You know, from the time we identify an opportunity for this new client, until we close, an average in financial services, it takes about 12 months. So if you compare that, for instance, to automotive, that would be six months. So it's significantly longer, but within the clients with

existing accounts, decisions are taking--and again, outside of top two. Top two is just some special case.

But outside of top two, we see we didn't exist in client's decision, you know, getting made, you know, faster.

Ms. Maggie Nolan: Okay, great, and for your HPA accounts, I know you've talked about the margin profile on those growing over time. Is that starting to trend upward as these HPAs get a little bit more mature?

Mr. Dmitry Loschinin: Yeah. We see pretty much the same trajectory, so the proportion of the business that's attributable or contributed by HPA is growing, as we showed that, you know, so it's getting close to 40%.

And overall, the group has started to show a better performance in terms of the margins. So again, this is a steady process.

Ms. Maggie Nolan: Thank you.

Mr. Dmitry Loschinin: Thanks.

Operator: Thank you. Our next question comes up from the line of Lou Miscioscia with Pivotal Research Group. Please proceed with your question.

Mr. Lou Miscioscia: Yes. I haven't been able to fully run the numbers

are you here yet, but if you look at your comments for Deutsche Bank and UBS, do you think that they'll be down together on a year-over-year basis up to almost 40 million? And then maybe, if so, could you comment on what you would expect for either financial services growth year-over-year in fiscal '19 or just fiscal '19 overall, because obviously that would be a material absolute dollar drag in trying to get the full year revenue growth back up.

Mr. Dmitry Loschinin: So if you look at the--and it's the right assumption, so combined the top two, I would say it's about, you know, like a close to 40 mil decline and we should expect a similar performance next year overall. Again, we would be rather conservative here and make it better, but let's really think of this as another 40 million decline, which should bring the concentration down.

However, the overall performance of the industry, of the segment for us is going to grow. So we are still in the planning cycles. Of course, we will report the results by segments on our next call, but again what you see that the company is going to grow double digits in the financial services vertical despite the decline of top two. We'll continue--we'll show some growth.

Mr. Lou Miscioscia: Okay, thank you. That's helpful. So I was also out at CES and to set in a lot of sessions on AI. Obviously, it seems like you guys are having great success in the auto area. Could you mentioned, are there other things outside of auto, because it really seemed to be dominated, from what I saw, mostly in the auto sector for things like Alexa and Google and what have you. But are you seeing demand for AI outside of that? If you could maybe give us a couple of examples.

Mr. Dmitry Loschinin: Well, it's definitely--it's happening all across the industry. Why auto is, I would say in number terms, this is a relatively low. Still, it's earlier stage, you know, kind of in terms of the adoption curve. There is a lot of buzz about AI, but once you use Alexa or any other AI engines that can be immediately deployed, it's a pretty clear use case, especially for the speech recognition and some other purposes.

So just to answer, it goes across multiple domains. In terms of the absolute number of the businesses associated with AI, and we have really lots of opportunity in this space. One of them

that's been reported, you know, is the automotive. The other one is it just, you know, we just got a business in the telecom space and the other one in the health care.

So it's still there. The slice of the opportunity is not huge, but we believe that it will take another one year for the technology to mature and have better applicability for the business.

Mr. Lou Miscioscia: Okay, thank you. Good luck on the new year.

Mr. Dmitry Loschinin: Thank you.

Operator: Thank you. Our next question comes from the line of Moshe Katri with Wedbush Securities. Please proceed with your question.

Mr. Moshe Katri: Hey, thanks. My biggest worry is margin trends and the fact that margins have been degrading or pretty much coming under pressure pretty consistently here. So what makes us comfortable that margin trends will improve next year? Maybe you can talk also about some of the factors impacting margins during the quarter, and also in a related subject, we also talk about free cash flow for the quarter and for the year and what makes us comfortable that that number also will improve down the road?

Mr. Dmitry Loschinin: Hi, Moshe. So I will answer the margin question. Again, we'll talk about free cash flow. So on the margin side, the main indicator for us in terms of the margin is the gross margins. So if you look at the dynamic over the quarters, it's actually positive, and, uh, I think that's the main indicator.

The same time, the drop, which is here throughout the year, is attributable to the large investment that we have to make to stimulate the growth in new sales, and especially driving the digital agenda and form a strong digital arm. It's very important we have invested in--invested about 12 million, at least, this fiscal year.

So I guess going forward, we probably will continue to invest. However, it will not grow the amount of investment needed with the same speed as the growth of the business. As for the gross margin trajectory, it will be around 38, 39%, which we believe is the main indicator. It's really about how much a company invests to boost the top line.

So again, what we said, even though we had some decline, again obviously this has been a very tough year for us. You know, both top two declined, and we had to absorb and digest this acquisition we didn't perform super-well with some of the lower margin business. So going forward, we have much less challenges and therefore what we are saying is that you are going to see some margin improvement.

Because the nature, again, the main component of the margin is still gross margin, and gross margins are at a decent level. And Evgeny will address the cash flow questions.

Mr. Evgeny Fetisov: Yeah, thank you. So on the cash flow side, we have said that we're improving the situation working through the collections and as we sort out the billing cycle changes of one of our top clients. So when we look at these two on a monthly basis, we definitely see a very strong improvement and that's why we're fairly confident talking about the improvement in the Q4.

So if I want to be cautious, I would say we'll definitely be seeing these are lower than 75 days. I mean, the target is to come back to our normal levels of free cash flow at about 10% of revenue.

Mr. Moshe Katri: So, Evgeny, can you, again, this is to follow up with the margin question. You know, how much did investments impact margins during the quarter in terms of basis points, and then maybe you can talk about some of the other factors like pricing, utilization, etc. That would be really helpful.

Mr. Evgeny Fetisov: So how much do investments impact the margins?

Mr. Moshe Katri: Yeah. You're talking about investments impacting margins, so is there any way you can kind of break down some of those factors that you're talking about to give us a feel on, you know, what's recurring and what's nonrecurring, right?

Mr. Evgeny Fetisov: Yeah. I think there is a very straightforward way to look at this, to take this 12 million that Dmitry mentioned and basically translate it into the--it'd be the percentage points. That would be roughly 1.2 percentage points. So if we beat that, that's the impact of the investments this year. So that's the way we see that.

Mr. Moshe Katri: And pricing?

Mr. Evgeny Fetisov: Pricing-wise, Dmitry has also mentioned that we were seeing improved, uh, improved gross margins. As you see, we have ended 39% this quarter, so that's--and again, we said that we will be staying north of 37% for the year, so we're at 37.8% for nine months. So I think that's the level we should be seeing in the coming quarters.

Mr. Moshe Katri: All right, thank you.

Operator: Thank you. Our next question comes from the line of Charles Brennan with Credit Suisse. Please proceed with your question.

Mr. Charles Brennan: Great. So I've just got a couple questions, if that's, ah, if that's possible. Um, firstly, if I just think about the guidance of this year and what's happened to FX, according to my model, you've had an incremental FX benefit since the last time you reported. I calculate that could be worth maybe an extra $4 million, something like that, to your top line.

That implies even larger underlying downgrades to your Q4 expectations. Is my math right there or is there a different way to think about it? The second question is just related to your comments around revenues and margins. I'm just struggling to get my head around the idea of you losing low margin revenue as an explanation for the weaker topline outlook, and yet at the same time, you're cutting margin guidance. I would've thought margin should be rising if you're cutting lay margin work. Thank you.

Mr. Evgeny Fetisov: This is Evgeny. So on the facts, you are correct. So in the beginning of the year, currency revenue will be lower. Although if we take the FX rate again, like they were a year ago, our margins will be higher.

So that's great. So there are different, say, different ways FX rates affect us given the combination of the currencies that we have in the portfolio.

Mr. Charles Brennan: Yeah. Okay, maybe we'll take that one off-line. Uh, and as for revenues and margins?

Mr. Dmitry Loschinin: On the margins, guess that we do get rid of lower margins, uh, at a certain point, but the substitute margins don't come as fast as we expected. That's the major explanation.

Mr. Evgeny Fetisov: So just the fact that we don't get enough revenue and therefore margins with this revenue just didn't produce enough margins for us to improve the bottom line. So that's pretty much, you know, the impact of the drop in the top line.

Mr. Charles Brennan: Yeah, okay, thank you.

Operator: Thank you. Our next question comes from the line of Alexander Vengranovich with Otkritie Capital. Please proceed with your question.

Mr. Alexander Vengranovich: Yes, hi. Thank you very much for taking my call. Analyzing everything you said, did I get it right that because you're deemphasizing the low-margin revenues from your telecom and healthcare accounts, you had some sort of lower utilization rate in the previous quarter, and this should also be impacting your performance next quarter.

And the same, related question here, I just can't understand what's the idea behind the losing low-margin revenue if you can't immediately replicate it with a new revenue stream, or maybe do you have any limitations in terms of the growing headcount, adding, like, uh, new projects. For example, do you have spare people and you're just sort of like dropping some of the projects. What's the point? Because the projects were still, like, bring some margin to you over the short term or how it worked? Thank you.

Mr. Dmitry Loschinin: Yes, hi, so first on the margin and growth side, so there is a certain strategy which we apply for each of the accounts. At first, uh, I think what we do, you know, if we look in the longer run, if the account has a certain margin profile and you stay with this margin profile and you grow this account and it becomes, you know, sizable and significant, that it starts dragging the overall company performance down. So we have, you know, a certain threshold, you know, and we talked about that.

So that should be significantly higher with a 30% GM, which is close to our 36, 37%. So once we start dealing with an account, and that's what we inherited from Insys specifically, that was, you know around 20% GM.

So then, definitely. If it stays like a lot, it goes below our margin and longer-term it is not the business we want to keep, so if we restructure the business and it takes, you know, some of the traditional services provided by the company, replacing with a higher-valued ad services, you know, ramping it up as a value-added and sometimes fixed-price deal.

So it is a combination of techniques and approaches which we do. And again, it's a sophisticated thing, but we do it in parallel. So one, we really tried to not continue this low margin business because we just do not see that as strategic, and what we use this account and the business we have it there, it is some sort of an entry point.

So we already connected to these people as business owners, and we come as Luxoft. We explain that this is the offering. We can do much more than before--what we did before and this is why we push. So that was the initial plan, so we had started trimming down this business, and is not that we stop the execution, we just don't push for a new sell. And at the same time, we try to flip the account and start growing.

But in a large share of institutions, and especially in this one case, we experienced a really very slow decision-making cycle. And in the middle of the year they got a pretty significant internal shift in the management. And if we talk about the telecom story, this is a bit different. It's not very low margins. Actually, the margin profile is not bad, even though it could be improved.

But we just faced that during the year the company went through significant budget cuts in what is called the entertainment area. So the entertainment dropped significantly kind of reduced the budget for--it was significantly reduced, and that was the major factor for us to drop [unintelligible] on the plans. And also, the management of the company at the beginning was overly optimistic. So this kind of pretty much explains the situation.

Mr. Alexander Vengranovich: Okay. And loan utilization rates?

Mr. Dmitry Loschinin: Well, utilization, you're right. And now in Q4 we're going to see some utilization drop. But again, it's factored in to the numbers and our guidance. They must come from some of the ramping down business with this account, but more on the DB side. So we see some of the DB ramping down that continues in Q4. But again, it's in the numbers.

Mr. Alexander Vengranovich: Do you think you're going to slow down new hiring over the next couple of quarters because you are sort of--have some additional free capacity of people? Is that the right thing?

Mr. Dmitry Loschinin: Whenever we can use, we reuse. We have what we call internal mobility. Automatically everyone that has, you know, a certain skill set, we'll get there and we keep the person on the bench for one or two months, just trying to deploy at some other places and when we know it in advance, then of course we can do it practically.

Still, we may face situations then and where ramping down some part of the business with a skill set that cannot be redeployed somewhere else. For instance, automotive is a rapidly growing area for us and you cannot just take someone, an engineer with enterprise skills, and deploy there.

So also, this is reflected in our annual attrition rate, so it's a pretty high this year. But that's predominantly due to rebalancing of the business. So ramping up some of the legacy engagements or all of the engagements and growing up into new areas, the skill sets are different. Fortunately or not fortunately, but that's the situation.

Mr. Alexander Vengranovich: Thank you.

Operator: Thank you. Our next question comes from the line of Vladimir Bespalov with VTB Capital. Please proceed with your question.

Mr. Vladimir Bespalov: Hello. Thank you for taking my question. I also have a full op question on your guidance. When I look at the numbers, given the third quarter was more or less in line, so the decline of the guidance is mostly attributable to the fourth quarter, as far as I understand. So we have a 15 to 20 million lower revenues and if we annualize these, this comes to 60 to 80 million of revenues.

Basically, if we look, then, and the revenues of Insys and IntroPro, if I am correct, these were 80 million and 30 million when you acquired. So basically this means that this drop in revenue wipes out most of the revenue of the acquired [unintelligible]. Am I correct in this respect? This also raises a question about the quality of your due diligence and when you look at this account, or there are some other issues--issues with other accounts which affected your guidance for the fourth quarter and for the full year. This is the first question.

The second question, could you give the breakdown of your organic versus nonorganic growth for the full year and shortly and very brief may be, how do you see Luxoft in the long-term? Is it

10% plus growth story, 15%, or is it still, like, a 20% plus growth story in the long term? Thank you.

Mr. Evgeny Fetisov: This is Evgeny. On the first question, I don't think that will be the correct assumption to annualize the numbers. First off, there is about--if we take the current actual numbers plus forecasted at about $5 million difference in quarter versus quarter, so the $5 million revenue decline, which is close to the normal seasonality patterns, then we shouldn't be annualizing and attributing to in-season IntroPro.

When we look at these two accounts, or these two targets, their revenues for the next year, I would say it will be more or less flat through this year, so we will be seeing a bottom as it relates to this particular target. So your second question, you know, your second question was?

Mr. Vladimir Bespalov: Organic versus non-organic growth.

Mr. Dmitry Loschinin: For the full year?

Mr. Vladimir Bespalov: Yeah, for the full year, based on your expectations.

Mr. Dmitry Loschinin: The full year regarding growth expectations was 10%, and the rest will be coming from organic.

Mr. Vladimir Bespalov: Okay.

Mr. Dmitry Loschinin: Yeah, for the longer-term growth rate at Luxoft, we expect it to be a 15% plus growth company.

Mr. Vladimir Bespalov: This is organic, you mean, right?

Mr. Dmitry Loschinin: Yes.

Mr. Vladimir Bespalov: Okay, thank you very much.

Mr. Dmitry Loschinin: Thank you.

Operator: Thank you. Mr. Loschinin, there are no further questions. I'll turn the floor back to you for any final comments.

Mr. Dmitry Loschinin: Thank you for joining our call today and for your questions. While we are disappointed with the guidance revisions for this year, we make a conscious decision to go off the high-margin business and taking steps to strengthen the company over the long run. As we further advance our business transformation, we are focused on improving execution and driving margin expansion, topline growth and value creation for the shareholders.

And we look forward to sharing our progress and speaking with you again in May on our Q4 call. Thank you very much. Goodbye.

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