Grid Dynamics

GDYN Q2 2023 Earnings Call
Recording Transcript

GDYN Q2 2023 Earnings Call

Company Participants
• Leonard Livschitz, Chief Executive Officer and Director
• Anil Doradla, Chief Financial Officer
• Bin Jiang, Head of Investor Relations

Other Participants
• Puneet Jain, Analyst, JP Morgan
• Joshua Siegler, Analyst, Cantor Fitzgerald
• Maggie Nolan, Analyst, William Blair
• Bryan Bergin, Analyst, TD Cowen
• Ryan Potter, Analyst, Citi
• Mayank Tandon, Analyst, Needham

Bin Jiang, Head of Investor Relations

Good afternoon, and welcome to Grid Dynamics Second Quarter 2023 earnings conference call. I'm Bin Jiang, Head of Investor Relations. At this time, all participants are in listen-only mode.

Joining us on the call today are CEO, Leonard Livschitz; and CFO, Anil Doradla. Following their prepared remarks, we will open the call to your questions. Please note, today's conference is being recorded.

Before we begin, I would like to remind everyone that today's discussion will contain forward-looking statements. This includes our business and financial outlook and the answers to some of your questions. Such statements are subject to the risks and uncertainties as described in the company's earnings release and other filings with the SEC.

During this call, we will discuss certain non-GAAP measures of our performance. GAAP to non-GAAP financial reconciliations and supplemental financial information are provided in the earnings press release and the 8-K filed with the SEC. You can find all the information I have just described in the Investor Relations section of our website.

With that, I'll now turn the call over to Leonard, our CEO.

Leonard Livschitz, Chief Executive Officer

Thank you, Bin. Good afternoon everyone and thank you for joining us today.

As you have seen from our published results, Grid Dynamics second quarter revenue was in our guidance range, and non-GAAP EBITDA significantly exceeded expectations. Also, on a GAAP basis, we achieved record Net Income since becoming a public company. Our results are commendable and reflect the company's unrelentless commitment to our clients. There were some noteworthy trends, including strong new logo wins, meaningful contributions from logos that we won over the past couple of quarters, and deeper relationships with our partnership ecosystem. This has been a recurring theme for the past several quarters and reflects the strength of our offering. Additionally, a significant interest and engagement with our customers on Artificial Intelligence initiatives continued to positively impact our business. With our GigaCube initiative, we operationalized many KPIs across the company.

On the macro, our opinions have remained unchanged. During the quarter, with many of our clients, we witnessed continued recalibration of spending priorities and investments. Also, customers continue to transition their projects from higher cost locations to lower cost offshore locations and this is playing to our favor as we have a global delivery footprint in locations of choice for our clients. During the quarter, we ensured our spending levels aligned with the current demand environment and this discipline paid off with our second quarter profitability.

We are witnessing three important trends that lead us to the incrementally positive conclusions. These trends are expected to play out in the third quarter too. First, the magnitude of resets across our customers are diminishing. Second, we are seeing stabilization in business across the majority of our accounts. And finally third, all forms of new engagements, both with new clients and existing clients are on the rise. This includes enhanced activities with partnerships, engagements on Artificial Intelligence, and willingness of new logos to work with us on their digital transformation needs. While uncertainties persist and it is too early to make any definitive commentary around demand snapback, we believe underlying trends are moving in the right direction, leading us to an incrementally positive view. Yet, we remain conservative in our third quarter outlook.

As I highlighted in the past, coming out of economic cycles Grid Dynamics is stronger as the company proves to be a reliable partner in delivering our customer's business objectives in an efficient manner. Also, the current economic cycle has provided us a great opportunity to realign and organize according to our GigaCube initiatives. This includes adding new talent across different industry verticals, both in the sales and CTO organizations. We are witnessing greater access to high quality talent as our strengths and differentiation become more visible across the industry. Over the past couple of quarters we have incrementally invested our engineering resources towards building new R&D artifacts, accelerators, and Artificial Intelligence capabilities.

There were many positive trends with our technology organization. This includes several exciting opportunities with AI. Generative AI has been front and center across a broad range of clients and we are witnessing exponential interest in our Enterprise AI solutions, particularly in Generative AI, including conversational AI, Data Harmonization solutions, and others. We are currently engaged in multiple billable projects and have created a robust portfolio of demos, capabilities, and solutions. Our R&D organization completed 9 AI projects during the quarter and we are currently involved with over 20 enterprise clients. As a reminder, Grid Dynamics AI engagements are based on more than seven years of internal research and successful implementations. With our generative AI offering, we partner with customers to employ Large Language Models and prompt-guided image generation to the applications in product design & visualization, as well as knowledge retrieval, wealth management, and customer support.

During the quarter we announced a significant global partnership with Google Cloud to develop and implement innovative Generative AI solutions. This partnership will result in incremental customer wins for Grid Dynamics in the second half of 2023 and beyond. Also, this partnership is a reflection of Grid Dynamics' position as an industry leader in AI. Grid Dynamics will leverage Google Cloud's Vertex AI, a platform that incorporates powerful foundational large language models (LLMs) and advanced image generation capabilities. With this partnership, we expect to significantly accelerate and develop innovative AI solutions across the Financial Services & Insurance, Manufacturing, and Life Science/Pharma industries.

On the GigaCube initiative, we continue to make good progress. As you know, GigaCube is our strategic blueprint that lays out a framework for our company towards a $1 billion in revenue. It involves all parts of the organization that include sales, R&D, marketing, operations, as well as M&A. We made some exciting additions to the team. This includes a senior sales leader and specialized sales executives across automotive, pharma, and insurance. These additions will accelerate our new industrial vertical penetration highlighted in our GigaCube Initiatives.

In the quarter there were several notable trends and I want to share with you some of them:

Logo Momentum: In the second quarter we signed 9 large enterprise clients. This brings the new enterprise logos added in 2023 to a total of 18. Additionally, we added new customers from our recent acquisitions. We believe Q2 client acquisition is a further testament of our competency and the confidence for large global enterprises to sign up with Grid Dynamics in the current environment. Some of the more notable ones to mention include a leading digital payment service company, a Global consumer healthcare company, a global athletic-wear company, a global Hotel and hospitality chain, and a North American arts and craft chain. We are very proud of our achievements and this is a testament of our differentiation and value we bring to our customers.

Delivery Location support: Moving to our delivery operations, our execution remained flawless. At some of our recent logo wins, we were able to quickly put together and ramp up dedicated teams across our global delivery locations. Additionally, our integration with NextSphere and Mutual Mobile is in full swing and have started to implement synergies across engineering, operations, and other back-end functions. Today our customers have a choice of over a dozen countries across North America, Central Europe, and India. Our "Follow-the-Sun" strategy enables our clients to be served in an uninterrupted fashion around the clock. Clients support our geographic diversification and choice of locations for engineering support.

European Business: During the quarter, we made good progress in expanding our footprint across industry verticals with our European clients. At a global specialty auto parts company, we are implementing a major "composable commerce" modernization platform. At another global automotive and tire company, we are involved in a significant digital transformation initiative, tied to automotive tire wear-and-tear predictive maintenance using data engineering and analytics. With Artificial Intelligence, we are also engaged with a high-end apparel customer in Netherlands in automating product description using product attributes and images, and finally with a Europe-based global truck manufacturer we are starting a project to modernize DMS (Deal Management System) in the near future.

Partnership: They will continue to be an important part of our growth and have become a significant contributor to lead generation. In addition to the Generative AI partnership with Google Cloud that I spoke of a couple of minutes ago, we are also working with many of our clients across industry verticals as they move from advanced Proof of Concepts (POCs) to real world business transforming solutions. Our relationship with Microsoft Azure and AWS are expanding in the quarter. Grid Dynamics has been recognized for its Advanced Specializations by Microsoft, which earned us the membership at Microsoft's Azure Migration and Modernization Program (AMMP). Additionally, we continue to invest in growing number of Independent Software Vendor partnerships in Supply Chain, Digital Experience, Marketing and Commerce domains; expanding and enhancing the value we deliver across the entire C-Suites. We are engaging with COOs, CMOs, Chief Product Officers, and others.

M&A: With M&A, the integration of our acquisition of NextSphere Technologies, which we acquired on April 18th 2023, is working well. To remind you, this acquisition strengthened our presence in the strategic verticals such as Healthcare, Fintech, and Manufacturing. I am happy to report that in the short time of three plus months, we were able to integrate the operational backend functions. Additionally, we were able to relocate the employees in Hyderabad to the newly constructed Grid Dynamics office. We also have an office in Chennai. We are currently working on the business development synergies and expect to start cross selling across our customer base in the next couple of quarters. Beyond our recent acquisitions, the pipeline for M&A opportunities is robust. We are actively working on multiple opportunities and will be happy to provide updates as the time becomes right. As a reminder, our M&A focuses on capabilities, key customers, and delivery locations.

During the quarter, Grid Dynamics delivered some notable projects.

At a renowned financial services and wealth management firm, we are piloting an innovative AI-based knowledge management platform. This platform offers thousands of financial advisors with direct access to the firm's vast enterprise data via natural languages. Leveraging retrieval-augmented generation technology and leading Large Language Models (LLMs), this platform will improve productivity of financial advisors and help them to create highly personalized updates and offerings to their clients.

For a leading global technology company, we successfully executed a massive migration of user segmentation pipelines to a new cloud data platform. These pipelines play a crucial role in processing an extensive range of data signals, encompassing diverse aspects such as user demographics, spending deciles, usage frequencies, and more. This solution ensures better scalability to address growing amounts of data and fault tolerance.

At a prominent membership-only chain, we modernized their Mobile app to enable and enhance better security, frictionless payments, and user experience. The efforts resulted in an increase in the browse-to-pay conversion and substantially reduced the uninstall rate by a factor of 7x. Currently, the mobile app is serving tens of millions of shoppers in the US.

For a major CPG brand, we delivered a solution that significantly shortens checkout time in their physical stores, even for orders with many small items. It uses existing security tags to scan shopping bags and requires minimal modifications to the store layout or POS hardware. Once deployed across the client's 900+ stores, it has potential to significantly decrease labor cost and increase customer satisfaction.

With that, let me turn the call over to Anil, who will discuss Q2 results in more detail. Anil?

Anil Doradla, Chief Financial Officer

Thanks, Leonard. Good afternoon everyone.

Revenue Commentary

Our second quarter revenue of $77.3 million was within our guidance range of $76.0 million to $78.0 million that we provided to you all in our earnings call in May and reiterated it on June 6th. On a year-over-year basis, both on a reported and constant currency the growth was flat as the impacts of the currency movements was negligible. On a sequential basis our revenue declined by 3.4%. During the quarter, we witnessed headwinds from some of our customers as they continued to rationalize their spending levels. During the quarter, new logo revenue contributions offset macro-driven caution from others.

During the second quarter, retail, our largest vertical representing 33.7% of our revenues, increased by 2.5% on a sequential basis and grew 2.3% on a year over year basis. Within the retail vertical, on a sequential basis, we witnessed growth from areas such as home-improvement, department stores, and specialty retail.

TMT, our second largest vertical represented 31.2% of our second quarter revenues, decreased by (10.1)% on a sequential basis and grew 3.0% on a year over year basis. On a sequential basis, we

witnessed continued caution at some of our larger TMT customers. This was offset by growth both from existing and new logos.
Here are the details of the revenue mix of other verticals. Our CPG & Manufacturing represented 14.1% of our revenue in the second quarter, a decrease of (14.0)% on a sequential basis and (32.4)% on a year-over-year basis. The decline on a sequential and a year -over-year basis came from some of our large customers as they readjusted their spending levels to the current macro environment. The Finance vertical represented 8.7% of revenue, an increase of 3.6% on a sequential basis and 33.7% on a year over year basis. The growth in the quarter came from a combination of financial technology, customers and new logos. And finally, the Other segment represented 12.3% of our second quarter revenue and was up 10.1% on a sequential basis. The strong sequential growth was driven by growth at our healthcare and pharma customers.

Headcount Commentary

We exited the second quarter with a total headcount of 3,862 up from 3,744 employees in the first quarter of 2023 and up from 3,763 in the second quarter of 2022. The sequential increase of 118 employees or 3.2% was largely due to our recent acquisition of NextSphere Technologies which we acquired in April.

At the end of the second quarter of 2023, our total US headcount was 317, or 8.2% of the company's total headcount. This remained on the same level compared to 8.1% in the first quarter of 2023 and slightly decreased from 8.7% in the year ago quarter. The year over year decline as a percentage of the total headcount was largely driven by growth at our offshore locations resulting in greater mix of non-US headcount. Our non-US headcount, located in Central and Eastern Europe, India, UK, the Netherlands, Mexico and "other" locations was 3,545, or 91.8%.

Customers:

In the second quarter, Revenues from our top 5 and top 10 customers were 37.6% and 56.6%, respectively, versus 44.2% and 60.2% in the same period a year ago, respectively.

During the second quarter, we had a total of 216 customers down from 220 in the first quarter of 2023 and up from 208 in the year ago quarter. The decline in customers on a sequential basis was largely from our commercial business which focuses on smaller customers. During the quarter we signed nine new logos from our organic enterprise business.

P&L Commentary – GM, EBITDA, and EPS

Moving to the income statement, Our GAAP Gross Profit during the quarter was $28.3 million, or 36.6%, versus $28.6 million or 35.7% in the first quarter of 2023 and down from $28.9 million, or 37.3% in the year ago quarter. On a non-GAAP basis, our GM was $28.8 million or 37.3% versus $29.0 million or 36.3% in the first quarter of 2023 and down from $29.1 million or 37.7% in the year ago quarter. The increase in GM% on a sequential basis, both on a GAAP and non-GAAP basis was largely due to higher utilization of engineering resources.

Non-GAAP EBITDA during the second quarter that excluded stock-based compensation, depreciation and amortization, restructuring and expenses related to the geographic reorganizations, transaction and other related costs was $12.0 million or 15.5% up from $10.8 million or 13.5% in the first quarter of 2023 and down from $13.3 million or 17.2%, in the year ago quarter. The sequential increase in non-GAAP EBITDA was largely due to a combination of higher levels of GM% combined with lower operating expenses. On a year-over-year basis, the decline in non-GAAP EBITDA was driven by increase in operating expenses from our recent acquisitions.

Our GAAP net income in the second quarter totaled a $2.6 million or a $0.03, based on a basic share count of 75.1 million shares, compared to the first quarter loss of $(8.0) million or $(0.11) based on a basic share count of 74.5 million and a loss of $(13.2) million or $(0.20) per share based on 67.1 million basic shares in the year ago quarter. The year-over-year increase in GAAP Net Income was largely due to lower levels of stock-based compensation and significant decrease in geographic reorganization expenses. On a sequential basis, the increase in GAAP Net Income was largely driven by reduction in stock-based compensation expenses. On a non-GAAP basis, in the second quarter our non-GAAP-NI was $7.0 million, or $0.09 per share based on 76.9 million diluted shares, compared to the first quarter non-GAAP NI of $6.5 million or $0.08 per share based on 77.1 million diluted shares and $8.2 million or $0.12 per diluted share based on $69.9 million diluted shares in the year ago quarter. The increase in the non-gaap NI from the second quarter was largely due to higher gross margins and lower operating expenses. The decrease in the non-GAAP NI in comparison to the year ago quarter was largely from higher levels of operating expenses.

Balance Sheet

On June 30, 2023, our Cash and cash equivalents totaled $246.2 million, down from $258.4 million in the first quarter of 2023. The key reason for the decrease on a sequential basis was due to the all-cash acquisition of NextSphere Technologies which was made on April 18th.

Q3 Guidance

Coming to the third quarter guidance, we expect both revenue and non-GAAP EBITDA to be at similar levels to what we guided for Q2 in May. We expect revenues to be in the range of $ 76 million to $ 78 million, and non-GAAP EBITDA in the third quarter to be in the range of $10 million to $11 million.

For Q3 2023, we expect our basic share count to be in the 75 to 76 million range and our diluted share count to be in the 78 to 79 million range.

That concludes my prepared comments. Bin, we are ready to take questions.

Questions and Answers

Bin Jiang: Thank you, Anil. As we go through the Q&A session, I will first announce your name. At this moment, please unmute your line and turn on the camera. Our first question comes from the line of Puneet Jain from JP Morgan. Please go ahead.

Puneet Jain @ JP Morgan: Hey, thanks for taking my question. Leonard, like you talked about like 20 clients who you are providing some sort of AI services. Which I believe is out of total Of 100 enterprise customers. So that would be like 20% of total customers to whom you are providing Generative AI services. So can you talk about what type of services you are providing to those clients in AI and since some of these customers also outsource to your peers as well, how are you going to win share in AI at those clients?

Leonard Livschitz: Thank you, Puneet. Well, it's quite a comprehensive question so thank you for pointing out the percentage too. We're quite proud that we're still in basically, at the cradle of, AI expansion or revolution. We already capture a substantial point percentage of our client base. So, the projects we have started. Some of them actually run from before when AI was defined as a the modernization of technologies. We've been known of the own investments in machine learning, data science, large models, data formatting and other features. So, now when it kind of becomes more as a part of creating some tangible monetization for the clients, you see in some transfer reaction to the participant. First and foremost, Generative AI is only a subset of what we do. Since we are focused on a large enterprises mostly, the ultimate definition for us is the enterprise transformation in progress which comes with the supply chain of a predicted models for the supply demand, logistic travel, you know, the variances of the forecast and others. When it comes to the wealth management financial companies, it's basically accelerating the adjustments, you know, which relate to the personal bespoke portfolios. We were talking about, medical, you know, the clients in the areas of pharmaceuticals life sciences, those are into their own models. We show them how to accelerate the decision on a certain internal critical development. And so on and so forth, not to forget about our beloved, consumer world where most of the work is B2C. So far I mentioned B2B mostly, in the B2C world, it's a lot of customer and consumer behaviors which are scaling to the very large amount of the preparation. We anticipate a significant cost savings associated with those businesses. Now in terms of our competition. It's absolutely true. I mean, everybody stands up and says we are the leaders in artificial intelligence. We are taking a more the modest approach. We're looking at more and more proven cases of the ROI. In other words, where the customer financial gains start becoming intangible. So we do quite a few proof of concepts, but I think one of the key advantages of Grid Dynamics since we started this initiative over 7 years ago, some of the full and convertible analytics comes into fruition even as we speak. So, we'll continue to update you Puneet and your team and we're very bullish on expansion of our assets.

Puneet Jain @ JP Morgan: Got it. Thanks for a comprehensive answer as well. So let me ask about new logo contribution you have talked about in the past, 85, 10, 5 model. So given like the strong client activity, new new logo contribution that you are seeing, is that at a point where you'd expect to be in any normal year like the new client contribution. And I understand the remaining 95% of business is week. But are new clients at a point where you would expect them to be in a normal year?

Leonard Livschitz: Very good question, very good number. You know, the reality is, you know yourself well that some of the traditional clients which started at the high the year ago have reduced the spending, right? So, the reason why it's important that we reported 18 new clients in the enterprise level since the beginning of the year, we expect that second half of the year monetization will come at a full swing. Now, we tend to be, continuously cautious because the first projects for not all of them, but for quite few of them, in the learn and expand mode, their hyperscaler engagements for their cloud transformations. With some notable ISVs, some of them come into the work ready to the define project like in the payment systems. But there are few we start at much higher level. So, we see that the numbers are increasing, but I wanna make sure that 5 is beaten not because the 85 goes down, but because the absolute value returns. So, but the answer is yes, more likely we'll see the higher contribution.

Puneet Jain @ JP Morgan: Thank you.

Bin Jiang: Thank you Puneet. Our next question comes from Josh Sigler from Cantor Fitzgerald. Please go ahead.

Josh Siegler @ Cantor Fitzgerald: Yes, hi. Thanks for taking my question today. First I like to start an AI just given its significance. And obviously it's gaining a lot of traction. So are you seeing any specific interest from any one vertical over another for AI solutions or is a broad demand. And further, you know, is Grid's AI solutions helping to provide a nice strong pipeline for future new logo additions?

Leonard Livschitz: Okay, well, the area we've been known for a really long time with, you know, the retail, the bespoke brands, the more of the B2C side of business. The momentum is enormous because the results are easy to verify on a very short time, right? So, We've been leaders in natural language processing for a long time. And now when it comes to large language models, we continue to be a leadership position, so that space just from the percentage of our businesses is pretty significant. The upcoming and expanding the business in the supply chain. That's obviously, a subset of the manufacturing, it's becoming more and more substantial for us. We see the notable momentum in Life

Sciences. That's truly a big momentum, which is gonna be, what I tell my team, with or without us. So we better be sharpening out pencils with custom bespoke models for them, which we are at the early stage, but it's working. And the area of the, pretty much everything, but the tech itself. And the reason I want to emphasize the tech part is because we are together partnering to provide the solutions for the enterprise AI. So enterprise AI really falls on the enterprise side as the tech companies have their own models, right? So, there is a combination of the open source models and the proprietary models with the manufacturing, and, the fintech and what I said, the life Sciences is becoming more and more trend. Those 2 would be very competitive races which we'll participate on both sides with our partners. The other part which becomes a very critical for us is actually cybersecurity. We've been investing into cybersecurity for a while. Now it becomes even more clear critical where, some of the notable, you know, AI discoveries are happening simultaneously with a massive number of data sets being provided. And finally, the cloud is one part of it. But a lot of computational and capable capabilities will run on a defined and continued to grown enterprises. And, you know, working on enterprise capabilities become more and more critical. So it's really, attacking from all the fronts and we are very bullish in terms of our positioning with our clients.

Josh Siegler @ Cantor Fitzgerald: Understood. That's helpful color. Thank you very much. And then in your prepared remarks, I believe you mentioned driving higher utilization from your employees, which is helping us foster those higher gross margins. Can you provide some more color on this and can you expect these levels of elevated utilization to remain as we, move into the back half of 2023?

Leonard Livschitz: Well, it's never good enough, right? You're building your business momentum and you always think about what is going to be the business momentum to the next level when the inflection point does hit a material return to growth. So, we are doing massive retraining of the people. But at the same time our own predictable models which we build internal in terms of understanding the probability and variance of the business help us to tailor better the skill sets of the people. So in other words, when we get projects going, we have much lower level of delays between turning people into profitable business versus the, you know, involving them to enter into new project. And it's notable when you get a new enterprise client, you can't wait for months till the people become trained and capable to implement. So that's probably the biggest impact which will continue to foster internally—how to fit the training and capability of our engineering workforce on the project level, the system level with our clients.

Anil Doradla: Just adding one statement to that. Josh, I think that's a very key statement that Leonard put because that's the leverage in the model going forward, right? We have the resources. We have the capabilities. And as we see some of these, demand trends come back, you'll see all these people put to work and then that'll have an impact—a positive.

Josh Siegler @ Cantor Fitzgerald: Understood. Thank you very much. Appreciate it.

Bin Jiang: Thank you, Josh. Thanks for your question. Our next question comes from Maggie Nolan from William Blair. The line is open.

Maggie Nolan @ William Blair: Hi Leonard. Hi Anil. So on AI, it's pretty clear that you have years worth of expertise kind of building up to this moment. Should we expect to see any perceptible pickup in, you know, dollar spend or investment in AI for Gen AI and then what would that look like in terms of magnitude?

Leonard Livschitz: Yeah, so, ou know, the magic wand is here, but the crystal ball is not. So, we do have all the tools necessary to scale the business. It's really, how it's becoming more as a consultancy play, right? Because the ability to build the model, scale the model, or create in the predictable, you know, recommendation is there. Depending on the business, the financial benefit may vary because it takes some time, not only to train the model but verify the financial impact because there are other variances besides this optimization of the forecasting and other stuff. For example, the market trends, the, you know, the competitive trends for our clients. So what they try to do, they try to take projects rather than massive transformation at this point. And they win around those cases at least with what we are involved. So there are sizeable dollars, but I almost remember when we moved the cloud transformation from on-prem to a private cloud, to hybrid cloud to the public cloud. And now we're kind of reversing the trend—roll out of those computational capabilities. So I see that we're going to have a bit of a step function. Right now we're in the early stage where dollars are still limited but the projects are notable. But I think it's gonna roll up into the sizeable part of the business, which means one of the important factor for us—there are many questions to asked. What's the role of the software engineers? Will the future requires less of IT people and how those IT people will look like? And we would not call Grid Dynamics, you know, IT engineers. We are highly trained, intellectually developed professionals in a data and software development space, in the cloud space, which means that while the industry goes through transformation, we are expanding more and more into meeting the match from the capabilities and it's relatively beneficial to us versus some more traditional IT suppliers.

Maggie Nolan @ William Blair: Thanks, Leonard. And, Anil, the margins were strong this quarter. I'm wondering if you can talk a little bit about specific drivers of operating expenses. Is there a possibility that these trend lower over the next couple of quarters?

Anil Doradla: Thanks for the question, Maggie. So as you saw, this quarter we had, roughly, almost 200 bits of expansion on the ebitda side, right? We saw gross margin expanding driven by comments that we had in our prepared remarks around greater utilization of engineers. And then also on the operating front, you saw it go down by about a million dollars, largely driven by the fact that, given the environment that we're in, we're just prioritizing our investments and spending. Now as we go into the back half of the year, our approaches continues to be cautious on the spending. But that said, you know, certain initiatives and projects that we deem as essential are being prioritized. So, we will see how things play out on the revenue side, on the demand side. Obviously, there's going to be a lot of leverage there. But, you know, we'll go one quarter at a time and the hope and the aspiration is, you know, from a margins point of view, we should see some tailwinds.

Maggie Nolan @ William Blair: Thank you guys.

Bin Jiang: Thank you. Alright, thank you, Maggie. Next question comes from Bryan Bergin, From TD COWEN. Please go ahead.

Bryan Bergin @ TD Cowen: Hey guys, good afternoon. Good to see you. Wanted to start on kinda existing base and industry expectations as you go into the next quarter. So can you talk about what you're seeing in the existing client base, whether you are seeing signs of stabilization that are becoming a little bit more broad based and specifically if you can kind of key in on TMT and CPG as you plan for the third quarter.

Leonard Livschitz: Okay, Bryan. I would not select any specific vertical. I think it pretty much goes across all of them at this point. We do see a stabilization. On a technology space, specifically, it's a little bit more client to client varied, but mostly because there are giants, right? So one department goes a little bit more active in spending, the other one takes a backseat, but from the CPG it's no different than Manufacturing or you know Life Sciences. We see that dynamics of conversations start becoming more deterministic by dollars for investment. And recently we won a couple of very notable RFP's. Which is kind of great for us anyways because that's something we are doing a little bit more aggressive and we see that the companies are start preparing. There's anticipation then there would be an inflection point in Q4, and maybe even late Q3, but those are a little bit more speculative. We reflect our guidance based on the facts. But I would say that from the dynamics of the engagement, with the existing customers, because no new customers, you already know, were doing fine, but it doesn't create that, you know, inflection from the short term revenue perspective. So we do believe there is gonna be some positive momentum coming.

Bryan Bergin @ TD Cowen: Okay, that's good to hear. And then, generative AI question for you, but more so internally. So can you just talk a bit more about how you're applying Generative AI, obviously early proof of concepts internally, any early measures of success you can share around developer productivity? And I also wanted your viewpoint on a really high-level question, whether you think that this technology can potentially reduce the competitive benefits of scale, meaning do you see this as an opportunity for some of the smaller more specialized vendors to have a leg up in competitive positioning versus some of the large scale global players?

Leonard Livschitz: Let me start with the last one. Of course I would love to tell you there is nobody in the world better than us, right? There's that saying - The big guys can invest big dollars. Big dollars can lead to big failures. Because this is not the time to compete on the size of investment per se. It's how smart is the investment. The models must be proven. You know, you can't prove the models till there's a, you know, sizable result in the industry and you need to remove the bias, the noise. You know, I hope anybody who has done their modeling, they realize that how sensitive the environment of the forecasting to the boundary condition to the variance and all this stuff. And you need to really look at the consistent correlation. So that's on the more technical side. See, I do believe, on a laser-focused engagements rather than a broad base announcement that we're gonna put x 1 billion of dollars. Now, seeing what we do internally, there are a lot of things happening. So first of all, on the code itself. It's not a secret. Like people say, you know, the code could be developed, you know, with the, with, natural commands, augmentation of the code, the quality controls, the automation to the next level where there's a, I would say, artificially driven factors.

Again, internally it always works great. Because you know it's we're paying for ourselves. But the importance is to test those samples of the code with the clients. What I did say and I mentioned just before you asked this question in terms of the productivity in terms of selection of skill, I mean, the skillset map, which we've been using for a long time, there's a lot of guesswork there. I think it's becoming a little bit more deterministic by using the process and the large models. So we do believe that internal productivity increases, but our focus is on, experimenting the models, also on code substitutions, and the ability to implement the, you know, independent software vendor products into the major stream.

Bryan Bergin @ TD Cowen: Okay, that's clear. Thank you.

Leonard Livschitz: Thanks, Bryan.

Bin Jiang: Thank you, Bryan. Our next question comes from Ryan Potter from Citi. Please go ahead.

Ryan Potter @ Citi: Yeah, hey guys. Thanks for taking my question. I want to start on pricing. I was wondering if you could give some color on how pricing trends have kind of evolved in the past few quarters. Are clients pushing back more on price or is it becoming more of a partner criteria in a new logo wins, and have you also seen any increase of adoption of your fixed fee or pod models?

Anil Doradla: Sure. Thanks for the question. Look, this is a question that we've answered in the past when there's no exception to that even today. Clients always want a better price, right? I mean that is always one of those eternal themes. I think what we go back to every client is value per dollar spent. You know whether it's on some of these cutting-edge technologies, whether it is some you know some of these difficult problems to solve. And time again we prove ourselves to be a partner of choice where the value of dollar that they spend is high. Now in the current environment, as we have macro headwinds play out as we've seen in the past, if there is some incremental pressure with the clients, we have a talk with them on a one-on-one basis. We have sometimes short-term arrangements where we accommodate some of their requests and then you know we revert back to historical levels. I would say that from a pricing point of view, nothing is fundamentally changed long term, but in the short term, there's a little bit of a give and take as some of our clients also face pressure, and we being good partners of them, help them out. I don't know, Leonard, whether you want to add something.

Leonard Livschitz: I think the question is probably on the back of the mind of all you guys. How are we dealing with the pricing coming out of India? Did I take it out of your mouths or I'm just volunteering too much? Why? Because it's no secret when you move your force from Central Eastern Europe and you scale India, the biggest question becomes - What's your pricing position? Well, we've done a few acquisitions already. We're expanding our existing team. I think we're holding the pricing well, and this is because our teams are extremely well trained and intertwined. We hire good quality people intertwined with our European organization. So we don't necessarily run just projects from one region, you know, we're a truly global follow the sun strategy. As we're getting more and more involved with the Indian offices of our clients, which, by the way, is a great addition to our business, we'll see how it's gonna hold. But we maintain the focus on hiring top people. Creating the consultancy approach that all our people kind of work the same quality around the world, and also maintaining the high quality of the interns. So right now it's fine. I think what Anil was telling you, it's a generic trend. But, I'm quite proud that we implement our GigaCube approach with the follow the sun, very consistently across all the regions.

Ryan Potter @ Citi: Got it. Following up delivery and GigaCube. In the earnings deck, it looks like you added five additional countries to your delivery mix like Spain, Portugal, Turkey. Were these organic additions or did they come through acquisitions and then more broadly can you kind of discuss your strategy around delivery expansion and diversification.

Leonard Livschitz: Well, we have not added these countries as big centers of engineering yet. There is a mix of local hires, with some other relocated people. And we review each center with the great filter in terms of the synergies with other locations. And I recently visited pretty much all of the countries you just named. And I'm not a collector of the geographies. You know, it's one of those things you put a... walk with a suitcase which has a little sticker from every country you visit, right? That's for the tourists not for the business. We need to make money in every place we go and we need to bring the value with the local partnership. So the number one guiding factor for the new countries is the relationship with the universities. That's in the early stage. We met some very key notable universities. And as those relationships will prosper, then we can say definitively how scalable those new countries will be. But certainly the young talent is there. I would say that, as I've repeated multiple times, we're not creating shelters for people to relocate. I mean, that's just the one part.

We need to be a homegrown organization with homegrown relationships with universities. So time will tell and will keep you updated, but right now the focus from the overall growth is unquestionably India, Mexico, and in Central Europe it's going between, Poland, Romania, and in Serbia to some extent. We have a good team and Armenia. We still have a good team in Ukraine and a few other places, but as we expand, we need to take all these factors into concentration, but we'll keep you posted.

Ryan Potter @ Citi: Got it. Got it. Thanks again.

Leonard Livschitz: Thank you, Ryan.

Bin Jiang: Thank you, Ryan. Our next question comes from the line of Mayank Tandon from Needham.

Mayank Tandon @ Needham: Thank you, good evening. I had a couple of questions. First was, you didn't comment on the fourth quarter specifically. So just curious, are there fewer billing days as we're modeling our fourth quarter revenue off the third quarter I just want to make sure we check on that one. And secondly, we've been hearing from certain companies, some of your peers, that there's that potential for a budget flush given the sort of pent-up demand that's building. Any comments around that to help us frame the fourth quarter?

Anil Doradla: Sure. So you bring two things which have, you know, opposing effects, right? You're absolutely right. Fourth quarter tends to be, from a billing days point of view, across the industry and we're no exception. Now in the past being a smaller company with high growth, you know, you know, one off clients, if they start growing, also the timing of some of these projects can actually impact the movement from Q3 to Q4 but in general yes from a number of days point of view there's a little bit of a decline. Now the second point that you bring up is budget flush, which is a very good point. And that is something we all have to see as an industry. Like what we saw in previous cycles, you know, if you don't spend it, you lose it, right? There's a little bit of that going on. So I don't want to comment upon, you know, Q4 at this stage, right? We're doing one quarter at a time.

Leonard Livschitz: But these two points that you bring up are very valid and it's part of our overall planning process as we look into the business. Yeah, one more just a quick comment on that in the very early of this session, Punnet asked a question about the contribution of the new clients. So, that's one of the areas where we also see the contribution later in the year, whether it's gonna be larger or medium, time will tell in a month or two. So we'll talk about this in November. And, from the existing customers, I would not call it a budget flush and the reason being is we find that more and more, as we grow through the diversity of the industries, they tend to have fiscal years not necessarily aligned with the calendar years. What we do see for the Q4, it's what's missing from the investments earlier in the year, they may consider to start this slightly earlier, but again, there's, and as Anil said, it's a bit speculative but it's not without, you know, a reason.

Mayank Tandon @ Needham: That's a helpful color. And then, my second question is really more housekeeping. One, Anil, what was the revenue contribution from the acquisition in the second quarter? Was that for the full quarter? And then also really good to see the stock compensation expense come down as a percentage. Should we assume that the run rate is going forward or should we expect further drops may be more inline with industry peers?

Anil Doradla: So I'll start with the second question. Yes, the way you should model is, call it 7. We had about 7.1 million this quarter, right? So plus minus around that range for the remainder of the year. So that's a good observation that you made. In terms of the new logos and I mean new acquisition, revenue contribution, as you know, NextSphere was acquired on April 18th, right? And as we said in the last quarter to kind of you know low to mid single digits is what you should be looking at from that contribution.

Mayank Tandon @ Needham: Sorry, just to be clear, low single digits in terms of absolute dollars, right?

Anil Doradla: Percentage.

Mayank Tandon @ Needham: Got it. Great. Thank you so much.

Anil Doradla: Thank you.

Bin Jiang: Thank you, Mayanak. Thanks for your question. Ladies and gentlemen, that will be all of the Q & A session today. At this moment, I'll pass the line back to Leonard for closing remarks.

CLOSING COMMENTS

Leonard Livschitz, Chief Executive Officer

Grid Dynamics

Thank you everybody for joining us on the call today. We continue to focus on executing towards our stated goals. There are many reasons to feel positive about our business. Grid Dynamics' strong execution, technology leadership, and flawless delivery set us up extremely well coming out of this economic cycle. Our clients continue to place their confidence in our abilities and we continue to execute towards our plan towards a billion dollar revenue company. Recent trends with AI only validate our technology strength and I look forward to sharing with you many new and exciting updates in November.

Thank you