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Syntel Participants

Bharat Desai	**Co-Chairman and Co-Founder**
Rakesh Khanna	**Interim CEO and President**
Anil Agrawal	**CFO**
Zaineb Bokhari	**VP, Finance**

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Syntel Fourth Quarter 2016 earnings call. At this time all participants are in a listen-only mode. Later we will conduct a question and answer session.

At that time if you have any questions, you need to press star then the number 1 on your telephone keypad to place your line into the question queue. If you would like to withdraw your question, press the pound key.

As a reminder, this call is being recorded today, Thursday, February 16, 2017. I would now like to turn the call over to **Zaineb Bokhari**, Syntel's Vice President of Finance.

Zaineb Bokhari

Thank you and good morning, everyone. Syntel's fourth quarter earnings release crossed Globe Newswire at 8.30 AM today. It's also available on our website at www.syntelinc.com. Before I begin my prepared comments, I want to clarify one typo in one of our segment headings in the press release. The outlook that we've shared is for 2017, not 2016.

On the call with us today we have Bharat Desai, Syntel's Co-Chairman, Rakesh Khanna, Syntel's interim CEO and President, and Anil Agrawal, Syntel's Chief Financial Officer. Our other Co-Chairman, Prashant Ranade is not able to attend this call due to an earlier commitment. Before we begin, I'd like to remind you that some of the comments made on today's call and responses to questions may contain forward-looking statements. These statements are subject to the risks and uncertainties described in the Company's earnings release and other filings with the SEC.

I'll now turn the call over to Syntel's Co-Chairman, **Bharat Desai**. Bharat?

Bharat Desai

Good morning, everybody. And thank you for joining us today we faced some challenges in 2016 in a soft macroeconomic environment as our customers experienced considerable uncertainty in their businesses. Thus far in 2017 the business climate key markets remain uncertain. As a result there's still a fair amount of caution built into our customers spending plans for the year.

We are also monitoring ongoing policy proposals that could potentially have an impact on our industry.

It is early to comment on this developing situation. Over the course of our Company's history, Syntel has had to evolve its business model several times in response to regulatory, economic, and technological changes. We have always been consistent in our focus on staying relevant to our customers. By leveraging our US centers and our global delivery footprint across Europe, India and the Philippines, we are confident in our ability to continue to provide uninterrupted service delivery to our customers.

Despite near term business or policy development from any company, the longer term focus remains on helping our customers succeed in the digital economy.

Across each industry, the shift to digital has created many new opportunities for growth and has simultaneously introduced disruption and spurred innovation. Most Global 2000 organizations also rely on systems applications that for decades have served as core processing engines for critical tasks. Sustaining the systems and applications consumes significant resources that could otherwise be channeled into driving growth or building competitive advantage.

Syntel has made significant investments in key technology areas to help our customer succeed in their digital journeys. Our comprehensive service offerings and innovative tools enable implementation and support our customers initiatives in areas like mobility, Internet of Things, cloud and Big Data and analytics, helping them become more connected, responsive, competitive.

Syntel is also helping customers modernize critical systems through these capabilities in core application and infrastructure management. Our intelligent automation platform, SyntBots, amplifies the values of these services to drive outsized benefits and free up scarce resources to fund modernization and growth initiatives.

We have a clear strategy and a disciplined approach that is centered on the business and operational needs of our customers. Syntel's commitment to our customers as a mark on the transformation journey will help them through market uncertainties.

I would now like to turn the call over to **Rakesh Khanna**, Syntel's interim Chief Executive Officer and President to provide further details. Rakesh?

Rakesh Khanna

Thank you, Bharat and welcome everyone. I'm excited to speak with all of you in my new role. Before discussing our fourth quarter results, I want to share some insights about the environment from our discussions with customers. It is clearly a time of significant change for the industries we serve. Our customers are focused on building sustainable competitive advantage while catering to ever changing consumer services. To help achieve this, they continue to prioritize spending on digital initiatives.

At the same time, significant resources are consumed in the support of existing application and infrastructure that sustain critical business functions and processes. Syntel has developed cutting-edge software tools to help our customers handle their digital front end and improve customer experiences. We've also enhanced our application offerings with high-impact solutions that modernize the core systems that businesses rely on. Our SyntBots intelligent automation platform is a great example.

We have taken this holistic approach because we believe that increasingly more companies will need to undertake this journey. We already have work force in our service offerings to align with this shift. Customer preferences and needs have evolved. Project sizes for new engagements are smaller and deals are being unbundled. The nature of service delivery has also changed with short-burst, agile development becoming the norm.

Despite these issues we are focused on improving our sales growth and execution. We are stepping up our investment in sales. In addition, we have expanded band width and account coverage to support each customer relationship. This includes the continued focus on strengthening our ties with our customers.

We are also directing a great deal of this investment at customers for 250. This is expansion of our earlier focus on driving higher contribution from customers for 230. Given the normal evolution of our business and our larger scale, this expansion is the logical next step. We have also invested in our US centers to focus on digital initiatives and opened new ones in Europe. But, as noted, there is ongoing macroeconomic softness in key markets like the US and Europe.

As a result of this, the demand environment is looking muted in the near term.

We are seeing this in financial services where some of our larger customers have remained cautious. We are also seeing this in Healthcare and Life Sciences. We are engaged in regular discussions with our customers. In keeping normal practice we have incorporated everything about our business at this time into our 2017 outlook. As we've seen in past period uncertainty can delay finalization of spending plans and other positions. We are watching our developments closely and we continue to provide updates on subsequent earnings calls.

After evaluating what we know as of now, we anticipate a slow start to the year. This was followed by modest growth in each successive quarter. Now, let's review our results for the fourth quarter.

Syntel's fourth quarter revenue was $237.9 million, down (6.6% year over year and 1.4% on a sequential basis. As discussed on our last earnings call, conditions remain challenging during Q4, with uncertainty across global markets and several of our industry segments. This contributed to delays in project start and the push out of these from second half 2016. Discretionary spending remained weak in the fourth quarter amid soft macroeconomic trends.

At an industry level, we also faced difficult year over year growth comparisons in banking and financial services segment in Q4. In the Health Care and Life Sciences group spending impacted by pending M&A and regulatory and policy uncertainty. During the fourth quarter, we continued to see discretionary spending recover in personal lines insurance. This was offset partly by some weakness in the commercial lines and life and retirement areas. Looking ahead, we expect measured growth from our insurance segment in 2017. Retail, Logistics, and Telecom segments grew on a sequential basis with balanced contribution from customers across retail and logistics.

While growth in Europe was impacted by push-outs seen during the quarter, growth for the region continued to outpace overall Company growth for all of 2016. We anticipate that growth from Europe will continue pace overall revenue growth in 2017. We also continue to watch for any developments related to BREXIT. Anil will expand on our Q4 metrics and 2017 outlook in his prepared remarks.

We estimate that revenue from digital projects accounted for approximately 15.8% of revenue in Q4, up from 15.5% in Q3 and 15% in the year over quarter. Demand for digital services remains solid and we expect it to continue in 2017.

Fourth quarter gross margin expanded to 40.2% from 39.2% in the third quarter. Reflects higher average utilization for IT, modestly lower head count and a slight improvement in delivery mix. The mix between onsite versus offshore delivery improved to 24.4% and 75.6% in Q4 as compared to 24.9% and 75.1% in Q3.

Offshore utilization for IT fell to 70.9% in Q4 from 73.4% in Q3 on a period-end basis.

It rose to 73.1% in Q4 from 71.3% in the previous quarter on average. We still expect to drive utilization about long term historical trends. Net headcount decreased by 44 employees on a sequential basis to 23,011 in the fourth quarter. Hiring continues across each of our geographic regions tied to our specific needs and requirements of customers.

Attrition, calculated on a current quarter annualized basis was 21.3% in Q4, improving from 25.4% in Q3. We are pleased with our efforts to reduce attrition and remain focused on that. This includes Syntel X.O, our new approach to talent management that helps foster a learning environment at Syntel. With Syntel X.O we will enhance employee engagement power our work force to acquire new skills and realize their potential more fully.

I will now turn the call over to **Anil Agrawal**, Syntel's Chief Financial Officer, who will discuss Syntel's financial performance. Anil?

Anil Agrawal

Thank you Rakesh and good morning, everyone. After I conclude my comments, we will open the call for questions. Syntel's fourth quarter revenue came in at $237.9 million, down 6.6% from the prior year period and 1.4% lower than the prior quarter.

For the fourth quarter, banking and financial services contributed 48.4% with Retail, Logistics, and Telecom at 17.6%, Health and Life Sciences 16%, Insurance 13.7% and manufacturing 4.3%. On a year over year basis segment growth was led by the Insurance segment which grew 3.3%. Syntel's customer concentration levels were as follows. Our top three clients represented 48.3% in the fourth quarter of 2016 as compared to 49.1% in the year over quarter and 47.2% in the third quarter.

Accounts 4 to 30 represented 42.2 percent of revenue in the fourth quarter of 2016 as compared to 42.3% in the year ago quarter and 42.9% in the third quarter. Accounts 4 to 50 represented 47.6% of revenue in the fourth quarter of 2016 as compared to 47.2% in the year ago quarter and 48.2% in the third quarter.

Fixed price component of our business was at 44% of revenue for fourth quarter of 2016. With respect to Syntel's margin performance, our fourth quarter revenue gross margin was 40.2% as compared to 41.8% reported in the year-ago period and 39.2% in the third quarter of 2016. By segment, gross margin for Banking and Financial Services was 41.4% with Retail, Logistics and Telecom at 43.4%, Healthcare and Life Sciences at 39.8%, Insurance 36.3% and Manufacturing 30.9%

During the fourth quarter, the Indian rupee depreciated by 1.3% on average relative to the US dollar from the prior quarter. This raised gross margins by approximately 20 basis points.

Moving down the income statement, our selling, general and administrative expenses were 13.1% fourth quarter of 2016 compared to 11% in the prior year period and 12.2% in the third quarter.

SG&A was higher by $1.5 million sequentially. The impact on Q4 SG&A from currency related balance sheet translations based on quarter end exchange rates was a $2.8 million loss as compared to a $1.8 million gain recorded in the third quarter.

The depreciation in the average rupee rate lowered SG&A by $0.3 million. Other expense was $2.1 million during the fourth quarter, as compared to income of $4.2 million in the third quarter, including a gain of approximately $0.3 million from mutual fund sales in the fourth quarter versus a $3 million gain in the third quarter.

Tax rate for the fourth quarter came in at 23% as compared to 413.5% for the third quarter.

The third quarter tax rate included a one-time tax of approximately $271 million, net of foreign tax credits, upon the repatriation of $1.24 billion of cash held by Syntel's foreign subsidiaries. Net income for the fourth quarter was $48 million, or $0.57 per diluted share as compared to net income of $74.2 million R&D expense per diluted share in the prior year period and net loss of $217.2 million, or $2.58 per diluted share in the previous quarter.

The balance sheet at the end of the fourth quarter of 2016 remained healthy. Our total cash and short term investments balance on December 31st was $100 million and the portion held in US dollars stood at 64%. DSO levels were at 54 days. Capital spending in the quarter was approximately $2.2 million.

Syntel ended the fourth quarter with total headcount of 23,011, of which 7,710 were assigned to KPO. Our global headcount was lower by 0.2% from the third quarter. Our billable headcount was 4,556 on-site and 16,731 offshore for a total of 21,287. Utilization levels at the end of the quarter were 92.2% on-site, 77.7% offshore, and 80.8% globally. Our delivery mix at the quarter end was 24% on site and 76% offshore.

Voluntary attrition during the quarter was 21.3% as compared to 25.4% reported last quarter. Syntel added five new customers in the fourth quarter. Looking forward, I will now like to provide you with guidance for 2017.

Based on our current visibility levels Syntel expects revenue to be in the range of $900 million to $945 million and earnings per share to be in the range of $1.75 to $2.00 for the full year of 2017. The Company currently has 63% visibility to the low end of the revenue range and our guidance is based on an assumption for an average exchange rate of 67 rupees to the dollar. We anticipate that operating margins will be in the 24% to 26% range. Our effective tax rate will be in the mid 20% range for 2017 and CapEx is expected to be in the range of $15 million to $25 million.

We will now open the call for question and answer session.

Operator

At this time I would like to remind everyone that if you would like to ask a question please press star then the number 1 on your telephone keypad. To ensure that all of our participants have an opportunity to ask a questions, please limit yourself to one question and one follow up. We'll pause for just a moment to compile the Q&A roster. Our first question comes from the line of **Ed Caso**, with Wells Fargo. Your line is open.

Rick Eskelsen

Hi good morning it's actually Rick Eskelsen on for Ed. I just want to ask a question on discretionary spending outlook and particularly in the banking and healthcare verticals. We've heard from some of your peers a more, I would say, optimistic tone on spending. Especially in banking for 2017 than what you guys shared. So just curious if you could talk a little bit more about what you're seeing demand wise and what you're hearing from clients and why you're more cautious going into the year?

Rakesh Khanna

Well, what we've seen is in pockets of sectors and banking financial service segment so we do see softness. We see some macro headwind, which is causing more scrutiny on the budgets, on the spending and, you know, that's really impacting some of the decision cycles and delaying decisions and that's what we see.

Zaineb Bokhari

I'm sorry. I was just going to say that in some of these industries, I don't think what we're calling out is terribly unique. For example, policy uncertainty in healthcare, but we do have we think a bigger footprint in the industry. And so that is impacting us as well.

Rick Eskelsen

And specifically in financial services, I'm wondering if you'd go maybe a little bit deeper on what are the pockets where you're seeing the most weakness, maybe if you can break it down among banks, payments, things like that. Thank you.

Rakesh Khanna

Yes. We are seeing some softness and some of our banking and financial services customers are facing some headwinds. And that's really impacting some of the decision cycle so those are some of the specific areas where we are seeing softness.

Rick Eskelsen

And just a last question on that, are you seeing projects getting canceled or just at this point being delayed to start and slower to start than they typically would be?

Rakesh Khanna

We are seeing projects getting pushed out — delayed and getting pushed out.

Rick Eskelsen

Thank you very much.

Zaineb Bokhari

If I could just finish on that point, you know, I think that the uncertainty is contributing to delays and what it also probably is going to translate into is a different seasonal pattern for the year where we'll probably get off to a slower start and then see modest improvement in successive quarters.

Rick Eskelsen

Thank you.

Operator

And our next question comes from the line of **Anil Doradla**, with William Blair. Your line is open.

Anil Doradla

Hi, guys, thanks for taking my question. So, Bharat I had a couple of big picture questions. Clearly there are many moving parts. When you look at your 27 outlook how much would you attribute? I mean perhaps a little bit more qualitative, but if you can quantify that's greater how much would you attribute to the more company specific, you know, issues versus macro demand environment specific?

Bharat Desai

For us, it is kind of our lens into the business world – into our customers business. This is the viewpoint we have, and we're giving you the best view of the picture we see in the markets we serve.

Anil Doradla

Okay. The reason I say that is if you look at your overall growth over the last couple of years relative to the industry, it's been lower, and, obviously, today's commentary around the macro environment which you're saying is volatile. Is that perhaps in some ways consistent with what everyone else is saying so I'm just trying to understand how much is it macro versus Company specific?

Okay. As a follow-up, clearly when you look at some of your business, it's a high quality, you see that in the margin structure. It's almost like BPO and when I talk about some of your big customers, isn't it time to take a big picture look and make some perhaps, big strategic (inaudible) decisions when it comes to, you know, exploiting some of your strong areas such as, you know, State Street and what you do there and kind of scale it to other parts? I know it's difficult, but the current environment in which you guys are in focusing on the IT business, given whatever's going on in the macro, is clearly tough. How about repositioning your business altogether as more of a BPO company and then kind build up from there?

Bharat Desai

I think you asked the same question last time, so I will give you the same answer. We take a — first of all, remember 90% of our revenue – close to — is IT. And this is where we're investing significant (inaudible). We actually believe that with the way that we've invested across the value chain, we see some outsize opportunities. And, you know, we're just focused on executing on them. I think maybe in a couple of industries we serve there's uncertainty due to the environment. But we're engaged in many conversations about how this IT can be leveraged. We're engaged in several pilots and initial engagements. So -- and we spend a lot of time thinking about this and our strategy will be focused on market opportunities that we see and how we leverage our capabilities to gain, to create a competitive edge and serve our customers. To that end I think we are -- we have a pretty clear focus and are comfortable that our strategy is bang-on.

Anil Doradla

Okay. Thanks.

Operator

And our next question comes from the line of **Joseph Vafi** with Loop Capital. Your line is open.

Joseph Vafi

Hi, guys, good morning. I was wondering if we could talk a little bit about gross margins for next year? I heard the operating margin range, and I know you did a 40% number here in Q4. Maybe what you think the gross margin outlook may be for next year? And then secondly, I've heard a couple times on the overall outlook that may be down Q1 numbers which maybe it sounds like you're calling that the trough. And some color on your confidence that you think that is indeed the trough at Q1. Thank you.

Anil Agrawal

So thanks Joseph. I'll take the margin questions and then Rakesh may add on. So margin guidance will be 37% to 39% for the year 2017.

Rakesh Khanna

In terms of we are looking at a soft Q1 but definitely looking at modest growth in successive quarters and, you know, we continue to invest in our business. Like Bharat said, we have some very strong service offerings which are resonating extremely well and as some of the macro headwinds in the sectors we called out, really in banking and financial services and healthcare due to some uncertainty around spending and M&A. Think we are definitely in a strong position for growth.

Joseph Vafi

Thank you.

Rakesh Khanna

You're welcome.

Operator

And our next question comes from the line of **Bryan Bergin** with Cowen and Company. Your line is open.

Bryan Bergin

Hi. Thank you. I heard you mention the scaled investment in sales. Can you quantify what you're doing there? And then your overall strategy, target strategy, your ability to expand any funnel opportunities, how should we think about that?

Rakesh Khanna

Yeah. We are stepping up our investments in client facing, in sales, in deal closure related activity. And of course we continue to invest in IP, in our intelligent operation platform, SyntBots, so really that's our directionally.

What we've also done is we've released band width and provide executive cover to really look at deal closures and we believe as soon as some of the uncertainty around (inaudible) eases -- and hopefully we will give you some color or better refresh -- when we come with our Q1 results. We should be able to update you at that time. But we believe that's the way going forward I'm very confident of our strategy. We have strong service offerings and that really will help position us for growth.

Bryan Bergin

Okay. And then the client list you have, clients 4 through 30, can you just talk about what's going on there? I know insurance is weighed throughout the year, but during the fourth quarter is there a continuation of that, anything different there, and then what are you expecting in that group of clients for 2017?

Rakesh Khanna

We do expect clients 4 through 30 to grow faster than Company average. Now, last year because of some of the uncertainty in healthcare and insurance, if you kind of take those accounts out, the 4 through 30 did grow faster than the Company average. What we've done is we've expanded the coverage to cover accounts 4 through 50. Now, as we scale, as we grow, we believe there is an opportunity to mine the accounts and that is expanded the coverage. Like I said, we've stepped up investment and we've released executive bandwidth and we believe, again, that of course we will continue to grow our top three accounts. These are very deep relationships. We have very, very good queue, we are inside the room for a long time and definitely are able to replicate some of these successes in the top three and also take it from accounts 4 through 50. We believe is a strong foundation for growth and we see every customer as the growth account for Syntel.

Bryan Bergin

Okay. Last one for me. What share of your client base now has deployed SyntBots, particularly outside of the top three. Just want to understand the client reception to the managed service offering. Thank you.

Rakesh Khanna

Approximately one third of our customers are at various stages of implementation and we are really getting some fantastic feedback and a great response. We have a first-mover advantage and we've invested ahead of the curve. It's too early to quantify the results, but we are getting a great initial response as we propagate and go deeper in each of our client segments.

Bryan Bergin

Thank you.

Operator

And our next question comes from the line of **James Friedman**, with Susquehanna. Your line is now open.

James Friedman

Hi. Thank you for taking my question. This is Jamie at Susquehanna. I'll ask my two up front. Bharat, in your prepared remarks, you were calling out mobility and IOT and analytics. Where are we in the journey for those, maybe measured by client penetration or the growth contribution to the Company. And then Rakesh, with regard to your response on the SyntBots question, can you help us think about how SyntBots impact linearity of headcount at the Company? Those would be the two, mobility, IOT, analytics and then the SyntBots question. Thank you.

Rakesh Khanna

Thanks, Jamie. From SyntBots and managed services, clearly what we've seen, is that headcount growth trails revenue growth okay? So that definitely has been the trend. We've shown that and, you know, we are on the same journey, right? So that will continue.

On the digital part, Jamie, you know, that we do expect, you know, if you see digital we grew 10% percent on an annual basis last year, and we do expect digital to grow faster than Company average. And what we look at as digital is really the SMAC – social, mobility, analytics, cloud, plus IOT – including IOT, that's really the combination — which is the front end stuff that we do. And we believe Jamie, there is great opportunity for us to improve and modernize the core assets. See, a lot of our customers have huge technical debt, the legacy systems. And we believe (inaudible) journey for our customers, you know, they've extracted (inaudible) focused on the digital as a customer engagement layer. But to now move to an e-commerce or transactional layer on the digital part, there is an imperative need to upgrade the core systems, to modernize the core systems. And that's really the sweet spot, coupled with the front end digital and legacy core back end we believe we have a very strong position going in, and we see that as the next evolution going forward.

Bharat Desai

Thanks Rakesh. And to your question on where we are on mobility, IOT and analytics. I'd say we are probably in the early innings of penetration with our customers. But we've won some very strategic engagements and are executing on some high impact initiatives in each of those areas. And the plan is to now leverage those successes and identify areas in our customer's businesses where we have an opportunity to scale these. And each of them, you know, has a lot of potential. I think the issue is that in each case the customer has to create a business case, and the work at this stage is kind of missionary work with the customer in identifying the areas where this can be a meaningful initiative. So, you know, based on the successes we've seen, we think the potential is quite strong and we are scaling into these areas.

James Friedman

Thank you, both.

Bharat Desai

I hope that answered your question.

James Friedman

Yes.

Operator

And our next question comes from the line of **Eric Ciura** with Robert W. Baird. Your line is open.

Eric Ciura

Hi, guys thanks for taking my question. First, on the margin guidance, operating margin of 24% to 26% next year, can you maybe just walk through the moving parts between FX impacts both from the weaker INR and SG&A impacts as well as the core margin expectations for 2017? And why it's down versus 2016?

Anil Agrawal

Let me start with saying we are pleased with our margin performance and we are committed to deliver superior margins. As Rakesh alluded we have stepped up our investments in client engagement and geographic expansion, while we continue to invest in technology transformation and IP development. And our projections, you know, do not factor in exchange gain and loss. We had a one-time gain of $8.3 million in 2016. This is not factored into our projections.

Eric Ciura

Okay. Thank you. And then secondly, just for interest expense next year, is the about $2 million rate in Q4 a right expectation for throughout 2017 as well?

Anil Agrawal

Interest expense will be in the range of $3.2 million, I would say. Per quarter.

Eric Ciura

All right. Thank you.

Operator

And our next question comes from the line of **Puneet Jain**, with JPMorgan. Your line is open.

Puneet Jain

Hi. Thanks for taking my question. A related question to one of the prior questions on digital. With high focus with clients' high focus on digital areas, can you comment on opportunities for small and medium sized providers that are not pure-play in those areas? Specifically, some of the largest firms are heavily investing in digital acquiring companies to build capabilities. So what does that mean for small mid-cap provider like Syntel competitively?

Bharat Desai

Yes. That's an interesting question, Puneet. And what we're actually finding is customers are looking for specialists and are looking for organizations that bring special skills as opposed to generic skills. And are clearly rethinking their venture partnership. So, you know, at the end of the day, I think what matters is do you understand the customer's problem, do you know how to solve it, and does the customer has confidence in your abilities to do so. So those are the things we are focused on working with customers to grow our businesses.

Puneet Jain

Understood. And I don't know if you disclosed it. What was the size of your digital practice in Q4?

Anil Agrawal

That was covered by Rakesh in his prepared remarks, and was 15.8%.

Puneet Jain

Thank you. Sorry I missed that, I think. Last one, quickly. Given increasing concerns around immigration rules in the US, can you talk about your Visa mix, and what can you do to minimize impact from a potential changes, from potential changes in Visa regulations?

Zaineb Bokhari

Clearly we are monitoring all the policy proposals that are coming out that that could potentially have an impact on us and our industry. It's fairly early to offer any kind of a comment on the developing situation. I think Syntel has always been very committed with complying with whatever laws when they are enacted. In addition to that, if you look across our history, there have been many periods of time during which we have had to evolve and our flexibility has allowed us to do that. But I think our focus is on continuing to provide uninterrupted high quality service delivery to our customers, and we are certainly monitoring all the developments that are coming through.

Puneet Jain

Got it. Thank you.

Operator

And our next question comes from the line of **Joseph Foresi**, with Cantor Fitzgerald. Your line is now open.

Joseph Foresi

Hi. So my first question is I think you talked about the business and financial services and healthcare being delayed as we go into the year. Why would it be delayed and not canceled? And from a competitive standpoint, have you seen any market share shifts or the repurposing of budgets?

Zaineb Bokhari

So, Joe, I'll start that and maybe Rakesh will chime in. On the healthcare side throughout 2016 we saw pending M&As create a pause in terms of some of the spending and moving forward plans. And as we enter this year there has been some new flow that end but there is a lot of policy uncertainty. So what we're seeing is that in that case, you know, customers are taking some time to evaluate what their go forward plans are and we think that it's more of a pause.

Similarly in banking and financial services, the macro uncertainty is something that we called out as worsening in Q3. We saw some of that continue in Q4 and as we entered the year, some of those conditions have persisted. And again, uncertainty creates longer decision cycles and that's what we're seeing at this point in time.

Joseph Foresi

Okay. And maybe just a little bit more color in banking and financial services. Maybe you could be more specific on what type of uncertainty is causing the hold up among banks because a lot of the companies have talked about, you know, the interest rate environment getting a little bit better and maybe possibly lower regulations.

So is it one client? Is it three clients? What do the projects look like? Just a little bit more color would be helpful.

Zaineb Bokhari

I think the weakness that we're seeing is certainly coming out of the caution with respect to the macroeconomic uncertainty. And we've noted that we've seen some of that caution at of some of our larger banking and financial services customers. And so I'll leave it at that.

Joseph Foresi

Okay. And then if I could stick a numbers one in, do you expect headcount and utilization to be up in 2017? I know you don't give guidance there but I'm just wondering how those two pieces balance out throughout the year? Thanks.

Zaineb Bokhari

I think that we are going to continue to focus on driving toward utilization that is above trend. And there is no change there.

Joseph Foresi

Thank you.

Operator

And our next question comes from the line of **Frank Atkins**, with SunTrust. Your line is now open.

Frank Atkins

Thanks for taking my questions. I want to ask a little bit about capital structure, capital allocation, capital return. Given the top line trajectory, is there any change to your philosophy when you think about repurchase, dividend or M&A?

Bharat Desai

No change. I think we will continue to follow the principles we have in the past. As you know, our Board reviews this on a regular basis and when they feel that we have excess capital we've returned it to shareholders. So we will continue to monitor our progress and continue to take a close look at capital structure. And optimize as we go forward.

Frank Atkins

Okay. And as my follow-up, I wanted to go back to the political environment a little bit. One, are you seeing any changes in client behavior as a result of this? And, two, any exposure or is it too early to comment on a border adjusted tax type scenario?

Anil Agrawal

On the border adjustment tax, we are still monitoring the policy proposals but it's actually too early to comment on the situation that is still developing. However, I can just assure you that Syntel is committed to adherence of whatever policies are enacted.

Bharat Desai

I didn't quite get the first part of your question.

Frank Atkins

Are you seeing any changes in clients' behavior as the political environment and headlines around offshoring.

Bharat Desai

In the political environment? I think, no, but the customers – we've been proactive about communicating to customers about our principles in running our business. And so far we don't know of any action taken by any customers, but I think everybody's waiting to see what's the end outcome.

Frank Atkins

Okay. Great. Thank you very much.

Operator

And our next question comes from the line of **Vincent Colicchio**, with Barrington Research. Your line is now open.

Vincent Colicchio

Bharat and Rakesh, when do you expect to potentially benefit from the cancellation of the healthcare mergers?

Rakesh Khanna

It's a bit early to determine that. We do see some lingering uncertainty and I guess as clarity emerges, we do expect a measured recovery. But it's really too early right now. And hopefully we'll update you in April with a refresh as we get more details.

Bharat Desai

Yeah. A number of the companies involved in the transaction, you know, that are well-known, are actually Syntel clients so we are very closely monitoring the situation and, you know, we'll update you as the opportunity develops.

Vincent Colicchio

And your lines of communication remain fresh and strong throughout this process with those clients?

Zaineb Bokhari

Absolutely.

Bharat Desai

Absolutely.

Rakesh Khanna

Yes. And in the long-term we are bullish in our patient, payer, entire lifecycle management approach, investment and some of the domain-led solutions. You know, we're very confident once some of these uncertainties abate, clearly -- we see opportunity for Syntel to add additional value.

Bharat Desai

Yeah. I think there are two initiatives each of the organizations will have to take. One is the whole area of consumer-driven health plans and, you know, most of these organizations have put new initiatives pretty much on the back burner. So this is a key one because that's what gives them a competitive edge and that's what their customers, their consumers are asking for. And we actually have some really good experience developing those. So that's one. And the second is any fall out that may happen from the Affordable Care Act will have a direct impact on the processing and managing of systems. So both those are things we are hawkishly following.

Vincent Colicchio

And what was the trend and win rates in the quarter for the business overall, and then for digital projects in particular?

Rakesh Khanna

We won five new customers in the quarter. In terms of digital, that's roughly 15.8% of our revenue and we grew to 10% on an annual basis and we do expect that to outpace Company growth going forward.

Vincent Colicchio

Okay. Thanks for answering my question.

Operator

And our next question comes from the line of **David Stratton**, with Great Lakes Review. Your line is now open.

David Stratton

Good morning, thanks for taking my question. Most of them have been answered at this point. But I was wondering if you could talk a little bit about the current pricing environment and the competitive landscape given the overall uncertainty of the entire industry.

Rakesh Khanna

Yeah. At a company level we see pricing is stable. We did see some pressure on 'run the business,' and we kind of used our managed services, which is an automation-driven management of lights-on, run the business work. So it's some of the pressures we saw in that part. But, we have a very strong M3 service offering, where what we do is we offer a managed lights-on kind of work to clients, and really the efficiency in that part to fund some of the modernization efforts of the business. So, that's our strategy and it's actually helped us see stable pricing on a company level.

David Stratton

All right. Thank you. And then I don't know if you mentioned this earlier, but did you give a cash flow number and, if not, would you please?

Anil Agrawal

Okay. Free cash flow for the quarter was $2.6 million, which we have (inaudible) in the quarter, and components of that were cash flow of $4.7 million and a CapEx of $2.1 million.

David Stratton

All right. Thank you very much.

Operator

And our next question comes from the line of **Brian Kinstlinger**, with Maxim Group. Your line is now open.

Brian Kinstlinger

Great. Good morning. Syntel traditionally focused, I believe, compared to some of the others on maximizing profitability in its space and then Bharat, you mentioned you've transformed the Company several times over the years which you have, for sure. I know you're always making investments but in the face of two years of declining revenue does management plan to accelerate investments once again to transform the Company? Is that already happening or will we see SG&A increase steadily this year and next year?

Bharat Desai

I think we will -- we have stepped up and we continue to make investments where we can, to gain a competitive edge, and to gain share. And those investments are already baked into our forecast.

Brian Kinstlinger

Okay.

Zaineb Bokhari

Brian, if you take a look at the gross margin and the overall margin outlook those certainly incorporate some of the investments on customer engagement and some of the stepped up investments on the sales side that we talked about.

Brian Kinstlinger

Great. I know Rakesh is the interim CEO. There's been significant turnover at this position since I've covered the Company for a long time and I'm curious. Is the Board thinking about looking outside the Company? I know mostly CEO's have come from within the ranks and have grown up at Syntel, or do they look for a new point of view and look for someone outside the Company. I'm curious, Rakesh — is it likely he will become the CEO? What's the process right now of finding who will lead the Company next?

Bharat Desai

That's something the Board decides on. I can share with you our philosophy has always been to provide opportunities for our proven leaders inside the Company, to run any position that comes open and we, as you know, have a very strong track record of having done so.

Brian Kinstlinger

Great. Thank you.

Operator

And that concludes the question and answer portion of today's call. I would now like to turn the call back over to Mr. **Rakesh Khanna** for closing remarks.

Rakesh Khanna

Thank you, Operator. And I want to close today's call by thanking Syntel's employees for their contributions. I look forward to updating you on our progress on our next quarter call. Thank you.

Operator

This concludes Syntel's fourth quarter earnings call. A replay of today's call will be available until February 23, 2017 by dialing (855)859-2056 and entering the pass code which is 60632903. Thank you.