# Syntel Participants

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

## Operator

Ladies and gentlemen, thank you for standing by and welcome to the Syntel Second Quarter 2017 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, July 20, 2017. I will now turn the call over to Zaineb Bokhari, Syntel's Vice President of Finance.

## Zaineb Bokhari

Thank you and good morning everyone. Syntel's second quarter earnings release crossed Globe Newswire at 830 a.m. today. It's also available on our Web site at www.syntelinc.com.

On the call with us today we have Bharat Desai and Prashant Ranade, Syntel's co-Chairmen, Rakesh Khanna, Syntel's CEO and President and Anil Agrawal, Syntel's Chief Financial Officer.

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

Thank you, Zaineb. Good morning everybody and thank you for joining us today. We made progress in a challenging environment during the second quarter. Our customers continue to deal with some uncertainty in their businesses; this is impacting their willingness to move forward with discretionary spending. Our team is focused on stabilizing revenues and working with our strategic clients to help with their key imperatives. We've been implementing our strategy to deepen and broaden our coverage across clients 4 to 50. We have increased our client-facing executive bandwidth and plan to stay the course, as we work to deepen our relationships, rebuild revenue momentum and manage our business prudently. We will continue to make focused, high-impact investments in differentiated solutions and in our go-to-market engine. It will take some time for our plan to play out, but I am confident this approach will put Syntel on a growth path.

Companies have relied on technology to improve customer service, time to market, to mitigate operational risks, and to gain stronger insights into their business. Over time these benefits have increasingly been undercut by the technical debt and rising costs associated with keeping aging systems alive. As technology takes center stage and companies try to embrace innovative technologies, they are experiencing the limitations and inflexibly of their aging legacy systems.

This is the balancing act many organizations are attempting; modernizing their applications for agility, scalability and a significantly improved customer experience while continuing to support current systems. Syntel's investments in automation and Cloud services reflect our commitment to supporting our clients' digital transformation. We have

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robust automation led capabilities across ITOps, BizOps and DevOps and legacy modernization to help our customers with their transformation. We view this as a very compelling offering las we evangelize our approach and execute our strategic plan.

Before I conclude my comments, I have two announcements to make on behalf of the Syntel Board of Directors. First, our Board has approved a $60 million share repurchase program. Anil will cover the details of this in his prepared remarks. In addition to this, I'm very pleased to announce that the Board has appointed Rakesh Khanna as Chief Executive Officer and President and elected him to the Syntel Board effective immediately. Rakesh is an experienced leader with a demonstrated track record of success in several different roles at Syntel. Syntel's Board is confident that Rakesh is the right person to help lead the Company and build on our strong foundation of innovation and customer service.

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

## Rakesh Khanna

Thank you Bharat and welcome everyone. I am honored to accept this position and I would like to thank the Syntel Board for their confidence in me.

Before discussing our results for the second quarter, I want to provide an update on the demand environment and some of the key trends we are seeing in our business at the midpoint of this year. The broader environment has not changed meaningfully from what we shared on our previous earnings call and the year is largely progressing as expected. Overall spending is below year ago level as customers contend with macroeconomic uncertainty and industry specific or policy related headwinds. The budget reductions we called out last quarter remain in place and decision cycles are extended. We continue to see weakness in our Banking and Financial Services and Healthcare segments. At the same time, our relationships with our strategic customers and our positioning remains strong; our wallet share is stable.

During the second quarter, we continued to make progress on our plan to improve our sales execution and broaden our coverage across customers 4 to 50. We've seen some early benefits from the changes we have made to increase executive bandwidth and focus on deal closures, but it will take some time for our teams to fully hit their stride.

There are clearly pockets of strength in our business that are outperforming overall company growth. The demand for digital services remains strong across each industry segment. In addition, we continue to see rising interest in modernization of systems and applications. Our Insurance segment is another bright spot and is expected to register positive year over year growth in 2017. While Healthcare is weak overall, we are seeing promising growth from the Life Sciences sub-segment. Based on everything we know about our business at this time and the greater visibility we have into the full year, we are raising the low end of our calendar 2017 revenue and EPS outlook.

We take some encouragement from the progress made in the second quarter and the improvement in our outlook; HOWEVER, I want to emphasize that the headwinds seen across our business have not abated. For this reason, we anticipate that revenue for second-half 2017 will be weaker than what we've reported for the first half of the year. As I've said before, it will take some time to overcome the revenue decline we expect for this year. Now, let's review our results.

Syntel's second quarter revenue was $226.8 million, down 7.8 percent year-over-year but up 0.4 percent on a sequential basis. Most of the pressure we are seeing in on discretionary spending in areas like traditional application development. We saw declines across our Banking and Financial Services segment in Q2, including at some of our large BNFS customers. We continued to see weak spending in the Healthcare industry segment, particularly among payers. A lack of clarity on the policy front continues to inject conservatism into their spending plans.

Insurance segment revenue grew 2.6 percent year over year led by the Commercial and Life and Retirement areas. We continue to expect measured but positive growth for this segment in 2017, led by growth in these two sub-

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segments. Retail, Logistics and Telecom segment declined 1.4 percent on a year over year basis impacted by weakness in the Retail, where traditional brick and mortar companies are experiencing disruption from digital peers and undergoing retrenchment. Finally, Manufacturing was weak in Q2 amid a slowdown in manufacturing activity, impacted by macro-economic and cyclical factors.

Our European revenue grew on a sequential basis during the second quarter but declined from a year ago. Some of this year over year decline is the result of weakness we're seeing in Banking and Financial Services. In addition to this, we are seeing some conservatism from customers as they experience policy uncertainty and other developments. We continue to invest in Europe and expect the region to be an important driver of growth over the longer-term. However, based the current visibility we have to the full year, we anticipate growth from Europe to underperform overall company growth. Anil will expand on our Q2 metrics and 2017 outlook in his prepared remarks.

Revenue from digital projects accounted for approximately 19.9 percent of revenue in Q2, up from 18.3 percent in Q1 2017 and 15.5 percent in the year ago quarter. We are seeing encouraging traction across a range of our offerings including AI, Big Data, analytics, and IoT and machine learning.

Second quarter gross margin narrowed to 35.9 percent from 36.5 percent in the first quarter. This includes the normal seasonal impact on gross margins from immigration-related expenses and wage increases and the impact from the appreciation of the Indian rupee. On average, offshore wage increases were in the mid-single digits and in the low to mid-single digits for onsite.

Offshore utilization for IT rose to 73.6 percent in Q2 from 67.6 percent in Q1 on a period-end basis. It rose to 70.3 percent in Q2 from 67.6 percent in the previous quarter, on average. We continue to expect to drive utilization above long-term historical trends. The mix between onsite versus offshore delivery was 24.2 percent and 75.8 percent in Q2; as compared to 24.3 percent and 75.7 percent in Q1.

Net head count decreased by 945 employees on a sequential basis to 21,850 in the second quarter. Hiring continues across geographic regions tied to anticipated needs and requirements of our customers. Attrition, calculated on a current quarter annualized basis, was 22.6 percent in Q2, as compared to 20.8 percent in Q1.

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

Thanks, Rakesh and good morning everyone. After I conclude my comments, we will open the call for questions. Syntel's second quarter revenue came in at $226.8 million, down 7.8 percent from the prior-year period and up 0.4 percent from the prior quarter. For the second quarter, Banking and Financial Services contributed 45.6 percent, with Retail, Logistics and Telecom at 18.1 percent, Healthcare and Life sciences 17.5 percent, Insurance 14.6 percent, and Manufacturing 4.2 percent. On a year-over-year basis, segment growth was led by the Insurance segment, which grew 2.6 percent.

Syntel's customer concentration levels were as follows our top 3 clients represented 45.5 percent in the second quarter of 2017, as compared to 47.9 percent in the year ago quarter and 47 percent in the first quarter of 2017. Accounts 4 to 50 represented 50.3 percent of revenue in the second quarter of 2017, as compared to 47.6 percent in the year ago quarter and 48.7 percent in the first quarter 2017. The fixed-price component of our business was at 43.5 percent of revenue for second quarter of 2017.

With respect to Syntel's margin performance, our second quarter gross margin was 35.9 percent, as compared to 37 percent reported in the year-ago period and 36.5 percent in the first quarter of 2017. By segment, gross margin for Banking and Financial Services was 36.3 percent, with Retail, Logistics and Telecom at 39.1 percent, Healthcare and Life Sciences at 39 percent, Insurance 31.3 percent, and Manufacturing 26.4 percent. During the second quarter 2017, the Indian Rupee appreciated by 3.1 percent on average relative to the U.S. Dollar from the prior quarter. This lowered gross margins by approximately 50 basis points. Visa, immigration and costs related to employee increments lowered second quarter margins by 190 basis points.

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Moving down the income statement our selling, general and administrative expenses were 12.7 percent in the second quarter of 2017, compared to 7.4 percent in the prior-year period and 13.4 percent in the first quarter 2017. On a dollar basis, SG&A was lower by $1.6 million sequentially. The impact on Q2 SG&A from currency-related balance sheet translations, based on quarter end exchange rates, was a $3 thousand loss as compared to a $1.6 million gain recorded in the first quarter 2017. The appreciation in the average rupee rate raised SG&A by $0.8 million.

Other expense was $2.8 million during the second quarter of 2017 as compared to $2.9 million in the first quarter of 2017, including a gain of approximately $0.3 million from mutual fund sales in the second quarter of 2017 versus a $0.2 million gain in the first quarter 2017.

Our tax rate for the second quarter came in at 26.7 percent, as compared to 22.1 percent posted in the first quarter 2017. During the first quarter we had a one-time reversal of approximately $2.1 million, net in tax provisions which did not recur in the second quarter.

Net income for the second quarter was $36.7 million or 44 cents per diluted share as compared to net income of $58.8 million, or 70 cents per diluted share in the prior-year period and net income of $38.4 million or 46 cents per diluted share in the previous quarter.

The Company's Balance Sheet at the end of the second quarter of 2017 remained healthy. Our total cash and short term investments balance on June 30 was $87 million and the portion held in U.S. dollars stood at 55 percent. DSO levels were at 51 days. Capital spending for the quarter was approximately $1.8 million.

Syntel ended the second quarter with total headcount of 21,850 of which 8,021 were assigned to KPO. Our global headcount was lower by 4.1 percent from the first quarter. Our billable headcount was 4,329 onsite and 15,929 offshore for a total of 20,258. Utilization levels at the end of the quarter were 94.6 percent onsite, 80.3 percent offshore and 83.4 percent globally. Our delivery mix at quarter end was 24.2 percent onsite and 75.8 percent offshore. Voluntary attrition during the quarter was 22.6 percent as compared to 20.8 percent reported last quarter. Syntel added 5 new customers in the second quarter.

As Bharat mentioned, Syntel's Board of Directors has approved a $60 million share repurchase authorization. The authorization is valid through 2018. We have filed an 8K this morning containing these and other details.

Looking forward, I would now like to provide you with guidance for 2017. Based on our current visibility levels, Syntel expects revenue to be in the range of $865 million to $900 million and earnings per share to be in the range of $1.62 to $1.77 for the full year of 2017. The Company currently has 95 percent visibility to the low end of the revenue range, and our guidance is based on an assumption for an average exchange rate of 64.5 rupees to the dollar. We anticipate that operating margins will be in the 22 to 24 percent range. Our effective tax rate will be in the mid 20 percent range for 2017 and CAPEX is expected to be in the range of $10 to $15 million.

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

## 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 **Frank Atkins** with SunTrust.

## Frank Atkins

I wanted to ask a little bit about digital. What are the areas that you're seeing more traction from clients? And then, what percentage of clients are using digital?

## Rakesh Khanna

Yes, Frank, we are seeing a good demand in the areas of hybrid integration across the cloud-native applications and around microservices. The UI UX, where we are using some AI, chatbots, Alexa, Siri interfaces — stuff like that — and also around analytics. That's really some of the spend and demand that we see across our customer base.

## Zaineb Bokhari

Yes. And by digital, I think Anil shared, was 19.9% of revenues this quarter. And I mean, this demand is across just about every industry that we've seen. I don't think we've gone in and broken out how many customers. But broadly speaking, there's strong demand for digital services.

## Frank Atkins

Okay, great. And then within Insurance, you did pretty well there this quarter. I wanted to ask a little bit about margins. What's impacting insurance vertical margins?

## Anil Agrawal

The normal factors that can impact the gross margin include the proportion of development, maintenance, mix of onsite/offshore, and the project lifecycle. So I would say it was a combination of these, which would have impacted because the margin for Insurance in the Q2.

## Operator

Our next question comes from **Joseph Vafi** with Loop Capital.

## Joseph Vafi

Rakesh, congratulations on the permanent role. I was wondering if you could comment a little bit, I know the sequential increase in Q2 wasn't that large. But was that a seasonal factor, or was there anything else driving that in Q2?

And then, secondly, on your top clients, I was wondering if you have any comment on those and the outlook? I know you talked about Financial Services being weak, but I was wondering if there's any commentary around your logistics client there. And if that's -- if the business there is seeing headwinds and what types of headwinds those might be?

## Rakesh Khanna

Thank you, Joe. Yes. The sequential increase we saw, although it's small, but we were pleased with our growth in our digital services. The other area we saw a good uptake was in the accounts 4 to 50. In my last call, I talked about stepping up investments, which we did in more executive cover, increasing the sales presence. And our service offerings are clearly resonating well with our top 50 customers. So those were really -- and of course, I talked about the insurance in the life and retirement and commercial space.

Now these were really the bright spots that led to the sequential increase. On the other hand, what we see is a continued weakness in the Banking and Financial Services segment and also Healthcare due to a combination of macro headwinds, policy uncertainty. Coming specifically to the Retail, Logistics and Telecom, we saw some softness in Retail, but the Logistics piece of the business is doing good, so that's the overall status.

## Operator

Our next question comes from **Anil Doradla** with William Blair.

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## Anil Doradla

Rakesh, congrats on being nominated to the board and wishing you all the best. I have a couple of big-picture questions. Bharat, I wanted to follow-up once again on the question that I asked last quarter, and you said you would look into it, which was putting out some milestones or metrics as your company embarks on this journey of turnaround. Is that still on the cards or you feel that the execution that you guys are working on is good enough for the Street?

## Bharat Desai

No. We've given some thought to that and embedded that into our strategy. So I would say, at this time, the -- our performance on clients 4 to 50, which we expect to be drivers of growth for our organization would probably be the best metric. We have focused on our top 50 customers, and we feel that for -- particularly for clients 4 through 50, we are underpenetrated vis-a-vis the total wallet share available. And as we mentioned in our prepared remarks, we have put a focus on expanding those, and that, combined with our very focused automated-powered services should be our drivers for growth.

## Anil Doradla

Okay, good. And as a follow-up, given what you know now and the vantage point that you're in, if you played back, call it, the last 1 year or 15 months and distilled all the issues down to one thing or maybe 2 things, what would it be, Bharat? Was it just customer concentration that hurt you guys? I mean the numbers are there, we all know that. But kind of qualitatively, was it the industry moved towards a cloud which hurt you? Was it under investments? So if you were to look, played back over the last 15 months, what would you say would be the single most issue that perhaps was a headwind to the company?

## Bharat Desai

Well, as you know, the entire industry is facing headwinds. And if you look at our performance outside one specific client — where there was a significant drop because of their budget cuts — I would say we've performed more or less in tandem with the industry.

## Anil Doradla

Okay. So it really boils down to a customer event, not capabilities or not investments but just the customer event which had a ripple effect on you guys in a way?

## Bharat Desai

Yes, if you look at the data, I think that's what the data will show you.

## Operator

Our next question comes from **David Stratton** with Great Lakes Review.

## David Stratton

Can you give a little more color around the trends that you mentioned in the Life Sciences area and what you're seeing in that end market?

## Rakesh Khanna

Yes, David. What we are seeing in Life Sciences is this medical device regulation, the MDR, we see customer demand in that area. And related to that, on the TMF and associated areas, there's a compliance requirement by 2020. These would be the top three trends in Life Sciences, David.

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## David Stratton

And then when we look at Europe, which is, I guess, improving, although still negative, what are you seeing as far as a timeline for maybe returning to growth in that market? And how can we look at that as far as being impacted by the current, as you mentioned, policy headwinds?

## Zaineb Bokhari

So, David, longer term we definitely continue to believe that Europe is a terrific long-term opportunity for us and we've been investing to support that future growth. I think near term that what you are seeing, we did grow on a sequential basis. The year-over-year is negative, and some of that is because of what we called out, the weakness in B&FS. It's carrying over into that geography. In the background, there remains uncertainty around some of the policy situation around Brexit. I think in calendar 2017, you'll probably see Europe underperform a little bit relative to the company overall, but the longer-term trend and our intention to continue to invest in that geography is very much intact. Longer term, faster than company overall growth.

## Operator

Our next question comes from **Dave Koning** with Baird.

## David Koning

I just had a couple of questions. The first one is you've given in your slide deck a number of new projects each quarter that you work on. I know it's a lumpy measure and it's probably hard to read a ton into it. But often you'll sign about 200 or so projects per quarter. I know this one was a little lighter at 119, and Q3 of last year is also around 113. Is there anything to read to it? Is that a forward kind of a leading indicator? Or is that more something that just because it was low it kind of correlates more with this quarter's revenue?

## Zaineb Bokhari

So, Dave, there is a bit of a seasonal pattern when it comes to the number of projects we'll have in any given period. If you look over a longer-term trend, the number of projects tends to be higher in Q4 and Q1. And although there isn't a really great correlation between the number of projects and quarterly revenue because the sizes may be very variable, we are and we're calling out project completions and some delays, just environmental factors. So that may be having an impact, although I would say the correlation is not great with revenue.

## David Koning

Okay, got you. And I guess, my question is a little more is it more of a leading indicators of ebb and flow? Is it projects that were signed during the quarter that might mean revenue in the future? Or is it more stuff that you would...

## Zaineb Bokhari

I don't believe it has that information value there.

## Rakesh Khanna

Yes.

## David Koning

Okay. And then the one other question I had on -- just employee count -- your KPO employees are actually up pretty nicely year-over-year. I think up about 5% or so in the first half, while IT employees are down 13% to 14% year-over-year. Is -- maybe you can just comment, is it just the State Street business is doing really well and growing nicely, and then just IT, obviously, is the weaker part of the business?

## Zaineb Bokhari

I think that some of this reflects the opportunities we're seeing on the BizOps side. But I don't want to comment too much on that particular service line, because we haven't continued to provide that as a breakout. Our relationship with State Street, which you did ask about, is very strong and healthy. And we continue to look for new ways to work with them. And that MSA, we had renewed a couple of years back, there was a great vote of confidence.

## Operator

Our next question comes from **Joseph Foresi** with Cantor Fitzgerald.

## Joseph Foresi

You had mentioned that, I think and correct me if I'm wrong, but you said the second half was going to be weaker. I'm wondering — what would cause that? And any updates on what your expectations are for either the large clients or some of the macro issues that you described in that second half?

## Rakesh Khanna

Yes. Joe, we definitely see headwinds in the Banking and Finance vertical, right? The delays in decision making and the spend pattern, reduction in discretionary spend. Then we also see policy uncertainty around the healthcare payer market. And also, Bharat talked about the one client where we have a contraction and ramp downs.

And these are the combination, really, which is where we expect a sequential decline in the subsequent quarters. And this is actually baked into our visibility metric. Although this time around, Joe, we've factored 95% visibility versus same time last year, we used 92%. So we have higher visibility, but due to the volatility that we see in the industries we serve and the volatility in the customer decisions, we are using a higher metric as a percentage of committed revenues, Joe. So that's really where we are.

## Joseph Foresi

Got it. Okay. And most companies that are in your position are talking about sort of a crossover, right? Where the digital growth rates exceed the decline in the core business. Is that what you're betting on here? Are you betting on digital to continue to expand as a percentage of revenue and eventually, overtake the core businesses' declines? Or do you think 2018 might be a year where you start to see a turnaround either in the large client, the healthcare vertical or financial services? I'm just wondering how to think about the model over the next couple of years?

## Rakesh Khanna

Yes, Joe, the answer to your first part of the question is yes, we do expect digital to grow faster than the traditional spend areas. Now 2018, probably in the Q4 call, when we get more visibility on the spend and the budget, we'll definitely share that outlook with you. But overall, the directionally, definitely we see -- expect digital to grow faster than company overall.

## Zaineb Bokhari

As far as the industry trends that you asked about, Joe. I think, we are talking about '17 and not '18 for the reasons that Rakesh mentioned. And we are not calling out a recovery, right? I mean, second half is going to be weaker. So I think that, we're very pleased with what we saw in Q2. But we don't think we're out of it yet. And that recovery, that inflection in those industries, we're not seeing it yet, not for 2017.

## Operator

Our next question comes from **Bryan Bergin** with Cowen.

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## Bryan Bergin

I just wanted to go into just progress on sales investments to rebuild the funnel. Can you give us some context there, potentially the number of people they're adding, where they're based, some of the industries that you might be focused in?

## Rakesh Khanna

Yes, Bryan. It's along the lines I talked in my last call, where we have increased and stepped up investments in the client partners, client-facing executives, giving more executive cover, releasing bandwidth at the BU head level and sharpening the message around our service offerings, which are resonating well. So that's really the -- we continue to -- I talked last time, we have good coverage in our top 50 accounts, we had very good coverage in the top accounts. But we've expanded it now to the top 50. So we are in good shape.

We have seen early results, what you see in this quarter, good sequential growth in the four to 50 category. But it will take time to show long-term results, and we are committed to serve the top 50 customers and deliver growth, right? But like Zaineb said, we do expect second half of the year to be muted. We do expect weakness arising out of these two large verticals, which contribute significant portions of our revenues.

## Zaineb Bokhari

Right, and these investments, Bryan, as we shared with you when we talked about the ranges last quarter, they're baked in to the operating range that we provided, 22% to 24%, which, again, clearly indicate investment, given that we were at about 27% in the prior year.

## Bryan Bergin

Okay. And then just on Healthcare. Obviously, I understand the current weakness in the payer environment. Have there been any changes, incrementally positive or negative just over the last quarter in their outlook? And then the split between payers and Life Sciences in that segment, if you can give us some context there?

## Zaineb Bokhari

So we haven't seen any meaningful change, really, that we can call out, that would give us any -- and we're not calling out an inflection in terms of what we're seeing during the course of calendar '17. It's -- Life Sciences was a positive thought for us, but it's fairly small. The payer space is the dominant sub-segment. But we haven't sized them for you, but just on a relative basis, it's the biggest area for us, payers.

## Operator

Our next question comes from **James Friedman** with Susquehanna Financial Group.

## James Friedman

Let me echo the congratulations. It's Jamie at Susquehanna. I just had a quick follow-up. I think most of mine have been answered. But with regard to utilization, I know you had some prepared remarks. It sounds like you're comfortable, potentially taking the utilization a little higher than historic. It came in over 83%. Now what's the company's philosophy about utilization going forward?

## Zaineb Bokhari

So, Jamie, I think the only thing we've said is that, we plan to run it above trend. And I think, we have tools like our automation and our managed services offerings that we are using along the way. But this intention to drive utilization above trend has been something we've been speaking about since at least 2015. Rakesh?

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## Rakesh Khanna

Yes. And thanks, Jamie, for your good wishes. Also, Jamie, we've always talked about the idea offshore sort of utilization in the 60% to 80% range and we are in that range, right? But like Zaineb said, we do expect to run at slightly elevated levels going forward.

## Operator

Our next question comes from **Puneet Jain** with JPMorgan.

### Puneet Jain

Good quarter, guys. So your comments around Financial Services indicate continued weakness, rest of the year, but trends significantly improved in the vertical outside of your top client in second quarter. So going forward, do you expect broad-based weakness in Financial Services? Or those comments were more specific -- were specific to certain clients?

## Rakesh Khanna

Yes. Thanks, Puneet. Puneet, I would classify it as a combination, right? And clearly, we do see clients impacted due to the macro headwinds. Now, one example, if you see the traditional bank model, if you see is everything -- every single service is pretty much chargeable. And if you compare that with the Fintech, all -- most services for consumers are free.

So a lot of these traditional players are under attack by born-digital companies. And of course, they're doing a good job of recovering, but that's also causing some volatility in that space, Puneet. So that would be my summary view out there.

### Puneet Jain

Got it, got it. And it's been a few quarters since you expanded focus clients to four to 50. So what's the response you are getting from 30 to 50 clients, where you are going to focus on go-forward basis?

## Rakesh Khanna

Yes. Puneet, in the 31 through 50, we have smaller market share. And the footprint is small. And our ability to go with our service offerings, powered by automation, does give us good position. And we see headroom to grow. Now we've seen early success, Puneet, but I will say it will take time for us to truly realize the full potential, Puneet.

### Puneet Jain

Got it. And let me ask one last question. How should we think about margins going forward? You are at the top end of annual guidance in first half, which is seasonally low quarter, given wage inflation, visa expenses in 2Q. So what are the various puts and takes for margins in second half?

## Anil Agrawal

So as I said, Puneet, the guidance, we guided the operating margin at 22% to 24% and I think we would be within that.

## Operator

Our next question comes from **Edward Caso** with Wells Fargo.

### Edward Caso

Congratulations, Rakesh. My first question is around client pressure to add resources in the U.S. Are you seeing any of that, either from a client push or a need to provide skill sets that are more local?

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## Rakesh Khanna

Thank you, Ed, for your good wishes. Overall, we have a good model, good organization structure in place to ensure uninterrupted service delivery. We have also a strong local hiring, which we've been doing it for quite some time now, right? And that coupled with our nearshore and offshore delivery capability and onsite delivery capability is a fairly robust delivery strength,

Ed, that we continue to -- but at the same time, we continue to look at the evolving situation. Of course, stay fully compliant on the visa immigration, and look at the changes that may emerge. And I believe we have strong this delivery models, which can get activated, depending on how the scenario unfolds.

## Zaineb Bokhari

Yes. And the one area, Ed, where we're seeing a little bit of this onsite shift is coming in the digital side, which we've called out before. That's impacted the overall mix. And it's been incremental, but that's the only area that I can really call out, seeing that trend in a pronounced way.

### Edward Caso

So my other question is around the intent of the repurchase program. Should we think of this as opportunistic? Or is there a desire to do a certain amount each quarter? And is any repurchase baked into the EPS guidance?

## Bharat Desai

So there's no repurchase baked into the EPS guidance, and I'll let Anil clarify that. The Board has approved this as a deployment of capital. And the purchase plan will be executed on by the CFO as he sees appropriate.

## Anil Agrawal

Thanks, Bharat. And, Ed, I agree with Bharat, that we have not baked any repurchase into the guidance. And we will update as and when we execute the transactions.

## Operator

Our next question comes from **Mayank Tandon** with Needham & Company.

### Mayank Tandon

Congratulations, Rakesh. I wanted to ask you specifically, and maybe Bharat to, in terms of M&A plans. If you've touched on this, I apologize, but you haven't done an acquisition in, I would say, a long time. And I was wondering, especially given your peers are very active in terms of buying up capabilities, particularly in digital, what is your thought process in terms of future M&A?

## Rakesh Khanna

Yes. Thank you, Mayank, for your wishes. And see, overall we continue to look for tuck-ins which could add to our digital capability or even for the geography expansion. But our strength has been organic, but that's really been the overall approach, Mayank.

Bharat, do you want to add something?

## Bharat Desai

Sure. So I think the overall approach we take is we define the strategy we want to embark on, and then either build the capability or if we think that we can't build it, then find a way to acquire it. And that's the same plan and philosophy we will follow. If we see a way to extend our reach, that might be another area to look at. But at this time, we think we have strong capabilities.

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We have a good customer base that's underpenetrated, and we're going to be very focused, like we've said, on expanding our share with our top 50 clients.

## Mayank Tandon

Right, that's helpful. And then on margins, just from a longer-term perspective. Your margins are still, I would say at the upper end of the industry range. How do you think about the margin profile of the business, especially as you focus on reigniting the top line, your organic growth in your business, and making the investments that you've called out? What do you think is a true sustainable margin level for Syntel as you look out over the next two, three years?

## Anil Agrawal

So, Mayank, I would say that we are managing our business smartly on the face of changing dynamics. And our key margin levers on automation, utilization and managing our operations efficiently and embracing lean are the tools that we use. And given the current year, I would say the margin -- operating margin is between 22% and 24%. And as of now, I'll leave it at that.

## Mayank Tandon

Got it.  Great, thank you.

## Operator

Our next question comes from **Brian Kinstlinger** with Maxim Group.

## Brian Kinstlinger

The question I wanted to ask was the -- sorry, the pressure that, Bharat, you mentioned from one customer contraction. Is that your top customer? And I'm wondering, what was behind that? Is that lost wallet share? Or is that fewer discretionary programs and will that pressure continue?

## Bharat Desai

So we don't comment on specific clients. But I think, as I called out in my response to an earlier question, there was a budget cutback with this particular client. And we are reasonably comfortable that both the relationship is strong and our share, wallet share, is steady.

## Brian Kinstlinger

Okay. And then the second half of the year is the lower revenues compared to the first half, is that a function of your top three customers? Or is that more broad-based?

## Bharat Desai

I'll let Rakesh and Anil step into that.

## Zaineb Bokhari

Yes, Brian. So it's going to be a combination of all the factors we've been talking about from the start of the year and what we're calling out in terms of the industry trends, yes.

## Brian Kinstlinger

Okay. Thank you.

## Operator

Our next question comes from **Vincent Colicchio** with Barrington Research.

## Vincent Colicchio

Just one for me. What -- it seems that the sub-verticals you're in, you've always been -- you're very deep in terms of what you do. Are you considering any other sub-verticals that may actually improve your growth prospects?

## Bharat Desai

Not at this time, Vince. We have a footprint in some industries that are very large. Syntel could grow into a very large company just based on our expansion in these verticals. If a future opportunity presents itself to enter another -- a vertical, sort of extend our reach, we would certainly consider it.

But at this time, like we've said, we are very focused on expanding our share with the top 50 clients, where the relationship is in place, we know their business and it's a question of focusing on expanding and building momentum.

## Vincent Colicchio

Is there any incremental feedback you could share in terms of what you're getting from clients related to SyntBots?

## Bharat Desai

They're actually quite -- I've been in many, many client meetings personally. And they are -- we're now going to market with four very specific offerings: ITOps powered by automation; BizOps powered by automation; legacy modernization powered by automation; and DevOps powered by automation. And I would say, across the board, interest is high, and we have many client engagements already in play. And our team is very focused on expanding that engagement, because, as that happens, we are very confident that this will be a disruptive force in the industry.

## Operator

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 comments.

## Rakesh Khanna

Thank you, operator. 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 quarterly call. Thank you.

## Operator

This concludes Syntel's second quarter earnings call. A replay of today's call will be available until July 27, 2017, by dialing (855) 859-2056 and entering the passcode, which is 47210731. Thank you.

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