

Tech Mahindra

Performance Highlights

(₹ cr)	1QFY16	4QFY15	% chg (qoq)	1QFY15	% chg (yoy)
Net revenue	6,294	6,117	2.9	5,122	22.9
EBITDA	936	929	0.7	928	0.8
EBITDA margin (%)	14.9	15.2	(32)bp	18.1	(326)bp
Adj. PAT	676	472	43.2	631	7.2

Source: Company, Angel Research;

Tech Mahindra has announced its 1QFY2016 results, which are marginally higher qoq on the sales front and ahead of our expectation on the net profit front. The company posted a 0.5% qoq growth in USD revenues to US\$989mn (V/s an expected US\$983mn and V/s US\$984mn in 4QFY2015). The EBDITA margin and EBIT margin came in line with our expectation at 14.9% and 12.1%, registering a dip of 32bp and 26bp qoq, respectively. Consequently, the PAT came in at ₹676cr V/s an expected ₹556cr and V/s ₹472cr in 4QFY2015 a growth of 43.2% qoq. This was mainly on back of other income, which came in at ₹136.6cr (on back of forex gains) for the quarter V/s a loss of ₹65cr in 4QFY2015. **We maintain our Buy rating on the stock with a target price of ₹646.**

Result highlights: Tech Mahindra posted a 0.5% qoq growth in USD revenues to US\$989mn (V/s an expected US\$983mn and V/s US\$984mn in 4QFY2015). The quarter's performance was impacted by a dip in the communication domain which is 52.7% of sales in 1QFY2016 V/s 55.3% of sales in 4QFY2015. The other domains showed an improvement or same performance as in 4QFY2015. The EBDITA margin and EBIT margin came in line with our expectation at 14.9% and 12.1%, registering a dip of 32bp and 26bp qoq, respectively. Consequently, the PAT came in at ₹676cr V/s an expected ₹556cr and V/s ₹472cr in 4QFY2015, a growth of 43.2% qoq. This was mainly on back of other income, which came in at ₹136.6cr (on back of forex gains) for the quarter V/s a loss of ₹65cr in 4QFY2015. On the operating front, the utilization level for the quarter stood at 74% V/s 71% in 4QFY2015, while the attrition rate stood steady at 19.1%. Client addition during the quarter remained tepid, with total clients at 770 (in 1QFY2016) V/s 767 in 4QFY2015.

Outlook and valuation: The Management remains confident of reverting back to the original profitability by FY2017-18. We expect a CAGR of 12.0% and 13.0% in USD and INR revenue respectively over FY2015-17E, driven by acquisitions. The PAT is expected to grow at a CAGR of 8.0% over FY2015-17. **We maintain our Buy recommendation on the stock.**

Key financials (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2014	FY2015	FY2016E	FY2017E
Net sales	18,831	22,621	25,566	28,890
% chg	31.4	20.1	13.0	13.0
Net profit	2,932	2,628	2,528	3,066
% chg	38.6	(10.4)	(3.8)	21.3
EBITDA margin (%)	22.2	18.4	16.0	17.0
EPS (₹)	30.5	27.4	26.3	31.9
P/E (x)	17.8	19.8	20.6	17.0
P/BV (x)	5.7	4.3	3.7	3.2
RoE (%)	31.9	21.5	17.9	18.6
RoCE (%)	31.3	24.0	20.5	21.7
EV/Sales (x)	2.6	2.2	1.9	1.6
EV/EBITDA (x)	11.5	12.2	11.9	9.5

Source: Company, Angel Research; Note: CMP as of August 4, 2015

BUY

CMP	₹542
Target Price	₹646

Investment Period	12 Months
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Stock Info

Sector	IT
Market Cap (₹ cr)	52,279
Net Debt (₹ cr)	(3,833)
Beta	0.4
52 Week High / Low	750/459
Avg. Daily Volume	194,653
Face Value (₹)	5
BSE Sensex	28,072
Nifty	8,517
Reuters Code	TEML.BO
Bloomberg Code	TECHM@IN

Shareholding Pattern (%)

Promoters	36.7
MF / Banks / Indian Fls	15.8
FII / NRIs / OCBs	35.2
Indian Public / Others	12.3

Abs.(%)	3m	1yr	3yr
Sensex	2.1	9.1	63.2
Tech Mahindra	(11.5)	(0.0)	184.8

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 1QFY2016 performance (Consolidated, Indian GAAP)

(₹ cr)	1QFY16	4QFY15	% chg (qoq)	1QFY15	% chg (yoy)	FY15	FY14	% chg (yoy)
Net revenue	6,294	6,117	2.9	5,122	22.9	22,621	18,831	20.1
Cost of revenue	4,451	4,253	4.7	3,439	29.4	15,158	9,736	55.7
Gross profit	1,843	1,864	(1.1)	1,682	9.6	7,464	9,096	(17.9)
SG&A expense	908	936	(3.0)	754	20.4	3,311	4,912	(32.6)
EBITDA	936	929	0.7	928	0.8	4,153	4,184	(0.7)
Dep. and amortization	173	172	0.7	149	16.2	611	522	17.1
EBIT	762	757	0.7	779	(2.2)	3,541	3,662	(3.3)
Interest	12	18		4		30	80	
Other income	137	(65)		89		107	113	
PBT	886	674	31.6	864	2.5	3,618	3,695	(2.1)
Income taxes	210	185	13.7	231	(9.1)	960	752	27.5
PAT	677	489	38.3	634	6.8	2,658	2,942	(9.7)
Minority interest	2	17		3		31	34	
PAT after minority interest	675	472	43.0	631	7.0	2,627	2,909	(9.7)
Profit from associates	1	-		-		0	-	
Exceptional item	-	-		-		-	120	
Reported PAT	676	472	43.2	631	7.2	2,628	3,029	(13.2)
Adj. PAT	676	472	43.2	631	7.2	2,628	2,932	(10.4)
Diluted EPS	7.0	4.9	43.2	6.6	7.2	27.3	30.5	(10.4)
Gross margin (%)	29.3	30.5	(119)bp	32.8	(356)bp	33.0	48.3	(1531)bp
EBITDA margin (%)	14.9	15.2	(32)bp	18.1	(326)bp	18.4	22.2	(386)bp
EBIT margin (%)	12.1	12.4	(26)bp	15.2	(310)bp	15.7	19.4	(379)bp
PAT margin (%)	10.7	7.7	303bp	12.3	(157)bp	11.6	15.6	(396)bp

Source: Company, Angel Research

Exhibit 2: 1QFY2016 – Actual vs Angel estimates

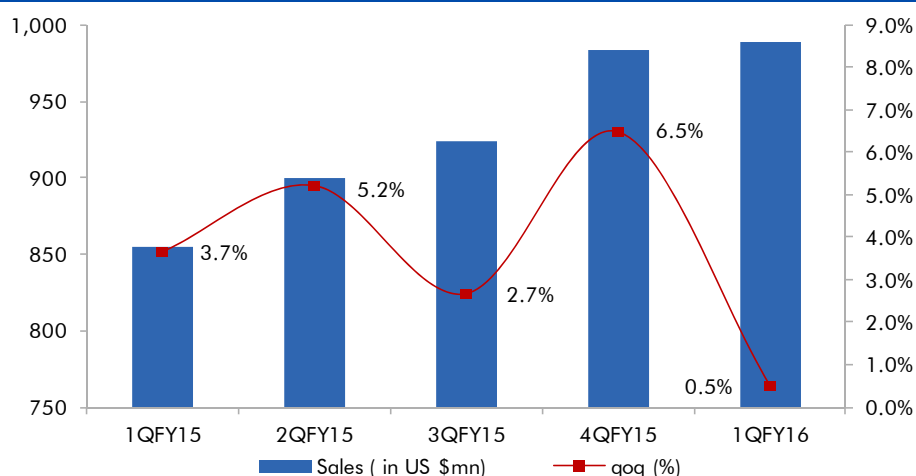
(₹ cr)	Actual	Estimate	Var. (%)
Net revenue	6,294	6,242	0.8
EBIT margin (%)	14.9	14.9	(3.6)bps
PAT	676	556	21.5

Source: Company, Angel Research

Revenue growth, led by acquisitions

The company posted a 0.5% qoq growth in USD revenues to US\$989mn (V/s an expected US\$983mn and V/s US\$984mn in 4QFY2015). In rupee terms, the revenues came in at ₹6,294cr V/s an expected ₹6,242cr and V/s ₹6,117cr in 4QFY2015, ie a qoq growth of 2.9%.

In terms of verticals, the key vertical of the company - Telecom - posted a qoq de-growth of 4.2%. The growth drivers during the quarter were BFSI; Manufacturing; Technology, Media & Entertainment (TME); and Retail, Transport & Logistics. These posted a qoq growth of 10.5%, 4.2%, 4.8% and 5.4% respectively.

Exhibit 3: Trend in revenue growth


Source: Company, Angel Research

Exhibit 4: Growth in industry segments

Particulars	% to revenue	% growth (qoq)	% growth (yoy)
Telecom	53	(4.2)	19.5
Manufacturing	17	4.2	9.9
TME	7	4.8	(6.2)
BFSI	10	10.5	15.7
RTL	7	5.4	25.3
Others	7	8.9	25.3

Source: Company, Angel Research

In terms of geographies, ROW posted a qoq de-growth of 7.2%. Europe posted a 0.8% qoq de-growth, while the US posted a 5.6% qoq growth.

Exhibit 5: Growth trend in geographies

Particulars	% to revenue	% growth (qoq)	% growth (yoy)
Americas	48	5.6	17.4
Europe	29	(0.8)	9.7
RoW	23	(7.2)	20.4

Source: Company, Angel Research

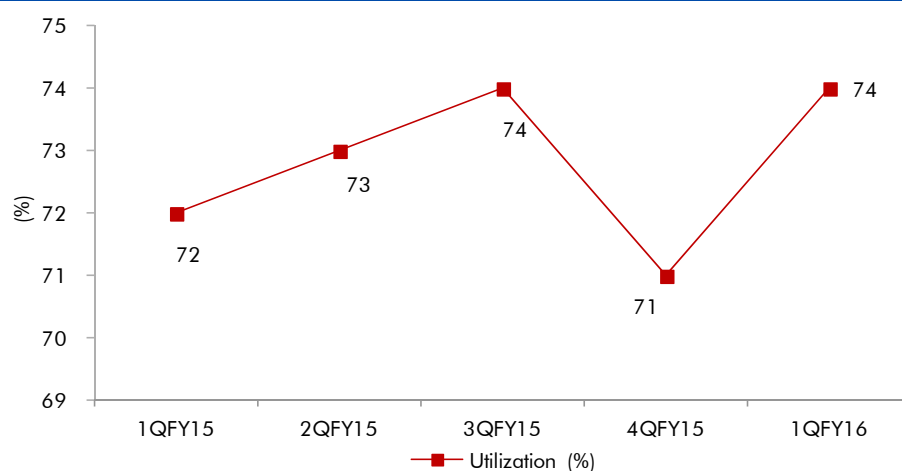
Hiring and client metrics

During the quarter, the company reported a net addition of 5,272 employees, taking its overall headcount to 1,03,281. The BPO headcount has been on a declining trajectory since the last few quarters and currently stands at 22,693. Attrition (on LTM basis) was at 19%.

Exhibit 6: Employee metrics

Particulars	1QFY15	2QFY15	3QFY15	4QFY15	1QFY16
Software professionals	64,095	66,175	67,592	72,952	71,997
BPO professionals	21,936	22,433	23,566	22,693	24,394
Sales & support	6,698	6,701	6,851	7,636	7,232
Total employees	92,729	95,309	98,009	1,03,281	1,03,673
Attritions (%)	16	18	19	19	19

Source: Company, Angel Research

Exhibit 7: Trend in utilization rate


Source: Company, Angel Research

In terms of client additions, the company added a mere 3 clients during the quarter, taking the active client base to 770 V/s 767 in 4QFY2015. Overall, the company added 1 client in the US\$20mn+ bracket and 3 clients in the US\$10mn+ bracket.

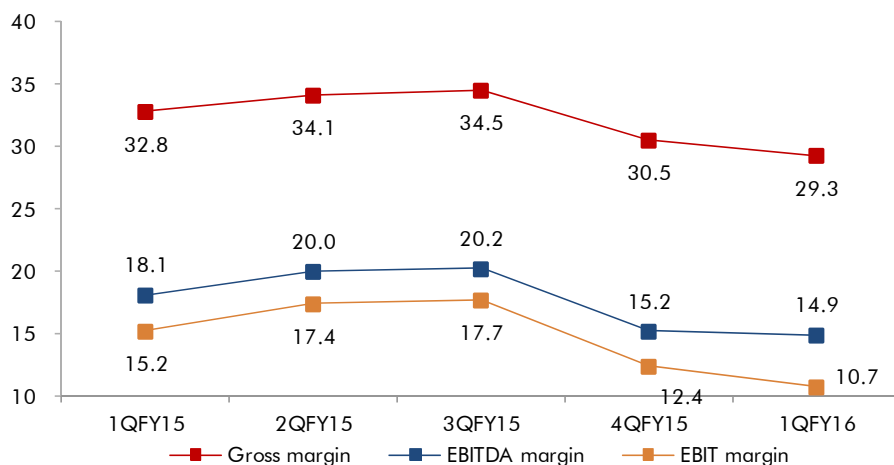
Exhibit 8: Client metrics

Particulars	1QFY15	2QFY15	3QFY15	4QFY14	1QFY16
Total active clients	632	649	674	767	770
US\$1mn–5mn	162	159	166	195	195
US\$5mn–10mn	29	36	37	40	41
US\$10mn–20mn	22	20	19	21	24
US\$20mn–50mn	18	18	19	22	23
US\$50mn+	11	12	13	13	13

Source: Company, Angel Research

Operating margin dips

The EBDITA margin and EBIT margin came in line with our expectation at 14.9% and 12.1%, registering a dip of 32bp and 26bp qoq, respectively. Tech Mahindra continues to focus on improving operational factors like utilization. Utilization including trainees was at 74% during 1QFY2016, improving by ~300bp qoq. The dip in the EBDITA margin came inspite of the high contraction in the gross margins (which dipped by ~120bp qoq to 29.3%).

Exhibit 9: Margin trend (%)


Source: Company, Angel Research

Investment arguments

Growth prospects robust: The Management indicated that the company remains confident of growth in the non-BT business with it continuing to see a robust deal pipeline across geographies. Also, the company in recent past has been looking at inorganic mode to enhance its presence in the non-telecom segment. Tech Mahindra has been able to scale up well across verticals through its focused approach on large deals. We expect a CAGR of 12.0% and 13.0% in USD and INR revenue, respectively, over FY2015-17E.

Deal pipeline healthy: Tech Mahindra remains confident of improving revenue growth citing healthy deal pipeline along with pick up in discretionary spending, primarily in the US. The Management sounded confident of demand from BFSI, Healthcare, Manufacturing and Retail. Tech Mahindra is following a two-pronged strategy to expand its enterprise business; ie providing end-to-end offerings in leadership areas like Manufacturing, and following a niche offerings-led entry strategy in areas like BFSI where it is a challenger. Better cross-sell of services can help grow marquee accounts post-merger. We expect the enterprise segment growth to be led by broader revival in the markets and deepening of existing relationships. During, 1QFY2016 the company won deals worth TCV of US\$400mn and indicated that while deal closures are a bit slow, pipeline is building up. Revenues from Telecom are expected to be weak for another quarter but the deal pipeline continues to be healthy.

Inorganic growth initiatives to augment well for company: The company has been active in the M&A space, with it having acquired Satyam a few years back, to acquiring LCC and Softgen recently. Softgen's and LCC's acquisition has been consolidated in 4QFY2015. LCC is one of the world's largest independent global providers of network engineering services to the telecommunications industry. LCC is estimated to have annual revenues of more than US\$400mn (estimated for CY2014), with workforce of over 5,700 network professionals across five continents and more than 50 countries. With this acquisition, Tech Mahindra will also be addressing a rapidly growing market opportunity as telecommunications companies and enterprises accelerate the network upgrade cycle.

Outlook and valuation

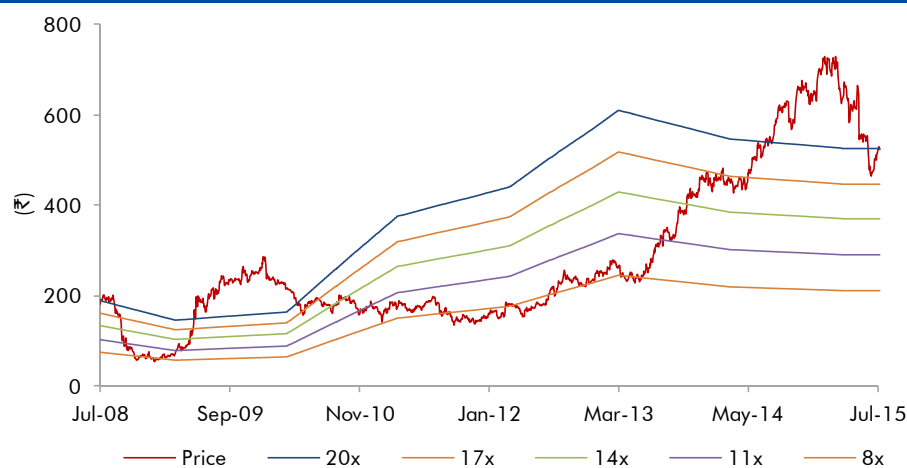
Given the recent acquisitions and healthy order pipeline, the company is expected to post a healthy US\$ and INR CAGR of 12.0% and 13.0% respectively. However, the acquisition of LCC will be margin dilutive in the near term, leading the FY2016 EBDIT margins to drop to 16.0% in FY2016 from 22.2% in FY2014. The company, given its success in turnaround of its earlier acquisition - Satyam, believes it would be able to do the same with the recent acquisitions and would be able to get close to achieving the 20.0% EBIT levels in future. The company is one of the fastest growing IT companies. Given the conducive valuations on EV/sales front, where it trades at a significant discount to its peers, we believe the stock should witness uptrend once the profitability returns to its mean average. **We recommend a Buy rating on the stock.**

Exhibit 10: Key assumptions

	FY2016E	FY2017E
Revenue growth (US\$)	11.0	13.0
USD-INR rate (realized)	62.5	62.5
Revenue growth (₹)	13.0	13.0
EBITDA margin (%)	16.0	17.0
Tax rate (%)	26.4	26.4
EPS growth (%)	(3.8)	21.3

Source: Company, Angel Research

Exhibit 11: One-year forward PE (x)



Source: Company, Angel Research. Note: P/E includes profits of Mahindra Satyam from FY2012

Exhibit 12: Recommendation summary

Company	Reco	CMP (₹)	Tgt Price (₹)	Upside (%)	FY2017E EBITDA (%)	FY2017E P/E (x)	FY2015-17E EPS CAGR (%)	FY2017E EV/Sales (x)	FY2017E RoE (%)
HCL Tech	Buy	935	1,100	17.7	23.4	15.3	11.7	2.6	17.7
Infosys	Buy	1,060	1,306	23.2	28.0	16.6	9.2	2.9	19.7
TCS	Buy	2,509	3,168	26.3	28.7	17.4	13.9	3.6	41.8
Tech Mahindra	Buy	542	646	19.1	18.4	17.0	8.0	1.5	18.6
Wipro	Buy	558	719	28.8	23.8	13.2	9.7	1.8	18.0

Source: Company, Angel Research.

Company Background

Tech Mahindra was founded in 1986 as a joint venture between Mahindra Group and British Telecom (BT) to service the latter. Later on, the company started servicing other external clients as well (solely in the telecom industry). In June 2009, Tech Mahindra acquired a 42.7% stake in erstwhile Satyam Computers (now Mahindra Satyam) and now the latter is entirely merged with the company.

The company has recently acquired the companies - LCC and Softgen. These two acquisitions have been consolidated in 4QFY2015. LCC is one of the world's largest independent global providers of network engineering services to the telecommunications industry. LCC is estimated to have annual revenues of more than US\$400mn (estimated for CY2014), with workforce of over 5,700 network professionals across five continents and more than 50 countries.

Profit and loss statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2013	FY2014E	FY2015	FY2016E	FY2017E
Net sales	14,332	18,831	22,621	25,566	28,890
Cost of revenues	9,001	9,736	11,914	17,385	19,356
Gross profit	5,331	9,096	10,708	8,181	9,534
% of net sales	37.2	48.3	47.3	32.0	33.0
SG&A expenses	2,268	4,912	6,555	4,091	4,622
% of net sales	15.8	26.1	29.0	16.0	16.0
EBITDA	3,063	4,184	4,153	4,091	4,911
% of net sales	21.4	22.2	18.4	16.0	17.0
Dep. and amortization	390	522	611	690	780
% of net sales	2.7	2.8	2.7	2.7	2.7
EBIT	2,674	3,662	3,541	3,400	4,131
% of net sales	18.7	19.4	15.7	13.3	14.3
Interest expense	92	80	30	30	30
Other income, net of forex	212	113	106	106	106
Profit before tax	2,793	3,695	3,618	3,477	4,208
Provision for tax	648	752	960	918	1,111
% of PBT	23.2	20.4	26.5	26.4	26.4
Recurring PAT	2,146	2,942	2,659	2,559	3,097
Share from associates	-	-	-	-	-
Exceptional item	160	120	-	-	-
Minority interest	30	34	31	31	31
Reported PAT	1,955	3,029	2,628	2,528	3,066
Adjusted PAT	2,115	2,932	2,628	2,528	3,066
Fully diluted EPS (₹)	22.0	30.5	27.4	26.3	31.9

Balance sheet (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Equity capital	232	234	480	480	480
Preference capital	-	-	-	-	-
Share premium	-	-	-	-	-
Profit and loss	6,621	8,947	11,768	13,622	16,014
Other reserves	-	2	0	0	0
Net worth	6,854	9,182	12,249	14,103	16,494
Secured loans	322	309	621	621	621
Unsecured loans	531	54	54	54	55
Total debt	853	363	675	675	676
Other long term liability	224	376	376	376	377
Long-term provisions	393	414	414	414	415
Minority interest	134	144	160	144	145
Amount pending investigation	1,230	1,230	895	895	895
Total capital employed	9,689	11,709	14,768	16,605	19,001
Gross block	3,611	5,460	7,811	8,811	9,811
Accumulated dep.	(1,379)	(2,866)	(3,477)	(4,167)	(4,947)
Net block	2,232	2,594	4,334	4,644	4,864
Capital WIP	260	266	266	266	267
Total fixed assets	2,491	2,861	4,601	4,910	5,131
Investments	36	36	2,103	2,103	2,103
Long term loans and adv.	743	914	1,306	1,502	1,727
Interest in TML benefit trust	1,207	-	-	-	-
Deferred tax asset, net	348	383	390	390	390
Other non-current assets	120	16	-	-	-
Inventories	11	10	24	11	11
Sundry debtors	3,369	4,349	5,206	5,987	6,885
Cash and cash equiv.	3,463	4,756	2,405	4,547	6,473
Loans and advances	1,293	2,616	3,813	2,998	2,999
Current investments	175	-	-	-	-
Unbilled revenue	556	-	-	-	-
Sundry creditors	(858)	(1,549)	(1,654)	(1,903)	(2,188)
Other liabilities	(2,037)	(1,415)	(1,627)	(1,871)	(2,152)
Provision	(1,227)	(1,267)	(1,799)	(2,068)	(2,379)
Working capital	4,744	7,500	6,368	7,700	9,650
Total capital deployed	9,689	11,709	14,768	16,605	19,001

Cash flow statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Pre tax profit from operations	2,581	2,942	2,659	2,559	3,097
Depreciation	390	522	611	690	780
Expenses (deferred)/written off/others	-	-	-	-	-
Pre tax cash from operations	2,971	3,464	3,270	3,249	3,877
Other income/prior period ad	182	113	106	106	106
Net cash from operations	3,153	3,577	3,376	3,356	3,984
Tax	(648)	(752)	(960)	(918)	(1,111)
Cash profits	2,505	2,825	2,417	2,438	2,873
(Inc)/dec in					
Sundry Debtors	(647)	(980)	(857)	(781)	(898)
Inventories	4	1	(15)	13	-
Loans and advances	(235)	(1,324)	(1,197)	815	(1)
Sundry creditors	167	692	105	248	285
Others	673	(623)	212	244	281
Net trade working capital	(39)	(2,233)	(1,752)	540	(333)
Cashflow from operating activities	2,466	592	665	2,978	2,540
(Inc)/dec in fixed assets	(1,025)	(369)	(1,740)	(310)	(221)
(Inc)/dec in investments	(1)	-	(2,067)	-	-
(Inc)/dec in other non current assets	(611)	104	16	-	-
Cashflow from investing activities	(1,636)	(265)	(3,791)	(310)	(221)
Inc/(dec) in debt	(297)	490	(311)	-	(1)
Inc/(dec) in deferred revenue	(207)	-	-	-	1
Inc/(dec) in equity/premium	1	(2)	1	-	-
Inc/(dec) in minority interest	119	(9)	(16)	16	(1)
Addition to reserves on amalgamation	70	-	-	-	1
Dividends	(149)	(231)	(674)	(674)	(674)
Others		720	1,776	131	282
Cashflow from financing activities	(463)	967	775	(527)	(392)
Cash generated/(utilised)	367	1,294	(2,351)	2,141	1,926
Cash at start of the year	3,096	3,463	4,756	2,405	4,547
Cash at end of the year	3,463	4,756	2,405	4,547	6,473

Key Ratios

Y/E March	FY2013	FY2014	FY2015	FY2016E	FY2017E
Valuation ratio (x)					
P/E (on FDEPS)	24.6	17.8	19.8	20.6	17.0
P/CEPS	22.2	14.7	16.1	16.2	13.5
P/BVPS	7.6	5.7	4.3	3.7	3.2
Dividend yield (%)	0.9	0.9	0.9	0.9	1.1
EV/Sales	3.5	2.6	2.2	1.9	1.6
EV/EBITDA	16.2	11.5	12.2	11.9	9.5
EV/Total assets	20.0	16.8	11.0	9.9	9.1
Per share data (₹)					
EPS	22.0	30.5	27.4	26.3	31.9
Cash EPS	24.4	37.0	33.7	33.5	40.0
Dividend	5.0	5.0	5.0	5.0	6.0
Book value	71.3	95.6	127.5	146.8	171.7
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.7	0.8	0.7	0.7	0.7
Cost of debt (PBT/EBIT)	1.0	1.0	1.0	1.0	1.0
EBIT margin (EBIT/Sales)	0.2	0.2	0.2	0.1	0.1
Asset turnover ratio (Sales/Assets)	5.8	6.6	4.9	5.2	5.6
Leverage ratio (Assets/Equity)	0.4	0.3	0.4	0.3	0.3
Operating ROE (%)	28.5	33.0	21.5	17.9	18.6
Return ratios (%)					
RoCE (pre-tax)	27.6	31.3	24.0	20.5	21.7
Angel RoIC	46.2	54.8	29.3	28.8	33.7
RoE	30.9	31.9	21.5	17.9	18.6
Turnover ratios(x)					
Asset turnover (fixed assets)	5.8	6.6	4.9	5.2	5.6
Receivables days	78	78	92	91	92
Payable days	25	26	29	29	29

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 Website: www.angelbroking.com

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Disclosure of Interest Statement	Tech Mahindra
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	Yes
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Based on expected returns over 12 months investment period):	Buy (> 15%)	Accumulate (5% to 15%) Reduce (-5% to -15%)	Neutral (-5 to 5%) Sell (< -15%)
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