

Tech Mahindra

Performance Highlights

(₹ cr)	4QFY15	3QFY15	% chg (qoq)	4QFY14	% chg (yoy)
Net revenue	6,117	5,752	6.3	5,058	20.9
EBITDA	929	1,160	(20.0)	1,072	(13.4)
EBITDA margin (%)	15.2	20.2	(499)bps	21.2	(601)bps
Adj. PAT	472	777	(39.2)	614	(23.2)

Source: Company, Angel Research;

Tech Mahindra's 4QFY2015 results have come in much lower than our expectations. Sales came in at US\$984mn V/s an expected US\$989mn and V/s US\$924mn in 3QFY2015, a qoq growth of 6.5%. Revenue contribution from its acquisitions like LCC and Sofgen was at US\$100mn, adjusting for which the the revenue de-grew by 4.3% qoq (1.2% dip on constant currency [CC] basis). On the operating front, the EBITDA margin came in at 15.2% V/s 18.4% expected and V/s 20.2% in 3QFY2015, a dip of 499bp qoq. Thus, the Adj. PAT came in at ₹472cr V/s ₹751cr expected and V/s ₹777cr in 3QFY2015, a qoq de-growth of 39.2%. Apart from the lower than expected EBDITA margin, a forex loss of ₹154.1cr booked during the quarter also impacted the net profit. Given that the stock price has corrected significantly, **we maintain our Buy rating on the stock.**

Result highlights: Tech Mahindra's 4QFY2015 results have come in much lower than our expectations. Sales came in at US\$984mn V/s an expected US\$989mn and V/s US\$924mn in 3QFY2015, a qoq growth of 6.5%. Revenue contribution from its acquisitions like LCC and Sofgen was at US\$100mn, adjusting for which the the revenue de-grew by 4.3% qoq (1.2% dip on constant currency [CC] basis). On the operating front, the EBITDA margin came in at 15.2% V/s 18.4% expected and V/s 20.2% in 3QFY2015, a dip of 499bp qoq. One of the reasons for the dip in the EBDITA margin is the utilization levels, which came in at 71% V/s 74% in 3QFY2015, and wage hikes. Thus, the Adj. PAT came in at ₹472cr V/s ₹751cr expected and V/s ₹777cr in 3QFY2015, a qoq de-growth of 39.2%. Apart from the lower than expected EBDITA margin, a forex loss of ₹154.1cr booked during the quarter also impacted the net profit.

Outlook and valuation: The Management remains confident of reverting back to the original profitability, by FY2017-18. We expect a CAGR of 20.0% and 21.1% in USD and INR revenue respectively over FY2015-17E, driven by acquisitions. The PAT is expected to grow at a CAGR of 21.2% over FY2015-17. **We maintain our Buy rating on the stock, given the recent correction in the stock price, and on account of conducive valuations.**

Key financials (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Net sales	14,332	18,831	22,621	28,864	33,194
% chg	22.5	31.4	20.1	27.6	15.0
Net profit	2,115	2,932	2,628	3,127	3,861
% chg	17.1	38.6	(10.4)	19.0	23.5
EBITDA margin (%)	21.4	22.2	18.4	17.3	18.4
EPS (₹)	22.0	30.5	27.4	32.6	40.2
P/E (x)	24.9	18.0	20.1	16.9	13.7
P/BV (x)	7.7	5.7	4.3	3.6	3.0
RoE (%)	30.9	31.9	21.5	21.3	21.6
RoCE (%)	27.6	31.3	24.0	24.5	25.6
EV/Sales (x)	3.5	2.6	2.3	1.7	1.4
EV/EBITDA (x)	16.3	11.6	12.3	9.7	7.4

Source: Company, Angel Research; Note: CMP as of May 27, 2015

BUY

CMP	₹549
Target Price	₹683

Investment Period	12 Months
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Stock Info

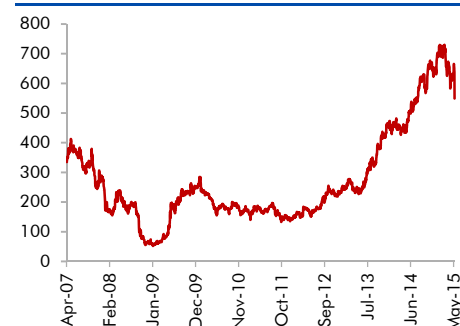
Sector	IT
Market Cap (₹ cr)	52,934
Net Debt (₹ cr)	(3,833)
Beta	0.4
52 Week High / Low	750/447
Avg. Daily Volume	135,988
Face Value (₹)	5
BSE Sensex	27,565
Nifty	8,335
Reuters Code	TEML.BO
Bloomberg Code	TECHM@IN

Shareholding Pattern (%)

Promoters	36.7
MF / Banks / Indian Fls	12.7
FII / NRIs / OCBs	38.5
Indian Public / Others	12.1

Abs.(%)	3m	1yr	3yr
Sensex	(5.7)	12.3	70.0
Mahindra Tech	(22.5)	18.5	230.6

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 4QFY2015 performance (Consolidated, Indian GAAP)

(₹ cr)	4QFY15	3QFY15	% chg (qoq)	4QFY14	% chg (yoy)	FY15	FY14	% chg (yoy)
Net revenue	6,117	5,752	6.3	5,058	20.9	22,621	18,831	20.1
Cost of revenue	4,253	3,766	12.9	3,247	31.0	12,911	9,736	32.6
Gross profit	1,864	1,986	(6.1)	1,811	2.9	9,711	9,096	6.8
SG&A expense	936	826	13.3	739	26.6	5,558	4,912	13.1
EBITDA	929	1,160	(20.0)	1,072	(13.4)	4,153	4,184	(0.7)
Dep. and amortization	172	144	19.4	143	20.4	611	522	17.1
EBIT	757	1,016	(25.5)	929	(18.6)	3,542	3,662	(3.3)
Interest	18	4		10		30	80	
Other income	(65)	19		(87)		106	113	
PBT	674	1,031	(34.7)	832	(19.1)	3,618	3,695	(2.1)
Income taxes	185	251	(26.6)	209	(11.8)	960	752	27.5
PAT	489	780	(37.3)	623	(21.6)	2,659	2,942	(9.6)
Minority interest	17	3		9		31	34	
PAT after minority interest	472	777	(39.2)	614	(23.2)	2,628	2,909	(9.7)
Profit from associates	-	-		-		-	-	
Exceptional item	-	26		-		-	120	
Reported PAT	472	805	(41.4)	614	(23.2)	2,628	3,029	(13.2)
Adj. PAT	472	777	(39.2)	614	(23.2)	2,628	2,932	(10.4)
Diluted EPS	4.9	8.1	(39.2)	6.4	(23.2)	27.4	30.5	(10.4)
Gross margin (%)	30.5	34.5	(405)bp	35.8	(532)bp	42.9	48.3	(537)bp
EBITDA margin (%)	15.2	20.2	(499)bp	21.2	(601)bp	18.4	22.2	(386)bp
EBIT margin (%)	12.4	17.7	(530)bp	18.4	(600)bp	15.7	19.4	(379)bp
PAT margin (%)	7.7	13.5	(579)bp	12.1	(443)bp	11.6	15.6	(396)bp

Source: Company, Angel Research

Exhibit 2: 4QFY2015 – Actual vs Angel estimates

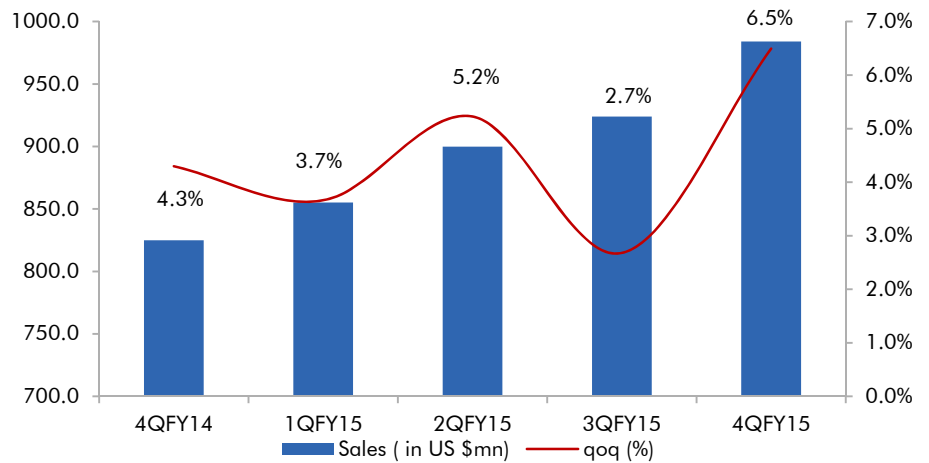
(₹ cr)	Actual	Estimate	Var. (%)
Net revenue	6,117	6,159	(0.7)
EBIT margin (%)	15.2	18.4	(320)bps
PAT	472	751	(37.2)

Source: Company, Angel Research

Strong revenue growth, led by acquisitions

For 4QFY2015, Tech Mahindra announced results much lower than our expectations, mainly due to underperformance at the EBDITA and net profit levels. Sales came in at US\$984mn V/s an expected US\$989mn and V/s US\$924mn in 3QFY2015, a qoq growth of 6.5%. Revenue contribution from its acquisitions like LCC and Sofgen was at US\$100mn in rupee terms, adjusting for which the revenue de-grew by 4.4% qoq. In rupee term, the company posted sales of ₹6,117cr V/s an expected ₹6,159cr and V/s ₹5,752cr during 3QFY2015, a qoq growth of 6.3%.

In CC terms, the de-growth was of 1.2% qoq (in organic terms). In terms of verticals, the growth was led by Telecom, which posted a qoq growth of 15.7%. Manufacturing on the other hand de-grew by 10.8% qoq. Technology, Media & Entertainment (TME) posted a 2.1% qoq growth, while Retail, Transport & Logistics posted a growth of 3.2% qoq. BFSI posted a qoq de-growth of 1.1%.

Exhibit 3: Trend in revenue growth (qoq)


Source: Company, Angel Research

Exhibit 4: Growth in industry segments

Particulars	% to revenue	% growth (qoq)	% growth (yoy)
Telecom	55	15.7	31.9
Manufacturing	17	(10.8)	9.3
TME	7	2.1	(7.2)
BFSI	9	(1.1)	8.5
RTL	6	3.2	23.2
Others	6	6.5	19.3

Source: Company, Angel Research

In terms of geographies, the growth was mainly driven by ROW, which posted a qoq growth of 33.4%. Europe posted a 1.1% qoq growth, while the US posted a 0.9% dip qoq.

Exhibit 5: Growth trend in geographies

Particulars	% to revenue	% growth (qoq)	% growth (yoy)
Americas	45	(0.9)	20.3
Europe	30	1.1	14.7
RoW	25	33.4	23.2

Source: Company, Angel Research

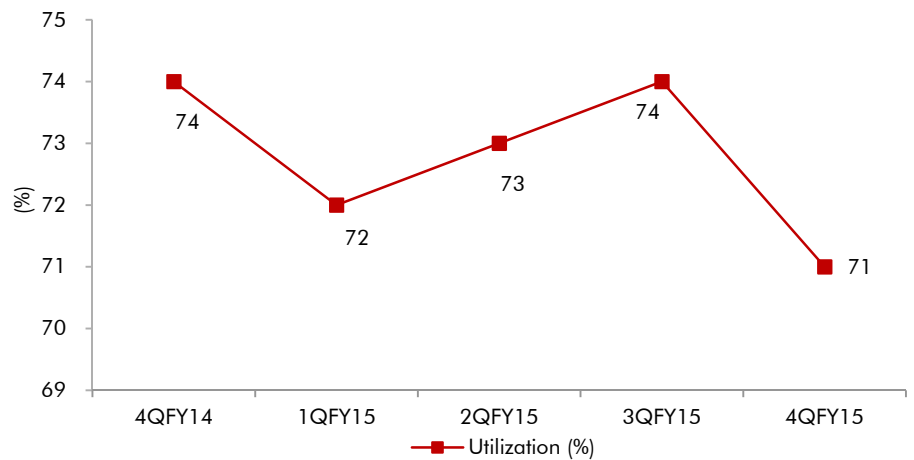
Hiring and client metrics

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	4QFY14	1QFY15	2QFY15	3QFY15	4QFY15
Software professionals	60,997	64,095	66,175	67,592	72,952
BPO professionals	21,830	21,936	22,433	23,566	22,693
Sales & support	6,614	6,698	6,701	6,851	7,636
Total employees	89,441	92,729	95,309	98,009	1,03,281
Attritions (%)	15	16	18	19	19

Source: Company, Angel Research

Exhibit 7: Trend in utilization rate


Source: Company, Angel Research

In terms of client additions, the company added 93 clients during the period, taking the active client base to 767 V/s 674 in 3QFY2015. Overall, the company added 3 clients in the US\$20mn+ bracket and 2 clients in the US\$10mn+ bracket.

Exhibit 8: Client metrics

Particulars	4QFY14	1QFY15	2QFY15	3QFY15	4QFY14
Total active clients	629	632	649	674	767
US\$1mn–5mn	164	162	159	166	195
US\$5mn–10mn	23	29	36	37	40
US\$10mn–20mn	25	22	20	19	21
US\$20mn–50mn	16	18	18	19	22
US\$50mn+	11	11	12	13	13

Source: Company, Angel Research

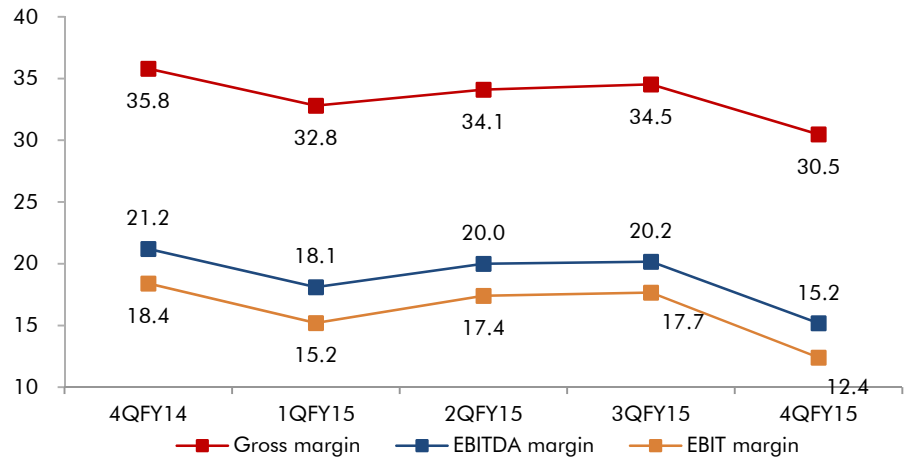
Operating margin dip

On the operating front, the EBITDA margin came in at 15.2% V/s an expected 18.4% and V/s 20.2% in 3QFY2015, a dip of 499bp qoq. One of the reasons for the dip in the EBDITA margin is the utilization levels, which came in at 71% V/s 74% in 3QFY2015, along with higher wage cost.

From the ~500bp margin decline seen in the quarter, the company expects to reverse the impact of wage hikes (200bp) through levers of offshore, utilization

and other efficiencies; and also bring back margins in LCC (margin at 2.5% during the quarter) to high single digits over the next 2-3 quarters.

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 20.0% and 21.2% 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 (healthy demand across players and providers), manufacturing and retail. Tech Mahindra is following a two-pronged strategy to expand its enterprise business; ie end-to-end offerings in leadership areas like manufacturing, and 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, 4QFY2015 the company won deals worth TCV of US\$175mn 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

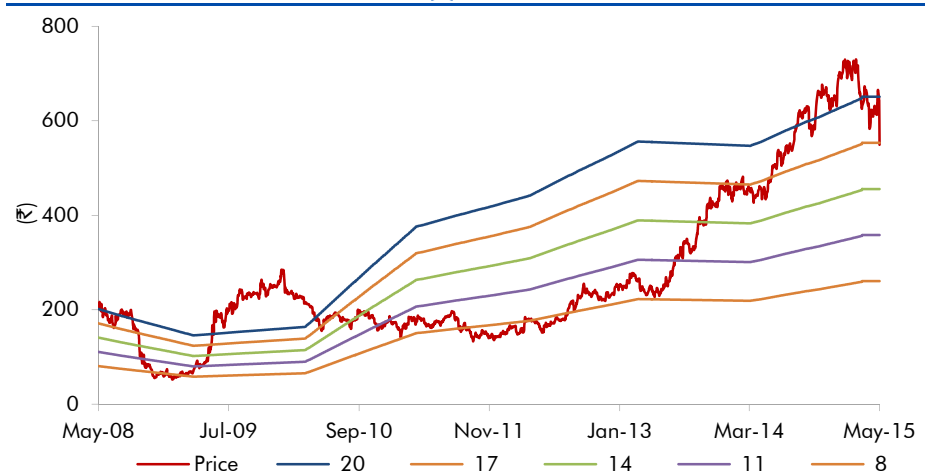
Given the recent acquisitions and healthy order pipeline, the company is expected to post a healthy US\$ and INR CAGR of 20.0% and 21.1% respectively. However, the acquisition of LLC will be margin dilutive in the near term, leading the FY2016 EBDIT margins to drop to 17.3% in FY2016 from 22.2% in FY2014. 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, **we recommend a Buy rating on the stock.**

Exhibit 10: Key assumptions

	FY2016E	FY2017E
Revenue growth (US\$)	25.3	15.0
USD-INR rate (realized)	62.5	62.5
Revenue growth (₹)	27.6	15.0
EBITDA margin (%)	17.3	18.4
Tax rate (%)	26.4	26.4
EPS growth (%)	19.0	23.5

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	Neutral	993	1,100	10.8	23.4	16.3	10.5	2.8	17.7
Infosys	Accumulate	1,969	2,570	30.5	28.0	15.3	9.2	2.8	19.7
TCS	Accumulate	2,617	3,168	21.1	28.7	18.2	13.9	3.7	41.8
Tech Mahindra	Buy	549	683	24.3	18.4	13.7	21.2	1.3	21.6
Wipro	Accumulate	553	753	36.2	23.8	12.5	12.0	1.7	18.8

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	FY2014	FY2015	FY2016E	FY2017E
Net sales	14,332	18,831	22,621	28,864	33,194
Cost of revenues	9,001	9,736	11,914	15,212	17,493
Gross profit	5,331	9,096	10,708	13,653	15,701
% of net sales	37.2	48.3	47.3	47.3	47.3
SG&A expenses	2,268	4,912	6,555	8,659	9,593
% of net sales	15.8	26.1	29.0	30.0	28.9
EBITDA	3,063	4,184	4,153	4,994	6,108
% of net sales	21.4	22.2	18.4	17.3	18.4
Dep. and amortization	390	522	611	779	896
% of net sales	2.7	2.8	2.7	2.7	2.7
EBIT	2,674	3,662	3,541	4,214	5,211
% of net sales	18.7	19.4	15.7	14.6	15.7
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	4,291	5,288
Provision for tax	648	752	960	1,133	1,396
% of PBT	23.2	20.4	26.5	26.4	26.4
Recurring PAT	2,146	2,942	2,659	3,158	3,892
Share from associates	-	-	-	-	-
Exceptional item	160	120	-	-	-
Minority interest	30	34	31	31	31
Reported PAT	1,955	3,029	2,628	3,127	3,861
Adjusted PAT	2,115	2,932	2,628	3,127	3,861
Fully diluted EPS (₹)	22.0	30.5	27.4	32.6	40.2

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	14,221	17,408
Other reserves	-	2	0	0	0
Net worth	6,854	9,182	12,249	14,702	17,888
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	17,204	20,395
Gross block	3,611	5,460	7,811	8,811	9,811
Accumulated dep.	(1,379)	(2,866)	(3,477)	(4,256)	(5,153)
Net block	2,232	2,594	4,334	4,555	4,659
Capital WIP	260	266	266	266	267
Total fixed assets	2,491	2,861	4,601	4,821	4,926
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	5,235	8,072
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	8,388	11,249
Total capital deployed	9,689	11,709	14,768	17,204	20,395

Cash flow statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Pre tax profit from operations	2,581	2,728	2,659	3,158	3,892
Depreciation	390	522	611	779	896
Expenses (deferred)/written off/others	-	-	-	-	-
Pre tax cash from operations	2,971	3,250	3,270	3,937	4,788
Other income/prior period ad	182	113	106	106	106
Net cash from operations	3,153	3,363	3,376	4,044	4,895
Tax	(648)	(979)	(960)	(1,133)	(1,396)
Cash profits	2,505	2,384	2,417	2,911	3,499
(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	151	665	3,451	3,166
(Inc)/dec in fixed assets	(1,025)	(369)	(1,740)	(221)	(105)
(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)	(221)	(105)
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		1,161	1,776	257	451
Cashflow from financing activities	(463)	1,408	775	(401)	(223)
Cash generated/(utilised)	367	1,294	(2,351)	2,829	2,838
Cash at start of the year	3,096	3,463	4,756	2,405	5,235
Cash at end of the year	3,463	4,756	2,405	5,235	8,072

Key Ratios

Y/E March	FY2013	FY2014	FY2015	FY2016E	FY2017E
Valuation ratio (x)					
P/E (on FDEPS)	24.9	19.8	20.1	16.9	13.7
P/CEPS	22.5	15.3	16.3	13.5	11.1
P/BVPS	7.7	5.7	4.3	3.6	3.0
Dividend yield (%)	0.9	0.9	0.9	0.9	1.1
EV/Sales	3.5	2.6	2.3	1.7	1.4
EV/EBITDA	16.3	11.6	12.3	9.7	7.4
EV/Total assets	20.1	16.9	11.1	10.0	9.2
Per share data (₹)					
EPS	22.0	27.8	27.4	32.6	40.2
Cash EPS	24.4	35.8	33.7	40.7	49.5
Dividend	5.0	5.0	5.0	5.0	6.0
Book value	71.3	95.6	127.5	153.0	186.2
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	0.2
Asset turnover ratio (Sales/Assets)	5.8	6.6	4.9	6.0	6.7
Leverage ratio (Assets/Equity)	0.4	0.3	0.4	0.3	0.3
Operating ROE (%)	28.5	31.8	21.5	21.3	21.6
Return ratios (%)					
RoCE (pre-tax)	27.6	31.3	24.0	24.5	25.6
Angel RoC	46.2	54.8	29.3	36.0	43.2
RoE	30.9	29.1	21.5	21.3	21.6
Turnover ratios(x)					
Asset turnover (fixed assets)	5.8	6.6	4.9	6.0	6.7
Receivables days	78	78	92	85	81

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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%)	Neutral (-5 to 5%)
		Reduce (-5% to -15%)	Sell (< -15%)