

Tech Mahindra

Performance Highlights

(₹ cr)	2QFY17	1QFY17	% chg (QoQ)	2QFY16	% chg (YoY)
Net revenue	7,167	6,921	3.6	6,294	13.9
EBITDA	1,070	1,029	4.0	935	14.4
EBITDA margin (%)	14.9	14.6	(22)bps	14.9	(21)bps
Adj. PAT	645	750	(14.0)	676	(4.6)

Source: Company, Angel Research;

Tech Mahindra is expected to post sales of US\$107mn (vs. US\$106mn expected), registering a qoq growth of 4.0%. In Constant Currency (CC) terms, the company posted a qoq growth of 5.0%. The EBITDA margin came in at 14.9% (vs. 14.6% expected vs. 14.6% in 1QFY2017). Margins adjusting for one-time restricting expenses came in at 16.1%, an expansion of 120bps. Consequently, the PAT came in at ₹645cr (vs. ₹755cr expected vs. ₹750cr in 1QFY2017), a decline of 14.0% qoq. **We maintain our Buy rating on the stock.**

Result highlights: Tech Mahindra is expected to post sales of US\$107mn (vs. US\$106mn expected), registering a qoq growth of 4.0%. In Constant Currency (CC) terms, the company posted a qoq growth of 5.0%. In INR terms, the company posted net revenue of ₹7,167cr (vs. ₹7,068cr expected vs. ₹6,921cr in 1QFY2017), a qoq growth of 3.6%. In terms of geography, Europe was the key driver contributing about 29.7% of sales in 2QFY2017 (vs. 28.3% in 1QFY2017) and in terms of Industry, Manufacturing contributing about 19.2% of sales in 2QFY2017 (vs. 18.1% in 1QFY2017). The EBITDA margin came in at 14.9% (vs. 14.6% expected vs. 14.6% in 1QFY2017). Margins adjusting for one-time restricting expenses came in at 16.1%, an expansion of 120bps. Consequently, the PAT came in at ₹645cr (vs. ₹755cr expected vs. ₹750cr in 1QFY2017), a decline of 14.0% qoq.

Outlook and valuation: We expect a CAGR of 10.6% and 11.5% in USD and INR revenue, respectively, over FY2016-18E. The PAT is expected to grow at a CAGR of 11.4% over FY2016-18E. **We maintain our Buy rating on the stock.**

Key financials (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E
Net sales	22,621	26,494	29,673	32,937
% chg	20.1	17.1	12.0	11.0
Net profit	2,628	3,118	3,173	3,866
% chg	(10.4)	18.7	1.8	21.9
EBITDA margin (%)	18.4	16.3	15.5	17.0
EPS (₹)	27.1	32.2	32.8	39.9
P/E (x)	16.0	13.5	13.2	10.9
P/BV (x)	3.4	2.9	2.6	2.2
RoE (%)	21.5	21.7	19.6	20.7
RoCE (%)	24.0	20.8	19.8	21.7
EV/Sales (x)	1.8	1.4	1.2	1.0
EV/EBITDA (x)	9.7	8.7	7.9	6.1

Source: Company, Angel Research; Note: CMP as of November 1, 2016

BUY

CMP	₹434
Target Price	₹600

Investment Period	12 Months
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Stock Info	
Sector	IT
Market Cap (₹ cr)	42,141
Net Debt (₹ cr)	(6,370)
Beta	0.9
52 Week High / Low	569/405
Avg. Daily Volume	219,894
Face Value (₹)	5
BSE Sensex	27,877
Nifty	7,502
Reuters Code	TEML.BO
Bloomberg Code	TECHM@IN

Shareholding Pattern (%)	
Promoters	36.3
MF / Banks / Indian Fls	12.4
FII / NRIs / OCBs	40.1
Indian Public / Others	11.2

Abs.(%)	3m	1yr	3yr
Sensex	(0.5)	4.6	31.5
Tech Mahindra	(11.5)	(19.6)	13.7

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 2QFY2017 performance (Consolidated, Indian GAAP)

(₹ cr)	2QFY17	1QFY17	% chg (qoq)	2QFY16	% chg (yoy)	1HFY17	1HFY16	% chg (yoy)
Net revenue	7,167	6,921	3.6	6,616	8.3	14,088	12,909	9.1
Cost of revenue	4,972	4,881	1.9	4,500	10.5	9,852	8,944	10.2
Gross profit	2,196	2,040	7.6	2,116	3.8	4,236	3,965	6.8
SG&A expense	1,126	1,011	11.3	1,029	9.4	2,137	1,974	8.3
EBITDA	1,070	1,029	4.0	1,087	(1.5)	2,099	1,991	5.4
Dep. and amortization	245	202	21.2	197	24.2	447	369	21.1
EBIT	825	827	(0.2)	890	(8.6)	1,653	1,622	1.9
Interest	35	27	25.9	18	97.0	62	39	58.7
Other income	139	246	(43.6)	98	42.1	385	222	73.1
PBT	930	1,046	(11.1)	970	(5.5)	1,975	1,806	9.4
Income taxes	286	247	15.9	191	50.1	533	405	31.6
PAT	644	799	(19.4)	779	(18.9)	1,442	1,401	3.0
Minority interest	1	(46)	-	4	(65.8)	-	(3)	
PAT after minority interest	645	752	(14.3)	776	(16.9)	1,442	1,403	2.8
Profit from associates	-	(2)	-	-	-	(2)	-	
Exceptional item	-	-	-	-	-	-	-	
Reported PAT	645	750	(14.0)	776	(16.9)	1,440	1,403	2.6
Adj. PAT	645	750	(14.0)	776	(16.9)	1,440	1,403	2.6
Diluted EPS	6.7	7.9	(14.5)	8.1	(16.9)	15.0	14.6	2.6
Gross margin (%)	30.6	29.3	138bp	32.0	(135)bps	30.1	30.7	(63)bp
EBITDA margin (%)	14.9	14.6	28bp	16.4	(150)bps	14.9	15.4	(87)bp
EBIT margin (%)	11.5	11.7	(23)bp	13.4	(193)bps	11.7	12.6	(117)bp
PAT margin (%)	9.0	10.7	(168)bps	11.7	(273)bps	10.2	10.9	(110)bp

Source: Company, Angel Research

Exhibit 2: 2QFY2017 – Actual Vs Angel estimates

(₹ cr)	Actual	Estimate	% Var
Net revenue	7,167	7,068	1.4
EBITDA margin (%)	14.9	14.6	28bps
PAT	645	755	(14.5)

Source: Company, Angel Research

Revenue growth led by Europe

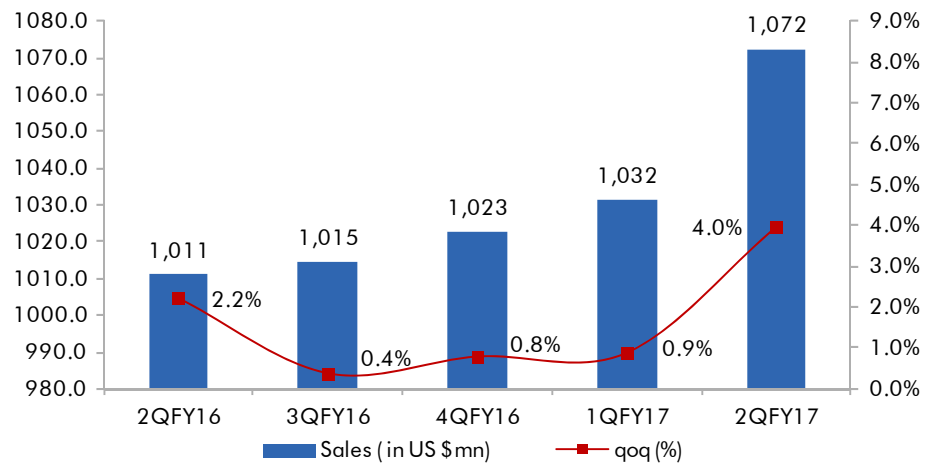
For 2QFY2017, the company posted sales of ₹7,167cr (vs. ₹7,068cr expected and vs. ₹6,921cr in 1QFY2017), a qoq growth of 3.6%. In US\$ terms, the revenue posted sales of US\$107mn (vs. US\$106mn expected), registering a qoq growth of 4.0%. In Constant Currency (CC) terms, the company posted a qoq growth of 5.0%. Organic revenue growth was at 2.5% qoq and the contribution from acquisitions tune to 2.5%.

The top-line growth was driven by Europe, which was 29.7% of sales (vs. 28.3% in 1QFY2017); while ROW was a drag constituting ~22.0% (vs. 22.8% in 1QFY2017). Both these geographies posted qoq growth of 9.1% and 0.3%, respectively. USA, on other hand had contributed around ~48.3% (vs. ~49.0% in 1QFY2017), registering a qoq growth of 2.5%.

In terms of industries, Manufacturing and BFSI were the key drivers of top-line, registering a qoq growth of 10.3% and 5.8%, respectively. Manufacturing constituted ~19.2% of sales (vs. 18.1% in 1QFY2017), while BFSI contributed ~11.5% of sales (vs. 11.3% of sales in 1QFY2017). Retail, Transport and Logistics

contributed ~6.8% of sales (vs. 6.5% of sales in 1QFY2017), registering a qoq growth of 8.8%. Communication, on the other hand, contributed ~48.4% of sales (vs. 49.4% of sales in 1QFY2017), registering a qoq growth of 2.3%.

Exhibit 3: Trend in revenue growth



Source: Company, Angel Research

Exhibit 4: Growth in industry segments

Particulars	% to revenue	% growth (QoQ)	% growth (YoY)
Telecom	48.4	2.3	(3.0)
Manufacturing	19.2	10.3	22.0
TME	7.2	(0.2)	(6..9)
BFSI	11.5	5.8	27.1
RTL	6.8	8.8	20.2
Others	6.8	(3.2)	9.3

Source: Company, Angel Research

In terms of geographies, ROW posted a growth of 0.3% qoq, while Europe and US posted a growth of 9.1% and 2.5% qoq, respectively.

Exhibit 5: Growth trend in geographies

Particulars	% to revenue	% growth (QoQ)	% growth (YoY)
Americas	48.3	2.5	4.8
Europe	29.7	9.1	7.5
RoW	22.0	0.3	6.6

Source: Company, Angel Research

Hiring and client metrics

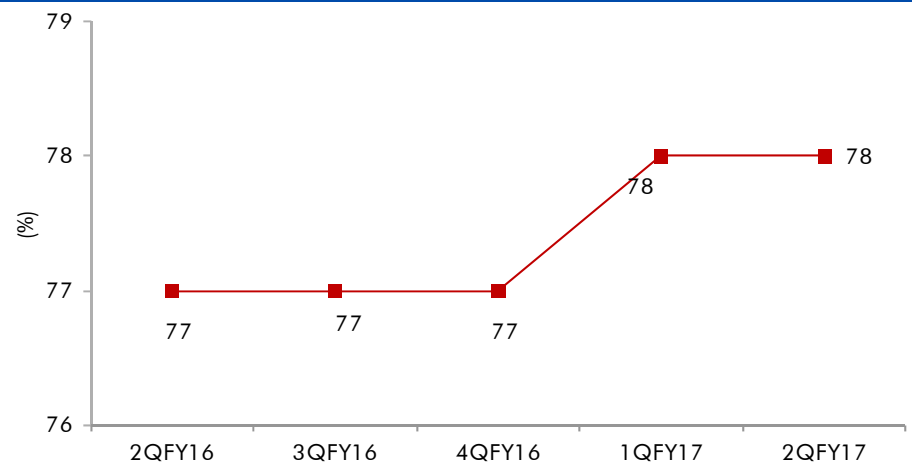
During the quarter, the company reported a net addition of 5,670 employees, taking its overall headcount to 1,12,886. The BPO headcount currently stands at 27, 669 and was the only division to witness additions. Attrition (on LTM basis) was at 19%.

Exhibit 6: Employee metrics

Particulars	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17
Software professionals	71,657	71,892	72,125	73,590	78,404
BPO professionals	26,513	28,279	27,254	27,326	27,669
Sales & support	7,065	6,966	6,053	6,300	6,813
Total employees	1,05,235	1,07,137	105,432	107,216	112,886
Attritions (%)	20	20	21	21	19

Source: Company, Angel Research

Exhibit 7: Trend in utilization rate



Source: Company, Angel Research

The company added 7 new clients during the quarter, taking the active client base to 825 (vs. 818 in 1QFY2017), with 4 clients added in US\$10mn-20mn+ bracket and other additions mainly in the US\$5mn-10mn+ bracket.

Exhibit 8: Client metrics

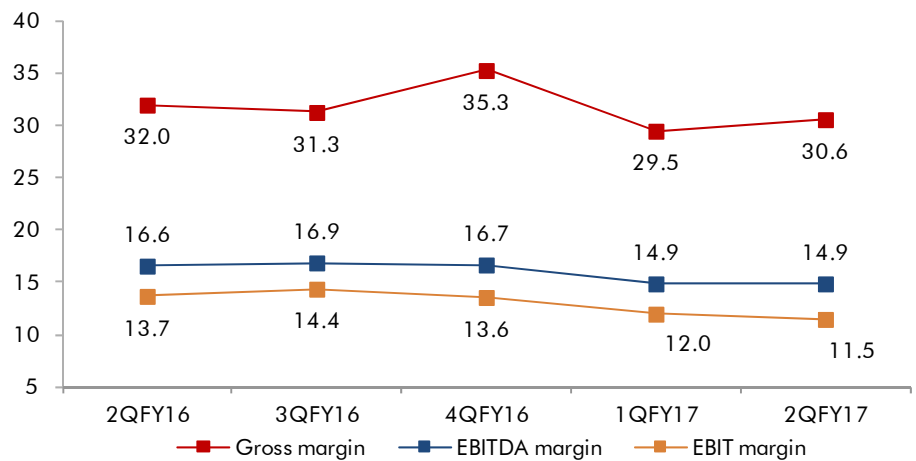
Particulars	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17
Total active clients	767	801	807	818	825
US\$1mn–5mn	195	221	207	197	221
US\$5mn–10mn	40	42	49	56	54
US\$10mn–20mn	21	26	23	22	26
US\$20mn–50mn	22	23	26	28	26
US\$50mn+	13	14	14	14	14

Source: Company, Angel Research

Operating margin expands

On the operating front, the EBDITA margin came in at 14.9%, a qoq expansion of 28bps. The EBIT margin came in at 11.5% (vs. 11.7% in 1QFY2017), while it was down qoq 23bps. However, adjusting for onetime restructuring expenses the EBDITA margin was 16.4%.

Exhibit 9: Margin trend (%)



Source: Company, Angel Research

Investment arguments

Growth prospects decent; Brexit - a near term concern: The Management is more optimistic about the Communications vertical (excluding LCC, where a lot of portfolio rationalization has taken place). In the near term, the Management feels Brexit could cause temporary instability and uncertainty; however it is too early to call out any immediate business implications. We expect a CAGR of 10.6% and 11.5% in USD and INR revenue, respectively, over FY2016-18E.

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 i.e., 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 the recent acquisitions. We expect the enterprise segment growth to be led by broader revival in the markets and deepening of existing relationships. During 2QFY2017 the company won deals worth TCv of US\$325mn. The pipeline has been healthy and most of the deals won are in newer areas like product engineering, cloud, IoT and IMS.

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 was consolidated in 4QFY2015. LCC is one of the world's largest independent global providers of network engineering services to the telecommunications industry with an estimated annual revenues of more than US\$400mn (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 their network upgrade cycle.

Outlook and valuation

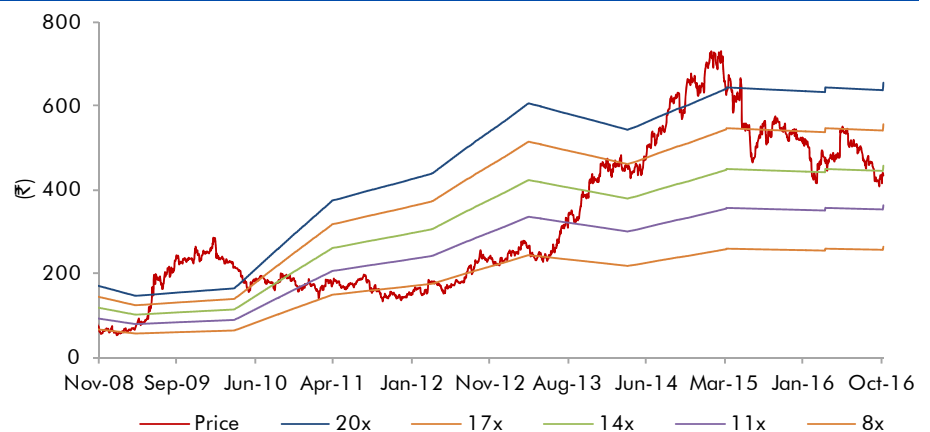
Given the recent acquisitions and healthy order pipeline, the company is expected to post a healthy US\$ and INR CAGR of 10.6% and 11.5%, respectively, over FY2016-18E. However, the acquisition of LCC will be margin dilutive in the near term, leading the FY2016 EBDIT margin to drop to 16.3% from 22.2% 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% EBIT levels in future. Given the conducive valuation 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

	FY2017E	FY2018E
Revenue growth (US\$)	10.3	11.0
USD-INR rate (realized)	66.0	66.0
Revenue growth (₹)	12.0	11.0
EBITDA margin (%)	15.5	17.0
Tax rate (%)	23.4	23.4
EPS growth (%)	1.8	21.9

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 (%)	FY2018E EBITDA (%)	FY2018E P/E (x)	FY2016-18E EPS CAGR (%)	FY2018E EV/Sales (x)	FY2018E RoE (%)
HCL Tech	Buy	773	1,000	29.4	20.5	12.1	9.6	1.7	17.9
Infosys	Buy	989	1,249	26.3	27.0	14.2	8.4	2.4	21.6
TCS	Accumulate	2,348	2,620	11.6	27.6	16.1	8.5	3.2	33.1
Tech Mahindra	Buy	434	600	38.9	17.0	10.9	11.4	0.9	20.7
Wipro	Buy	461	590	28.0	18.1	11.6	5.3	1.6	19.3

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 (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)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Net sales	18,831	22,621	26,494	29,673	32,937
Cost of revenues	12,427	15,920	18,323	20,177	22,068
Gross profit	6,404	6,701	8,172	9,495	10,869
% of net sales	34.0	29.6	30.8	32.0	33.0
SG&A expenses	2,220	2,549	3,853	4,896	5,270
% of net sales	11.8	11.3	14.5	16.5	16.0
EBITDA	4,184	4,153	4,318	4,599	5,599
% of net sales	22.2	18.4	16.3	15.5	17.0
Depreciation and amortization	522	611	762	861	955
% of net sales	2.8	2.7	2.9	2.9	2.9
EBIT	3,662	3,541	3,556	3,739	4,644
% of net sales	19.4	15.7	13.4	12.6	14.1
Interest expense	80	30	96	96	96
Other inc., net of forex gain/(loss)	233	106	557	557	557
Profit before tax	3,815	3,618	4,017	4,199	5,105
Provision for tax	752	960	860	983	1,194
% of PBT	19.7	26.5	21.4	23.4	23.4
PAT	3,063	2,659	3,157	3,217	3,910
Exceptional item	-	-	-	-	-
Minority interest	34	31	44	44	44
Reported PAT	3,029	2,628	3,118	3,173	3,866
Adjusted PAT	2,933	2,628	3,118	3,173	3,866
Fully diluted EPS (₹)	30.3	27.1	32.2	32.8	39.9

Balance sheet (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Equity capital	234	480	484	484	484
Preference capital	-	-	-	-	-
Share premium	-	-	-	-	-
Profit and loss	8,947	11,768	13,882	15,696	18,204
Other reserves	2	0	0	0	-
Net worth	9,182	12,249	14,367	16,181	18,688
Secured loans	309	621	806	806	806
Unsecured loans	54	54	54	55	56
Total debt	363	675	859	860	861
Other long term liability	376	376	376	377	377
Long-term provisions	414	414	414	415	415
Minority interest	144	160	203	145	145
Amount pending investigation	1,230	895	895	895	895
Total capital employed	11,709	14,768	17,114	18,872	21,380
Gross block	5,460	7,811	8,811	9,811	10,811
Accumulated dep.	(2,866)	(3,477)	(4,239)	(5,099)	(6,055)
Net block	2,594	4,334	4,572	4,712	4,757
Capital WIP	266	266	266	267	268
Total fixed assets	2,861	4,601	4,839	4,979	5,025
Investments	36	2,103	2,103	2,103	2,103
Long term loans and adv.	914	1,306	1,502	1,727	1,986
Interest in TML benefit trust	-	-	-	-	-
Deferred tax asset, net	383	390	390	390	390
Other non-current assets	16	-	-	-	-
Inventories	10	24	11	11	11
Sundry debtors	4,349	5,206	5,987	6,896	7,980
Cash and cash equiv.	4,756	2,405	5,127	6,486	8,612
Loans and advances	2,616	3,813	2,998	2,999	2,999
Current investments	-	-	-	-	-
Unbilled revenue	-	-	-	-	-
Sundry creditors	(1,549)	(1,654)	(1,903)	(2,188)	(2,516)
Other liabilities	(1,415)	(1,627)	(1,871)	(2,152)	(2,474)
Provision	(1,267)	(1,799)	(2,068)	(2,379)	(2,736)
Working capital	7,500	6,368	8,280	9,673	11,876
Total capital deployed	11,709	14,768	17,114	18,872	21,380

Cash flow statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Pre tax profit from operations	3,063	2,659	3,157	3,217	3,910
Depreciation	522	611	762	861	955
Exp. (deferred)/written off/others	-	-	-	-	-
Pre tax cash from operations	3,585	3,270	3,919	4,077	4,865
Other income/prior period ad	233	106	557	557	557
Net cash from operations	3,818	3,376	4,475	4,634	5,422
Tax	(752)	(960)	(860)	(983)	(1,194)
Cash profits	3,066	2,417	3,615	3,651	4,227
Sundry Debtors					
Inventories	(980)	(857)	(781)	(909)	(1,085)
Loans and advances	1	(15)	13	-	-
Sundry creditors	(1,324)	(1,197)	815	(1)	-
Others	692	105	248	285	328
Net trade working capital	(623)	212	244	281	323
Cashflow from operating activities	(2,233)	(1,752)	540	(344)	(434)
(Inc)/dec in fixed assets	832	665	4,155	3,307	3,794
(Inc)/dec in investments	(369)	(1,740)	(238)	(140)	(46)
(Inc)/dec in other non current assets	-	(2,067)	-	-	-
Cashflow from investing activities	104	16	-	-	-
Inc/(dec) in debt	(265)	(3,791)	(238)	(140)	(46)
Inc/(dec) in deferred revenue	490	(311)	(185)	(1)	(1)
Inc/(dec) in equity/premium	-	-	-	-	-
Inc/(dec) in minority interest	(2)	1	-	-	0
Addition to reser. on amalgamation	(9)	(16)	(43)	59	-
Dividends	-	-	-	-	-
Others	(231)	(679)	(1,359)	(1,359)	(1,359)
Cashflow from financing activities	479	1,781	392	(507)	(343)
Cash generated/(utilised)	726	775	(1,195)	(1,808)	(1,702)
Cash at start of the year	1,294	(2,351)	2,722	1,359	2,046
Cash at end of the year	3,463	4,756	2,405	5,127	6,308

Key Ratios

Y/E March	FY2014	FY2015	FY2016	FY2017E	FY2018E
Valuation ratio (x)					
P/E (on FDEPS)	14.3	16.0	13.5	13.2	10.9
P/CEPS	11.8	13.0	10.8	10.4	8.7
P/BVPS	4.6	3.4	2.9	2.6	2.2
Dividend yield (%)	1.2	1.2	2.8	1.4	1.6
EV/Sales	2.0	1.8	1.4	1.2	1.0
EV/EBITDA	8.9	9.7	8.7	7.9	6.1
EV/Total assets	13.1	8.7	7.8	7.3	6.8
Per share data (₹)					
EPS	30.3	27.1	32.2	32.8	39.9
Cash EPS	36.7	33.5	40.1	41.7	49.8
Dividend	5.0	5.0	12.0	6.0	7.0
Book value	94.9	126.6	148.4	167.2	193.1
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.8	0.7	0.8	0.8	0.8
Cost of debt (PBT/EBIT)	1.0	1.0	1.1	1.1	1.1
EBIT margin (EBIT/Sales)	0.2	0.2	0.1	0.1	0.1
Asset turnover ratio (Sales/Assets)	6.6	4.9	5.5	6.0	6.6
Leverage ratio (Assets/Equity)	0.3	0.4	0.3	0.3	0.3
Operating ROE (%)	33.0	21.5	21.7	19.6	20.7
Return ratios (%)					
RoCE (pre-tax)	31.3	24.0	20.8	19.8	21.7
Angel RoIC	54.8	29.3	30.3	30.8	37.2
RoE	31.9	21.5	21.7	19.6	20.7
Turnover ratios(x)					
Asset turnover (fixed assets)	6.6	4.9	5.5	6.0	6.6
Receivables days	78	92	89	90	93
Payable days	26	29	28	28	29

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Tech Mahindra

1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

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)