

Tech Mahindra

Performance Highlights

(₹ cr)	3QFY16	2QFY16	% chg (qoq)	3QFY15	% chg (yoy)
Net revenue	6,701	6,616	1.3	5,752	16.5
EBITDA	1,136	1,101	3.2	1,170	(2.9)
EBITDA margin (%)	16.9	16.6	31bp	20.3	(339)bp
Adj. PAT	759	786	(3.4)	805	(5.7)

Source: Company, Angel Research;

For 3QFY2016, Tech Mahindra posted a 0.4% qoq growth in revenues to US\$1,015mn V/s an expected US\$1,021mn and V/s US\$1,011mn in 2QFY2016. On constant currency (CC), the company posted a 1.2% qoq revenue growth. On the operating front, the EBDITA margin came in at 16.9% V/s an expected 17.2% and V/s 16.6% in 2QFY2016, a qoq expansion of 70bp. The EBIT margin came in at 14.3% V/s an expected 14.2% and V/s 13.7% in 2QFY2016. The company posted a net profit of ₹759cr V/s an expected ₹809cr and V/s ₹786cr in 2QFY2016, a qoq de-growth of 3.4%. **We remain positive on the stock and recommend a Buy rating with a price target of ₹530.**

Result highlights: For 3QFY2016, the company posted a 0.4% qoq growth in revenues to US\$1,015mn V/s an expected US\$1,021mn and V/s US\$1,011mn in 2QFY2016.. In INR terms, the company posted sales of ₹6,701cr V/s an expected ₹6,729cr, a qoq growth of 1.3%. On CC, the company posted a 1.2% qoq revenue growth. The growth was mainly driven by ROW, which constituted around 23.2% of sales in 3QFY2016 V/s 21.9% of sales in 2QFY2016. USA and Europe constituted 47.8% (48.9% of sales in 2QFY2016) and 28.9% (29.3% of sales in 2QFY2016) of sales, respectively. In terms of industry, the growth was driven by manufacturing. On the operating front, the EBDITA margin came in at 16.9% V/s an expected 17.2% and V/s 16.6% in 2QFY2016, a qoq expansion of 70bp. The EBIT margin came in at 14.3% V/s an expected 14.2% and V/s 13.7% in 2QFY2016. The company posted a net profit of ₹759cr V/s an expected ₹809cr and V/s ₹786cr in 2QFY2016, a qoq de-growth of 3.4%.

Outlook and valuation: The Management remains confident of reverting back to the original profitability by FY2017-18. We expect a CAGR of 10.3% and 13.6% in USD and INR revenue respectively over FY2015-17E, driven by acquisitions. The PAT is expected to grow at a CAGR of 10.8% over FY2015-17. **We maintain our Buy on the stock.**

Key financials (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2014	FY2015	FY2016E	FY2017E
Net sales	18,831	22,621	26,524	29,177
% chg	31.4	20.1	17.3	10.0
Net profit	2,932	2,628	2,771	3,224
% chg	38.6	(10.4)	5.4	16.4
EBITDA margin (%)	29.6	18.4	16.2	17.0
EPS (₹)	30.5	27.4	28.8	33.6
P/E (x)	14.4	16.1	15.2	13.1
P/BV (x)	4.6	3.4	2.9	2.5
RoE (%)	31.9	21.5	19.3	19.1
RoCE (%)	43.2	24.0	21.3	21.5
EV/Sales (x)	2.0	1.8	1.4	1.2
EV/EBITDA (x)	6.8	9.8	8.9	7.3

Source: Company, Angel Research; Note: CMP as of February 19, 2016

BUY

CMP	₹440
Target Price	₹530

Investment Period	12 Months
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Stock Info

Sector	IT
Market Cap (₹ cr)	42,533
Net Debt (₹ cr)	(3,833)
Beta	0.5
52 Week High / Low	736/416
Avg. Daily Volume	229,545
Face Value (₹)	5
BSE Sensex	23,709
Nifty	7,211
Reuters Code	TEML.BO
Bloomberg Code	TECHM@IN

Shareholding Pattern (%)

Promoters	36.5
MF / Banks / Indian Fls	14.2
FII / NRIs / OCBs	37.7
Indian Public / Others	11.6

Abs.(%)	3m	1yr	3yr
Sensex	(8.3)	(19.5)	20.7
Tech Mahindra	(17.7)	(37.9)	70.1

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 3QFY2016 performance (Consolidated, Indian GAAP)

(₹ cr)	3QFY16	2QFY16	% chg (qoq)	3QFY15	% chg (yoy)	9MFY16	9MFY15	% chg (yoy)
Net revenue	6,701	6,616	1.3	5,752	16.5	19,611	16,504	18.8
Cost of revenue	4,607	4,496	2.5	3,756	22.7	13,544	10,790	25.5
Gross profit	2,095	2,120	(1.2)	1,996	4.9	6,067	5,715	6.2
SG&A expense	959	1,019	(5.9)	826	16.1	2,885	2,459	17.3
EBITDA	1,136	1,101	3.2	1,170	(2.9)	3,181	3,255	(2.3)
Dep. and amortization	174	197	(12.1)	144	20.5	544	439	23.9
EBIT	962	904	6.5	1,026	(6.2)	2,637	2,816	(6.4)
Interest	24	17	41.0	14	78.1	63	43	45.6
Other income	64	166	(61.5)	19	236.3	366	172	113.2
PBT	1,002	1,052	(4.8)	1,031	(2.9)	2,940	2,945	(0.1)
Income taxes	233	260	(10.6)	251	(7.4)	703	775	(9.3)
PAT	769	792	(2.9)	780	(1.4)	2,237	2,170	3.1
Minority interest	10	7	49.2	3	212.9	18	14	27.2
PAT after minority interest	759	786	(3.4)	777	(2.3)	2,220	2,156	3.0
Profit from associates	(0)	0		29		1	-	
Exceptional item	-	-		-		-	-	
Reported PAT	759	786	(3.4)	805	(5.7)	2,221	2,156	3.0
Adj. PAT	759	786	(3.4)	805	(5.7)	2,221	2,156	3.0
Diluted EPS	7.9	8.2	(3.4)	8.4	(5.7)	23.1	22.4	3.0
Gross margin (%)	31.3	32.0	(79)bp	34.7	(345)bp	30.9	34.6	(369)bp
EBITDA margin (%)	16.9	16.6	31bp	20.3	(339)bp	16.2	19.7	(350)bp
EBIT margin (%)	14.4	13.7	70bp	17.8	(348)bp	13.4	17.1	(362)bp
PAT margin (%)	11.3	11.9	(55)bps	14.0	(267)bp	11.3	13.1	(174)bp

Source: Company, Angel Research

Exhibit 2: 3QFY2016 – Actual vs Angel estimates

(₹ cr)	Actual	Estimate	Var. (%)
Net revenue	6,701	6,729	(0.4)
EBITDA margin (%)	16.9	17.2	(23)bps
PAT	759	809	(6.2)

Source: Company, Angel Research

Revenue growth led by ROW

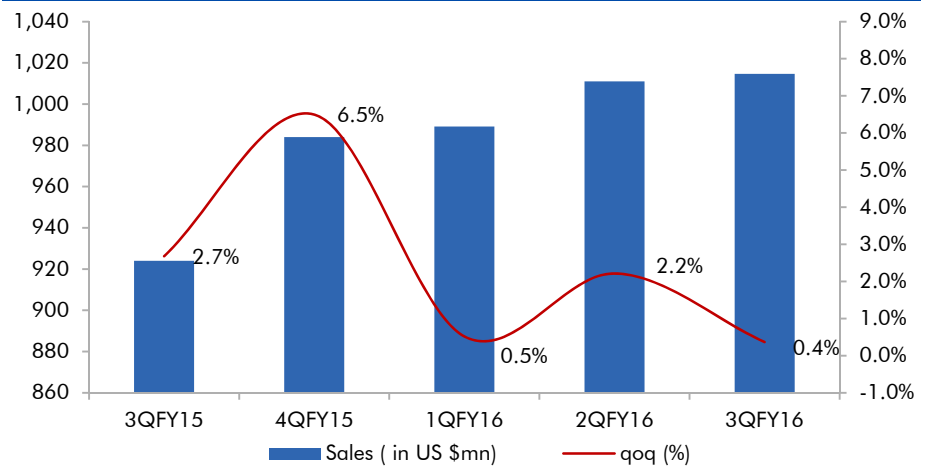
For 3QFY2016, the company posted a 0.4% qoq growth in revenues to US\$1,015mn V/s an expected US\$1,021mn and V/s US\$1,011mn in 2QFY2016. In INR terms, the company posted sales of ₹6,701cr V/s an expected ₹6,729cr, a qoq growth of 1.3%. On CC, the company posted a 1.2% qoq revenue growth.

The growth was mainly driven by ROW, which constituted ~23.2% of sales in 3QFY2016 V/s 21.9% of sales in 2QFY2016. USA and Europe constituted 47.8% (48.9% of sales in 2QFY2016) and 28.9% (29.3% of sales in 2QFY2016) of sales, respectively. In terms of industry, growth was driven by manufacturing. Its key domain telecom posted a 2.7% qoq de-growth. The business from the Top 5 players constituted ~28% of sales in 3QFY2016 V/s 32% of sales in 2QFY2016.

Delayed decision making in telecom is expected to continue in the near term. The pressure on service providers in the voice business, budgetary control and newer areas of capital projects are likely to continue driving volatility for a couple of

quarters. The decline in top 5 customers during the quarter was led by negative impact of cross-currency movement, furloughs and ramp down in certain accounts.

Exhibit 3: Trend in revenue growth



Source: Company, Angel Research

Exhibit 4: Growth in industry segments

Particulars	% to revenue	% growth (qoq)	% growth (yoy)
Telecom	51	(2.7)	10.7
Manufacturing	17	2.8	(4.7)
TME	7	(9.4)	11.3
BFSI	10	2.5	9.8
RTL	7	13.7	16.7
Others	8	15.6	39.1

Source: Company, Angel Research

In terms of geographies, ROW posted a qoq growth of 5.4%. Europe and the US posted a 1.0% qoq and 1.9% qoq de-growth, respectively.

Exhibit 5: Growth trend in geographies

Particulars	% to revenue	% growth (qoq)	% growth (yoy)
Americas	48	(1.9)	7.6
Europe	29	(1.0)	1.1
RoW	23	5.4	27.6

Source: Company, Angel Research

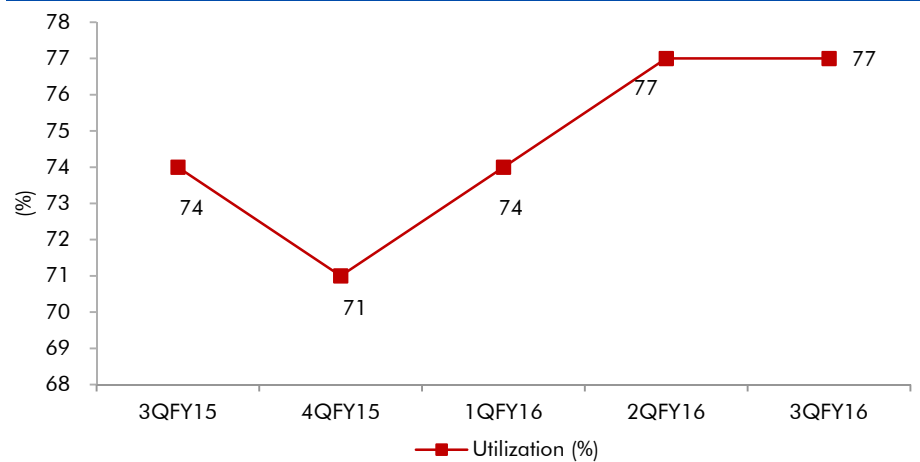
Hiring and client metrics

During the quarter, the company reported a net addition of 1,902 employees, taking its overall headcount to 1,07,137. The BPO headcount currently stands at 28,279 and was the only division to witness additions. Attrition (on LTM basis) was at 20%.

Exhibit 6: Employee metrics

Particulars	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16
Software professionals	67,592	72,952	71,997	71,657	71,892
BPO professionals	23,566	22,693	24,394	26,513	28,279
Sales & support	6,851	7,636	7,232	7,065	6,966
Total employees	98,009	1,03,281	1,03,673	1,05,235	1,07,137
Attritions (%)	19	19	19	20	20

Source: Company, Angel Research

Exhibit 7: Trend in utilization rate


Source: Company, Angel Research

The company added 13 new clients during the quarter, taking the active client base to 801 V/s 788 in 2QFY2016, with 1 client added in US\$20-50mn+ bracket and others mainly in the US\$1-5mn+ bracket.

Exhibit 8: Client metrics

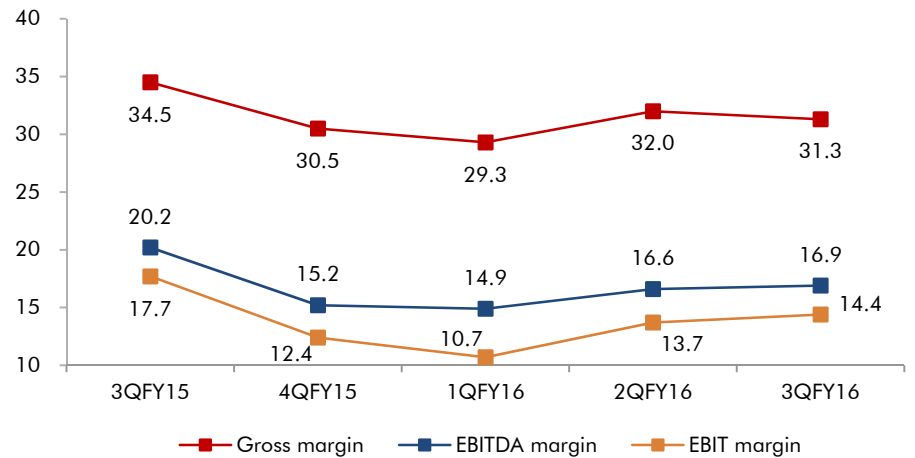
Particulars	3QFY15	4QFY14	1QFY16	2QFY16	3QFY16
Total active clients	674	767	770	788	801
US\$1mn–5mn	166	195	195	196	221
US\$5mn–10mn	37	40	41	40	42
US\$10mn–20mn	19	21	24	26	26
US\$20mn–50mn	19	22	23	22	23
US\$50mn+	13	13	13	14	14

Source: Company, Angel Research

Operating margin expands

On the operating front, the EBDITA margin came in at 16.9% V/s an expected 17.2% and V/s 16.6% in 2QFY2016, a qoq expansion of 70bp. The EBIT margin came in at 14.3% V/s an expected 14.2% and V/s 13.7% in 2QFY2016. During the quarter, tailwinds of utilization, INR depreciation and SG&A leverage aided margin expansion.

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 the 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 10.3% and 13.6% 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 3QFY2016 the company won deals worth TCV of US\$275mn, mainly from the enterprise vertical.

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. 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. 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

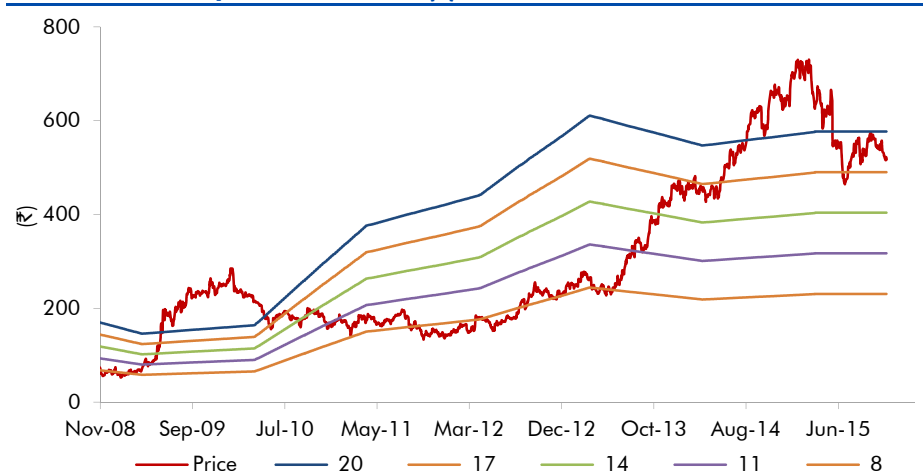
Given the recent acquisitions and healthy order pipeline, the company is expected to post a healthy US\$ and INR CAGR of 10.3% and 13.6%, respectively, over FY2015-17. However, the acquisition of LCC will be margin dilutive in the near term, leading the FY2016E EBDIT margin to drop to 16.2% from 22.2% 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 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

	FY2016E	FY2017E
Revenue growth (US\$)	10.7	10.0
USD-INR rate (realized)	65.0	65.0
Revenue growth (₹)	17.3	10.0
EBITDA margin (%)	16.2	17.0
Tax rate (%)	23.4	23.4
EPS growth (%)	5.4	16.4

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	850	1,038	22.1	21.5	14.7	6.0	2.0	18.8
Infosys	Buy	1,126	1,347	19.7	27.5	17.1	10.6	2.9	20.1
TCS	Buy	2,320	2,854	23.0	28.5	16.8	11.8	3.3	38.9
Tech Mahindra	Buy	440	530	20.5	17.0	13.1	10.8	1.2	19.1
Wipro	Buy	547	670	22.5	23.8	13.0	9.7	1.7	17.2

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)	FY2013	FY2014E	FY2015	FY2016E	FY2017E
Net sales	14,332	18,831	22,621	26,524	29,177
Cost of revenues	9,001	10,790	11,914	18,036	19,548
Gross profit	5,331	8,042	10,708	8,488	9,628
% of net sales	37.2	42.7	47.3	32.0	33.0
SG&A expenses	2,268	2,459	6,555	4,191	4,668
% of net sales	15.8	13.1	29.0	15.8	16.0
EBITDA	3,063	5,582	4,153	4,297	4,960
% of net sales	21.4	29.6	18.4	16.2	17.0
Depreciation and amortization	390	522	611	716	788
% of net sales	2.7	2.8	2.7	2.7	2.7
EBIT	2,674	5,060	3,541	3,581	4,172
% of net sales	18.7	26.9	15.7	13.5	14.3
Interest expense	92	43	30	30	30
Other inc., net of forex gain/(loss)	212	113	106	106	106
Profit before tax	2,793	5,130	3,618	3,657	4,249
Provision for tax	648	775	960	856	994
% of PBT	23.2	15.1	26.5	23.4	23.4
PAT	2,146	4,355	2,659	2,802	3,255
Exceptional item	160	120	-	-	-
Minority interest	30	14	31	31	31
Reported PAT	1,955	4,461	2,628	2,771	3,224
Adjusted PAT	2,115	2,932	2,628	2,771	3,224
Fully diluted EPS (₹)	22.0	30.5	27.4	28.8	33.6

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	13,864	16,414
Other reserves	-	2	0	0	0
Net worth	6,854	9,182	12,249	14,345	16,894
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	16,848	19,401
Gross block	3,611	5,460	7,811	8,811	9,811
Accumulated dep.	(1,379)	(2,866)	(3,477)	(4,193)	(4,981)
Net block	2,232	2,594	4,334	4,618	4,830
Capital WIP	260	266	266	266	267
Total fixed assets	2,491	2,861	4,601	4,884	5,098
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	4,815	6,907
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	7,969	10,083
Total capital deployed	9,689	11,709	14,768	16,848	19,401

Cash flow statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Pre tax profit from operations	2,581	4,355	2,659	2,802	3,255
Depreciation	390	522	611	716	788
Exp. (deferred)/written off/others	-	-	-	-	-
Pre tax cash from operations	2,971	4,877	3,270	3,518	4,042
Other income/prior period ad	182	113	106	106	106
Net cash from operations	3,153	4,990	3,376	3,624	4,149
Tax	(648)	(775)	(960)	(856)	(994)
Cash profits	2,505	4,215	2,417	2,768	3,155
(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	1,981	665	3,308	2,822
(Inc)/dec in fixed assets	(1,025)	(369)	(1,740)	(284)	(213)
(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)	(284)	(213)
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 reser. on amalgamation	70	-	-	-	1
Dividends	(149)	(231)	(674)	(674)	(674)
Others		(670)	1,776	44	158
Cashflow from financing activities	(463)	(423)	775	(614)	(516)
Cash generated/(utilised)	367	1,293	(2,351)	2,410	2,092
Cash at start of the year	3,096	3,463	4,756	2,405	4,815
Cash at end of the year	3,463	4,756	2,405	4,815	6,907

Key Ratios

Y/E March	FY2013	FY2014	FY2015	FY2016E	FY2017E
Valuation ratio (x)					
P/E (on FDEPS)	20.0	14.4	16.1	15.2	13.1
P/CEPS	18.0	8.5	13.0	12.1	10.5
P/BVPS	6.2	4.6	3.4	2.9	2.5
Dividend yield (%)	1.1	1.1	1.1	1.1	1.4
EV/Sales	2.8	2.0	1.8	1.4	1.2
EV/EBITDA	13.0	6.8	9.8	8.9	7.3
EV/Total assets	16.0	13.3	8.9	7.9	7.1
Per share data (₹)					
EPS	22.0	30.5	27.4	28.8	33.6
Cash EPS	24.4	51.9	33.7	36.3	41.8
Dividend	5.0	5.0	5.0	5.0	6.0
Book value	71.3	95.6	127.5	149.3	175.9
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.7	0.9	0.7	0.8	0.8
Cost of debt (PBT/EBIT)	1.0	1.0	1.0	1.0	1.0
EBIT margin (EBIT/Sales)	0.2	0.3	0.2	0.1	0.1
Asset turnover ratio (Sales/Assets)	5.8	6.6	4.9	5.4	5.7
Leverage ratio (Assets/Equity)	0.4	0.3	0.4	0.3	0.3
Operating ROE (%)	28.5	48.6	21.5	19.3	19.1
Return ratios (%)					
RoCE (pre-tax)	27.6	43.2	24.0	21.3	21.5
Angel RoIC	46.2	75.7	29.3	30.4	34.1
RoE	30.9	31.9	21.5	19.3	19.1
Turnover ratios(x)					
Asset turnover (fixed assets)	5.8	6.6	4.9	5.4	5.7
Receivables days	78	78	92	89	90
Payable days	25	26	29	28	29

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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	No
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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