

Tech Mahindra

Performance Highlights

(₹ cr)	4QFY16	3QFY16	% chg (QoQ)	4QFY15	% chg (YoY)
Net revenue	6,884	6,701	2.7	6,117	12.5
EBITDA	1,161	1,136	2.2	928	25.1
EBITDA margin (%)	16.9	16.9	(8)bp	15.2	170bp
Adj. PAT	897	759	18.2	472	90.1

Source: Company, Angel Research;

Tech Mahindra posted sales of ₹6,884cr for 4QFY2016 (V/s ₹6,701cr in 3QFY2016), which is a QoQ growth of 2.7%. In US\$ terms, sales came in at US\$1,023mn (V/s our expectation of US\$1,021mn), a QoQ growth of 0.8%. In terms of geographies, growth was driven by ROW (accounted for 24.7% of sales V/s 23.2% of sales in 3QFY2016). In terms of industry, growth was driven by BFSI (which accounted for 10.6% of sales V/s 9.8% of sales in 3QFY2016). On the operating front, the EBDITA margin came in flat on a QoQ basis at 16.9%, while the EBIT margin stood at 13.7% V/s 14.4% in 3QFY2016. The net profit came in at ₹897cr V/s ₹759cr in 3QFY2016, a QoQ growth of 18.2%, mainly driven by a rise in other income. Other income for the quarter stood at ₹166cr V/s ₹64cr in 3QFY2016. **We maintain our Buy on the stock.**

Result highlights: Tech Mahindra posted sales of ₹6,884cr for 4QFY2016 (V/s ₹6,701cr in 3QFY2016), which is a QoQ growth of 2.7%. In US\$ terms, sales came in at US\$1,023mn (V/s our expectation of US\$1,021mn), a QoQ growth of 0.8%. In terms of geographies, growth was driven by ROW (accounted for 24.7% of sales V/s 23.2% of sales in 3QFY2016). Europe accounted for 28.5% of sales V/s 28.9% in 3QFY2016, while USA contributed 46.8% of sales V/s 47.8% in 3QFY2016. In terms of industry, growth was driven by BFSI (which accounted for 10.6% of sales V/s 9.8% of sales in 3QFY2016). On the operating front, the EBDITA margin came in flat on a QoQ basis at 16.9%, while the EBIT margin stood at 13.7% V/s 14.4% in 3QFY2016. The net profit came in at ₹897cr V/s ₹759cr in 3QFY2016, a QoQ growth of 18.2%, mainly driven by a rise in other income. Other income for the quarter stood at ₹166cr V/s ₹64cr in 3QFY2016.

Outlook and valuation: The Management remains confident of reverting back to the original profitability by FY2016-18E. We expect a CAGR of 10.6% and 12.8% in USD and INR revenue respectively over FY2016-18E, driven by acquisitions. The PAT is expected to grow at a CAGR of 13.2% over FY2016-18E. **We maintain our Buy on the stock.**

Key financials (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E
Net sales	22,621	26,494	30,347	33,685
% chg	20.1	17.1	14.5	11.0
Net profit	2,628	3,118	3,633	3,999
% chg	(10.4)	18.7	16.5	10.1
EBITDA margin (%)	18.4	16.3	17.0	17.0
EPS (₹)	27.1	32.2	37.5	41.3
P/E (x)	20.1	17.0	14.6	13.2
P/BV (x)	4.3	3.7	3.2	2.7
RoE (%)	21.5	21.7	21.8	20.7
RoCE (%)	24.0	20.8	22.4	21.9
EV/Sales (x)	2.3	1.9	1.6	1.3
EV/EBITDA (x)	12.5	11.4	9.2	7.9

Source: Company, Angel Research; Note: CMP as of June 2, 2016

BUY

CMP	₹546
Target Price	₹700

Investment Period	12 Months
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Stock Info

Sector	IT
Market Cap (₹ cr)	53,015
Net Debt (₹ cr)	(6,370)
Beta	0.7
52 Week High / Low	582/408
Avg. Daily Volume	225,175
Face Value (₹)	5
BSE Sensex	26,843
Nifty	8,219
Reuters Code	TEML.BO
Bloomberg Code	TECHM@IN

Shareholding Pattern (%)

Promoters	36.4
MF / Banks / Indian Fls	13.0
FII / NRIs / OCBs	38.8
Indian Public / Others	11.8

Abs.(%)	3m	1yr	3yr
Sensex	6.2	(1.3)	35.8
Tech Mahindra	18.0	(0.5)	126.0

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 4QFY2016 performance (Consolidated, Indian GAAP)

(₹ cr)	4QFY16	3QFY16	% chg (QoQ)	4QFY15	% chg (yoy)	FY16	FY15	% chg (YoY)
Net revenue	6,884	6,701	2.7	6,117	12.5	26,494	22,621	17.1
Cost of revenue	4,454	4,607	(3.3)	4,253	4.7	18,323	12,911	41.9
Gross profit	2,429	2,095	16.0	1,864	30.3	8,172	9,710	(15.8)
SG&A expense	1,268	959	32.3	936	35.5	3,853	5,558	(30.7)
EBITDA	1,161	1,136	2.2	928	25.1	4,318	4,152	4.0
Dep. and amortization	218	174	25.4	172	26.5	762	611	24.7
EBIT	944	962	(1.9)	756	24.8	3,556	3,541	0.4
Interest	33	24	35.4	18	83.5	96	30	220.3
Other income	166	64	159.6	(65)	(355.2)	557	106	425.1
PBT	1,077	1,002	7.5	673	60.0	4,017	3,617	11.1
Income taxes	157	233	(32.5)	185	(15.1)	860	960	(10.4)
PAT	919	769	19.6	489	88.0	3,157	2,657	18.8
Minority interest	(24)	10	(342.6)	17	(238.4)	-	14	(100.0)
PAT after minority interest	896	759	18.0	472	89.8	3,157	2,628	20.1
Profit from associates	1	-	-	-	-	39	-	-
Exceptional item	-	-	-	-	-	-	-	-
Reported PAT	897	759	18.2	472	90.1	3,118	2,628	18.7
Adj. PAT	897	759	18.2	472	90.1	3,118	2,628	18.7
Diluted EPS	9.3	7.9	18.2	4.9	90.1	32.2	27.1	18.7
Gross margin (%)	35.3	31.3	403bp	30.5	482bp	30.8	42.9	(1208)bp
EBITDA margin (%)	16.9	16.9	(8)bp	15.2	170bp	16.3	18.4	(206)bp
EBIT margin (%)	13.7	14.4	(65)bp	12.4	135bp	13.4	15.7	(223)bp
PAT margin (%)	13.0	11.3	170bps	7.7	532bp	12.0	11.6	39bp

Source: Company, Angel Research

Exhibit 2: 4QFY2016 – Actual vs Angel estimates

(₹ cr)	Actual	Estimate	% Var
Net revenue	6,884	6,890	(0.1)
EBITDA margin (%)	16.9	16.6	27.4bps
PAT	897	732	22.6

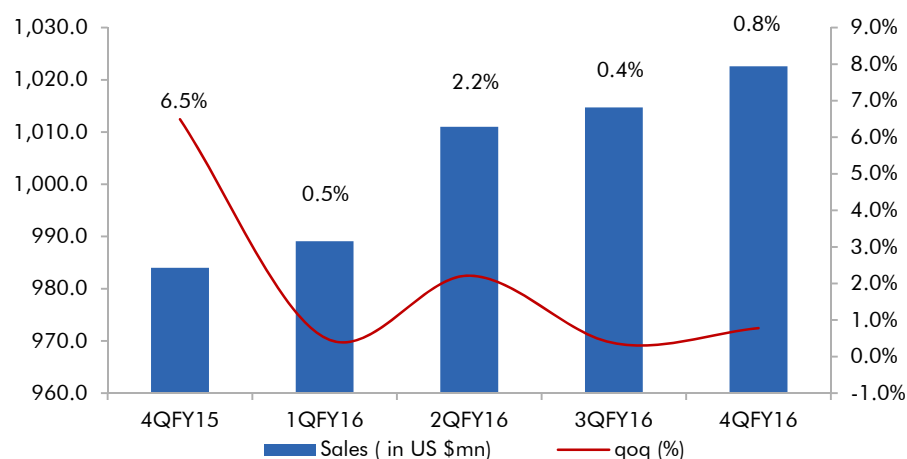
Source: Company, Angel Research

Revenue growth led by ROW

For 4QFY2016, Tech Mahindra posted sales of ₹6,884cr V/s ₹6,701cr in 3QFY2016, a QoQ growth of 2.7%. In US\$ terms, the company posted sales of US\$1,023mn (V/s our expectation of US\$1021mn), a QoQ growth of 0.8%. On constant currency (CC) basis, revenue grew 1.0% QoQ.

In terms of geographies, growth was driven by ROW where revenues rose 8.2% QoQ; for the quarter, ROW accounted for 24.7% of sales V/s 23.2% of sales in 3QFY2016. Europe registered a QoQ growth of 0.6% and accounted for 28.5% of sales V/s 28.9% in 3QFY2016. USA registered a QoQ de-growth of 1.3% (the region accounted for 46.8% of sales V/s 47.8% of sales in 3QFY2016). In terms of industry, growth was driven by BFSI which accounted for 10.6% of sales V/s 9.8% of sales in 3QFY2016; revenues from the segment were up 9.0% QoQ. TME posted a QoQ growth of 2.1%, while Manufacturing posted a QoQ growth of 0.8%. RTL de-grew by 8.1% QoQ.

During the quarter, the Communication vertical's revenue was flat despite seasonal strength in Comviva. The company is in the process of cutting down on non-core/non-profitable business in LCC, which caused a decline in run-rate to ~USD320mn compared to ~USD400mn when the company was acquired. Growth in the Manufacturing vertical (0.8% QoQ) continued to remain weak on account of pressure in the oil & gas sector.

Exhibit 3: Trend in revenue growth


Source: Company, Angel Research

Exhibit 4: Growth in industry segments

Particulars	% to revenue	% growth (QoQ)	% growth (YoY)
Telecom	50.9	(0.0)	(4.3)
Manufacturing	17.1	0.8	7.7
TME	7.5	2.1	11.3
BFSI	10.6	9.0	21.1
RTL	6.2	(8.1)	3.9
Others	7.7	2.1	33.4

Source: Company, Angel Research

In terms of geographies, ROW posted a growth of 8.2% QoQ. Europe and the US posted a 0.6% QoQ and 1.3% QoQ de-growth, respectively. This was the second consecutive quarter of a decline in Americas and Europe, mainly attributed to the consolidation exercise in LCC.

Exhibit 5: Growth trend in geographies

Particulars	% to revenue	% growth (QoQ)	% growth (YoY)
Americas	46.8	(1.3)	7.1
Europe	28.5	(0.6)	(0.6)
RoW	24.7	8.2	3.5

Source: Company, Angel Research

Hiring and client metrics

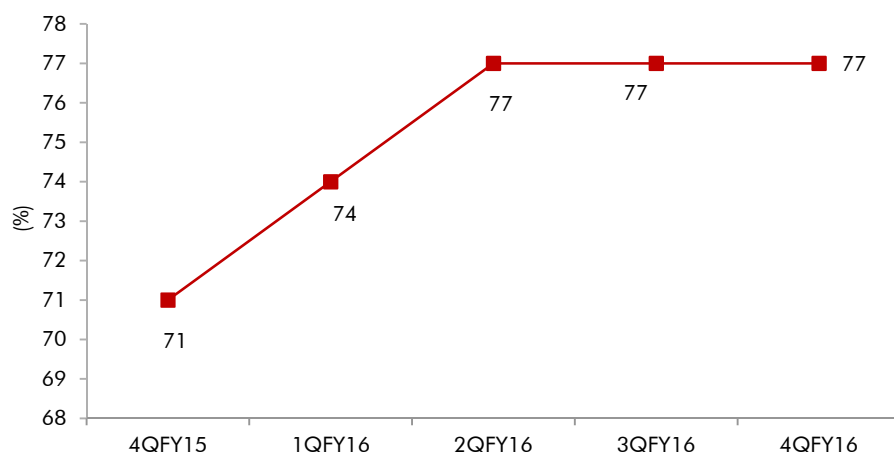
During the quarter, the company reported a net reduction of 1,705 employees, taking its overall headcount to 1,05,432. The BPO headcount currently stands at 27,254 and was the only division to witness additions. Attrition (on LTM basis) was at 21%.

Exhibit 6: Employee metrics

Particulars	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16
Software professionals	72,952	71,997	71,657	71,892	72,125
BPO professionals	22,693	24,394	26,513	28,279	27,254
Sales & support	7,636	7,232	7,065	6,966	6,053
Total employees	1,03,281	1,03,673	1,05,235	1,07,137	105,432
Attritions (%)	19	19	20	20	21

Source: Company, Angel Research

Exhibit 7: Trend in utilization rate



Source: Company, Angel Research

The company added 6 new clients during the quarter, taking the active client base to 807 V/s 801 in 3QFY2016, with 3 clients added in US\$20-50mn+ bracket and others mainly in the US\$5-10mn+ bracket.

Exhibit 8: Client metrics

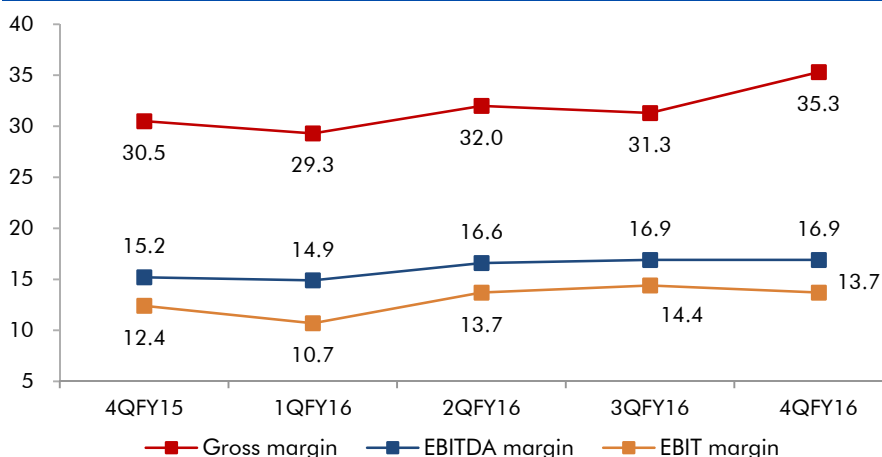
Particulars	4QFY14	1QFY16	2QFY16	3QFY16	4QFY16
Total active clients	770	788	767	801	807
US\$1mn–5mn	195	196	195	221	207
US\$5mn–10mn	41	40	40	42	49
US\$10mn–20mn	24	26	21	26	23
US\$20mn–50mn	23	22	22	23	26
US\$50mn+	13	14	13	14	14

Source: Company, Angel Research

Operating margin expands

On the operating front, the EBDITA came in flat QoQ at 16.9%, while the EBIT came in at 13.7% V/s 14.4% in 3QFY2016. During the quarter, the headwinds of wage hike (-100bp) and revenue decline in LCC (-50bp) were offset by efficiency improvement (+50-60bp) and seasonal strength in Comviva (+50-60bp).

Exhibit 9: Margin trend (%)



Source: Company, Angel Research

Investment arguments

Growth prospects robust: The Management is more optimistic about the Communications vertical (excluding the LCC, where a lot of portfolio rationalization has taken place). The company has gone through a cycle of decline over the last 3-4 quarters. However, the stability seen in 4QFY2016, pipeline building up and discussions with clients has led to increased optimism around the outlook in the space. In other verticals, like BFSI, where the company's footprint has been smaller compared to peers, it has been investing in Digital and specific product implementation capabilities, helping increased traction. We expect a CAGR of 10.6% and 12.8% 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; 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 the recent acquisitions. We expect the enterprise segment growth to be led by broader revival in the markets and deepening of existing relationships. During 4QFY2016 the company won deals worth TCV of US\$300mn.

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

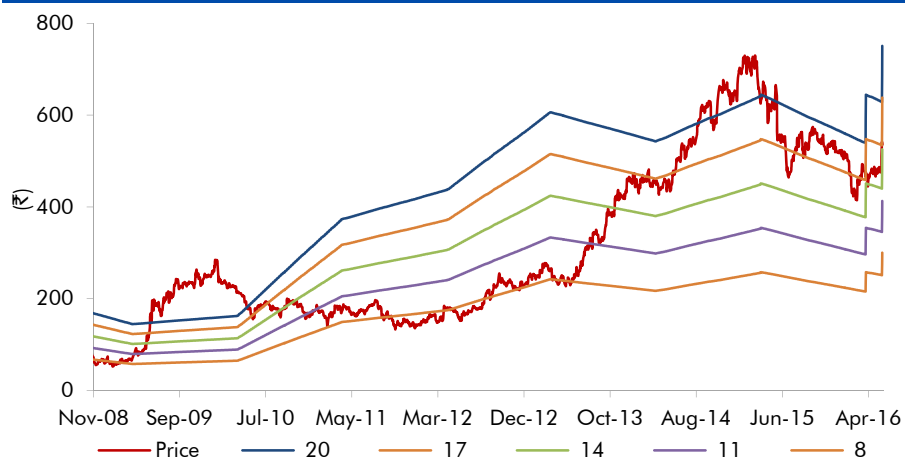
Given the recent acquisitions and healthy order pipeline, the company is expected to post a healthy US\$ and INR CAGR of 10.6% and 12.8%, respectively, over FY2016-18E. However, the acquisition of LCC will be margin dilutive in the near term, leading the FY2016 EBDIT margin to drop to 16.3% from 22.2% 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. 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

	FY2017E	FY2018E
Revenue growth (US\$)	10.3	11.0
USD-INR rate (realized)	67.5	67.5
Revenue growth (₹)	14.5	11.0
EBITDA margin (%)	17.0	17.0
Tax rate (%)	23.4	23.4
EPS growth (%)	16.5	10.1

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	721	1,000	38.7	20.5	11.3	26.5	1.2	17.9
Infosys	Buy	1,260	1,374	9.0	27.5	17.4	11.0	3.1	22.4
TCS	Buy	2,647	3,004	13.5	28.3	15.7	13.0	3.1	35.5
Tech Mahindra	Buy	546	700	28.1	17.0	13.2	13.2	1.3	20.7
Wipro	Buy	540	680	25.9	23.5	11.8	9.9	1.5	19.6

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	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)	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	16,157	18,796
Other reserves	2	0	0	0	-
Net worth	9,182	12,249	14,367	16,641	19,280
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	19,333	21,973
Gross block	5,460	7,811	8,811	9,811	10,811
Accumulated dep.	(2,866)	(3,477)	(4,239)	(5,058)	(5,968)
Net block	2,594	4,334	4,572	4,753	4,844
Capital WIP	266	266	266	267	268
Total fixed assets	2,861	4,601	4,839	5,020	5,112
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	6,905	9,118
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	10,092	12,382
Total capital deployed	11,709	14,768	17,114	19,333	21,973

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	3,677	4,043
Depreciation	522	611	762	819	910
Exp. (deferred)/written off/others	-	-	-	-	-
Pre tax cash from operations	3,585	3,270	3,919	4,496	4,952
Other income/prior period ad	233	106	557	557	557
Net cash from operations	3,818	3,376	4,475	5,053	5,509
Tax	(752)	(960)	(860)	(1,123)	(1,235)
Cash profits	3,066	2,417	3,615	3,930	4,274
(Inc)/dec in					
Sundry Debtors	(980)	(857)	(781)	(909)	(1,085)
Inventories	1	(15)	13	-	-
Loans and advances	(1,324)	(1,197)	815	(1)	-
Sundry creditors	692	105	248	285	328
Others	(623)	212	244	281	323
Net trade working capital	(2,233)	(1,752)	540	(344)	(434)
Cashflow from operating activities	832	665	4,155	3,586	3,840
(Inc)/dec in fixed assets	(369)	(1,740)	(238)	(182)	(91)
(Inc)/dec in investments	-	(2,067)	-	-	-
(Inc)/dec in other non current assets	104	16	-	-	-
Cashflow from investing activities	(265)	(3,791)	(238)	(182)	(91)
Inc/(dec) in debt	490	(311)	(185)	(1)	(1)
Inc/(dec) in deferred revenue	-	-	-	-	-
Inc/(dec) in equity/premium	(2)	1	-	-	0
Inc/(dec) in minority interest	(9)	(16)	(43)	59	-
Addition to reser. on amalgamation	-	-	-	-	-
Dividends	(231)	(679)	(1,359)	(1,359)	(1,359)
Others	479	1,781	392	(325)	(176)
Cashflow from financing activities	726	775	(1,195)	(1,626)	(1,535)
Cash generated/(utilised)	1,294	(2,351)	2,722	1,778	2,213
Cash at start of the year	3,463	4,756	2,405	5,127	6,905
Cash at end of the year	4756	2405	5127	6905	9118

Key Ratios

Y/E March	FY2014	FY2015	FY2016	FY2017E	FY2018E
Valuation ratio (x)					
P/E (on FDEPS)	18.0	20.1	17.0	14.6	13.2
P/CEPS	14.9	16.3	13.6	11.9	10.8
P/BVPS	5.8	4.3	3.7	3.2	2.7
Dividend yield (%)	0.9	0.9	2.2	1.1	1.3
EV/Sales	2.6	2.3	1.9	1.6	1.3
EV/EBITDA	11.8	12.5	11.4	9.2	7.9
EV/Total assets	17.2	11.3	10.2	9.5	8.9
Per share data (₹)					
EPS	30.3	27.1	32.2	37.5	41.3
Cash EPS	36.7	33.5	40.1	46.0	50.7
Dividend	5.0	5.0	12.0	6.0	7.0
Book value	94.9	126.6	148.4	171.9	199.2
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	21.8	20.7
Return ratios (%)					
RoCE (pre-tax)	31.3	24.0	20.8	22.4	21.9
Angel RoIC	54.8	29.3	30.3	35.7	38.3
RoE	31.9	21.5	21.7	21.8	20.7
Turnover ratios(x)					
Asset turnover (fixed assets)	6.6	4.9	5.5	6.0	6.6
Receivables days	78	92	89	89	91
Payable days	26	29	28	28	29

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Note: Please refer to the important 'Stock Holding Disclosure' report on the Angel website (Research Section). Also, please refer to the latest update on respective stocks for the disclosure status in respect of those stocks. Angel Broking Pvt. Limited and its affiliates may have investment positions in the stocks recommended in this report.

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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