June 29, 2022

Virtusa Consulting Services Private Limited: Ratings Reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	2000.00	2000.00	[ICRA]A (Stable); Reaffirmed
Total	**2000.00**	**2000.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation continues to factor in Virtusa Consulting Services Private Limited's (VCS) parent, Austin HoldCo Inc.'s established presence as Information Technology (IT) consultancy and IT enabled Services (ITeS) provider with healthy execution track record. It clocked annual revenues of more than $1.6 billion in FY2022. Globally, Austin HoldCo Inc. enjoys a healthy business position with a reputed client base and high proportion of repeat business, has strong execution capabilities and an experienced management team. VCS derives a sizeable proportion of revenues from the offshoring of work from Austin HoldCo Inc and is the group's larges offshore development center. VCS recorded healthy revenue growth of 26.6% in FY2022 (provisional) to Rs. 6192.2 crore and its margins remained healthy at 15.6% despite moderating from 17.0% in FY2022 on the back of increase in employee costs and reduction in the transfer pricing markup. The rating also derives comfort from the adequate liquidity position of the company as demonstrated by healthy cash and equivalents of ~ Rs. 462.2 crore as of March 31, 2022, along with healthy accruals and limited debt repayment commitments in the medium term (only interest outgo). Moreover, the company exercised call option to prepay Rs. 385.2 crore of 9% coupon NCDs in FY2022, resulting in significant improvement in its debt metrics and RoCE. The total prepayment of the 9% coupon NCDs as at FY2022 is to the tune of Rs. 1320 crore as against the issue size of Rs. 1360 crore.

The rating is constrained by the dependence of VCS' revenues on workflow from Austin HoldCo Inc., as well as geographical dependence on US and Europe. As a result, it remains susceptible to any adverse legislation in the US/Europe that may restrict the outsourcing to low-cost countries as well as visa tightening by the US authorities. Any reduction in business flow from Austin HoldCo Inc., which contributed 41% of the revenues in FY2022, may adversely impact the revenues and cash flows of VCS. Moreover, given that most of the orders are priced on cost plus markup formula, any significant downward revision in the markup by the parent company will impact the company's margins. ICRA notes that the debt of the parent Austin HoldCo. Increased to $1.6 billion in FY2022 from the $900 million in FY2021 on the back of a debt funded shareholder distribution which has resulted in the deterioration of the coverage indicators and capitalization metrics. The profitability of the company remains exposed to adverse foreign exchange movement, given that most of its revenues are generated in USD and Euro and a significant part of its expenses are in INR. Nevertheless, ICRA notes that the company has benefited from the appreciation of USD in the recent months. The rating also takes into consideration the end-user industry vertical-concentration risk as more than 56% of the group's (Austin HoldCo Inc. and its subsidiaries) revenues is derived from banking, financial services and insurance (BFSI) segment, exposing its top line to any slowdown in the sector. ICRA notes the intense competition in the IT industry, especially the global landscape with larger peers and uncertainty on account of the visa and immigration legislations in key developed markets. Also, in light of the tight labor markets across the world, the company also faces challenges with respect to employee attrition rates and talent retention. The attrition rate at the group level was in line with the industry at ~28% in FY2022.

The Stable outlook reflects ICRA's expectation that VCS will be able to maintain a mid-single digit revenue growth and stable profit margins in the near term. Moreover, ICRA will continue to monitor any adverse developments that can lead to reduction in workflow from parent company to VCS, significant repatriation of funds to the parent, impacting VCS' liquidity or deterioration of credit metrics of the parent and adverse visa norms that can impact the IT business in general.

Key rating drivers and their description

Credit strengths

Established position of Austin HoldCo Inc. in IT services industry – Austin HoldCo Inc.'s established position in the IT consulting and ITeS segments is characterised by its established client base, global execution capabilities and experienced management team. Austin HoldCo Inc. caters to over 2,000 global clients across key industries including BFSI, healthcare, communications, technology, and media and entertainment. Austin's active clientele has grown steadily over the years with high repeat business, resulting in a healthy CAGR of 13.3% in its operating income(OI) during FY2017–FY2022, despite slowdown in revenue growth in FY2021 owing to the Covid-19 pandemic. As VCS is one of the parent's largest delivery centers, it derives a sizeable proportion of revenues from the offshoring of work from Austin HoldCo Inc., resulting in a CAGR of 15.2% in VCS's OI during FY2017–FY2022.

Adequate liquidity profile with availability of cash balances supported by healthy margins – The company's liquidity profile remained adequate with cash balances of around Rs. 462.2 crore as on March 31, 2022 aided by healthy revenue growth and margins over the years. The margins moderated in FY2022 to 15.6% owing to marginal increase in employee costs and reduction in the transfer pricing mark up on the contracts received from the parent. The liquidity position is supported by healthy accruals and limited repayment commitments in the medium term as the redemption of the NCDs are back ended with significant portion to be redeemed only in FY2025. Moreover, the company exercised call option to prepay Rs. 385.3 crore NCDs in FY2022, resulting in significant improvement in its debt metrics and RoCE.

Credit challenges

Weakened credit profile of the parent company which is also its largest customer – VCS derives 41% of its revenues from its parent company, Austin HoldCo Inc. In February 2021, Baring Private Equity Asia (BPEA) and its affiliate companies acquired Virtusa Corporation through its wholly owned subsidiary, Austin HoldCo Inc for approximately $1.8 billion. The acquisition was funded using cash from the balance sheet of $231 million, $900 million debt, and equity infusion of $1.1 billion. Further in FY2022 Austin HoldCo Inc. raised an addition debt of $720.0 million, proceeds of which were utilized to fund a shareholder distribution to the tune of $746.3 million. With the steep increase in debt, leverage indicators and debt protection metrics deteriorated in FY2022 and are expected to be stretched in the near-term for Austin HoldCo Inc. As the parent company is the primary customer of VCS, accounting for 41% of its revenues, any weakening of the parent's credit profile would impact VCS' growth prospects and overall credit profile. Moreover, any repatriation of funds to the parent company impacting the liquidity position of VCS would be a key monitorable; VCS' dividend outflow in FY2022 increased to Rs. 270.0 crore from Rs. 85.2 crore in FY2021. However, ICRA notes that exercising call options to repay NCDs would improve the debt metrics of VCS going forward.

Significant geographical dependence on US and Europe – VCS derives most of its revenues from the US and European markets. Thus, the company's operations remain susceptible to any legislation, especially in the US/Europe, which may restrict outsourcing to low-cost countries like India. Further, visa tightening by the US authorities will have a bearing on the IT services being rendered in the American markets.

Vulnerability of profitability to competitive pressures; forex risk remains a concern – The profitability of VCS remains vulnerable to competitive pressures from other low-cost countries. Moreover, its profitability is exposed to adverse foreign exchange movement, given that most of its revenues are generated in USD and Euro, while a significant part of expenses is incurred in INR. Also, given that most of the orders are priced on cost plus markup formula, any significant downward revision in the markup by its parent company will impact the company's margins. However, ICRA, notes that the current depreciation pressure of INR is expected to benefit VCS in the near term.

Significant vertical-concentration risk – VCS derives a significant proportion of its revenues from the BFSI segment. This makes its operations vulnerable to any slowdown in the segment. BFSI contributed 94% of VCS' revenues in FY2022 (FY2021-96%) and 56% of the overall group revenues. ICRA notes the intense competition in the IT industry, especially the global landscape with larger peers with better financial flexibility and resources. Albeit, comfort is taken from the fact that the company has had a longstanding relationship with reputed clientele with significant repeat income as demonstrated in the past.

Liquidity position: Adequate

The company's liquidity position is adequate as it has cash of around Rs. 462.2 crore as on March 31, 2022 and is expected to generate retained cash flows of ~Rs. 400 crore in FY2023. As against these funds, it has capex plans of ~Rs. 70-100 crore and limited debt obligations. However, the repatriation of this cash to the parent company can impact the liquidity position of the company.

Rating sensitivities

Positive Factor: Rating could be upgraded if the company demonstrates healthy growth in operating income (OI), driven by healthy order flow from its parent, Austin HoldCo Inc., along with improvement in profitability on a sustained basis. Improved business profile of the parent marked by a sustained growth in parent's scale and debt coverage metrics would be a positive trigger.

Negative Factor: – Negative pressure on VCS' ratings may arise, if any significant reduction in the company's revenues and profitability weakens its debt metrics. The ratings may also be downgraded if any debt-funded acquisitions weaken the debt coverage indicators or if a sizeable repatriation of funds to the parent impacts VCS' liquidity position. Weakening of the company's linkages with the parent company or further moderation in credit profile of the parent entity would also be a negative trigger.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Information Technology (Services) Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of VCS. As on March 31, 2022, there were 14 entities, which were consolidated into the VCS financials, those are enlisted in Annexure-2

About the company

VCS was incorporated in 2008 as a multi-level stepdown subsidiary of Virtusa Corporation. The parent company is headquartered in Massachusetts and provides IT services including IT consulting, application development and maintenance, systems integration and managed services. VCS is one of the major delivery centres of Austin HoldCo Inc. in India, accounting for around 50% of the parent's revenues in FY2021. The company mainly performs the work offshored by Austin HoldCo Inc. and other Group companies such as Virtusa Netherlands and Virtusa UK. VCS increased its stake in Polaris to 100% in FY2020 and the company has been merged with it with effect from April 1, 2018. Further, VCS acquired mobile application development and data analytics solutions provider — TechChefs Software Private Limited — in FY2020.

Key financial indicators

Consolidated	FY2020	FY2021	FY2022*
Operating Income (Rs. crore)	4489.0	4892.2	6192.2
PAT (Rs. crore)	363.0	221.0	499.5
OPBDIT/OI (%)	13.5%	17.0%	15.6%
PAT/OI (%)	8.1%	4.5%	8.1%
Total Outside Liabilities/Tangible Net Worth (times)	2.7	1.9	1.4
Debt^/OPBDIT (times)	3.7	1.7	1.0
Interest Coverage (times)	2.9	4.9	10.1

*Source: Company; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation, * provisional numbers;*

^ *includes lease liability; FY2022 figures mentioned in the rationale are provisional financials; All the figures mentioned in the above table are as per ICRA's computation.*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2022 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2021		Date & Rating in FY2020
					29-Jun-2022	29-Jun-2021	24-Sep-2020	25-Jun-2020	05-Apr-2019
1	Non-Convertible Debenture	Long-term	2,000.00	679.7	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**

Complexity level of the rated instrument

Instrument	Complexity Indicator
Non-Convertible Debenture	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
INE571O08018	Non-Convertible Debenture	Feb 29, 2016	9.0%	Apr 15, 2023	1,360.0	[ICRA]A (Stable)
INE571O08026	Non-Convertible Debenture	Dec 26, 2017	8.0%	Dec 26, 2024	330.0	[ICRA]A (Stable)
INE571O08034	Non-Convertible Debenture	Feb 06, 2018	8.0%	Feb 06, 2025	310.0	[ICRA]A (Stable)

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Polaris Consulting & Services Pte Ltd, Singapore	100%	Full Consolidation
Virtusa Consulting and Services FZ- LLC	100%	Full Consolidation
Virtusa Consulting and Services Japan K. K	100%	Full Consolidation
Virtusa Consulting & Services Pty Ltd, New Zealand Branch	100%	Full Consolidation
Virtusa Consulting & Services Inc, Canada	100%	Full Consolidation
Virtusa Consulting & Services Pty Ltd, Australia	100%	Full Consolidation
Virtusa Consulting & Services Ltd, UK	100%	Full Consolidation
Virtusa Consulting & Services SA	100%	Full Consolidation
Virtusa Consulting & Services Ireland Limited	100%	Full Consolidation
Virtusa Malaysia SDN BHD	100%	Full Consolidation
Polaris Software Consulting & Services Sdn. Bhd., Malaysia	100%	Full Consolidation
Virtusa QFC IT Consulting LLC	100%	Full Consolidation
Techchefs Software Private Limited, India	100%	Full Consolidation
Virtusa Systems India Private Limited, India (erstwhile eTouch Systems India Private Limited)	100%	Full Consolidation

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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