

Virtusa Consulting Services Private Limited

Instrument	Amount	Rating Action
	In Rs. Crore	December 2015
Non Convertible Debentures	2000.00	Assigned [ICRA]A+ (stable)

ICRA has assigned an [ICRA]A+ (pronounced ICRA A plus) rating to the Rs. 2000.00 crore^{*} Non-Convertible Debentures programme of Virtusa Consulting Services Private Limited (VCS)^{††}. The outlook on the rating is Stable.

The rating factors in the strengths that VCS derives from its parentage viz. Virtusa Corporation (referred to as Virtusa), an Information Technology (IT) consultancy and IT enabled Services (ITeS) provider with annual revenues of US\$ 479 million[‡]. The rating is supported by the healthy business position of Virtusa characterized by a steady client base with repeat business and consistent new client addition; its global execution capabilities and an experienced management team. Virtusa has service offerings across business verticals (majorly banking, financial services and insurance (BFSI) and communications and technology) and long term customer relationships which lend stability to cash flows. The rating takes into consideration that VCS is one of the major delivery center of Virtusa in India and revenues of VCS account for 18% of Virtusa's consolidated revenues and ~38% of global headcount is based in VCS. Further, the proposed NCD would fund the acquisition of Polaris Consulting & Services Limited (Polaris) to strengthen the position of the consolidated entity in the BFSI segment with growth in addressable markets and client base.

The rating also draws comfort from the robust financial profile of Virtusa as reflected by the healthy revenue growth and strong cash flows driven by steady business generation. While Virtusa's operating profitability has been moderate on account of high competitive intensity, low depreciation and negligible interest expenses, coupled with availability of certain tax benefits, have led to robust net margins. Further, the capital structure of Virtusa remains robust with healthy cash and liquid investments (of \$203 million) and negligible debt as on March 31, 2015. This along with steady internal cash generation has translated into robust debt protection metrics.

The proposed NCD would be issued by VCS to Virtusa to fund the acquisition of 53% stake through share purchase agreement (with promoter group and other minority shareholders) and 26% stake through open offer (both together up to a maximum of 74.99%) of Polaris. To fund the proposed acquisition cost of \$270 million (for 53% + 26% stake arrived at the announced price of Rs. 220.73 per share), Virtusa has lined up debt funding of \$300 million, allowing it to meet any contingency. These funds would be infused into VCS in the form of NCD. This would result in leveraging of Virtusa's balance sheet at consolidated level leading to gross debt/EDBITA at ~2.9x.

The servicing of the proposed NCD by VCS would depend on its cashflow generation and access to cashflows of Polaris. VCS derives its entire revenues from Virtusa and has reported steady growth in revenue generation along with stable operating profitability over the years, mirroring the trend in Virtusa. The operating margins have been healthy at around 25% based on the transfer pricing mechanism between Virtusa and VCS. Further, the financial profile is strong as reflected by robust capital structure, strong debt protection metrics and healthy cash holdings. ICRA also factors in the long-term stable outlook for outsourcing services from India, considering its technical talent pool and cost advantage.

However, the rating of the NCD is constrained by the inadequacy of cashflows towards the proposed debt servicing on standalone basis for VCS, and its ability to service the debt hinges on timeliness and quantum of dividend payout from Polaris. Further, given that the tax exemptions of VCS are scheduled to expire in March 2018, there remains the risk of reduction in workflow from Virtusa to VCS, thereby

* 100 lakh = 1 crore = 10 million

† † For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications.

‡ For financial year ended March 31, 2015



adversely affecting the cashflows of VCS. While so far, there have not been significant dividend payouts from VCS to Virtusa, any dividend payout, share buyback, or up-streaming of cashflows by VCS at higher than envisaged levels (to support Virtusa's own debt repayment commitment) may adversely impact its liquidity. The rating also takes into consideration the revenue concentration risk faced by Virtusa with more than 50% of revenue being contributed to by the BFSI segment, exposing it to any slowdown in this segment. Further, the company faces relatively high client concentration and geographical concentration risks. In addition, similar to other companies in the industry, Virtusa faces challenges with respect to employee attrition rates and recovery of dues from clients. ICRA notes that for VCS, the operations remain susceptible to any legislation, especially in the US/EU region, which may restrict outsourcing to low cost countries. The profitability of the VCS is also exposed to adverse foreign exchange movement given that majority of company's revenues are generated in US\$ and a significant part of expenses are in Indian Rupee. However, this risk is hedged to a large extent by buying forward covers at Virtusa level.

ICRA expects the proposed acquisition of Polaris to complete at the envisaged acquisition price, however, any significant variation in the acquisition cost and timing would be a rating sensitivity.

About Virtusa Corporation

Virtusa Corporation is incorporated in 1996 by Mr. Kris Canekaratne, Ms. Tushara Canekaratne and Mr. John Gillis. The company provides IT services, which include IT consulting, application development and maintenance, systems integration and managed services. Virtusa's serviced client base includes around 2000 companies covering Banking & Financial Services, Insurance, Telecommunications, Technology and Media, Information & Education sectors. The key markets are North America and Europe. Virtusa has offices in the United States, the United Kingdom, Germany, Sweden and Austria, with global delivery centers in India, Sri Lanka, Hungary, Singapore and Malaysia, as well as a near shore delivery center in the United States. The company is listed on NASDAQ.

About VCS

VCS is incorporated in 2008 and is a major delivery center of Virtusa in India, accounting for 18% of Virtusa's revenues and 75% of total India revenues. VCS has offices in Hyderabad, Pune and Bangalore. VCS largely works on the work offshored by Virtusa and other group companies such as Virtusa Netherlands and Virtusa UK.

About Polaris Consulting & Services Private Limited

Polaris is a mid-sized financial technology company for BFSI vertical founded in 1993 headquartered in Chennai with over 25 years of experience in digital transformation, and more than 300 clients across the globe.

Recent Results

During FY15, Virtusa has reported consolidated operating income of \$478.99 million and net profit of \$42.45 million as against operating income of \$396.93 million and net profit of \$34.38 million during FY14. During H1 FY16, Virtusa reported operating income of \$277.85 million and net profit of \$21.20 million.

During FY15, VCS reported operating income of Rs. 517.92 crore and net profit of Rs. 94.68 crore as against operating income of Rs. 432.26 crore and net profit of Rs. 84.10 crore during FY14. During H1 FY16, VCS reported operating income of Rs. 295.39 crore and net profit of Rs. 57.66 crore.

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