June 25, 2020

Virtusa Consulting Services Private Limited: Rating reaffirmed

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	2,000.00	2,000.00	[ICRA]A+(Stable); reaffirmed
Total	**2,000.00**	**2,000.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation continues to factor in Virtusa Consulting Services Private Limited's (VCS) parentage, i.e. Virtusa Corporation (Virtusa), which is an established Information Technology (IT) consultancy and IT enabled Services (ITeS) provider with healthy execution track record. It clocked annual revenues of more than $1.3 billion in FY2020. Globally, Virtusa enjoys a healthy business position with a reputed client base and high proportion of repeat business, strong execution capabilities and an experienced management team. The company has undertaken acquisitions over the years to build upon its capabilities and diversify revenue streams. VCS derives a sizeable proportion of revenues from the offshoring of work from Virtusa. The rating also derives comfort from the adequate liquidity position of the company as demonstrated by healthy cash and equivalents of more than Rs. 1,100 crore as of March 31, 2020, along with healthy accruals and limited debt repayment commitments in the medium term (only interest outgo to the tune of Rs. 200 crore per year). The rating also factors in the company's healthy operating margins on the back of cost-plus basis of offshoring work from Virtusa. Further, while the headwinds remain in the near term due to the impact of the Covid-19 pandemic in terms of cancellation of orders, cut down on discretionary spends and delay in client decision making, long-term prospects look favourable with the focus on digital and cloud transformations, remote working solutions and collaborative technologies.

The rating is constrained by the dependence of VCS' revenues on workflow from Virtusa, 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 Virtusa may adversely impact the revenues and cash flows of VCS. The rating also takes into consideration the end-user industry vertical-concentration risk as more than 60% of the company's revenues is contributed by the 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 evolving visa and immigration legislations in key developed markets are challenges that the industry faces. Like other companies in the industry, VCS also faces challenges with respect to employee attrition rates. 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. Further, the debt levels remained high on account of the debt-funded acquisition of Polaris and Etouch, which has added Rs. 2,000 crore of NCDs and Rs. 494 crore of compulsorily convertible debentures (CCDs). While these have been issued to Group companies, the NCDs have bullet repayments due in FY2024 and FY025 and hence, do not entail immediate repayment obligations. However, there remains a call option in these NCDs and VCS has exercised a call option to prepay $25 million (~Rs. 190 crore) to the parent entity in April 2020. Any such instance cannot be ruled out in future and can impact the liquidity position of VCS.

While the weakening of the global macro-economic outlook in the wake of the Covid-19 pandemic is likely to impact the revenue growth and profitability in the near term, the long-term demand prospects remain favourable on the back of increased requirement of remoting, collaborative technologies, cloud and digital transformation solutions. The Stable outlook reflects ICRA's expectation that VCS will be able to maintain its liquidity position despite an impact on revenue growth and profit margins in the near term. Moreover, ICRA will continue to monitor any adverse macroeconomic developments in the US or Europe that can lead to reduction in workflow from Virtusa to VCS, or adverse visa norms that can impact the IT business in general.

Key rating drivers

Credit strengths

Established position of Virtusa in IT services industry - Virtusa's established position in the IT consulting and ITeS segments is characterised by its established client base, global execution capabilities and experienced management team. The company reported a healthy CAGR of 22% in its OI during FY2015–FY2020, despite slowdown in revenue growth in FY2020 owing to the Covid-19 pandemic.

Adequate liquidity profile with availability of cash balances – The company's liquidity profile remained adequate with the availability of cash balances of around Rs. 1,100 crore as on March 31, 2021. Further, the liquidity position is supported by healthy accruals and limited repayment commitments in the medium term.

Credit challenges

Significant geographical dependence on US and Europe - VCS derives around 85% 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 are incurred in INR.

Significant vertical-concentration risk – VCS derives a significant proportion of its revenues (more than 60%) from the BFSI segment. This makes its operations vulnerable to any slowdown in the segment. Further, amid the slowdown caused by the pandemic, the discretionary spending on IT in the BFSI sector will be delayed, which can impact the revenue growth for VCS.

Expected moderation in near-term demand outlook- Moderation in IT budgets of the parent company's customers in the backdrop of the Covid-19 pandemic would adversely impact on VCS' revenue and earnings prospects in the near term. However, increasing business from cloud and digital transformation can mitigate the impact to some extent in the medium term.

Liquidity position: Adequate

The availability of sizeable cash of around Rs. 1,100 crore on the books of the company as on March 31, 2020 coupled with low working capital intensity of operations, limited capex plans and limited debt repayment commitments translates into adequate liquidity position. However, the repatriation of this cash in the form of call options on the NCDs can impact the cash position and thus, the liquidity position of the company.

Rating sensitivities

Positive triggers – The ratings can be upgraded if the company demonstrates healthy growth in operating income (OI) along with improvement in profitability, leading to improvement in ROCE beyond 20% on a sustained basis.

Negative triggers – Negative pressure on VCS' ratings may arise, if any significant reduction in the company's revenues and profitability weakens its RoCE. 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. Further, weakening of the company's linkages with the parent company or moderation in credit profile of the parent entity may impact the rating.

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, 2020, there were 15 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. 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 Virtusa in India, accounting for around 50% of the parent's revenues in FY2020. The company mainly performs the work offshored by Virtusa and other Group companies such as Virtusa Netherlands and Virtusa UK. VCS has completed the acquisition of Polaris 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.

In FY2020 (provisional), VCS reported net profit of Rs. 427.0 crore on an OI of Rs. 4,477 crore vis-à-vis profit after tax (PAT) of Rs. 217 crore on an OI of Rs. 4,373 crore in FY2019.

Key financial indicators – VCS (Consolidated)

Consolidated	FY2019 Audited	FY2020 Provisional
Operating Income (Rs. crore)	4,373	4,477
PAT (Rs. crore)	217	427
OPBDIT/OI (%)	13.5%	13.1%
RoCE (%)	18.9%	17.1%
Total Outside Liabilities/Tangible Net Worth (times)	3.88	2.76
Total Debt/OPBDIT (times)	3.78	3.82
Interest Coverage (times)	3.05	2.91
DSCR	2.40	2.54

Source: VCS Annual reports and provisional financials

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding as on March 31, 2020	Rating	FY2020	FY2019	FY2018
					25-Jun-2020	05-Apr-2019	06-Apr-2018	08-Nov-2017
1	Non-Convertible Debenture	Long Term	2,000.0	2,000.0	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)

Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the 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: VCS

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Polaris Consulting & Services Pte Ltd, Singapore	100%	Full Consolidation
Polaris Consulting & Services Pty Ltd, Australia	100%	Full Consolidation
Polaris Consulting & Services Limited (UK)	100%	Full Consolidation
Polaris Consulting and Services Japan K K	100%	Full Consolidation
Polaris Consulting & Services Ireland Limited	100%	Full Consolidation
Polaris Consulting & Services Inc, Canada	100%	Full Consolidation
Polaris Consulting and Services FZ-LLC	100%	Full Consolidation
Polaris Consulting & Services SA	100%	Full Consolidation
Polaris Consulting and Services B V, Netherlands	100%	Full Consolidation
Polaris Software Consulting & Services Sdn Bhd	100%	Full Consolidation
Virtusa Malaysia SDN BHD	100%	Full Consolidation
Virtusa Qatar	100%	Full Consolidation
Virtusa Switzerland	100%	Full Consolidation
Vitusa Systems India Private Limited	100%	Full Consolidation
Techchefs Software Private Limited	100%	Full Consolidation

Source: VCS

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About ICRA Limited:

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