

VIRTUSA CORP  
Form 10-Q  
February 03, 2010

Table of Contents

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, DC 20549

---

**FORM 10-Q**

**Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the quarterly period ended December 31, 2009**

**Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 001-33625**

**VIRTUSA CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

---

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**7371**  
(Primary Standard Industrial  
Classification Code Number)

---

**04-3512883**  
(I.R.S. Employer  
Identification Number)

**2000 West Park Drive**  
**Westborough, Massachusetts 01581**  
**(508) 389-7300**  
(Address, Including Zip Code, and Telephone Number,  
Including Area Code, of Registrant's Principal Executive Offices)

---

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange

Edgar Filing: VIRTUSA CORP - Form 10-Q

Act. (Check one):

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's class of common stock, as of February 1, 2010:

Class	Number of Shares
Common Stock, par value \$.01 per share	23,816,611

---

Table of Contents

**Virtusa Corporation and Subsidiaries**  
**Table of Contents**

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<u>Item 1.</u> <u>Consolidated Financial Statements (Unaudited)</u>	<u>3</u>
<u>Consolidated Balance Sheets at December 31, 2009 and March 31, 2009</u>	<u>3</u>
<u>Consolidated Statements of Income and Other Comprehensive Income (Loss) for the Three and Nine Months Ended</u>	
<u>December 31, 2009 and 2008</u>	<u>4</u>
<u>Consolidated Statements of Cash Flows for the Nine Months Ended December 31, 2009 and 2008</u>	<u>5</u>
<u>Notes to Consolidated Financial Statements</u>	<u>6</u>
<u>Item 2.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>21</u>
<u>Item 3.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>30</u>
<u>Item 4.</u> <u>Controls and Procedures</u>	<u>32</u>
<b><u>PART II. OTHER INFORMATION</u></b>	
<u>Item 1A.</u> <u>Risk Factors</u>	<u>33</u>
<u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>33</u>
<u>Item 6.</u> <u>Exhibits</u>	<u>34</u>
<b><u>SIGNATURES</u></b>	<b><u>35</u></b>
<b><u>EXHIBIT INDEX</u></b>	<b><u>36</u></b>

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements (Unaudited)****Virtusa Corporation and Subsidiaries****Consolidated Balance Sheets****(Unaudited)**

**December 31, 2009      March 31, 2009**  
**(In thousands, except share**  
**and per share amounts)**

<b>Assets</b>			
Current assets:			
Cash and cash equivalents	\$	59,365	\$ 55,698
Short-term investments		28,463	23,333
Accounts receivable, net of allowance of \$936 and \$1,041 at December 31, 2009 and March 31, 2009, respectively		28,043	28,244
Unbilled accounts receivable		4,423	4,005
Prepaid expenses		3,016	5,050
Deferred income taxes		1,583	4,139
Other current assets		7,181	5,668
<b>Total current assets</b>		<b>132,074</b>	<b>126,137</b>
Property and equipment, net of accumulated depreciation of \$21,680 and \$17,415 at December 31, 2009 and March 31, 2009, respectively		20,084	19,680
Long-term investments		34,847	28,054
Goodwill		3,774	
Restricted cash		885	3,489
Deferred income taxes		5,450	5,040
Other long-term assets		5,138	4,623
<b>Total assets</b>	\$	<b>202,252</b>	\$ <b>187,023</b>

**Liabilities and Stockholders' Equity**

Current liabilities:			
Accounts payable	\$	4,557	\$ 5,499
Accrued employee compensation and benefits		10,252	9,520
Accrued expenses and other current liabilities		7,579	7,347
Foreign currency derivative contracts, current portion		773	7,781
Deferred revenue		1,147	1,016
Income taxes payable		1,162	151
<b>Total current liabilities</b>		<b>25,470</b>	<b>31,314</b>
Long-term liabilities		1,827	3,123
<b>Total liabilities</b>		<b>27,297</b>	<b>34,437</b>

**Commitments and guarantees****Stockholders' equity:**

Undesignated preferred stock, \$0.01 par value:

Authorized 5,000,000 shares at December 31 and March 31, 2009; issued zero shares at December 31

Edgar Filing: VIRTUSA CORP - Form 10-Q

and March 31, 2009

Common stock, \$0.01 par value: Authorized  
120,000,000 shares at December 31, 2009 and  
March 31, 2009; issued 25,120,227 and 24,417,272  
shares at December 31, 2009 and March 31, 2009,  
respectively; outstanding 23,360,839 and  
22,657,884 shares at December 31, 2009 and  
March 31, 2009, respectively

251 244

Treasury stock, 1,759,388 common shares, at cost,  
at December 31, 2009 and March 31, 2009,  
respectively

(8,244) (8,244)

Additional paid-in capital

148,229 144,286

Accumulated earnings

39,032 30,485

Accumulated other comprehensive loss

(4,313) (14,185)

Total stockholders' equity

174,955 152,586

Total liabilities and stockholders' equity

\$ 202,252 \$ 187,023

*See accompanying notes to unaudited consolidated financial statements*

Table of Contents**Virtusa Corporation and Subsidiaries****Consolidated Statements of Income and Other Comprehensive Income (Loss)****(Unaudited)**

(In thousands, except per share amounts)	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Revenue	\$ 41,692	\$ 44,940	\$ 116,557	\$ 131,505
Costs of revenue	23,744	25,286	65,729	81,698
Gross profit	17,948	19,654	50,828	49,807
Operating expenses:				
Selling, general and administrative expenses	14,549	14,279	41,156	43,732
Income from operations	3,399	5,375	9,672	6,075
Other income (expense):				
Interest income	517	647	1,388	2,085
Foreign currency transaction gains (losses)	(416)	1,345	(1,252)	465
Other, net	4	38	13	61
Total other income	105	2,030	149	2,611
Income before income tax expense	3,504	7,405	9,821	8,686
Income tax expense	572	1,107	1,274	247
Net income	\$ 2,932	\$ 6,298	\$ 8,547	\$ 8,439
Net income per share of common stock				
Basic	\$ 0.13	\$ 0.28	\$ 0.37	\$ 0.37
Diluted	\$ 0.12	\$ 0.27	\$ 0.36	\$ 0.35
Comprehensive income (loss):				
Net income	\$ 2,932	\$ 6,298	\$ 8,547	\$ 8,439
Foreign currency translation adjustments	1,071	(4,433)	4,122	(8,926)
Unrealized gain (loss) on available-for-sale securities	(133)	897	251	154
Unrealized gain (loss) on effective cash flow hedges	1,424	801	5,499	(4,558)
Total comprehensive income (loss)	\$ 5,294	\$ 3,563	\$ 18,419	\$ (4,891)

*See accompanying notes to unaudited consolidated financial statements*

Table of Contents**Virtusa Corporation and Subsidiaries****Consolidated Statements of Cash Flows****(Unaudited)**

<b>(In thousands)</b>	<b>Nine Months Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash flows provided by operating activities:</b>		
Net income	\$ 8,547	\$ 8,439
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,481	3,226
Amortization of intangible assets	52	
Share based compensation expense	2,563	3,028
Gain on disposal of property and equipment and investments		(11)
Deferred income taxes	(325)	(750)
Foreign currency losses (gains), net	1,252	(465)
Net changes in operating assets and liabilities:		
Accounts receivable, net	3,040	(1,993)
Prepaid expenses and other current assets	2,420	(2,627)
Other long-term assets	(676)	(327)
Accounts payable	(2,263)	4,918
Accrued employee compensation and benefits	197	(1,299)
Accrued expenses and other current liabilities	(1,651)	1,854
Deferred revenue	1,036	1,530
Excess tax benefits from stock option exercises	(45)	
Income taxes payable	196	1,191
Other long-term liabilities	576	(1,990)
<b>Net cash provided by operating activities</b>	<b>18,400</b>	<b>14,724</b>
<b>Cash flows used for investing activities:</b>		
Purchase of short-term investments	(1,967)	(16,147)
Proceeds from sale or maturity of short-term investments	18,850	40,440
Purchase of long-term investments	(36,275)	(31,061)
Proceeds from sale or maturity of long-term investments	8,100	7,236
Purchase of property and equipment	(2,087)	(9,222)
Proceeds from sale of property and equipment		12
Acquisition of a business, net of cash acquired	(6,137)	
Decrease in restricted cash	1,966	409
<b>Net cash used for investing activities</b>	<b>(17,550)</b>	<b>(8,333)</b>
<b>Cash flows provided by (used for) financing activities:</b>		
Purchase of treasury stock		(6,302)
Proceeds from exercise of common stock options	1,670	548
Excess tax benefits from stock option exercises	45	
Principal payments on capital lease obligation	(4)	
<b>Net cash provided by (used for) financing activities</b>	<b>1,711</b>	<b>(5,754)</b>
Effect of exchange rate changes on cash and cash equivalents	1,106	(2,111)

Edgar Filing: VIRTUSA CORP - Form 10-Q

Net increase (decrease) in cash and cash equivalents	3,667	(1,474)
Cash and cash equivalents, beginning of period	55,698	41,047
Cash and cash equivalents, end of period	\$ 59,365	\$ 39,573

*See accompanying notes to unaudited consolidated financial statements*



Table of Contents

**Virtusa Corporation and Subsidiaries**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

**(In thousands, except share and per share amounts)**

**(1) Nature of Business**

Virtusa Corporation (the "Company" or "Virtusa") is a global information technology services company providing IT consulting, technology implementation and application outsourcing services. Using its enhanced global delivery model, innovative platforming approach and industry expertise, the Company provides high-value services that enhance clients' business performance, accelerate time-to-market, increase productivity and improve customer service. Headquartered in Massachusetts, Virtusa has offices in the United States and the United Kingdom, and global delivery centers in Hyderabad and Chennai, India and Colombo, Sri Lanka.

**(2) Unaudited Interim Financial Information**

*Basis of Presentation*

The accompanying unaudited consolidated financial statements included herein have been prepared by Virtusa in accordance with U.S. generally accepted accounting principles and Article 10 of Regulation S-X under the Securities and Exchange Act of 1934, as amended, and should be read in conjunction with the Company's audited consolidated financial statements (and notes thereto) for the fiscal year ended March 31, 2009 included in the Company's Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission, or SEC, on May 29, 2009. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States have been condensed or omitted pursuant to such SEC rules and regulations. In the opinion of the Company's management, all adjustments considered necessary for a fair presentation of the accompanying unaudited consolidated financial statements have been included, and all material adjustments are of a normal and recurring nature. Operating results for the interim periods are not necessarily indicative of results that may be expected to occur for the entire fiscal year. Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. The Company has evaluated all subsequent events through February 3, 2010, the date these financial statements were issued.

*Principles of Consolidation*

The consolidated financial statements reflect the accounts of the Company and its direct and indirect subsidiaries, Virtusa (India) Private Limited, Virtusa Consulting Services Private Limited and Virtusa Software Services Private Limited, each organized and located in India; Virtusa (Private) Limited, organized and located in Sri Lanka; Virtusa UK Limited, organized and located in the United Kingdom; Virtusa Securities Corporation, a Massachusetts securities corporation located in the United States, InSource Holdings Inc., a Connecticut corporation, and InSource, LLC, a Connecticut limited liability company, each located in the United States; and Virtusa International, B.V., organized and operating in the Netherlands. All intercompany transactions and balances have been eliminated in consolidation.

*Use of Estimates*

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including the recoverability of tangible assets, disclosure of contingent assets and liabilities as of

Table of Contents**Virtusa Corporation and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****(Unaudited)****(In thousands, except share and per share amounts)****(2) Unaudited Interim Financial Information (Continued)**

the date of the financial statements, and the reported amounts of revenue and expenses during the reported period. Management reevaluates these estimates on an ongoing basis. The most significant estimates relate to the recognition of revenue and profits based on the percentage of completion method of accounting for fixed-price contracts, share-based compensation, income taxes, including reserves for uncertain tax positions, deferred taxes and liabilities, valuation of financial instruments including derivative contracts and investments, and the valuation of intangibles and variable compensation related to the acquisition of InSource Holdings, Inc. and its subsidiaries. Management bases its estimates on historical experience and on various other factors and assumptions that are believed to be reasonable under the circumstances. The actual amounts may vary from the estimates used in the preparation of the accompanying consolidated financial statements.

Fair Value of Financial Instruments

At December 31, 2009 and March 31, 2009, the carrying amounts of the Company's financial instruments, which included cash and cash equivalents, accounts receivable, unbilled accounts receivable, restricted cash, accounts payable, accrued employee compensation and benefits and other accrued expenses, approximate their fair values due to the short-term nature of the items. In addition, investment securities and derivative instruments are also financial instruments (see Note 6).

**(3) Net Income per Share**

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding for the period, and diluted earnings per share is computed by including common stock equivalents outstanding for the period in the denominator. Unvested awards of share-based payments with non-forfeitable rights to receive dividends or dividend equivalents are considered participating securities for purposes of calculating earnings per share. The following table sets forth the computation of basic and diluted net income per share for the periods set forth below:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
<b>Numerators:</b>				
Net income	\$ 2,932	\$ 6,298	\$ 8,547	\$ 8,439
<b>Denominators:</b>				
Weighted average common shares outstanding	23,335,454	22,549,515	23,078,701	22,852,794
Dilutive effect of employee stock options	816,130	1,019,373	842,760	1,361,766
Dilutive effect of stock appreciation rights	47,089	40,247	50,034	40,247
Weighted average shares diluted	24,198,673	23,609,135	23,971,495	24,254,807
Net income per share basic	\$ 0.13	\$ 0.28	\$ 0.37	\$ 0.37
Net income per share diluted	\$ 0.12	\$ 0.27	\$ 0.36	\$ 0.35

Table of Contents

**Virtusa Corporation and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(Unaudited)**

**(In thousands, except share and per share amounts)**

**(3) Net Income per Share (Continued)**

During the three and nine months ended December 31, 2009, options to purchase 1,237,598 and 1,196,496 shares of common stock, respectively, were excluded from the calculations of diluted earnings per share as their effect would have been anti-dilutive.

During the three and nine months ended December 31, 2008, options to purchase 2,148,453 and 1,165,308 shares of common stock, respectively, were excluded from the calculations of diluted earnings per share as their effect would have been anti-dilutive.

**(4) Acquisition**

On November 4, 2009, the Company acquired all of the issued and outstanding stock of InSource Holdings, Inc., and its subsidiaries pursuant to a stock purchase agreement with InSource and its shareholders ("InSource"). The acquisition was consummated to expand the Company's service offerings in the insurance and health care industries.

The acquisition has been accounted for using the purchase method of accounting. Under the terms of the stock purchase agreement, the purchase price for the acquisition was \$7,250 in cash, subject to post-closing adjustments. Ten percent (10%), or \$725, of the purchase price was subject to a hold back by the Company for a period of 12 months as security for the sellers' indemnification obligations under the stock purchase agreement. This amount is included in restricted cash at December 31, 2009.

The purchase price was subject to adjustment after the closing for up to an additional \$500 in earn-out consideration based on the achievement of certain calendar year and fourth quarter 2009 revenue and operating margin targets. The Company determined the fair value of the contingent consideration on the date of acquisition to be \$400, based on the probability of InSource attaining the specified performance targets. At December 31, 2009, the Company determined that InSource met 100% of the performance targets, resulting in an increase in fair value of the contingent consideration to \$500. The change in fair value of \$100 was recorded to selling, general and administration expenses in the three-month period ended December 31, 2009. The \$500 is expected to be paid by March 31, 2010.

The purchase price was also subject to an adjustment that would reimburse the shareholders if the shareholders' tax burden from a specified tax election made exceeds a pre-determined amount. The Company estimated the fair value of the purchase price adjustment upon acquisition at \$208. There was no change in the fair value at December 31, 2009, which is provisional pending receipt of the final shareholder's tax filing.

In connection with the acquisition, the Company offered employment to all of InSource's employees, including an employment agreement with the founder/president with respect to his continued employment as InSource's president. The Company also established a performance-based cash bonus plan for certain employees of InSource based on the achievement of specified revenue and operating margin targets. The cash bonus plan allows for payment up to \$4,500, a portion of which is contingent on continued employment for the founder/president and the remainder is tied to both continued employment of certain employees and achievement of certain revenue and operating income targets. The cash bonus plan will be accrued over the period ending March 31, 2012 to the extent that it is deemed probable that the

Table of Contents**Virtusa Corporation and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****(Unaudited)****(In thousands, except share and per share amounts)****(4) Acquisition (Continued)**

performance targets will be attained. For the three and nine-month period ended December 31, 2009, \$128 has been recorded to earnings based on the probability of attaining the targets.

The goodwill of \$3,774 arising from the acquisition consists largely of the synergies and expansion of the Company's service offerings in the insurance and health care industries expected from combining the operations of the Company and InSource. The results of the InSource operations have been included in the Company's unaudited consolidated financial statements since the acquisition date. The Company has not furnished pro forma financial information relating to the InSource acquisition because such information is not material to the Company's financial results.

The following table presents the allocation of the acquisition purchase price:

	<b>Amount</b>
<b>Consideration Transferred:</b>	
Cash paid at closing	\$ 6,525
Holdback of 10%	725
Fair value of contingent consideration	400
Fair value of purchase price adjustment	208
Fair value of consideration transferred	7,858
Less cash acquired	(388)
Total purchase price, net of cash acquired	\$ 7,470
Acquisition-related costs	\$ 300
<b>Purchase Price Allocation:</b>	
Cash and cash equivalents	\$ 388
Accounts receivable	1,604
Other current assets	53
Property and equipment	259
Customer relationship and trademark	2,100
Other current liabilities	(320)
Goodwill	3,774
Total purchase price	7,858
Less cash acquired	(388)
Total purchase price, net of cash acquired	\$ 7,470

Table of Contents**Virtusa Corporation and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****(Unaudited)****(In thousands, except share and per share amounts)****(4) Acquisition (Continued)****Intangible Assets**

The following are details of intangible assets acquired from InSource included in other long-term assets at December 31, 2009 and amortization for the three and nine-month period ended December 31, 2009:

	Weighted Average Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortizable intangible assets:				
Customer relationships	7.7	\$ 2,000	\$ 44	\$ 1,956
Trademark	2.0	100	8	92
		\$ 2,100	\$ 52	\$ 2,048

The customer relationships and trademark of InSource are being amortized on a straight-line basis over their estimated useful lives.

**Goodwill**

The following are details of the Company's goodwill balance at December 31, 2009:

	Amount
Balance at April 1, 2009	\$
Goodwill arising from InSource	3,774
Balance at December 31, 2009	\$ 3,774

While performing the annual impairment test of goodwill, Virtusa compares the fair value of the Company's single reporting unit to the carrying amount of all assets and liabilities, including the existing goodwill and intangible assets. Fair value is determined using a discounted cash flow approach based upon the cash flow expected to be generated by the Company. In the case that the fair value of the reporting unit is less than its carrying value, a second step is performed which compares the implied fair value of the reporting unit's goodwill to the carrying value of the goodwill. If the fair value of the goodwill is less than the carrying value, the difference is recorded as an impairment.

The goodwill balance is expected to be deductible for tax purposes.

The Company will continue to evaluate whether events or circumstances have occurred that indicate that the estimated remaining useful life of its long lived assets, including intangible assets, may warrant revision or that the carrying value of these assets may be impaired. Any write downs are treated as permanent reductions in the carrying amount of the assets.

**(5) Investment Securities**

At December 31, 2009 and March 31, 2009, all of the Company's investment securities were classified as available-for-sale or trading and were carried on its balance sheet at their fair market value. A fair market value hierarchy based on three levels of inputs was used to measure each security (see Note 6).



Table of Contents

## Virtusa Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

(Unaudited)

(In thousands, except share and per share amounts)

**(5) Investment Securities (Continued)**

The following is a summary of investment securities at December 31, 2009:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available-for-sale securities:</b>				
Corporate bonds:				
Current	\$ 12,959	\$ 92	\$	\$ 13,051
Non-current	17,291	74	(33)	17,332
Auction-rate securities:				
Non-current	900		(35)	865
Agency and short-term notes:				
Current	2,630	38		2,668
Non-current	4,346	4	(6)	4,344
Municipal bonds:				
Current	1,210	2		1,212
Non-current	1,812		(23)	1,789
Treasury coupons:				
Current	5,082	30		5,112
Non-current	10,478	43	(4)	10,517
Total available-for-sale securities	56,708	283	(101)	56,890
<b>Trading securities:</b>				
Auction-rate securities (current)	5,501	919		6,420
<b>Total investments</b>	<b>\$ 62,209</b>	<b>\$ 1,202</b>	<b>\$ (101)</b>	<b>\$ 63,310</b>

Table of Contents**Virtusa Corporation and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****(Unaudited)****(In thousands, except share and per share amounts)****(5) Investment Securities (Continued)**

The following is a summary of investment securities at March 31, 2009:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available-for-sale securities:</b>				
Corporate bonds:				
Current	\$ 17,428	\$ 84	\$ (70)	\$ 17,442
Non-current	5,032	13	(79)	4,966
Auction-rate securities:				
Non-current	1,000		(96)	904
Medium and short-term notes:				
Current	1,402		(2)	1,400
Non-current	1,006	2		1,008
Euro dollar bonds:				
Current	1,501		(10)	1,491
Non-current	2,663	57		2,720
Treasury coupons:				
Current	3,000			3,000
Non-current	12,391	47	(15)	12,423
Total available-for-sale securities	45,423	203	(272)	45,354
<b>Trading securities:</b>				
Auction-rate securities (non-current)	5,501	532		6,033
<b>Total investments</b>	<b>\$ 50,924</b>	<b>\$ 735</b>	<b>\$ (272)</b>	<b>\$ 51,387</b>

The Company evaluates investments with unrealized losses to determine if the losses are other than temporary. The Company has determined that the gross unrealized losses at December 31, 2009 and March 31, 2009 are temporary. In making this determination, the Company considered the financial condition, credit ratings and near-term prospects of the issuers, the underlying collateral of the investments, the magnitude of the losses as compared to the cost and the length of time the investments have been in an unrealized loss position. Additionally, the Company does not intend to sell such investments, and it is more likely than not the Company will not be required to sell such investments prior to the recovery of its amortized cost basis, except as disclosed in Note 6.



Table of Contents

**Virtusa Corporation and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(Unaudited)**

**(In thousands, except share and per share amounts)**

**(6) Fair Value of Financial Instruments**

The Company uses a framework for measuring fair value under U.S. generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The Company's financial assets and liabilities reflected in the consolidated financial statements at carrying value include marketable securities and other financial instruments which approximate fair value. Fair value for marketable securities is determined using a market approach based on quoted market prices at period end in active markets. The fair value hierarchy is based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

An entity is allowed to elect to record financial assets and financial liabilities at fair value upon their initial recognition on a contract-by-contract basis. In the fiscal year ended March 31, 2009, the Company elected the fair value option to account for the Put Option (as defined and described below) related to certain of the Company's auction-rate securities.

Table of Contents**Virtusa Corporation and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****(Unaudited)****(In thousands, except share and per share amounts)****(6) Fair Value of Financial Instruments (Continued)**

The following table summarizes the Company's financial assets and liabilities measured at fair value on a recurring basis at December 31, 2009:

	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
<b>Cash equivalents:</b>				
Money market mutual funds	\$ 5,963	\$	\$	\$ 5,963
<b>Investments:</b>				
Available-for-sales securities current	22,043			22,043
Available-for-sales securities non-current	33,982		865	34,847
Trading securities current			6,420	6,420
<b>Derivative instruments current &amp; non-current</b>				
		1,304		1,304
<b>Other current assets:</b>				
Put option			255	255
<b>Total assets</b>	<b>\$ 61,988</b>	<b>\$ 1,304</b>	<b>\$ 7,540</b>	<b>\$ 70,832</b>
<b>Liabilities:</b>				
<b>Derivative instruments current &amp; non-current</b>				
	\$	\$ 878	\$	\$ 878
<b>Total liabilities</b>	<b>\$</b>	<b>\$ 878</b>	<b>\$</b>	<b>\$ 878</b>

The Company's investments in auction-rate securities and the related Put Option (as defined and described below) are classified within Level 3 because there are currently no active markets or observable market prices. Therefore, the auction-rate securities and related Put Option were valued primarily based on an income approach using an estimate of future cash flows. The Company has estimated the fair value using a discounted cash flow analysis which considered the following key inputs: (i) the underlying structure and maturity of each security; (ii) the timing of expected future principal and interest payments; and (iii) discount rates that are believed to reflect current market conditions and the relevant risk associated with each security.

Level 3 assets as listed in the table above include auction-rate securities whose underlying assets are generally student loans which are substantially backed by the U.S. federal government. In February 2008, auctions began to fail for these securities and each auction since then has failed. The Company classifies its investment in auction-rate securities as short and long-term investments, reflecting the fact that the Company's auction-rate securities have underlying final maturities of greater than one year and based on the Company's intent and ability to sell the securities within one year. These investments were recorded at fair value at December 31, 2009 and March 31, 2009.

In November 2008, the Company entered into an agreement (the "Agreement") with UBS AG, the investment firm that had sold the Company auction-rate securities at a par value of \$6,675. Under the Agreement, the Company (1) received the right (the "Put Option") to sell these auction-rate securities back to the investment firm at par, at the Company's sole discretion, any time during the period from June 30, 2010 through July 2, 2012, and (2) provided the investment firm the right to purchase these auction-rate securities or sell these securities on the Company's behalf at par any time after the execution of the Agreement through July 2, 2012. The Company anticipates that any future changes in the fair value



Table of Contents**Virtusa Corporation and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****(Unaudited)****(In thousands, except share and per share amounts)****(6) Fair Value of Financial Instruments (Continued)**

of the Put Option will be offset by the changes in the fair value of the related auction-rate securities with no material net impact to the consolidated statement of income. The Company intends to exercise its rights under the Agreement within the next twelve months.

The following table provides a summary of changes in fair value of the Company's Level 3 financial assets at December 31, 2009:

	<b>Level 3 Assets</b>
Balance at April 1, 2009	\$ 7,579
Redemption of auction-rate securities	(100)
Total unrealized gains (losses):	
Included in other accumulated comprehensive income	61
Balance at December 31, 2009	\$ 7,540

**(7) Derivative Financial Instruments**

The Company evaluates its foreign exchange policy on an ongoing basis to assess its ability to address foreign exchange exposures on its balance sheet, income statement and operating cash flows from all foreign currencies, including most significantly the U.K. pound sterling, Indian rupee and Sri Lankan rupee. The Company enters into hedging programs in accordance with its foreign exchange policy (as approved by the Company's audit committee and board of directors) which permits hedging of material, known foreign currency exposures. Currently, the Company maintains three hedging programs, each with varying contract types, duration and purposes. The Company's "Cash Flow Program" is designed to mitigate the impact of volatility in the U.S. dollar equivalent of the Company's Indian rupee denominated expenses over a rolling 24 month period. The Cash Flow Program transactions meet the criteria for hedge accounting as cash flow hedges. The Company's "Balance Sheet Program" involves the use of 30 day derivative instruments designed to mitigate the monthly impact of foreign exchange gains/losses on certain intercompany balances and payments. The Company's "U.K. Revenue and Cost Program" involves the purchase of derivative instruments with maturities of up to 90 days designed to mitigate the impact of foreign exchange on U.K. pound sterling denominated revenue and costs in the quarter in which such instruments are purchased.

Changes in fair value of the designated cash flow hedges for our Cash Flow Program are recorded as a component of accumulated other comprehensive income (loss) ("AOCI"), net of tax until the forecasted hedged transactions occur and are then recognized in the consolidated statement of income. The Company evaluates hedge effectiveness at the time a contract is entered into, as well as on an ongoing basis. If and when hedge relationships are discontinued because the forecasted transaction is deemed probable of not occurring by the end of the originally specified period or within an additional two-month period of time thereafter, any related derivative amounts recorded in equity are reclassified to earnings. There were no gains (losses) that were reclassified from AOCI into earnings as a result of forecasted transactions that were considered probable of not occurring for the three and nine months ended December 31, 2009.

Table of Contents**Virtusa Corporation and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****(Unaudited)****(In thousands, except share and per share amounts)****(7) Derivative Financial Instruments (Continued)**

Changes in the fair value for all other derivative contracts and the ineffective portion of cash flow hedges, if any, are recognized in the same line item as the underlying exposure being hedged. The Company values its derivatives based on market observable inputs including both forward and spot prices for currencies. Any significant change in the forward or spot prices for currencies would have a significant impact on the value of the Company's derivatives.

The Company also uses derivatives not designated as hedging instruments to hedge intercompany balances and certain other revenue and expenses denominated in currencies other than the functional currency. Changes in the fair value of these derivatives purchased under the Balance Sheet Program or the UK Revenue and Cost Program are recognized in the unaudited consolidated statement of income and are included in foreign exchange gains (losses).

The U.S. dollar equivalent market value of all outstanding foreign currency derivative contracts was \$46,267 and \$57,632, as of December 31, 2009 and March 31, 2009, respectively. Unrealized net gains related to these contracts which are expected to be reclassified from AOCI to earnings during the next 12 months were \$279 as of December 31, 2009. At December 31, 2009, the maximum outstanding term of any derivative instruments was 21 months.

The following tables set forth the fair value of derivative instruments included in the consolidated balance sheets at December 31, 2009 and March 31, 2009:

**Derivatives designated as hedging instruments**

	December 31, 2009	March 31, 2009
<b>Foreign currency exchange contracts:</b>		
Other current assets	\$ 1,052	\$ 388
Other long-term assets	\$ 252	\$ 153
Foreign currency derivative contracts, current portion	\$ (773)	\$ (7,614)
Long-term liabilities	\$ (105)	\$ (1,520)

**Derivatives not designated as hedging instruments**

<b>Foreign currency exchange contracts:</b>		
Other current assets	\$	\$ 44
Foreign currency derivative contracts, current portion	\$	\$ (167)

Table of Contents**Virtusa Corporation and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****(Unaudited)****(In thousands, except share and per share amounts)****(7) Derivative Financial Instruments (Continued)**

The following tables set forth the effect of the Company's foreign currency exchange contracts on the consolidated financial statements of the Company for the three and nine months ended December 31, 2009 and 2008:

Derivatives Designated as Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in AOCI on Derivatives (Effective Portion)			
	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Foreign currency exchange contracts	\$ 1,495	\$ (1,069)	\$ 4,892	\$ (11,624)

Location of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)			
	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Costs of revenue	\$ (475)	\$ (1,381)	\$ (2,670)	\$ (2,595)
Operating expenses	\$ (286)	\$ (668)	\$ (1,457)	\$ (1,253)

Derivatives not Designated as Hedging Instruments	Location of Gain Or (Loss) Recognized in Income on Derivatives	Amount of Gain or (Loss) Recognized in Income on Derivatives			
		Three Months Ended December 31,		Nine Months Ended December 31,	
		2009	2008	2009	2008
Foreign currency exchange contracts	Foreign currency transaction gains (losses)	\$ 14	\$ 1,886	\$ (151)	\$ 1,705
	Revenue	\$ (123)	\$ 1,039	\$ (449)	\$ 1,039
	Costs of revenue	\$ 57	\$ (296)	\$ 172	\$ (296)
	Selling, general and administrative expenses	\$ 4	\$ (21)	\$ 43	\$ (21)

**(8) Income Taxes**

Including discrete items, the Company's effective tax rate was 16.3% and 13.0% for the three and nine months ended December 31, 2009, as compared to an effective tax rate of 14.9% and 2.8% for the three and nine months ended December 31, 2008, respectively. This increase is primarily due to the geographic mix of the Company's forecasted taxable profit. The effective income tax rate is based on the estimated composition of income in different jurisdictions for the fiscal year and adjustments, if any, in the unrecognized tax benefits for uncertain income tax positions.

No events have occurred since March 31, 2009 that the Company believes would have a material effect on the total amount of unrecognized tax benefits related to its uncertain income tax positions. No significant changes in the unrecognized tax benefit balance are currently expected in the next twelve months.



Table of Contents**Virtusa Corporation and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****(Unaudited)****(In thousands, except share and per share amounts)****(8) Income Taxes (Continued)**

One of the Company's Indian subsidiaries, Virtusa (India) Private Ltd, or Virtusa India, is an export oriented company under the Indian Income Tax Act of 1961 and is entitled to claim tax exemption for a period of ten consecutive years for each Software Technology Park ("STP") that it operates. Virtusa India currently operates two STPs, in Chennai and in Hyderabad, India. Substantially all of the earnings of both STPs qualify as tax-exempt profits. The Hyderabad STP is set to expire on March 31, 2010 and the Chennai STP is set to sunset on March 31, 2011. Subsequent to March 31, 2011, all STP tax holidays will be phased out and any profits will be fully taxable at the Indian statutory rate, which is currently 33.99%.

In anticipation of the phase-out of the STP holidays, the Company located a portion of its new Indian operations in areas designated as a Special Economic Zone ("SEZ") under the SEZ Act of 2005. The Company's profits from its SEZ operations are eligible for certain additional income tax exemptions for a period of up to 15 years.

In addition, the Company's Sri Lankan subsidiary, Virtusa Private Ltd, is operating under a 12-year income tax holiday arrangement that is set to expire on March 31, 2019 and requires the Company to meet certain new job creation and investment criteria.

**(9) Concentration of Revenue and Assets**

Total revenue is attributed to geographic areas based on location of the client. Net assets represent total assets less total liabilities and are attributed to geographic area based on their location. Geographic information is summarized as follows:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Client revenue:				
North America	\$ 30,441	\$ 31,958	\$ 86,349	\$ 94,067
Europe	10,412	11,937	27,977	34,836
Rest of world	839	1,045	2,231	2,602
Consolidated revenue	\$ 41,692	\$ 44,940	\$ 116,557	\$ 131,505

	December 31, 2009	March 31, 2009
Net assets:		
United States	\$ 119,285	\$ 113,036
India	27,896	18,488
Sri Lanka	7,130	4,195
Europe	20,644	16,867
Consolidated net assets	\$ 174,955	\$ 152,586

During the three months ended December 31, 2009, revenue from four significant clients accounted for 15.6%, 10.6%, 9.0% and 8.7%, respectively, of the Company's consolidated revenue. During the nine months ended December 31, 2009, revenue from these four clients represented 15.5%, 10.7%, 10.9% and





Table of Contents

**Virtusa Corporation and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(Unaudited)**

**(In thousands, except share and per share amounts)**

**(9) Concentration of Revenue and Assets (Continued)**

11.8%, respectively, of the Company's consolidated revenue. During the three months ended December 31, 2008, revenue from three significant clients accounted for 17.6%, 11.9% and 11.2%, respectively, of the Company's consolidated revenue. During the nine months ended December 31, 2008, revenue from these three clients accounted for 19.7%, 11.6% and 9.6%, respectively, of the Company's consolidated revenue.

**(10) Treasury Stock**

In July 2008, the Company adopted a stock repurchase program for the purchase of up to \$15,000 of shares of the Company's outstanding common stock which expired on July 28, 2009. On August 5, 2009, the Company's board of directors approved a new stock repurchase program that authorized the purchase of up to \$15,000 of shares of the Company's outstanding common stock on or prior to August 5, 2010, subject to certain price and other trading restrictions. During the three and nine months ended December 31, 2009, the Company did not purchase any shares of its common stock under this program.

**(11) Debt**

On July 31, 2009, the Company entered into a new \$3,000 credit agreement with RBS Citizens, N.A. ("RBS") and J.P. Morgan Chase Bank, N.A. ("JPM"). The primary purpose of the new credit agreement is to support the Company's foreign currency hedging programs. The agreement contains financial and reporting covenants and limitations.

The Company is currently in compliance with all covenants contained in its credit facility and believes that the credit facility provides sufficient flexibility so that it will remain in compliance with its terms. The Company has a \$346 outstanding letter of credit under the facility to collateralize the Company's office lease in Westborough, MA. In connection with the execution of the new credit facility, the Company terminated its prior \$3,000 amended and restated line of credit agreement.

Beginning in fiscal 2009, the Company's U.K. subsidiary entered into an agreement with a financial institution to sell, without recourse, certain of its European-based accounts receivable balances to such financial institution. During the three and nine-month periods ended December 31, 2009, \$2,280 and \$10,408, respectively, of receivables were sold under the terms of the financing agreement. Fees paid pursuant to this agreement were immaterial during the three and nine-month periods ended December 31, 2009. No amounts were due as of December 31, 2009, but the Company may elect to use this program again in future periods. However, the Company cannot provide any assurances that this or any other financing facilities will be available or used in the future.

**(12) Subsequent Events**

On February 1, 2010, the Company acquired the business and assets of ConVista Consulting, LLC, a Virginia limited liability company ("ConVista"), pursuant to an Asset Purchase Agreement (the "Asset Purchase Agreement") with ConVista and the members of ConVista, dated as of February 1, 2010. ConVista is a U.S.-based, privately-held, market leader in finance transformation specifically focusing on high volume collection, disbursement, claims and billing systems in BFSI. The acquisition of ConVista extends the Company's enterprise application services offerings.

Table of Contents

**Virtusa Corporation and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**(Unaudited)**

**(In thousands, except share and per share amounts)**

**(12) Subsequent Events (Continued)**

The purchase price for the acquisition was approximately \$24,800 in cash, subject to post-closing adjustments. Approximately 10% of the purchase price is subject to a hold back by the Company for a period of 12 months as security for the sellers' indemnification obligations under the Asset Purchase Agreement. The purchase price is subject to adjustment after the closing of up to an additional \$2,000 in earn-out consideration upon the achievement of certain revenue and operating margin targets for the fiscal year ending March 31, 2011.

Under the terms of the Asset Purchase Agreement, the Company agreed to offer employment to substantially all of the employees of ConVista, including certain key employees and the two founders of ConVista, with respect to their continued employment within Virtusa. The Company also established a retention-based cash bonus plan for the employees of ConVista who accept employment with the Company.

With respect to the acquisition, certain required disclosures have been omitted from our Quarterly Report on Form 10-Q for the quarter ended December 31, 2009 because the initial accounting for the business combination is incomplete as of the filing date, due to the acquisition occurring subsequent to the reporting date and near the filing date.

On January 27, 2010, the Company purchased multiple foreign currency forward contracts designed to hedge fluctuation in the Indian rupee against the U.S. dollar and U.K. pound sterling. The U.S. dollar contracts have an aggregate notional amount of approximately 155,481 Indian rupees (approximately \$3,290) and an average settlement rate of 47.26 Indian rupees per U.S. dollar. The U.K. pound sterling contracts have an aggregate notional amount of approximately 38,871 Indian rupees (approximately £510) and have an average settlement rate of 76.16 Indian rupees per U.K. pound sterling. These contracts will expire at various dates during the 24 month period ending on December 31, 2011. The Company has the obligation to settle these contracts based upon the Reserve Bank of India published Indian rupee exchange rates. Based on the U.S. dollar to U.K. pound sterling spot rate on January 27, 2010 of \$1.62 per U.K. pound sterling, the blended weighted average Indian rupee rate associated with both the U.S. dollar and U.K. pound sterling contracts would be approximately 47.23 Indian rupees per U.S. dollar. Because these foreign currency forward contracts are designed to reduce volatility in the Indian rupee exchange rates, they not only reduce the negative impact of a stronger Indian rupee but also reduce the positive impact of a weaker Indian rupee on the Company's Indian rupee denominated expenses.

On January 4, 2010, the Company purchased multiple foreign currency forward contracts designed to hedge fluctuation in the U.K. pound sterling against the U.S. dollar. The contracts have an aggregate notional amount of approximately £1,885 U.K. pound sterling (approximately \$3,015 U.S. dollars) and will expire on various dates during the period ending March 31, 2010. The weighted average U.K. pound sterling rate associated with these contracts is approximately \$1.60 per U.K. pound sterling.

Table of Contents

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion of the financial condition and results of operations of Virtusa Corporation should be read in conjunction with the consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and the audited financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K, which has been filed with the Securities and Exchange Commission, or SEC.*

**Forward Looking Statements**

*The statements contained in this Quarterly Report on Form 10-Q that are not historical facts are forward-looking statements (within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended) that involve risks and uncertainties. Such forward-looking statements may be identified by, among other things, the use of forward-looking terminology such as "believes," "expects," "may," "will," "should" or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties. These forward-looking statements, such as statements regarding anticipated future revenue, contract percentage completions, capital expenditures, management's plans and objectives and other statements regarding matters that are not historical facts, involve predictions. Our actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. There are a number of important factors that could cause our results to differ materially from those indicated by such forward-looking statements, including those factors set forth in Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009. We urge you to consider those risks and uncertainties in evaluating our forward-looking statements. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. Except as otherwise required by the federal securities laws, we disclaim any obligation or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein (or elsewhere) to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.*

**Business overview**

We are a global information technology services company. We use an offshore delivery model to provide a broad range of IT services, including IT consulting, technology implementation and application outsourcing. Using our enhanced global delivery model, innovative platforming approach and industry expertise, we provide cost-effective services that enable our clients to use IT to enhance business performance, accelerate time-to-market, increase productivity and improve customer service. Headquartered in Massachusetts, we have offices in the United States and the United Kingdom and global delivery centers in Hyderabad and Chennai, India and Colombo, Sri Lanka. At December 31, 2009, we had 3,746 employees, or team members.

In our three months ended December 31, 2009, our revenue decreased by 7.2% to \$41.7 million, compared to \$44.9 million in our three months ended December 31, 2008. In our nine months ended December 31, 2009, our revenue decreased by 11.4% to \$116.6 million, compared to \$131.5 million in our nine months ended December 31, 2008. Net income decreased by \$3.4 million to \$2.9 million in our three months ended December 31, 2009, as compared to \$6.3 million in our three months ended December 31, 2008. Net income increased by \$0.1 million to \$8.5 million in our nine months ended December 31, 2009, as compared to \$8.4 million in our nine months ended December 31, 2008.

The decrease in revenue for the three and nine months ended December 31, 2009 primarily resulted from:

Lower revenue contribution from our existing clients, particularly two of our largest clients, and the conclusion of work with certain other clients

## Edgar Filing: VIRTUSA CORP - Form 10-Q

### Table of Contents

The key drivers of our decrease in net income for the three months ended December 31, 2009, as compared to the three months ended December 31, 2008, were as follows:

Lower revenue contributions from existing clients

Foreign exchange losses due to intercompany balances

Increased selling, general and administrative expenses, driven by investments in business development

The key drivers of our increase in net income for the nine months ended December 31, 2009 as compared to the nine months ended December 31, 2008 were as follows:

Decreased costs of revenue, driven by fewer IT professionals and higher utilization

Decreased selling, general and administrative expenses, driven by operational efficiencies

On February 1, 2010, we acquired the business and certain assets of ConVista Consulting, LLC ("ConVista") and the members of ConVista for \$24.8 million in cash, subject to post-closing adjustments, as described in Note 12 to the unaudited consolidated financial statements contained herein.

On November 4, 2009, we acquired all the issued and outstanding stock of InSource Holdings, Inc. ("InSource") and its subsidiaries for \$7.3 million in cash, subject to post-closing adjustments, as described in Note 4 to the unaudited consolidated financial statements contained herein.

High repeat business and client concentration are common in our industry. During our three months ended December 31, 2009, 81% of our revenue was derived from clients who had been using our services for more than one year, as compared to 84% for the three months ended December 31, 2008. During our nine months ended December 31, 2009, 88% of our revenue was derived from clients who had been using our services for more than one year, as compared to 91% for the nine months ended December 31, 2008. Accordingly, our global account management and service delivery teams focus on expanding client relationships and converting new engagements to long-term relationships to generate repeat revenue and expand revenue streams from existing clients. We also have a dedicated business development team focused on generating engagements with new clients to expand our client base and, over time, reduce client concentration. In the three months ended December 31, 2009, recent client additions and expansions, including business acquired from InSource, have comprised a larger percent of our total business.

Our European revenue decreased to \$10.4 million, or 25.0% of total revenue, from \$11.9 million, or 26.6% of total revenue, for the three months ended December 31, 2009 and 2008, respectively. European revenue for the nine months ended December 31, 2009 decreased to \$28.0 million, or 24.0% of total revenue, from \$34.8 million, or 26.5% of total revenue, for the nine months ended December 31, 2008. European revenue was negatively impacted by lower revenue contribution from one of our largest clients, British Telecommunications plc ("British Telecom"). Our European revenue excluding British Telecom declined 3% for the three months ended December 31, 2009 compared to the three months ended December 31, 2008 and increased 10% for the nine months ended December 31, 2009 compared to the nine months ended December 31, 2008.

On October 30, 2009, we amended our five-year Master Services Agreement ("MSA") with British Telecom to extend by one additional year the period by which we are to provide information technology services to British Telecom from March 31, 2012 to March 31, 2013, subject to earlier termination in certain circumstances. The amendment also revised various pricing terms between the parties, including reductions in rates charged and discounts provided by Virtusa UK Limited to British Telecom. The minimum aggregate expenditure commitment by British Telecom remained unchanged over the term of the amended MSA at approximately £102 million. The MSA contains provisions for warranties, insurance, indemnification, liquidated damages and other limitations of liability, and other customary terms and conditions. The MSA may be terminated by British Telecom upon 90 days notice, as well as by either party upon an uncured, material breach of the other party. British Telecom may also terminate without liability

Table of Contents

upon certain changes in control of Virtusa UK Limited. There can be no assurance that we will realize the full amount of those expenditures or that the agreement will not be terminated prior to the end of its term.

We perform our services under both time-and-materials and fixed-price contracts. Revenue from fixed-price contracts represented 18% and 17% of total revenue for the three and nine months ended December 31, 2009, as compared to 27% and 26% of total revenue for the three and nine months ended December 31, 2008, respectively. The decreased revenue earned from fixed-price contracts primarily reflects lower revenue contribution from one client, British Telecom, as fixed-price contracts came to their successful completion.

Our gross profit decreased by \$1.7 million, or 8.7% to \$17.9 million for the three months ended December 31, 2009 as compared to \$19.7 million in the three months ended December 31, 2008, and increased by \$1.0 million, or 2.0%, to \$50.8 million for the nine months ended December 31, 2009 as compared to \$49.8 million in the nine months ended December 31, 2008. The decrease in gross profit during the three months ended December 31, 2009 as compared to the three months ended December 31, 2008 was primarily driven by lower revenue. The increase in gross profit during the nine months ended December 31, 2009 as compared to the nine months ended December 31, 2008 is primarily due to a lower number of IT professionals and higher utilization

As an IT services company, our revenue growth is highly dependent on our ability to attract, develop, motivate and retain skilled IT professionals. We closely monitor our overall attrition rates and patterns to align our people management strategy with our growth objectives. For the twelve months ended December 31, 2009, our attrition rate reflects voluntary and involuntary attrition of 16.3% and 2.9%, respectively. These attrition rates reflect a lower rate of voluntary and involuntary attrition as compared to prior periods. We remain committed to improving our attrition levels. There remains intense competition for IT professionals with the specific domain skills necessary to provide the type of services we offer despite the current economic downturn impacting our industry. If our attrition rate increases or is sustained at higher levels, our growth may slow and our cost of attracting and retaining IT professionals could increase.

We continue to engage in a foreign currency hedging strategy using foreign currency forward contracts designed to hedge fluctuation in the Indian rupee and Sri Lankan Rupee against the U.S. dollar and U.K. pound sterling, as well as the U.K. pound sterling against the U.S. dollar, to reduce the effect of change in these foreign currency exchange rate changes on our foreign operations and intercompany balances. There is no assurance that these hedging programs or hedging contracts will be effective. Because these foreign currency forward contracts are designed to reduce volatility in the Indian rupee and U.K. pound sterling exchange rates, they not only reduce the negative impact of a stronger Indian rupee and weaker U.K. pound sterling but also could reduce the positive impact of a weaker Indian rupee and stronger U.K. pound sterling on our Indian rupee expenses and U.K. pound sterling denominated revenue and expenses. In addition, to the extent that these hedges do not qualify for hedge accounting, we may have to recognize gains or losses on the aggregate amount of hedges placed earlier than expected.

**Application of critical accounting estimates and risks**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates and judgments, in particular, those related to revenue recognition, income taxes, valuation of financial instruments and share-based compensation. Actual amounts could differ significantly from these estimates. Our management bases its estimates and judgments on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets

Table of Contents

and liabilities and the amounts of revenue and expenses that are not readily apparent from other sources. Additional information about these critical accounting policies may be found in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009.

**Results of operations****Three months ended December 31, 2009 compared to the three months ended December 31, 2008**

The following table presents an overview of our results of operations for the three months ended December 31, 2009 and 2008.

(dollars in thousands)	Three Months Ended		\$ Change	% Change
	2009	2008		
Revenue	\$ 41,692	\$ 44,940	\$ (3,248)	(7.2)%
Costs of revenue	23,744	25,286	(1,542)	(6.1)%
Gross profit	17,948	19,654	(1,706)	(8.7)%
Operating expenses	14,549	14,279	270	1.9%
Income from operations	3,399	5,375	(1,976)	(36.8)%
Other income	105	2,030	(1,925)	(94.8)%
Income before income tax expense	3,504	7,405	(3,901)	(52.7)%
Income tax expense	572	1,107	(535)	(48.3)%
Net income	\$ 2,932	\$ 6,298	\$ (3,366)	(53.4)%

**Revenue**

Revenue decreased by 7.2%, or \$3.2 million, from \$44.9 million during the three months ended December 31, 2008 to \$41.7 million in the three months ended December 31, 2009. Revenue from European clients decreased by \$1.5 million as compared to the three months ended December 31, 2008, due primarily to decreased revenue contribution from one client, British Telecom. Revenue from North American clients decreased by \$1.5 million as compared to the three months ended December 31, 2008 due to lower revenue contribution from our existing clients. Revenue from clients existing as of December 31, 2008 decreased in the three months ended December 31, 2009 by \$11.5 million as compared to the three months ended December 31, 2008. Revenue from new clients added since December 31, 2008 was \$7.8 million, or 18.8% of total revenue for the three months ended December 31, 2009. We had 57 active clients as of December 31, 2009 as compared to 54 active clients as of December 31, 2008.

**Costs of revenue**

Costs of revenue decreased from \$25.3 million in the three months ended December 31, 2008 to \$23.7 million in the three months ended December 31, 2009, a decrease of \$1.5 million, or 6.1%. The primary driver of the decrease was a reduction of \$1.9 million in compensation costs for our IT professionals in the three months ended December 31, 2009 as compared to the three months ended December 31, 2008. At December 31, 2009, we had 3,417 IT professionals as compared to 3,767 at December 31, 2008. In addition, in the three months ended December 31, 2009, there were lower hedging losses of \$1.3 million recorded on foreign currency forward contracts as part of our hedging program as compared to the three months ended December 31, 2008. This decrease was offset by an increase in travel cost of \$0.5 million and subcontractor costs of \$1.3 million in the three months ended December 31, 2009 as compared to the three months ended December 31, 2008.

Table of Contents

***Gross profit***

Our gross profit decreased by \$1.7 million, or 8.7%, from \$19.7 million for the three months ended December 31, 2008 as compared to \$17.9 million for the three months ended December 31, 2009 due to lower revenue. As a percentage of revenue, gross profit margin was 43.0% and 43.7% in the three months ended December 31, 2009 and 2008, respectively.

***Operating expenses***

Operating expenses increased from \$14.3 million in the three months ended December 31, 2008 to \$14.5 million in the three months ended December 31, 2009, an increase of \$0.3 million, or 1.9%. The increase in our operating expenses in the three months ended December 31, 2009 was primarily due to increases of \$1.3 million in compensation expenses and \$0.3 in acquisition-related costs. This increase was offset by decreases of \$0.3 million in infrastructure expenses, \$0.4 million in hedging losses and \$0.5 million in professional services received. As a percentage of revenue, our operating expenses increased to 34.9% in the three months ended December 31, 2009 from 31.8% in the three months ended December 31, 2008.

***Income from operations***

Income from operations decreased from \$5.4 million in the three months ended December 31, 2008 to \$3.4 million in the three months ended December 31, 2009. As a percentage of revenue, income from operations decreased from 12.0% in the three months ended December 31, 2008 to 8.2% in the three months ended December 31, 2009, primarily due to lower gross profit and higher operating expenses.

***Other income***

Other income decreased from \$2.0 million in the three months ended December 31, 2008 to \$0.1 million in the three months ended December 31, 2009. This decrease is primarily attributed to a \$0.4 million foreign currency translation loss in the three month ended December 31, 2009 as compared to one-time foreign currency transaction gains of \$1.3 million in the three months ended December 31, 2008.

***Income tax expense***

We had income tax expense of \$0.6 million in the three months ended December 31, 2009 as compared to an income tax expense of \$1.1 million in the three months ended December 31, 2008. Our effective tax rate was 16.3% for the three months ended December 31, 2009, as compared to an effective tax rate of 14.9% for the three months ended December 31, 2008. This increase is primarily due to a change in the geographic mix of our forecasted profit for the fiscal year and our overall level of profitability.

***Net income***

Net income decreased from \$6.3 million in the three months ended December 31, 2008 to \$2.9 million in the three months ended December 31, 2009. This decrease was driven primarily by lower gross profit, higher operating expenses and lower foreign transaction gains during the three months ended December 31, 2009 as compared to the three months ended December 31, 2008.



Table of Contents**Nine months ended December 31, 2009 compared to the nine months ended December 31, 2008**

The following table presents an overview of our results of operations for the nine months ended December 31, 2009 and 2008.

(dollars in thousands)	Nine Months Ended December 31,		\$ Change	% Change
	2009	2008		
Revenue	\$ 116,557	\$ 131,505	\$ (14,948)	(11.4)%
Costs of revenue	65,729	81,698	(15,969)	(19.6)%
Gross profit	50,828	49,807	1,021	2.0%
Operating expenses	41,156	43,732	(2,576)	(5.9)%
Income from operations	9,672	6,075	3,597	59.2%
Other income	149	2,611	(2,462)	(94.3)%
Income before income tax expense	9,821	8,686	1,135	13.1%
Income tax expense	1,274	247	1,027	415.8%
Net income	\$ 8,547	\$ 8,439	\$ 108	1.3%

**Revenue**

Revenue decreased by 11.4%, or \$14.9 million, from \$131.5 million during the nine months ended December 31, 2008 to \$116.6 million in the nine months ended December 31, 2009. Revenue from European clients decreased by \$6.9 million as compared to the nine months ended December 31, 2008, due primarily to decreased revenue contribution from one client, British Telecom. Revenue from North American clients decreased by \$7.7 million as compared to the nine months ended December 31, 2008 due to lower revenue contribution from our existing clients. Revenue from clients existing as of December 31, 2008 decreased in the nine months ended December 31, 2009 by \$29.0 million as compared to the nine months ended December 31, 2008. Revenue from new clients added since December 31, 2008 was \$14.3 million, or 12.3%, of total revenue for the nine months ended December 31, 2009. We had 57 active clients as of December 31, 2009 as compared to 54 active clients as of December 31, 2008.

**Costs of revenue**

Costs of revenue decreased from \$81.7 million in the nine months ended December 31, 2008 to \$65.7 million in the nine months ended December 31, 2009, a decrease of \$16.0 million, or 19.6%. The decrease was primarily attributable to a reduction of \$13.2 million in compensation costs for our IT professionals in the nine months ended December 31, 2009, as compared to the nine months ended December 31, 2008. At December 31, 2009 we had 3,417 IT professionals as compared to 3,767 at December 31, 2008. In addition, there were decreases of \$0.8 million in travel costs, \$0.2 million in subcontractor costs, \$0.5 million in facilities cost, \$0.2 million in share-based compensation and \$0.6 million in hedging losses recorded on foreign currency forward contracts as part of our hedging program in the three months ended December 31, 2009 as compared to the three months ended December 31, 2008.

**Gross profit**

Our gross profit increased by \$1.0 million, or 2.0%, to \$50.8 million for the nine months ended December 31, 2009 as compared to \$49.8 million in the nine months ended December 31, 2008 due to lower costs of revenue and higher utilization of our IT professionals. As a percentage of revenue, gross margin was 43.6% and 37.9% in the nine months ended December 31, 2009 and 2008, respectively.

Table of Contents

***Operating expenses***

Operating expenses decreased from \$43.7 million in the nine months ended December 31, 2008 to \$41.2 million in the nine months ended December 31, 2009, a decrease of \$2.6 million, or 5.9%. The decrease in our operating expenses in the nine months ended December 31, 2009 resulted from decreases of \$1.9 million in infrastructure expenses, \$0.5 million in share based compensation and \$0.8 million in sub-contractors and professional services. This decrease was offset by increases of \$0.5 million in compensation costs and \$0.3 in acquisition costs. As a percentage of revenue, our operating expenses increased from 33.3% in the nine months ended December 31, 2008 to 35.3% in the nine months ended December 31, 2009 due primarily to our increased investment in sales and marketing.

***Income from operations***

Income from operations increased from \$6.1 million in the nine months ended December 31, 2008 to \$9.7 million in the nine months ended December 31, 2009. As a percentage of revenue, income from operations increased from 4.6% in the nine months ended December 31, 2008 to 8.3% in the nine months ended December 31, 2009, primarily due to our higher gross profit as a result of higher utilization.

***Other income***

Other income decreased from \$2.6 million in the nine months ended December 31, 2008 to \$0.1 in the nine months ended December 31, 2009. The decrease is attributed to a decrease in foreign currency translation gains of \$1.7 million and a decrease in interest income of \$0.7 million during the nine month ended December 31, 2009 as compared to nine months ended December 31, 2008.

***Income tax expense***

We had an income tax expense of \$0.2 million in the nine months ended December 31, 2008 compared to an income tax expense of \$1.3 million in the nine months ended December 31, 2009. Our effective tax rate was an income tax rate of 13.0% for the nine months ended December 31, 2009, as compared to an effective tax rate of 2.8% for the nine months ended December 31, 2008. This increase is primarily due to the geographic mix of our forecasted profit.

***Net income***

Net income increased from \$8.4 million in the nine months ended December 31, 2008 to \$8.5 million in the nine months ended December 31, 2009. This slight increase was driven primarily by higher gross profit driven by higher utilization rate and lower operating expenses, despite lower revenue, during the nine months ended December 31, 2009 as compared to the nine months ended December 31, 2008, mainly offset by lower foreign transaction gains and lower interest income.

**Liquidity and capital resources**

We have financed our operations from sales of shares of equity securities, including common stock, and from cash from operations. We have not borrowed against our existing or preceding credit facilities.

On July 31, 2009, we entered into a new \$3.0 million credit agreement with RBS Citizens, N.A. ("RBS") and J.P. Morgan Chase Bank, N.A. ("JPM"). The primary purpose of the new credit agreement is to support our foreign currency hedging programs. The agreement contains financial and reporting covenants and limitations. We have a \$0.3 million outstanding letter of credit under the facility to collateralize our office lease in Westborough. As of December 31, 2009, there are no other amounts outstanding under this credit facility. In connection with the execution of the new credit facility, we terminated our prior \$3.0 million amended and restated line of credit agreement.

In November 2008, we entered into an agreement with UBS AG, the investment firm that had sold us auction-rate securities at a par value of \$6.7 million. Under the agreement, we (1) received the right to sell

Table of Contents

these auction-rate securities back to the investment firm at par, at our sole discretion, any time during the period from June 30, 2010 through July 2, 2012, and (2) gave the investment firm the right to purchase these auction-rate securities or sell these securities on our behalf at par any time after the execution of the agreement through July 2, 2012. We intend to exercise our rights under the agreement within the next twelve months.

Beginning in fiscal 2009, our U.K. subsidiary entered into an agreement with an unrelated financial institution to sell, without recourse, certain of its European-based accounts receivable balances from one client to such financial institution. During the nine months ended December 31, 2009, we sold \$10.4 million of receivables under the terms of the financing agreement. Fees paid pursuant to this agreement were immaterial during the nine months ended December 31, 2009. No amounts were due as of December 31, 2009, but we may elect to use this program again in future periods. However, we cannot provide any assurances that this or any other financing facilities will be available or utilized in the future.

On November 4, 2009, we acquired all of the issued and outstanding stock of InSource for \$7.3 million in cash, subject to post-closing adjustments as described in Note 4 to the unaudited consolidated financial statements contained herein.

On February 1, 2010, we acquired the business and certain assets of ConVista for \$24.8 million in cash, subject to post-closing adjustments, as described in Note 12 to the unaudited consolidated financial statements contained herein.

**Anticipated capital expenditures**

We are constructing a facility as part of a planned campus on a 6.3 acre site in Hyderabad, India. We expect to construct and build out this facility, which will be approximately 340,000 square feet, over the next two fiscal years at a total estimated cost of \$27.6 million, of which we anticipate incurring capital expenditures of approximately \$5.5 million during the fiscal year ending March 31, 2010. Through December 31, 2009, we have incurred \$14.9 million toward the completion of this facility with approximately \$1.0 million incurred during the nine months ended December 31, 2009. Other capital expenditures during the nine months ended December 31, 2009 were approximately \$1.2 million. We expect other capital expenditures in the normal course of business during the remainder of the fiscal year ending March 31, 2010 to be approximately \$0.3 million, primarily for leasehold improvements, capital equipment and purchased software.

**Cash flows**

The following table summarizes our cash flows for the periods presented:

(in thousands)	Nine Months Ended	
	December 31,	
	2009	2008
Net cash provided by operating activities	\$ 18,400	\$ 14,724
Net cash used for investing activities	(17,550)	(8,333)
Net cash provided by (used for) financing activities	1,711	(5,754)
Effect of exchange rate changes on cash	1,106	(2,111)
Net increase (decrease) in cash and cash equivalents	3,667	(1,474)
Cash and cash equivalents, beginning of period	55,698	41,047
Cash and cash equivalents, end of period	\$ 59,365	\$ 39,573

***Net cash provided by operating activities***

Net cash provided by operating activities was \$18.4 million during the nine months ended December 31, 2009 as compared to \$14.7 million during the nine months ended December 31, 2008. This change was

Table of Contents

attributable to an increase in net income of \$0.1 million, a net change in operating assets and liabilities of \$1.6 million, an increase in deferred income taxes of \$0.4 million, an increase of \$1.7 million due to foreign currency transaction gains and an increase in depreciation and amortization of \$0.3 million, which were offset by a decrease in share-based compensation of \$0.5 million during the nine months ended December 31, 2009 as compared to the nine months ended December 31, 2008.

***Net cash used for investing activities***

Net cash used for investing activities was \$17.6 million during the nine months ended December 31, 2009 as compared to \$8.3 million during the nine months ended December 31, 2008. The change was due to the net increase in investment securities of \$11.8 million and \$6.1 million net cash used to pay for the acquisition of InSource during the nine months ended December 31, 2009 as compared to the nine months ended December 31, 2008, offset by the release of restricted cash of \$1.6 million and a decrease in the purchase of property and equipment in the amount of \$7.1 million.

***Net cash provided by (used for) financing activities***

Net cash provided by financing activities was \$1.7 million during the nine months ended December 31, 2009, as compared to \$5.8 million used for financing activities during the nine months ended December 31, 2008. The change is due to the increase in cash provided by stock option exercises of \$1.1 million during the nine months ended December 31, 2009 as compared to the nine months ended December 31, 2008, in addition to the absence of repurchases of our common stock under our stock repurchase program during the nine months ended December 31, 2009 as compared to \$6.3 million used during the nine months ended December 31, 2008.

**Off-balance sheet arrangements**

We do not have investments in special purpose entities or undisclosed borrowings or debt.

We have a foreign currency cash flow hedging program designed to further mitigate the risks of volatility in the Indian rupee against the U.S. dollar and U.K. pound sterling as described below in "Qualitative and Quantitative Disclosures About Market Risk." The program contemplates a partially hedged position of the Indian rupee for a rolling eight quarter period. From time to time, we may also purchase multiple foreign currency forward contracts designed to hedge fluctuation in foreign currencies, such as the U.K. pound sterling, against the U.S. dollar, and multiple foreign currency hedges designed to hedge foreign currency transaction gains and losses on our intercompany balances. Other than these foreign currency derivative contracts, we have not entered into off-balance sheet transactions, arrangements or other relationships with unconsolidated entities or other persons that are likely to affect liquidity or the availability of or requirements for capital resources.

**Recent accounting pronouncements**

In December 2008, the Financial Accounting Standards Board ("FASB") issued guidance to require more detailed disclosures about the fair value measurements of employers' plan assets including (a) investment policies and strategies; (b) major categories of plan assets; (c) information about valuation techniques and inputs to those techniques, including the fair value hierarchy classifications of the major categories of plan assets; (d) the effects of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets; and (e) significant concentrations of risk within plan assets. The disclosures required will be included in our fiscal year ending March 31, 2010 consolidated financial statements. This guidance did not impact our consolidated financial results, but will require certain additional disclosures.

New authoritative accounting guidance requires the acquiring entity in a business combination to recognize and measure all assets and liabilities assumed in the transaction and any non-controlling interest in the acquiree at fair value as of the acquisition date. Such acquisitions will now be treated as business combinations, which will require transaction costs to be expensed as incurred, may generate gains or losses

Table of Contents

due to changes between the effective and closing dates of acquisitions, and will require possible recognition of goodwill given differences between the purchase price and fair value of assets received. The guidance further amends the initial recognition and measurement, subsequent measurement and accounting, and disclosures of assets and liabilities arising from contingencies in a business combination. This authoritative guidance became effective on January 1, 2009.

In April 2009, the FASB issued guidance where, if an entity determines that the level of activity for an asset or liability has significantly decreased and that a transaction is not orderly, further analysis of transactions or quoted prices is needed, and a significant adjustment to the transaction or quoted prices may be necessary to estimate fair value. This guidance is to be applied prospectively and is effective for interim and annual periods ended after June 15, 2009 with early adoption permitted for periods ended after March 15, 2009. We adopted this guidance for our quarter ended June 30, 2009, and it did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued guidance that applies to investments in debt securities for which other-than-temporary impairments may be recorded. If an entity's management asserts that it does not have the intent to sell a debt security and it is more likely than not that it will not have to sell the security before recovery of its cost basis, then an entity may separate other-than-temporary impairments into two components: 1) the amount related to credit losses (recorded in earnings), and 2) all other amounts (recorded in other comprehensive income). This guidance is to be applied prospectively and is effective for interim and annual periods ended after June 15, 2009 with early adoption permitted for periods ended after March 15, 2009. We adopted this guidance for our quarter ended June 30, 2009, and it did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued guidance to require an entity to provide disclosures about fair value of financial instruments in interim financial information. This guidance is to be applied prospectively and is effective for interim and annual periods ended after June 15, 2009 with early adoption permitted for periods ended after March 15, 2009. We adopted this guidance for our quarter ended June 30, 2009, and it did not have a material impact on our consolidated financial statements.

Effective April 1, 2009, we adopted guidance where unvested awards of share-based payments with non-forfeitable rights to receive dividends or dividend equivalents are considered participating securities for purposes of calculating earnings per share. The adoption of this guidance did not have a material impact on our consolidated financial statements.

In May 2009, the FASB issued guidance for disclosing events that occur after the balance sheet date, but before financial statements are issued or available to be issued, which is effective for the Company June 30, 2009. The adoption of this guidance did not have a material impact on our consolidated financial statements.

In June 2009, the FASB issued The FASB Accounting Standards Codification (the "Codification"). The Codification does not alter current U.S. GAAP, but rather integrates existing accounting standards with other authoritative guidance. Under the Codification, there will be a single source of authoritative U.S. GAAP for nongovernmental entities and this will supersede all other previously issued non-SEC accounting and reporting guidance. The Codification is effective for financial statement periods ended after September 15, 2009. The adoption of the Codification did not have a material effect on our financial condition or consolidated results of operations.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Our market risks, and the ways we manage them, are summarized in Item 7A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2009. There have been no material changes in the first nine months of our fiscal year ending March 31, 2010 to such risks or to our management of such risks except for the additional factors noted below.

Table of Contents

**Foreign Currency Exchange Rate Risk**

We are exposed to foreign currency exchange rate risk in the ordinary course of business. We have historically entered into, and in the future we may enter into, foreign currency derivative contracts to minimize the impact of foreign currency fluctuations on both foreign currency denominated assets and forecasted expenses. The purpose of this foreign exchange policy is to protect us from the risk that the recognition of and eventual cash flows related to Indian rupee denominated expenses might be affected by changes in exchange rates. Certain of these contracts meet the criteria for hedge accounting as cash flow hedges.

We evaluate our foreign exchange policy on an ongoing basis to assess our ability to address foreign exchange exposures on our balance sheet, income statement and operating cash flows from all foreign currencies, including most significantly the U.K. pound sterling, Indian rupee, and the Sri Lankan rupee.

We utilize foreign currency hedging programs to mitigate the risks of volatility in the Indian rupee against the U.S. dollar and U.K. pound sterling. The U.S. dollar equivalent market value of the outstanding foreign currency derivative contracts as of December 31, 2009 was \$46.3 million. There is no assurance that these hedging programs or hedging contracts will be effective. Because these foreign currency forward contracts are designed to reduce volatility in the Indian rupee and weaker U.K. pound sterling exchange rates, for example they not only reduce the negative impact of a stronger Indian rupee and U.K. pound sterling but also reduce the positive impact of a weaker Indian rupee and stronger U.K. pound sterling on our Indian rupee expenses and U.K. pound sterling denominated revenue and expenses. In addition, to the extent that these hedges do not qualify for hedge accounting, we may have to recognize gains or losses on the aggregate amount of hedges placed earlier than expected.

Historically the volatility in the U.K. pound sterling has had, and may continue to have, a negative impact on our revenue generated in U.K. pound sterling. In response to this volatility, we have entered into hedging transactions designed to hedge our forecasted revenue and expenses denominated in the U.K. pound sterling. The derivative contracts are less than 90 days in duration and do not meet the criteria for hedge accounting. Such hedges may not be effective in mitigating this currency volatility.

**Interest Rate Risk**

We had no debt outstanding at December 31, 2009. We do not believe we are exposed to material direct risks associated with changes in interest rates other than with our cash and cash equivalents, short-term investments and long-term investments. As of December 31, 2009, we had \$122.7 million in cash and cash equivalents, short-term investments and long-term investments, the interest income from which is affected by changes in interest rates. Our invested securities primarily consist of government sponsored entity bonds, money market mutual funds, commercial paper, corporate debts, municipal bonds and auction-rate securities. Our investments in debt securities are classified as either "available-for-sale" or "trading" and are recorded at fair value. Our "available-for-sale" and "trading" investments are sensitive to changes in interest rates. Interest rate changes would result in a change in the net fair value of these financial instruments due to the difference between the market interest rate and the market interest rate at the date of purchase of the financial instrument.

**Concentration of credit risk**

Financial instruments which potentially expose us to concentrations of credit risk primarily consist of cash and cash equivalents, short-term investments and long-term investments, accounts receivable, derivative contracts, other financial assets and unbilled accounts receivable. We place our operating cash, investments and derivatives in highly-rated financial institutions. We adhere to a formal investment policy with the primary objective of preservation of principal, which contains credit rating minimums and diversification requirements. We believe that our credit policies reflect normal industry terms and business risk. We do not anticipate non-performance by the counterparties and, accordingly, do not require collateral. Credit

Table of Contents

losses and write-offs of accounts receivable balances have historically not been material to our financial statements and have not exceeded our expectations.

In recent periods, financial markets in the United States, Europe and Asia experienced extreme disruption, including, among other things, extreme volatility in security prices, severely diminished liquidity and credit availability, rating downgrades of certain investments and declining valuations of others. While we do not currently require access to credit markets to finance our operations, these economic developments affect our clients in a number of ways. The tightening of credit in financial markets adversely affects the ability of our clients to obtain financing for their operations and could result in decreased global IT spending which, in turn, could result in delays, reductions in, or cancellation of engagements for our services. Regional and global economic weakness and uncertainty have also resulted in some companies reassessing their spending for technology and IT related projects and services. We are unable to predict the likely duration and severity of the recent disruption in financial markets and adverse economic conditions in the United States and other countries. Our revenue and profitability depend on the overall demand for IT services from our clients, including discretionary IT spending. As a result of the worldwide economic slowdown, it is difficult for us to forecast future revenue growth based on historical information and trends. Portions of our expenses are fixed and other expenses are tied to expected levels of utilization. To the extent that we do not achieve anticipated level of revenue growth, our gross profit and net income could be adversely affected until such expenses are reduced to an appropriate level.

**Item 4. Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of December 31, 2009, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) and internal controls over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective at that reasonable assurance level in (i) enabling us to record, process, summarize and report information required to be included in our periodic SEC filings within the required time period and (ii) ensuring that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

We have not made any changes in our internal control over financial reporting during the three and nine months ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

**PART II. OTHER INFORMATION**

**Item 1A. Risk Factors**

We operate in a rapidly changing environment that involves a number of risks that could materially affect our business, financial condition or future results, some of which are beyond our control. In addition to the other information set forth in this quarterly report on Form 10-Q, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009, as filed with the Securities and Exchange Commission, or SEC, on May 29, 2009 (the "Annual Report"), which could materially affect our business, financial condition or future results. There are no material changes to the risk factors described in our Annual Report.

**Item 2. Unregistered Sale of Equity Securities and Use of Proceeds**

On July 28, 2008, our board of directors authorized a share repurchase program of up to \$15 million of shares of our common stock which expired on July 28, 2009. On August 5, 2009, our board of directors approved a new stock repurchase program that authorized the purchase of up to \$15 million of shares of our outstanding common stock on or prior to August 5, 2010, subject to certain price and other trading restrictions. During the three and nine months ended December 31, 2009, we did not repurchase any shares of our common stock.

On August 8, 2007, we completed our initial public offering ("IPO") of 4,400,000 shares of common stock at a public offering price of \$14.00 per share which we offered for sale pursuant to a registration statement on Form S-1 as amended (File No. 333-141952), declared effective by the SEC on August 2, 2007. Net proceeds of the IPO were approximately \$52.8 million. We continue to use a portion of the net proceeds from our IPO to fund the construction and build-out of a new facility on our campus in Hyderabad, India, of which we have spent approximately \$14.9 million as of December 31, 2009 and plan to spend approximately \$13.7 million during our fiscal years ending March 31, 2010, 2011 and 2012. We also used a portion of our net proceeds to fund the acquisition of InSource. The balance of the net proceeds from our IPO will be used for working capital and other general corporate purposes.

Under the terms of our 2007 Stock Option and Incentive Plan, or 2007 Plan, we have issued shares of restricted stock to our employees. On the date that these restricted shares vest, we automatically withhold, via a net exercise provision pursuant to our applicable restricted stock agreements and the 2007 Plan, the number of vested shares (based on the closing price of our common stock on such vesting date) equal to the tax liability owed by such grantee. The shares withheld from the grantees to settle their tax liability are reallocated to the number of shares available for issuance under the 2007 Plan. For the nine-month period ended December 31, 2009, we withheld an aggregate of 7,236 shares of restricted stock at a price of \$9.03 per share.



Table of Contents

**Item 6. Exhibits.**

The following is a list of exhibits filed as part of this quarterly report on Form 10-Q:

<b>Exhibit No.</b>	<b>Description</b>
10.1	Stock Purchase Agreement by and among Registrant, InSource Holdings, Inc, David Shalaby and Michelle Shalaby, dated as of November 4, 2009 (previously filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed November 5, 2009, and incorporated herein by reference).
10.2*	Amendment No. 06 to the Contract for the Provision of IT Services by and between Registrant and British Telecommunications plc, dated as of October 30, 2009.
31.1*	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of principal financial and accounting officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of principal executive officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. 1350.
32.2**	Certification of principal financial and accounting officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. 1350.

---

Confidential treatment has been requested for certain provisions of this Exhibit.

\*

Filed herewith.

\*\*

Furnished herewith. This certification shall not be deemed filed for any purpose, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act of 1934.

Table of Contents

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Virtusa Corporation

Date: February 3, 2010

By: /s/ KRIS CANEKERATNE

---

Kris Canekeratne,  
*Chairman and Chief Executive Officer*  
*(Principal Executive Officer)*

Date: February 3, 2010

By: /s/ RANJAN KALIA

---

Ranjan Kalia,  
*Senior Vice President, Finance*  
*and Chief Financial Officer*  
*(Principal Financial and Accounting Officer)*

Table of Contents

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
10.1	Stock Purchase Agreement by and among Registrant, InSource Holdings, Inc, David Shalaby and Michelle Shalaby, dated as of November 4, 2009 (previously filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed November 5, 2009, and incorporated herein by reference).
10.2*	Amendment No. 06 to the Contract for the Provision of IT Services by and between Registrant and British Telecommunications plc, dated as of October 30, 2009.
31.1*	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of principal financial and accounting officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of principal executive officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. 1350.
32.2**	Certification of principal financial and accounting officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. 1350.

---

Confidential treatment has been requested for certain provisions of this Exhibit.

\*

Filed herewith.

\*\*

Furnished herewith. This certification shall not be deemed filed for any purpose, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act of 1934.