

## Demand For Indian Techies Powers A New Contender

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Virtusa Corp.  
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Lead underwriter: JPMorgan (NYSE:JPM PRH) (NYSE:JPM PRX) (NYSE:JPM PRK) (NYSE:JPM PRJ) (NYSE:JPT) (NYSE:JPM)  
Offering price: \$14-\$16  
Expected date: week of July 30  
Ticker: VRTU

### THE BUZZ

Second-quarter results are in for most offshore technology consultants, such as Infosys INFY, Cognizant (NASDAQ:CTSH) CTSH and Wipro WIT. Despite some foreign-exchange worries, most analysts like what they see.

"Demand trends for offshore IT work are still quite good," said Joseph Vafi, who covers the sector for Jefferies (NYSE:JEF) & Co. "Every (company) showed nice sequential growth."

That could buoy the IPO of Virtusa, a U.S.-based company which provides 80% of its services from India.

Virtusa is tiny compared to the industry's leaders, but it's gaining fast. Revenue has grown at a compound annual rate of 50% over the last five years, thanks to large client wins such as British Telecom BT and Aetna (NYSE:AEF) (NYSE:AET) AET.

In the road show, Chief Executive Kris Canekeratne said the company is leading the way as the offshore industry increasingly offers value over simple cost-saving. Vafi agrees that that's essential to competing in today's environment.

"I don't believe that, industry-wide, we would have witnessed such growth rates if (offshoring) were purely a cost-cutting play," he said.

### THE COMPANY

The company was founded in 1996 as Technology Providers. It adopted the name Virtusa in 2002.

Most of the client base is in communications, finance or technology. About three-quarters are in North America and the rest hail from Europe. Notable customers include IBM (NYSE:IBM) IBM, ING Group (NYSE:ING) ING, JPMorgan Chase JPM and Pegasystems (NASDAQ:PEGA) PEGA.

Virtusa provides a range of services covering all phases of the planning, implementation and management of a client's IT systems. About 20% of the services are provided on-site through the Massachusetts and British offices, with the rest delivered from the firm's centers in India and Sri

Lanka. Currently, Virtusa leases all its Asian offices, but funds from the IPO will go toward building its own center in a free-enterprise zone in Hyderabad, India.

In the road show, Canekeratne emphasized the firm's "platforming" approach as a key differentiator from its rivals. Instead of developing totally different systems for different markets or business segments, Virtusa uses a single proprietary platform across the board that it can adapt to different needs.

This flexibility helps the company add more services once it gets hold of a client. This in turn helps keep a high rate of retention. According to the prospectus, some 84% of current revenue comes from clients who've been on board for at least two years.

### **RISKS/CHALLENGES**

Despite strong industry fundamentals, analysts worry about the growing value of the rupee, India's currency. That caused Infosys, for instance, to trim its outlook for the year.

"Most of these companies get paid in dollars or pounds or euros, but they pay their programmers in rupees," said Vafi. "The appreciation of the rupee has affected margins."

Add to that the fact that the industry's growth also has driven up Indian programmers' salaries in absolute terms. This has encouraged a fairly high rate of attrition as well.

Nearly half of Virtusa's revenue comes from its top five clients. In the most recent year, 23% came from British Telecom alone. The firm will need to diversify to shield itself from sudden client losses.

Some of Virtusa's rivals are very, very big. On top of those already mentioned, the firm goes head to head with Accenture (NYSE:ACN) ACN, Electronic Data Systems EDS, BearingPoint BE and its own client, IBM.

Virtusa has made liberal use of stock options for its employees. The company warns that it may have been required to register as a reporting company as early as 2003, although it did not actually do so until it filed to go public. After researching the subject, the firm cut its options program in July 2005. Still, if the Securities and Exchange Commission decides to come down on it, this could bring fines and penalties.

### **THE RESULTS**

Revenue jumped 69% in the fiscal year ended March 31, reaching \$124.7 million. Net income multiplied nearly 10 times to \$1.03 a share.

### **USE OF PROCEEDS**

Virtusa is selling a modest 4.4 million shares, which should net the firm about \$57 million. The company will sink \$30 million into the Hyderabad project and the rest into general corporate uses.



## THE MANAGEMENT

**Krishan Canekeratne** - Chief executive and chairman

Co-founded the company and has been chairman since its inception. He served as CEO for the first year of Virtusa's existence, but then ceded leadership when he founded eDocs, now part of Oracle ORCL. He took up the reins at Virtusa again in 2000. Previously, he also founded INSCI. He holds a B.S. in computer science from Syracuse University.

**Danford Smith** - President and chief operating officer

Joined in 2004 from Cognizant, where he was a general manager. He was a partner at CSC Consulting from 1990 to 1998. Holds an M.B.A. from Rutgers University.

**Thomas Holler** - Executive vice president and chief financial officer

Joined in 2001 from Cerulean Technology, now part of Aether Systems. Holds an M.B.A. from Northeastern University.

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