

VIRTUSA CORP
Form 10-Q
February 12, 2008

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**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, 2007

☐ **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

7371

(Primary Standard Industrial

04-3512883

*(I.R.S. Employer Identification
Number)*

Incorporation or Organization)

Classification Code 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 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 Act. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer <input type="checkbox"/> | Accelerated filer <input type="checkbox"/> | Non-accelerated filer <input checked="" type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/> |
|---|---|---|---|

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 11, 2008:

| Class | Number of Shares |
|---|-------------------------|
| Common Stock, par value \$.01 per share | 22,888,019 |

**Virtusa Corporation and Subsidiaries
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Virtusa Corporation and Subsidiaries
Consolidated Balance Sheets (Unaudited)

| (In thousands, except share and per share amounts) | December 31, 2007 | March 31, 2007 |
|---|-------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 45,022 | \$ 45,079 |
| Short-term investments | 50,399 | |
| Accounts receivable, net of allowance of \$568 and \$420 at December 31, 2007 and March 31, 2007, respectively | 27,027 | 28,588 |
| Unbilled accounts receivable | 5,569 | 2,422 |
| Prepaid expenses | 7,494 | 5,266 |
| Deferred income taxes | 791 | 3,094 |
| Other current assets | 1,803 | 1,567 |
| Total current assets | 138,105 | 86,016 |
| Property and equipment, net | 14,666 | 7,541 |
| Long-term investments | 12,154 | 41 |
| Restricted cash | 1,748 | 1,588 |
| Deferred income taxes | 3,440 | 1,946 |
| Other long-term assets | 770 | 2,187 |
| Total assets | \$ 170,883 | \$ 99,319 |
| Liabilities, Redeemable Convertible Preferred Stock and Stockholders Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 2,036 | \$ 4,414 |
| Accrued employee compensation and benefits | 8,136 | 6,949 |
| Accrued expenses - other | 6,111 | 4,596 |
| Deferred revenue | 866 | 877 |
| Income taxes payable | 1,466 | 928 |
| Accrued liabilities - stock appreciation rights | | 1,170 |
| Total current liabilities | 18,615 | 18,934 |
| Long-term liabilities | 1,550 | 264 |
| Total liabilities | 20,165 | 19,198 |
| Redeemable convertible preferred stock, at accreted redemption value: | | |
| Series A redeemable convertible preferred stock, \$0.01 par value. Authorized, issued and outstanding zero and 4,043,582 shares at liquidation preference at December 31, 2007 and March 31, 2007, respectively | | 13,500 |
| Series B redeemable convertible preferred stock, \$0.01 par value. Authorized zero and 8,749,900 shares at December 31, 2007 and March 31, 2007, respectively; | | 15,132 |

| | | |
|--|--|--------|
| issued and outstanding zero and 8,647,043 shares at liquidation preference at December 31, 2007 and March 31, 2007, respectively | | |
| Series C redeemable convertible preferred stock, \$0.01 par value. Authorized, issued and outstanding zero and 12,807,624 shares at liquidation preference at December 31, 2007 and March 31, 2007, respectively | | 12,230 |
| Series D redeemable convertible preferred stock, \$0.01 par value. Authorized, issued and outstanding zero and 7,458,494 shares at liquidation preference at December 31, 2007 and March 31, 2007, respectively | | 20,000 |
| Total redeemable convertible preferred stock | | 60,862 |

Commitments and guarantees

Stockholders' equity:

| | | |
|---|------------|-----------|
| Undesignated preferred stock, \$0.01 par value; Authorized 5,000,000 and 29,016,038 shares at December 31, 2007 and March 31, 2007, respectively; issued zero shares at December 31, 2007 and March 31, 2007 | | |
| Common stock, \$0.01 par value; Authorized 120,000,000 and 80,000,000 shares at December 31, 2007 and March 31, 2007, respectively; issued 23,306,972 and 7,420,646 shares at December 31, 2007 and March 31, 2007, respectively; outstanding 22,887,407 and 7,001,081 shares at December 31, 2007 and March 31, 2007, respectively | 233 | 74 |
| Treasury stock, 419,565 common shares, at cost | (442) | (442) |
| Additional paid-in capital | 136,193 | 19,205 |
| Accumulated earnings | 13,169 | 752 |
| Accumulated other comprehensive income (loss) | 1,565 | (330) |
| Total stockholders' equity | 150,718 | 19,259 |
| Total liabilities, redeemable convertible preferred stock and stockholders' equity | \$ 170,883 | \$ 99,319 |

See accompanying notes to unaudited consolidated financial statements

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Virtusa Corporation and Subsidiaries
Consolidated Statements of Operations and Other Comprehensive Income
(Unaudited)

| (In thousands, except per share amounts) | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|--|------------------------------------|-----------|-----------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| Revenue | \$ 42,455 | \$ 33,673 | \$ 120,158 | \$ 89,388 |
| Costs of revenue | 23,307 | 18,360 | 67,943 | 48,630 |
| Gross profit | 19,148 | 15,313 | 52,215 | 40,758 |
| Operating expenses: | | | | |
| Selling, general and administrative expenses | 13,281 | 11,244 | 38,451 | 30,690 |
| Income from operations | 5,867 | 4,069 | 13,764 | 10,068 |
| Other income (expense): | | | | |
| Interest income, net | 1,216 | 301 | 2,644 | 849 |
| Foreign currency transaction gains (losses) | (123) | 34 | (559) | 460 |
| Other, net | 3 | (47) | 1 | (103) |
| Total other income | 1,096 | 288 | 2,086 | 1,206 |
| Income before income tax expense | 6,963 | 4,357 | 15,850 | 11,274 |
| Income tax expense (benefit) | 1,706 | (4,317) | 3,338 | (4,081) |
| Net income | \$ 5,257 | \$ 8,674 | \$ 12,512 | \$ 15,355 |
| Net income per share of common stock | | | | |
| Basic | \$ 0.23 | \$ 0.50 | \$ 0.60 | \$ 0.88 |
| Diluted | \$ 0.21 | \$ 0.47 | \$ 0.55 | \$ 0.84 |
| Comprehensive income: | | | | |
| Net income | \$ 5,257 | \$ 8,674 | \$ 12,512 | \$ 15,355 |
| Foreign currency translation adjustments | 364 | 429 | 1,711 | 144 |
| Unrealized gain on available-for-sale securities | 87 | | 39 | |
| Unrealized gain (loss) on effective cash flow hedges | (40) | | 186 | |
| Unrecognized actuarial gain (loss) on pension plans | 4 | | (41) | |
| Total comprehensive income | \$ 5,672 | \$ 9,103 | \$ 14,407 | \$ 15,499 |

See accompanying notes to unaudited consolidated financial statements

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

| (In thousands) | Nine Months Ended December 31, | |
|---|---------------------------------------|-------------|
| | 2007 | 2006 |
| Cash flows provided by operating activities: | | |
| Net income | \$ 12,512 | \$ 15,355 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 2,861 | 2,381 |
| Share-based compensation expense | 2,221 | 2,210 |
| Gain on disposal of property and equipment | (14) | (7) |
| Mark to market for liability classified warrants | | 108 |
| Deferred income taxes, net | 826 | (4,956) |
| Net changes in operating assets and liabilities: | | |
| Accounts receivable, net | (360) | (10,579) |
| Prepaid expenses and other current assets | (1,878) | (1,515) |
| Other assets | (694) | (9) |
| Accounts payable | (2,707) | (254) |
| Accrued employee compensation and benefits | 906 | 1,046 |
| Accrued expenses other | 1,401 | 1,100 |
| Deferred revenue | (28) | 171 |
| Income taxes payable | 1,052 | 460 |
| Other long-term liabilities | 500 | (37) |
| Net cash provided by operating activities | 16,598 | 5,474 |
| Cash flows used/provided by for investing activities: | | |
| Proceeds from sale of equity investment | | 466 |
| Purchase of short-term investments | (56,638) | |
| Proceeds from sale or maturity of short-term investments | 11,256 | |
| Purchase of long-term investments | (17,131) | |
| Proceeds from sale or maturity of long-term investments | 41 | |
| Purchase of property and equipment | (9,082) | (4,423) |
| Additions to internally-developed software costs | (32) | (151) |
| Proceeds from sale of property and equipment | 30 | 7 |
| Increase in restricted cash | (63) | (74) |
| Net cash used for investing activities | (71,619) | (4,175) |
| Cash flows used/ provided by financing activities: | | |
| Proceeds from sale of common stock | 61,600 | 452 |
| Net proceeds from exercise of common stock options | 33 | 38 |
| Stock offering costs | (6,948) | |
| Principal payments on capital lease obligation | (8) | (29) |

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| | | |
|--|-----------|-----------|
| Net cash provided by financing activities | \$ 54,677 | \$ 461 |
| Effect of exchange rate changes on cash and cash equivalents | 287 | 199 |
| Net increase (decrease) in cash and cash equivalents | (57) | 1,959 |
| Cash and cash equivalents, beginning of period | 45,079 | 30,237 |
| Cash and cash equivalents, end of period | \$ 45,022 | \$ 32,196 |

See accompanying notes to unaudited consolidated financial statements

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**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. The Company uses an offshore delivery model to provide a broad range of information technology, or IT, services, including IT consulting, technology implementation and application outsourcing. Using its enhanced global delivery model, innovative platforming approach and industry expertise, the Company provides cost-effective services that enable its clients to accelerate time to market, improve service and enhance productivity. 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.

The Company completed an initial public offering, or IPO, of its common stock on August 8, 2007. In connection with the Company's IPO, the Company issued and sold 4,400,000 shares of common stock at a public offering price of \$14.00 per share. The Company received net proceeds of \$52,910 after deducting underwriting discounts and commissions of \$4,312 and offering costs of \$4,378. Upon the closing of the IPO, all shares of redeemable convertible preferred stock automatically converted into 11,425,786 shares of the Company's common stock.

(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 consolidated financial statements (and notes thereto) for the fiscal year ended March 31, 2007 included in the Company's Registration Statement on Form S-1, as amended (File No. 333-141952), which was declared effective by the Securities and Exchange Commission, or SEC, on August 2, 2007. 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 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.

Reverse Stock-Split

On July 18, 2007, the Company effected a one-for-3.13 reverse stock split of its common stock. All impacted amounts included in the consolidated financial statements and notes thereto have been retroactively adjusted for the reverse stock split. Impacted amounts include shares of common stock outstanding, share issuances, shares underlying stock options, stock appreciation rights and warrants, shares reserved and net income per share.

Basis of Consolidation

The consolidated financial statements reflect the accounts of the Company and its subsidiaries: Virtusa (India) Private Limited, organized and located in India, Virtusa (Private) Limited, organized and located in Sri Lanka, Virtusa UK Limited, organized and located in the United Kingdom, and Virtusa Securities Corporation, a Massachusetts securities corporation located in the United States. 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

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the recoverability of tangible assets, disclosure of contingent assets and liabilities as of 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, income taxes and related deferred tax assets and liabilities and share based compensation. Management bases its estimates on historical experience and on various other 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.

(3) Net Income per Share

Prior to the Company's IPO, the Company calculated net income per share in accordance with SFAS No. 128, *Earnings per Share* (SFAS No. 128) and EITF Issue No. 03-6, *Participating Securities and the Two-Class Method under FASB Statement 128* (EITF No. 03-6). EITF No. 03-6 clarifies the use of the two-class method for the computation of earnings per share by companies with participating securities or multiple classes of common stock. The Company's series A, B, C and D redeemable convertible preferred stock were participating securities due to their participation rights related to cash dividends declared by the Company. When determining basic earnings per share under EITF No. 03-6, undistributed earnings for a period are allocated to a participating security based on the contractual participation rights of the security to share in those earnings as if all of the earnings for the period had been distributed. Net losses are not allocated to preferred stockholders.

Basic earnings per share for the three and nine months ended December 31, 2006 have been calculated using the two class method. Basic earnings per share is computed by dividing the net income available to common stockholders by the weighted average common shares outstanding. The net income available to common stockholders is calculated by deducting dividends allocable to the Company's redeemable convertible preferred stock from net income. There have been no dividends to common or redeemable convertible preferred stock for any of the periods presented. Diluted net income per share is computed giving effect to all potentially dilutive common stock, including stock options, stock appreciation rights, warrants, and all convertible securities to the extent they are dilutive.

Subsequent to the IPO for the three and nine months ended December 31, 2007, 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. 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, | |
|---|--|------------------------|---|----------------------|
| | 2007 | 2006 | 2007 | 2006 |
| Numerators: | | | | |
| Net income | \$ 5,257 | \$ 8,674 | \$ 12,512 | \$ 15,355 |
| Net income allocated to participating redeemable convertible preferred stockholders | | 5,669 | | 10,081 |
| Net income available to common stockholders | \$ 5,257 | \$ 3,005 | \$ 12,512 | \$ 5,274 |
| Denominators: | | | | |
| Weighted average common shares outstanding | 22,845,259 1,957,879 | 6,055,475 1,147,730 | 20,850,875 1,852,643 | 5,978,600 779,731 |

| | | | | |
|--|------------|------------|------------|------------|
| Dilutive effect of employee stock options and warrants | | | | |
| Dilutive effect of stock appreciation rights | 121,275 | | 121,275 | |
| Dilutive effect of redeemable convertible preferred shares | | 11,425,786 | | 11,425,786 |
| Weighted average shares-Diluted | 24,924,413 | 18,628,991 | 22,824,793 | 18,184,117 |
| Net income per share-Basic | \$ 0.23 | \$ 0.50 | \$ 0.60 | \$ 0.88 |
| Net income per share-Diluted | \$ 0.21 | \$ 0.47 | \$ 0.55 | \$ 0.84 |

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During the three and nine months ended December 31, 2007, options to purchase approximately 321,608 and 202,639 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, 2006, options to purchase 293,259 and 1,006,486 shares of common stock, respectively, were excluded from the calculations of diluted earnings per share as their effect would have been anti-dilutive.

(4) Investments

The Company classifies all debt securities with readily determinable market values as available for sale in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. These securities are classified as short-term investments and long-term investments on the consolidated balance sheet and are carried at fair market value. Any unrealized gains and losses on these securities are reported as other comprehensive income (loss) as a separate component of stockholders' equity unless the decline in value is deemed to be other-than-temporary, in which case, investments are written down to fair value and the loss is charged to the consolidated statement of operations. Short-term investments are those with original maturities of more than three months at the date of purchase and less than one year from the date of the balance sheet. Long-term investments are those with maturities of more than one year from the date of the balance sheet.

The following is a summary of short-term and long-term investments:

| | December 31, 2007 | March 31, 2007 |
|-------------------------------------|----------------------------------|-------------------------------|
| Short-term investments | | |
| Available-for-sale securities: | | |
| Auction rate securities | \$ 15,050 | \$ |
| Commercial paper | 17,177 | |
| Corporate bonds | 10,476 | |
| Other | 5,596 | |
| Total available-for-sale securities | 48,299 | |
| Time deposits | 2,100 | |
| Total short-term investments | \$ 50,399 | \$ |
| Long-term investments | | |
| Available-for-sale securities: | | |
| Corporate bonds | \$ 9,948 | \$ |
| Other | 2,206 | 41 |
| Total long-term investments | \$ 12,154 | \$ 41 |

Table of Contents**(5) Property and Equipment**

Property and equipment and their estimated useful lives in years consist of the following:

| | Estimated useful life (years) | December 31, 2007 | March 31, 2007 |
|--|---|----------------------------------|-------------------------------|
| Computer equipment | 3 | \$ 19,600 | \$ 16,446 |
| Furniture and fixtures | 7 | 1,944 | 2,005 |
| Vehicles | 4 | 268 | 299 |
| Software | 3 | 3,657 | 2,835 |
| | Lesser of estimated useful life or lease term | | |
| Leasehold improvements | | 1,312 | 438 |
| Capital work-in-progress | | 6,933 | 1,039 |
| | | 33,714 | 23,062 |
| Less accumulated depreciation and amortization | | 19,048 | 15,521 |
| Property and equipment, net | | \$ 14,666 | \$ 7,541 |

Depreciation and amortization expense was \$1,001 and \$910 for the three months ended December 31, 2007 and 2006, respectively, and \$2,861 and \$2,381 for the nine months ended December 31, 2007 and 2006, respectively. Capital work-in-progress represents advances paid towards the acquisition of property and equipment and the cost of property and equipment not put to use before the balance sheet date.

(6) Income Taxes

The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of SFAS No. 109* (FIN 48), on April 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing a minimum recognition threshold for a tax position taken or expected to be taken in a tax return that is required to be met before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The cumulative effect of adopting FIN 48 of \$94 was recorded as a reduction to opening retained earnings and an increase to long-term liabilities. The total amount of unrecognized tax benefits as of the date of adoption was \$1,260, of which the entire amount would reduce income tax expense and the effective income tax rate if recognized. There have been no changes to the unrecognized tax benefit balance during the three and nine months ended December 31, 2007. No significant changes in the unrecognized tax benefit balance are expected in the next twelve months.

The Company continues to classify accrued interest and penalties related to unrecognized tax benefits in income tax expense. At April 1, 2007, the Company had \$152 and \$49 accrued for interest and penalties relating to certain tax matters in India and United States, respectively.

Currently, the Company is under income tax examination in India. The Company does not believe that the outcome of any examination will have a material effect on its consolidated financial statements. The Company's major taxing jurisdictions include the United States, United Kingdom, India, and Sri Lanka. With few exceptions, the Company remains subject to examination for all years after 2000.

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The Company's effective tax rate was 24.5% and 21.1% for the three and nine months ended December 31, 2007, respectively, which is computed at the statutory federal, state and foreign tax rates without the benefit of previously recognized net operating losses, as compared to an income tax (benefit) rate of (99.1)% and (36.2)% for the three and nine months ended December 31, 2006, respectively. The Company recognized the benefit of all of its deferred tax assets during the fiscal year ended March 31, 2007, when the Company released its valuation allowance.

Table of Contents**(7) Post-Retirement Benefits**

The Company has noncontributory defined benefit plans (the Benefit Plans) covering its employees in India and Sri Lanka as mandated by the Indian and Sri Lankan governments. The Benefit Plans provide for a lump-sum payment to eligible employees at retirement, death, incapacitation or on termination of employment, of an amount based on the respective employee's salary and tenure of employment. Furthermore, India's gratuity rules only allow a maximum of approximately \$9 of gratuity payable to an employee.

The effect on the Company's consolidated statement of operations of the Benefit Plans is summarized in the following table:

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|---|--|-------------|---|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| Service cost | \$ 60 | \$ 31 | \$ 176 | \$ 86 |
| Interest cost on projected benefit obligation | 14 | 7 | 41 | 20 |
| Expected return on plan assets | (8) | | (24) | |
| Recognized net actuarial loss | 3 | | 10 | |
| Net periodic pension expense | \$ 69 | \$ 38 | \$ 203 | \$ 106 |

During the nine months ended December 31, 2007, the Company has contributed \$425 and \$302 to the Benefit Plans in India and Sri Lanka, respectively, which approximate the unfunded status of the respective plans as of December 31, 2007. The Company expects to contribute approximately \$90 to the Benefit Plan in India over the balance of the fiscal year ending March 31, 2008.

(8) Derivative Financial Instruments

The Company enters into foreign currency derivative contracts to mitigate the risk of changes in foreign exchange rates on inter-company transactions and forecasted transactions denominated in foreign currencies, particularly between the Indian rupee and the U.S. dollar and the U.K. pound sterling. The notional principal amounts of these foreign currency derivative contracts as of December 31, 2007 and 2006 were \$11,753 and \$0 respectively. Certain of these transactions entered into subsequent to June 30, 2007 meet the criteria for hedge accounting as cash flow hedges pursuant to SFAS No.133, *Accounting for Derivative Instruments and Hedging Activities*. Changes in the fair values of these hedges are deferred and recorded as a component of accumulated other comprehensive income until the hedged transactions occur and are then recognized in the consolidated statements of operations. In connection with the cash flow hedges, the Company has recorded an unrealized gain of \$186 as a component of accumulated other comprehensive income within stockholders' equity as of December 31, 2007. The Company also enters into foreign currency derivative contracts to mitigate the risk of changes in foreign exchange rates which did not meet the criteria for hedge accounting as cash flow hedges. Changes in the fair value for derivative contracts not designated as hedges and the ineffective portion of derivatives designated as cash flow hedges are recognized in the consolidated statements of operations.

Foreign currency (gains) losses on settlement of foreign currency derivative contracts were (\$158) and (\$89) during the three months ended December 31, 2007 and 2006, respectively, and (\$141) and \$202 during the nine months ended December 31, 2007 and 2006, respectively.

Table of Contents**(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, | |
|----------------------|--|-------------|---|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| Client revenue: | | | | |
| North America | \$ 29,085 | \$ 24,007 | \$ 83,438 | \$ 67,377 |
| Europe | 13,056 | 9,559 | 36,232 | 21,622 |
| Rest of the world | 314 | 107 | 488 | 389 |
| Consolidated revenue | \$ 42,455 | \$ 33,673 | \$ 120,158 | \$ 89,388 |

| | December 31, 2007 | March 31, 2007 |
|-------------------------|----------------------------------|---------------------------|
| Net assets: | | |
| United States | \$ 118,367 | \$ 58,848 |
| India | 12,608 | 6,681 |
| Sri Lanka | 5,623 | 2,128 |
| United Kingdom | 14,120 | 12,464 |
| Consolidated net assets | \$ 150,718 | \$ 80,121 |

During the three and nine months ended December 31, 2007, sales to one significant client accounted for 26.6% and 26.2%, respectively of the Company's consolidated revenue.

(10) Subsequent Events

On January 31, 2008, the Company purchased from two banking institutions multiple foreign currency forward contracts designed to hedge fluctuation in the Indian rupee against the U.S. dollar and U.K. pound sterling. The contracts have an aggregate notional amount of approximately 2.9 billion Indian rupees (approximately \$73.4 million) and will settle on a monthly basis over a 21 month period ending December 31, 2009. The Company has the obligation to settle these contracts based upon the Reserve Bank of India published Indian rupee exchange rates. The approximate weighted average Indian rupee rate associated with these contracts is 39.56.

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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 Registration Statement on Form S-1, as amended (File No. 333-141952), which was declared effective by the Securities and Exchange Commission, or SEC, on August 2, 2007.

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, 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, 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 Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2007, filed with the SEC on September 7, 2007. 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.

Initial Public Offering

We completed an initial public offering, or IPO, of our common stock on August 8, 2007. In connection with our IPO, we issued and sold 4,400,000 shares of common stock at a public offering price of \$14.00 per share. We received net proceeds of \$52.9 million, after deducting underwriting discounts and commissions of \$4.3 million and offering costs of \$4.4 million. Upon the closing of the IPO, all shares of redeemable convertible preferred stock automatically converted into 11,425,786 shares of our common stock.

Business overview

We are a global information technology services company. We use an offshore delivery model to provide a broad range of information technology, or 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. We have over 4,100 employees, or team members, and for the nine months ended December 31, 2007 we had revenue of \$120.2 million and income from operations of \$13.8 million.

We have a high level of repeat business among our clients and a significant portion of our revenue comes from a limited number of clients. For instance, during each of the three and nine months ended December 31, 2007, 95% of our revenues, came from clients to whom we had been providing services for at least one year, and during the three and nine months ended December 31, 2006, 98% and 97%, of our revenues, respectively, came from clients to whom we had been providing services for at least one year. Our ten largest clients accounted for 76% of our revenues for each of the three and nine months ended December 31, 2007, and 75% and 71% of our revenue for the three and nine months ended December 31, 2006, respectively. We expect to continue to realize high levels of repeat business. Client concentration is expected to decline as we grow, but we believe will remain high as a percentage of our revenue.

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High repeat business and client concentration is common in our industry. 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 continue to expand our client base and, over time, reduce client concentration.

We perform our services under both time-and-materials and fixed-price contracts. Revenue from fixed-price contracts was 21.8% and 19.4% of our total revenue as compared to 20.0% and 13.1% for the three and nine months ended December 31, 2007 and 2006, respectively. The increased revenue earned from fixed-price contracts reflects our clients' preferences to enter into fixed-price engagements. Our enhanced global delivery model leverages a highly-efficient onsite-to-offshore service delivery mix and proprietary tools and processes to manage and accelerate delivery, foster innovation and promote continual improvement. Our global service delivery teams work seamlessly at our client locations and at our global delivery centers in India and Sri Lanka to provide value-added services rapidly and cost-effectively. They do this by using our enhanced global delivery model, which we manage approximately to a 20/80 onsite-to-offshore service delivery mix.

As an IT services company, our revenue growth has and will continue to be highly dependent on our ability to attract, develop, motivate and retain skilled IT professionals. We closely monitor our overall attrition rates and patterns to ensure our people management strategy aligns with our growth objectives. Our attrition rate was 19.8% on a trailing twelve month basis as of December 31, 2007. There is intense competition for IT professionals with the skills necessary to provide the type of services that we offer. If our attrition rate increases and is sustained at higher levels, our growth may slow and our cost of hiring and retaining IT professionals could increase.

We expect that a majority of our revenue will continue to be generated in the U.S. dollar and U.K. pound sterling for the foreseeable future and that a significant portion of our expenses, including personnel costs, as well as capital and operating expenditures, will continue to be denominated in Indian and Sri Lankan rupees. The exchange rates among the Indian and Sri Lankan rupees and the U.S. dollar and the U.K. pound sterling have changed substantially in recent years, and continued fluctuations are likely to affect our operating results. For instance, the exchange rate for the Indian rupee to the U.S. dollar and U.K. pound sterling decreased from 43.4417 and 85.2552 on March 31, 2007 to 39.4350 and 78.7639 on December 31, 2007, respectively. This appreciation of the Indian rupee against the U.S. dollar and the U.K. pound sterling since March 31, 2007 has had a negative impact on our earnings and margins, and any continued appreciation is likely to have a negative impact on future earnings and margins. In response to these fluctuations in exchange rates between the Indian rupee and both the U.S. dollar and the U.K. pound sterling, respectively, we have implemented a foreign exchange hedging program using foreign currency derivative contracts.

Application of critical accounting estimates and risks

Our consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP. Preparation of these financial statements requires us to make estimates and assumptions that affect the reported amount of revenue and expenses, assets and liabilities and the disclosure of contingent assets and liabilities. We consider an accounting estimate to be critical to the preparation of our financial statements when both of the following are present:

- the estimate is complex in nature or requires a high degree of judgment; and

- the use of different estimates and assumptions could have a material impact on the consolidated financial statements

We have discussed the development and selection of our critical accounting estimates and related disclosures with the audit committee of our board of directors. Those estimates critical to the preparation of our consolidated financial statements are listed below.

Table of Contents**Revenue recognition**

Our revenue is derived from a variety of IT consulting, technology implementation and application outsourcing services. Our services are performed under both time-and-material and fixed-price arrangements. All revenue is recognized pursuant to GAAP. Revenue is recognized as work is performed and amounts are earned in accordance with the SEC Staff Accounting Bulletin, or SAB, No. 101, *Revenue Recognition in Financial Statements*, as amended by SAB No. 104, *Revenue Recognition*. We consider amounts to be earned once evidence of an arrangement has been obtained, services are delivered, fees are fixed or determinable and collectability is reasonably assured. For contracts with fees billed on a time-and-materials basis, we generally recognize revenue over the period of performance. Fixed-price engagements are accounted for under the percentage-of-completion method in accordance with the American Institute of Certified Public Accountants Statement of Position, or SOP, 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Under the percentage-of-completion method, we estimate the percentage-of-completion by comparing the actual number of work days performed to date to the estimated total number of days required to complete each engagement. The use of the percentage-of-completion method requires significant judgment relative to estimating total contract revenue and costs to completion, including assumptions and estimates relative to the length of time to complete the project, the nature and complexity of the work to be performed and anticipated changes in other engagement-related costs. Estimates of total contract revenue and costs to completion are continually monitored during the term of the contract and are subject to revision as the contract progresses. Unforeseen circumstances may arise during an engagement requiring us to revise our original estimates and may cause the estimated profitability to decrease. When revisions in estimated contract revenue and efforts are determined, such adjustments are recorded in the period in which they are first identified.

Income taxes

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations in multiple jurisdictions. We record liabilities for estimated tax obligations in the United States and other tax jurisdictions. Determining the consolidated provision for income tax expense, tax reserves, deferred tax assets and liabilities and related valuation allowance, if any, involves judgment. We calculate and provide for income taxes in each of the jurisdictions in which we operate, including India, Sri Lanka, the United States and the United Kingdom, and this can involve complex issues which require an extended period of time to resolve. In the year of any such resolution, additional adjustments may need to be recorded that result in increases or decreases to income. Our overall effective tax rate fluctuates due to a variety of factors, including arm's-length prices for our intercompany transactions, changes in the geographic mix or estimated level of annual pretax income, as well as newly enacted tax legislation in each of the jurisdictions in which we operate.

Applicable transfer pricing regulations require that transactions between and among our subsidiaries be conducted at an arm's-length price. On an ongoing basis we estimate appropriate arm's-length prices and use such estimates for our intercompany transactions.

At each financial statement date we evaluate whether a valuation allowance is needed to reduce our deferred tax assets to the amount that is more likely than not to be realized. This evaluation considers the weight of all available evidence, including both future taxable income and ongoing prudent and feasible tax planning strategies. In the event that we determine that we will not be able to realize a recognized deferred tax asset in the future, an adjustment to the valuation allowance would be made resulting in a decrease in income in the period such determination was made. Likewise, should we determine that we will be able to realize all or part of an unrecognized deferred tax asset in the future, an adjustment to the valuation allowance would be made resulting in an increase to income (or equity in the case of excess stock option tax benefits).

We have benefited from long-term income tax holiday arrangements in both India and Sri Lanka. Our Indian subsidiary is an export-oriented company that is entitled to claim a tax exemption for a period of ten years for each Software Technology Park, or STP, it operates. All of our STP holidays will be completely phased out by March 2009 and, at that time, any profits could be fully taxable at the Indian statutory rate, which is currently 34%. Although we believe we have complied with, and are eligible for, the STP holidays, it is possible that upon

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examination the government of India may deem us ineligible for the STP holidays or make adjustments to the profit level. In anticipation of the phase-out of the STP holidays, we intend to locate at least a portion of our Indian operations in areas designated as Special Economic Zones, or SEZs, to secure additional tax exemptions for a period of ten years, which could extend to 15 years if we meet certain reinvestment requirements. Our Sri Lankan subsidiary has been granted an income tax holiday by the Sri Lanka Board of Investment which expires on March 31, 2019. The tax holiday is contingent upon a certain level of job creation during a given timetable. Any inability to meet the agreed upon level or timetable for new job creation would jeopardize this holiday arrangement. Primarily as a result of these tax holiday arrangements, our worldwide profit has been subject to a relatively low effective tax rate, and the loss of any of these arrangements would increase our overall effective tax rate.

It is our intent to reinvest all accumulated earnings from India and Sri Lanka back into their respective operations to fund growth. As a component of this strategy, pursuant to Accounting Principles Board Opinion No. 23, *Accounting for Income Taxes-Special Areas*, we do not accrue incremental U.S. taxes on Indian or Sri Lanka earnings as these earnings are considered to be permanently or indefinitely reinvested outside of the United States. If such earnings were to be repatriated in the future or are no longer deemed to be indefinitely reinvested, we will accrue the applicable amount of taxes associated with such earnings, which would increase our overall effective tax rate.

Share-based compensation

Under the fair value recognition provisions of Statement of Financial Accounting Standards, or SFAS, No. 123R, *Share-Based Payment* (SFAS No. 123R), share-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of share-based awards at the grant date requires judgment, including estimating the expected term of stock based awards and the expected volatility of our stock. In addition, judgment is also required in estimating the income tax benefits related to the share-based awards and the amount of stock-based awards that are expected to be forfeited. If actual results differ significantly from our estimates, share-based compensation expense and our results of operations could be materially impacted.

We established a stock appreciation rights plan, or SAR Plan, during the fiscal year ended March 31, 2006. Prior to our IPO, under the terms of the SAR Plan, all stock appreciation rights, or SARs, were settled in cash and the compensation cost and future liability for these SARs were determined using the fair value at the grant date and remeasuring the fair value of the vested SARs at the close of each reporting period. After our IPO, we are obligated under the SAR Plan to settle all SARs in shares of our common stock. Therefore, the SARs are now equity classified and are no longer remeasured. The liability measured as of the IPO date was \$1.4 million and this amount has been reclassified as a component of additional paid in capital subsequent to the IPO.

Since April 1, 2007, we have been obligated to pay a fringe benefit tax related to the exercise of stock options and certain SARs by our employees in India. The amount of such tax was immaterial for the three and nine months ended December 31, 2007.

Table of Contents**Results of operations****Three months ended December 31, 2007 compared to the three months ended December 31, 2006**

The following table presents an overview of our results of operations for the three months ended December 31, 2007 and 2006.

| (dollars in thousands) | Three Months Ended December 31, | | \$ | % |
|----------------------------------|------------------------------------|-----------|------------|---------|
| | 2007 | 2006 | Change | Change |
| Revenue | \$ 42,455 | \$ 33,673 | \$ 8,782 | 26.1% |
| Costs of revenue | 23,307 | 18,360 | 4,947 | 26.9 |
| Gross profit | 19,148 | 15,313 | 3,835 | 25.0 |
| Operating expenses | 13,281 | 11,244 | 2,037 | 18.1 |
| Income from operations | 5,867 | 4,069 | 1,798 | 44.2 |
| Other income | 1,096 | 288 | 808 | 280.6 |
| Income before income tax expense | 6,963 | 4,357 | 2,606 | 59.8 |
| Income tax expense (benefit) | 1,706 | (4,317) | 6,023 | (139.5) |
| Net income | \$ 5,257 | \$ 8,674 | \$ (3,417) | (39.4)% |

Revenue

Revenue increased from \$33.7 million in the three months ended December 31, 2006 to \$42.5 million in the three months ended December 31, 2007, representing an increase of \$8.8 million, or 26.1%. This revenue increase was driven by continued, strong demand for our services. Billable days increased approximately 32% over this comparative time period contributing approximately \$9.0 million to the revenue increase. During the three months ended December 31, 2006, we experienced a higher percentage of on-site consulting services in Europe at higher average realized billing rates as compared to the services performed by us during the three months ended December 31, 2007. This increase in on-site consulting services offset the revenue increase in the three months ended December 31, 2007 by approximately \$1.0 million. In addition, the strengthening of the U.K. pound sterling against the U.S. dollar during the three months ended December 31, 2007 as compared to the three months ended December 31, 2006, contributed \$0.8 million to the revenue increase. Our top ten clients in the three months ended December 31, 2007 and 2006 accounted for 76% and 75% of our revenue, respectively. North America revenue increased 22.3%, from \$24.0 million in the three months ended December 31, 2006 to \$29.1 million in the three months ended December 31, 2007. Europe revenue increased 36.6%, from \$9.6 million in the three months ended December 31, 2006 to \$13.1 million in the three months ended December 31, 2007, due to significant growth in revenue from one of our clients.

Costs of revenue

Costs of revenue increased from \$18.4 million in the three months ended December 31, 2006 to \$23.3 million in the three months ended December 31, 2007, an increase of \$4.9 million, or 26.9%. A significant portion of the increase was attributable to an increase in the number of our IT professionals to support revenue growth, from 3,170 as of December 31, 2006 to 3,862 as of December 31, 2007, resulting in additional compensation costs of \$4.1 million. Wage increases in India and Sri Lanka during the three months ended December 31, 2007 added \$0.5 million to our costs of revenue as compared to the three months ended December 31, 2006. The net effects of a weaker U.S. dollar against the Indian rupee during the three months ended December 31, 2007 as compared to the three months ended December 31, 2006 also increased our costs of revenue by approximately \$1.0 million, which was partially offset by

the gain recorded as a result of the movement between the U.S. dollar and the Indian rupee relative to our hedged positions. These increases were partially offset by a decrease in share-based compensation expense of \$0.3 million and a decrease in subcontractors costs of \$0.5 million in the three months ended December 31, 2007 as compared to the three months ended December 31, 2006.

Table of Contents***Gross profit***

Our gross profit increased from \$15.3 million in the three months ended December 31, 2006 to \$19.1 million in the three months ended December 31, 2007, an increase of \$3.8 million, or 25.0%. As a percentage of revenue, gross margin was 45.5% in the three months ended December 31, 2006 and 45.1% in the three months ended December 31, 2007.

Operating expenses

Operating expenses increased from \$11.2 million in the three months ended December 31, 2006 to \$13.3 million in the three months ended December 31, 2007, an increase of \$2.0 million, or 18.1%. The increase in our operating expenses in absolute dollars is primarily due to the growth in our headcount in non-IT professionals resulting in an increase of \$0.7 million in compensation and benefit costs, \$0.1 million in share-based compensation expense and an additional \$0.9 million in infrastructure expenses. The net effects of a weaker U.S. dollar against the Indian rupee during the three months ended December 31, 2007, as compared to the three months ended December 31, 2006, also increased our operating expenses by approximately \$0.5 million, which was partially offset by the gain recorded as a result of the movement between the U.S. dollar and the Indian rupee relative to our hedged positions. These increases in operating expenses were partially offset by a decrease in our costs of professional services provided by outside accounting and legal firms, consulting firms and administrative consultants by \$0.3 million during the three months ended December 31, 2007 as compared to the three months ended December 31, 2006.

Income from operations

Income from operations increased from \$4.1 million in the three months ended December 31, 2006 to \$5.9 million in the three months ended December 31, 2007, an increase of \$1.8 million or 44.2%. This increase in income from operations resulted from higher overall gross profit and lower operating expenses as a percentage of revenue. As a percentage of revenue, income from operations increased from 12.1% in the three months ended December 31, 2006 to 13.8%, in the three months ended December 31, 2007, primarily due to our lower operating expenses as a percentage of revenue.

Other income

Other income increased from \$0.3 million in the three months ended December 31, 2006 to \$1.1 million in the three months ended December 31, 2007. The increase was primarily attributable to an increase in interest income by \$0.9 million in the three months ended December 31, 2007 due to an increase in average cash and cash equivalents and our investment balances when compared to the three months ended December 31, 2006. We expect the recent decreases in short-term interest rates to have a negative effect on interest rates earned on cash and cash equivalents and our investment balances in future periods.

Income tax expense

We had income tax benefit of \$4.3 million in the three months ended December 31, 2006 compared to income tax expense of \$1.7 million in the three months ended December 31, 2007. Our effective tax rate was an income tax (benefit) rate of (99.1)% for the three months ended December 31, 2006, which is largely due to the recognition of a discrete income tax benefit of approximately \$5.0 million due to the reversal of our deferred tax asset valuation allowance in our statement of operations during the three months ended December 31, 2006, as compared to an effective tax rate of 24.5% for the three months ended December 31, 2007, with an annualized effective tax rate of approximately 21%, which was computed at the statutory federal, state and foreign tax rates without the benefit of previously recognized net operating losses.

Table of Contents***Net income***

Net income decreased from \$8.7 million in the three months ended December 31, 2006 to \$5.3 million in the three months ended December 31, 2007. This decrease was driven primarily by the recognition of a discrete income tax benefit due to the reversal of our deferred tax valuation allowance during the three months ended December 31, 2006, and an increase in our effective tax rate for the comparative period, partially offset by an increase in income from operations and interest income during the three months ended December 31, 2007.

Nine months ended December 31, 2007 compared to the nine months ended December 31, 2006

The following table presents an overview of our results of operations for the nine months ended December 31, 2007 and 2006.

| | Nine Months Ended December 31, | | | % |
|----------------------------------|---|-------------|------------------|---------------|
| (dollars in thousands) | 2007 | 2006 | \$ Change | Change |
| Revenue | \$ 120,158 | \$ 89,388 | \$ 30,770 | 34.4% |
| Costs of revenue | 67,943 | 48,630 | 19,313 | 39.7 |
| Gross profit | 52,215 | 40,758 | 11,457 | 28.1 |
| Operating expenses | 38,451 | 30,690 | 7,761 | 25.3 |
| Income from operations | 13,764 | 10,068 | 3,696 | 36.7 |
| Other income | 2,086 | 1,206 | 880 | 73.0 |
| Income before income tax expense | 15,850 | 11,274 | 4,576 | 40.6 |
| Income tax expense (benefit) | 3,338 | (4,081) | 7,419 | (181.8) |
| Net income | \$ 12,512 | \$ 15,355 | \$ (2,843) | (18.5)% |

Revenue

Revenue increased from \$89.4 million in the nine months ended December 31, 2006 to \$120.2 million in the nine months ended December 31, 2007, representing an increase of \$30.8 million, or 34.4%. This revenue increase was driven by continued, strong demand for our services. Billable days increased approximately 39% over this comparative time period contributing approximately \$26.5 million to the revenue increase, while an increase in our average realized billing rate per consultant contributed approximately \$0.9 million to the revenue increase. The increase in our reimbursable expenses also contributed \$0.8 million of the total revenue increase. In addition, the strengthening of the U.K. pound sterling against the U.S. dollar during the nine months ended December 31, 2007 as compared to the nine months ended December 31, 2006, contributed \$2.6 million to the revenue increase. Our top ten clients in the nine months ended December 31, 2007 and 2006 accounted for 76% and 71% of our revenue, respectively. North America revenue increased 24.5%, from \$67.4 million in the nine months ended December 31, 2006 to \$83.4 million in the nine months ended December 31, 2007. Europe revenue increased 67.6%, from \$21.6 million in the nine months ended December 31, 2006 to \$36.2 million in the nine months ended December 31, 2007, due to significant growth in revenue from one of our clients.

Costs of revenue

Costs of revenue increased from \$48.6 million in the nine months ended December 31, 2006 to \$67.9 million in the nine months ended December 31, 2007, an increase of \$19.3 million, or 39.7%. A significant portion of the increase was attributable to an increase in the number of our IT professionals to support revenue growth, from 3,170 as of December 31, 2006 to 3,862 as of December 31, 2007, resulting in additional compensation costs of \$15.5 million and travel costs of \$0.7 million. Wage increases in India and Sri Lanka during the nine months ended December 31, 2007

added \$1.7 million to our costs of revenue as compared to the nine months ended December 31, 2006. The net effects of a weaker U.S. dollar against the Indian rupee during the nine months ended December 31, 2007 as compared to the nine months ended December 31, 2006, also increased our costs of revenue by approximately \$2.5 million, which was partially offset by the gain recorded as a result of the movement between the U.S. dollar and the Indian rupee relative to our hedged positions. These increases were partially offset by a decrease in subcontractors costs of \$0.5 million, decrease in share-based compensation expense of \$0.4 million, and a decrease in recruitment costs of \$0.4 million in the nine months ended December 31, 2007 as compared to the nine months ended December 31, 2006.

Table of Contents***Gross profit***

Our gross profit increased from \$40.8 million in the nine months ended December 31, 2006 to \$52.2 million in the nine months ended December 31, 2007, an increase of \$11.5 million, or 28.1%. As a percentage of revenue, gross margin decreased from 45.6% in the nine months ended December 31, 2006 to 43.5% in the nine months ended December 31, 2007. The decrease in gross margin as a percentage of revenue is primarily the result of the wage increases in India and Sri Lanka and the strengthening of the Indian rupee against the U.S. dollar.

Operating expenses

Operating expenses increased from \$30.7 million in the nine months ended December 31, 2006 to \$38.5 million in the nine months ended December 31, 2007, an increase of \$7.8 million, or 25.3%. The increase in our operating expenses in absolute dollars is primarily due to the growth in our overall headcount resulting in an increase of \$2.9 million in compensation and benefit costs, \$0.4 million in share-based compensation expense and an additional \$3.2 million in infrastructure expenses. In addition, operating expenses during the nine months ended December 31, 2007 increased by \$0.4 million with respect to the incremental non-payroll costs associated with being a public company. The net effects of a weaker U.S. dollar against the Indian rupee during the nine months ended December 31, 2007, as compared to the nine months ended December 31, 2006, also increased our operating expenses by approximately \$1.4 million, which was partially offset by the gain recorded as a result of the movement between the U.S. dollar and the Indian rupee relative to our hedged positions. These increases in operating expenses were partially offset by a decrease in our costs of professional services provided by outside accounting and legal firms, consulting firms and administrative consultants by \$0.5 million during the nine months ended December 31, 2007 as compared to the nine months ended December 31, 2006.

Income from operations

Income from operations increased from \$10.1 million in the nine months ended December 31, 2006 to \$13.8 million in the nine months ended December 31, 2007, an increase of \$3.7 million or 36.7%. This increase in income from operations resulted from higher overall gross profit and lower operating expenses as a percentage of revenue. As a percentage of revenue, income from operations increased marginally from 11.3% in the nine months ended December 31, 2006 to 11.5%, in the nine months ended December 31, 2007, primarily due to our lower operating expenses as a percentage of revenue, partially offset by a decline in gross margin as a percentage of revenue.

Other income

Other income increased from \$1.2 million in the nine months ended December 31, 2006 to \$2.1 million in the nine months ended December 31, 2007. The increase was primarily attributable to an increase in interest income by \$1.8 million in the nine months ended December 31, 2007 due to an increase in average cash and cash equivalents and our investment balances when compared to the nine months ended December 31, 2006, partially offset by the increase in foreign currency transaction losses of \$1.0 million, due to the effects of a weaker U.S. dollar against the Indian rupee. We expect the recent decreases in short-term interest rates to have a negative effect on interest rates earned on cash and cash equivalents and our investment balances in future periods.

Income tax expense

We had income tax benefit of \$4.1 million in the nine months ended December 31, 2006 compared to income tax expense of \$3.3 million in the nine months ended December 31, 2007. Our effective tax rate was an income tax

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(benefit) rate of (36.2)% for the nine months ended December 31, 2006, which was largely due to the recognition of a discrete income tax benefit of approximately \$5.0 million due to the reversal of our deferred tax asset valuation allowance in our statement of operations during the nine months ended December 31, 2006, as compared to an effective tax rate of 21.1% for the nine months ended December 31, 2007 which was computed at the statutory federal, state and foreign tax rates without the benefit of previously recognized net operating losses.

Net income

Net income decreased from \$15.4 million in the nine months ended December 31, 2006 to \$12.5 million in the nine months ended December 31, 2007. This decrease was driven primarily by the recognition of a discrete income tax benefit due to the reversal of our deferred tax valuation allowance during the nine months ended December 31, 2006, and an increase in our effective tax rate for the comparative periods, partially offset by an increase in income from operations and interest income during the nine months ended December 31, 2007.

Liquidity and capital resources

We completed an IPO of our common stock on August 8, 2007. In connection with our IPO, we issued and sold 4,400,000 shares of common stock at a public offering price of \$14.00 per share. We received net proceeds of \$52.9 million after deducting underwriting discounts and commissions of \$4.3 million and offering costs of \$4.4 million.

We have financed our operations primarily from sales of shares of equity securities, including preferred and common stock and from cash from operations. We have not borrowed against our available credit facilities.

As of December 31, 2007, we had cash and cash equivalents and short-term investments of \$95.4 million, of which \$8.2 million was held outside the United States. We have a \$3.0 million revolving line of credit with a bank. This facility provides a \$1.5 million sub-limit for letters of credit. The revolving line of credit also includes a foreign exchange line of credit requiring 15% of foreign exchange contracts to be supported by our borrowing base. There were foreign currency derivative contracts with a notional amount of \$11.8 million outstanding at December 31, 2007. Advances under our credit facility accrue interest at an annual rate equal to the prime rate minus 0.25%. Our credit facility is secured by certain U.S. assets in favor of the bank and contains financial and reporting covenants and limitations. We are currently in compliance with all covenants contained in our credit facility and believe that our credit facility provides sufficient flexibility so that we will remain in compliance with its terms. As of December 31, 2007, we had no amounts outstanding under this credit facility. Our credit facility expires on March 31, 2008.

The funds held at locations outside of the United States are for future operating expenses and expansion of our business, and we have no intention of repatriating those funds. We are not, however, restricted in repatriating those funds back to the United States, if necessary. If we decide to remit funds from India to the United States in the form of dividends, they would be subject to Indian dividend distribution tax, which is currently at a rate of approximately 17%, as well as U.S. corporate income tax on the dividends.

We believe that our available cash and cash equivalents, investments and cash flows expected to be generated from operations will be adequate to satisfy our current and planned operations for the foreseeable future. Our ability to expand and grow our business in accordance with current plans and to meet our long-term capital requirements will depend on many factors, including the rate, if any, at which our cash flow increases, our continued intent not to repatriate earnings from India and Sri Lanka and the availability of public and private debt and equity financing. To the extent we decide to pursue one or more significant strategic acquisitions, we may incur debt or sell additional equity to finance those acquisitions.

On January 31, 2008, the Company purchased from two banking institutions multiple foreign currency forward contracts designed to hedge fluctuation in the Indian rupee against the U.S. dollar and U.K. pound sterling. The contracts have an aggregate notional amount of approximately 2.9 billion Indian rupees (approximately \$73.4 million) and will settle on a monthly basis over a 21 month period ending December 31, 2009. The Company has the obligation to settle these contracts based upon the Reserve Bank of India published Indian rupee exchange rates. The approximate weighted average Indian rupee rate associated with these contracts is 39.56.

Table of Contents**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 three fiscal years at a total estimated cost of \$30.0 million, of which we anticipate spending between \$9.0 million and \$10.0 million during the fiscal year ending March 31, 2008. Through December 31, 2007, we have spent \$5.7 million toward the completion of this facility with \$5.2 million spent during the nine month period ended December 31, 2007. Other capital expenditures during the nine month period ended December 31, 2007 were approximately \$3.9 million. We expect other capital expenditures in the normal course of business for the remainder of fiscal 2008 to be approximately \$1.1 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, | |
|--|-----------------------------------|-----------|
| | 2007 | 2006 |
| Net cash provided by operating activities | \$ 16,598 | \$ 5,474 |
| Net cash used for investing activities | (71,619) | (4,175) |
| Net cash provided by financing activities | 54,677 | 461 |
| Effect of exchange rate changes on cash | 287 | 199 |
| Net increase (decrease) in cash and cash equivalents | (57) | 1,959 |
| Cash and cash equivalents, beginning of period | 45,079 | 30,237 |
| Cash and cash equivalents, end of period | \$ 45,022 | \$ 32,196 |

Net cash provided by operating activities

Net cash provided by operating activities was \$16.6 million during the nine months ended December 31, 2007 as compared to \$5.5 million during the nine months ended December 31, 2006. This increase was attributable to a decrease in our trade accounts receivable by \$10.2 million as a result of our increased collection efforts, an increase in deferred income taxes of \$5.8 million and an increase in depreciation and amortization of \$0.5 million during the nine months ended December 31, 2007 as compared to the nine months ended December 31, 2006. These increases were partially offset by decreases in net income of \$2.8 million and accounts payable of \$2.5 million during the nine months ended December 31, 2007 as compared to the nine months ended December 31, 2006.

Net cash used for investing activities

Net cash used for investing activities was \$71.6 million during the nine months ended December 31, 2007 as compared to \$4.2 million during the nine months ended December 31, 2006. The increase was due to investments of excess cash and IPO proceeds into short-term investments of \$56.6 million and long-term investments of \$17.1 million, partially offset by proceeds from sale of short-term investments of \$11.3 million. Additionally, we invested \$9.1 million on facilities and equipment including \$5.2 million on our Hyderabad facility during the nine months ended December 31, 2007, as compared to total capital expenditures of \$4.4 million during the nine months ended December 31, 2006. Further, the Company received proceeds from the sale of equity investments of \$0.5 million in the nine months ended December 31, 2006, with no such transaction in the nine months ended December 31 2007.

Net cash provided by financing activities

Net cash provided by financing activities was \$54.7 million during the nine months ended December 31, 2007, as compared to \$0.5 million during the nine months ended December 31, 2006. The increase is due to the gross proceeds from our IPO of \$61.6 million during the nine months ended December 31, 2007, as compared to proceeds from the sale of common stock of \$0.5 million during the nine months ended December 31, 2006. This increase was partially

offset by the \$6.9 million of cash used to fund our IPO during the nine months ended December 31, 2007.

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Off-balance sheet arrangements

We do not have any investments in special purpose entities or undisclosed borrowings or debt. We have cash-secured letters of credit totaling approximately \$0.6 million at December 31, 2007.

We have entered into foreign currency derivative contracts with the objective of limiting our exposure to changes in the Indian rupee described below in Qualitative and Quantitative Disclosures about Market Risk.

On January 31, 2008, the Company purchased from two banking institutions multiple foreign currency forward contracts designed to hedge fluctuation in the Indian rupee against the U.S. dollar and U.K. pound sterling. The contracts have an aggregate notional amount of approximately 2.9 billion Indian rupees (approximately \$73.4 million) and will settle on a monthly basis over a 21 month period ending December 31, 2009. The Company has the obligation to settle these contracts based upon the Reserve Bank of India published Indian rupee exchange rates. The approximate weighted average Indian rupee rate associated with these contracts is 39.56.

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 September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently evaluating the impact that SFAS No. 157 will have on our financial position or results of operations.

In February 2007, the FASB released SFAS 159, *The Fair Value Option for Financial Assets and Financial Liability*. SFAS 159 allows entities to measure many financial instruments and certain other items at their fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. We are currently evaluating the requirements of SFAS 159 and have not yet determined its impact on our financial position or results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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 India 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 under SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*.

The notional principal amounts of these foreign currency derivative contracts as of December 31, 2007 was \$11.8 million. There were no outstanding foreign currency derivative contracts as of December 31, 2006.

We evaluate our foreign exchange policy on an ongoing basis to assess our ability to address foreign exchange exposures on our balance sheet and operating cash flows from the U.K. pound sterling, India rupee, and the Sri Lanka rupee.

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Assuming the amount of expenditures by our Indian operations were consistent with fiscal 2007 and the timing of the funding of these operations were to remain consistent during the remainder of 2008, a constant increase or decrease in the exchange rate between the Indian rupee and the United States dollar during the remainder of fiscal 2008 of 10% would impact our net income by approximately \$1.1 million, excluding the effect of foreign currency derivative contracts which would offset approximately 80% of the impact.

On January 31, 2008, the Company purchased from two banking institutions multiple foreign currency forward contracts designed to hedge fluctuation in the Indian rupee against the U.S. dollar and U.K. pound sterling. The contracts have an aggregate notional amount of approximately 2.9 billion Indian rupees (approximately \$73.4 million) and will settle on a monthly basis over a 21 month period ending December 31, 2009. The Company has the obligation to settle these contracts based upon the Reserve Bank of India published Indian rupee exchange rates. The approximate weighted average Indian rupee rate associated with these contracts is 39.56.

Interest rate risk

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, 2007, we had \$107.6 million in cash and cash equivalents, short-term investments and long-term investments, the interest income from which is affected by changes in short-term interest rates. We expect the recent decreases in short-term interest rates to have a negative effect on interest rates earned on cash and cash equivalents and our investment balances in future periods. Our investment securities primarily consist of auction rate securities, commercial paper and corporate debts. All of our investments in debt securities are classified as available-for-sale and are recorded at fair value. Our available-for-sale 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. A 10% decrease in market interest rates at December 31, 2007 would impact the net fair value of such interest-sensitive financial instruments by \$0.3 million. We had no debt outstanding as of December 31, 2007.

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 and unbilled accounts receivable. We place our temporary cash in liquid investments at highly-rated financial institutions. 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 losses and write-offs of accounts receivable balances have historically not been material to our financial statements and have not exceeded our expectations.

Item 4. Controls and Procedures**Evaluation of Disclosure Controls and Procedures and Changes in Internal Control over Financial Reporting**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report were effective in ensuring that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. We believe that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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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 report, the risks and uncertainties that could materially affect our business, financial condition or future results, which we believe are most important for you to consider are discussed in Part I, Item 1A. Risk Factors in our Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2007, as filed with the Securities and Exchange Commission on September 7, 2007. There are no material changes to the Risk Factors described in our Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2007.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On August 8, 2007, we completed our 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). Such registration statement was declared effective by the SEC on August 2, 2007. The managing underwriters in the offering were J.P. Morgan Securities Inc., Bear, Stearns & Co. Inc., Cowen and Company, LLC and William Blair & Company, LLC. Net proceeds of the IPO were approximately \$52.9 million, after deducting underwriting discounts and commissions of approximately \$4.3 million and offering fees and expenses of approximately \$4.4 million, which includes legal, accounting and printing costs and various other fees associated with registration and listing of our common stock. No payments were made by us to directors, officers or persons owning ten percent or more of our common stock or to their associates, or to our affiliates, other than payments in the ordinary course of business to officers for salaries and to non-employee directors as compensation for board or board committee service. We expect to use approximately \$30 million of the net proceeds from our IPO to fund the construction and build-out of a new facility on our planned campus in Hyderabad, India. The balance of the net proceeds will be used for working capital and other general corporate purposes, including to finance the expansion of our global delivery centers in Chennai, India and Colombo, Sri Lanka, the hiring of additional personnel, sales and marketing activities, capital expenditures, the costs of operating as a public company and possible strategic alliances or acquisitions. Until such uses, the net IPO proceeds have been invested in interest bearing short-term and long-term marketable securities.

This expected use of the net proceeds represents our current intentions based upon our present plans and business condition. The amounts and timing of our actual expenditures will depend upon numerous factors, including cash flows from operations and the anticipated growth of our business. We will retain broad discretion in the allocation and use of our remaining net proceeds.

Item 5. Other Information

On December 31, 2007, pursuant to a Second Amendment to Amended and Restated Credit Agreement by and between us and RBS Citizens, N.A., we amended our Amended and Restated Credit Agreement to extend our revolving line of credit from December 31, 2007 until March 31, 2008. A copy of the Second Amendment to Amended and Restated Credit Agreement is filed as Exhibit 10.1 to this Quarterly Report on Form 10-Q.

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Item 6. Exhibits.

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

Exhibit No. Description

- | | |
|--------|--|
| 10.1* | Second Amendment to Amended and Restated Credit Agreement dated as of December 31, 2007. |
| 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. |

* 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.

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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 12, 2008

By: /s/ Kris Canekaratne
Kris Canekaratne,
Chairman and Chief Executive Officer
(Principal Executive Officer)

Date: February 12, 2008

By: /s/ Thomas R. Holler
Thomas R. Holler,
Executive Vice President, Finance and
Chief Financial Officer
(Principal Financial and Accounting
Officer)

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* 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.