

Mossberg's Investor Digest

Best Idea Profile

Virtusa Corp. (Nasdaq: VRTU)

DESCRIPTION:

Headquartered in Westborough, MA, Virtusa is a global IT services company. About one third of the business is generated from IT consulting and technology implementation. The remaining two thirds comes from Applications outsourcing. The company services Fortune 1000 customers across three verticals, 1) Financial services (approximately 45% of revenue), 2) Media (25%), 3) Technology (35%). The company has 3,764 employees with offices in the United States Europe and Asia. Most of the company's employees reside in India, or Sri Lanka.

KEY INVESTMENT CONSIDERATIONS:

Growth 2x secular growth trends – To save money, CIOs of large corporations are increasingly looking to move IT work offshore. According to a study by Glomark-Governan, offshore IT outsourcing can reduce overall IT operations costs by 21% to 55%. Due to this savings, offshore IT spending is expected to double between 2008 and 2012, representing 17% annual growth rate for that period (source: IDC). According to NeolT, 75% of the largest 2,000 companies are engaged in offshore outsourcing. Of these firms, the rate of spending on offshore contracts is expected to double from 20% of IT budgets to as much as 40% of budgets in the coming years. Benefiting from these trends, Virtusa has delivered 12 years of sequential growth and 32% CAGR over the past five years. While growth rates have abated recently due to the difficult economic environment, last year the company added 21 new clients to its base of 56 clients, which exceeded its targets.

Strong recurring revenue – With approximately 90% of revenue from existing clients, the company has stable and visible revenue streams.

Low cost delivery model – VRTU delivers its services with less than 20% of resources (people) on site and the remainder offshore. Compared to a industry average of 25%, VRTU can offer a lower cost solution for customers that still drives better margins for Virtusa.

Margin expansion opportunities – At 6% of sales, FY09 operating margin underperformed the prior two years primarily due to under-utilization of staff. Improved utilization and operational efficiency efforts have driven operating margin improvements in the second half of last fiscal year, which management believes are sustainable.

RISKS:

Customer Concentration – British Telecom accounts for 19% of revenue and 36% of gross profit during last fiscal year. A disruption from this customer could materially affect results. However, it would appear that British Telecom views its relationship with Virtusa as strategic. BT owns 4% stake in the company.

VALUATION:

Shares are currently trading just above tangible book value. With \$4.30 per share in cash and no debt, there is a significant margin of safety. The EV/ EBITDA multiple is just 5.2x. The company appears to have made sustainable margin improvements. Combined with the success in adding new clients last year, the company appears to be on track to resume significant revenue and profitability growth. Valuation multiples should expand as growth resumes.

(Nasdaq: VRTU)

Investment Data (as of 6/16/09)

Recent Price	\$7.26
52-Week Range	4.00 - 10.65
Fiscal Year End	March
Dividend	N/A
Yield	N/A
Shares Outstanding	24.8 MM
Average Trading Volume (3 mos) (NYSE Only)	100,000
Market Capitalization	180 MM
Cash	107 MM
Long Term Debt	N/A
Enterprise Value (EV)	73 MM
LT Debt/ Equity	N/A
Tangible BV/ Share	6.15
TTM Revenue	172 MM
P/ Revenue	1.0 x
TTM EPS (non-GAAP)	0.50
P/ EPS	14.6x
TTM EBITDA	14 MM
EV/ TTM EBITDA	5.2x

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