

VIRTUSA CORP  
Form 10-Q  
July 30, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, DC 20549

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**FORM 10-Q**

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

**For the quarterly period ended June 30, 2010**

**o 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)

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

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

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

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**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)

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer's class of common stock, as of July 28, 2010:

Class	Number of Shares
Common Stock, par value \$.01 per share	24,179,009



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**Virtusa Corporation and Subsidiaries**

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

	June 30, 2010	March 31, 2010
	(In thousands, except share and per share amounts)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 35,568	\$ 43,851
Short-term investments	32,402	27,820
Accounts receivable, net of allowance of \$521 and \$700 at June 30, 2010 and March 31, 2010, respectively	38,795	31,160
Unbilled accounts receivable	5,761	6,123
Prepaid expenses	4,875	3,451
Deferred income taxes	907	540
Restricted Cash	4,025	3,225
Other current assets	6,151	7,100
Total current assets	128,484	123,270
Property and equipment, net of accumulated depreciation of \$23,891 and \$22,808 at June 30, 2010 and March 31, 2010, respectively	25,564	24,525
Long-term investments	21,940	24,309
Long-term Restricted cash	358	953
Deferred income taxes	5,927	5,865
Goodwill	19,090	19,090
Intangible assets, net	11,870	12,697
Other long-term assets	4,129	5,164
Total assets	\$ 217,362	\$ 215,873
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 6,887	\$ 6,769
Accrued employee compensation and benefits	9,524	8,949
Accrued expenses and other current liabilities	12,903	13,575
Deferred revenue	886	685
Income taxes payable	897	925
Total current liabilities	31,097	30,903
Long-term liabilities	3,022	3,176
Total liabilities	34,119	34,079

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Commitments and guarantees

Stockholders' equity:

Undesignated preferred stock, \$0.01 par value: Authorized 5,000,000 shares at June 30 and March 31, 2010; issued zero shares at June 30 and March 31, 2010		
Common stock, \$0.01 par value: Authorized 120,000,000 shares at June 30, 2010 and March 31, 2010; issued 25,366,988 and 25,197,790 shares at June 30, 2010 and March 31, 2010, respectively; outstanding 23,607,600 and 23,438,402 shares at June 30, 2010 and March 31, 2010, respectively	254	252
Treasury stock, 1,759,388 common shares, at cost, at June 30, 2010 and March 31, 2010, respectively	(8,244)	(8,244)
Additional paid-in capital	150,610	149,394
Accumulated earnings	45,666	42,614
Accumulated other comprehensive loss	(5,043)	(2,222)
Total stockholders' equity	183,243	181,794
Total liabilities and stockholders' equity	\$ 217,362	\$ 215,873

See accompanying notes to unaudited consolidated financial statements

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## Virtusa Corporation and Subsidiaries

## Consolidated Statements of Income and Other Comprehensive Income (Loss)

(Unaudited)

(In thousands, except per share amounts)	Three Months Ended			
		2010	June 30,	2009
Revenue	\$	51,403	\$	37,368
Costs of revenue		31,887		20,871
Gross profit		19,516		16,497
Operating expenses:				
Selling, general and administrative expenses		16,420		13,401
Income from operations		3,096		3,096
Other income (expense):				
Interest income		367		421
Foreign currency transaction losses		(163)		(652)
Other, net		(42)		104
Total other income (expense)		162		(127)
Income before income tax expense		3,258		2,969
Income tax expense		206		340
Net income	\$	3,052	\$	2,629
Net income per share of common stock				
Basic	\$	0.13	\$	0.11
Diluted	\$	0.13	\$	0.11
Comprehensive income (loss):				
Net income	\$	3,052	\$	2,629
Foreign currency translation adjustments		(1,246)		3,375
Unrealized gain (loss) on available-for-sale securities		(83)		348
Unrealized gain (loss) on effective cash flow hedges		(1,492)		2,436
Total comprehensive income (loss)	\$	(231)	\$	8,788

See accompanying notes to unaudited consolidated financial statements

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

<b>(In thousands)</b>	<b>Three Months Ended</b>	
	<b>2010</b>	<b>June 30, 2009</b>
Cash flows provided by (used for) operating activities:		
Net income	\$ 3,052	\$ 2,629
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Depreciation and amortization	1,307	1,206
Amortization of intangible assets	827	
Share based compensation expense	894	864
Deferred income taxes		(164)
Foreign currency losses (gains), net	163	652
Net changes in operating assets and liabilities:		
Accounts receivable, net	(7,822)	3,519
Prepaid expenses and other current assets	(1,788)	1,125
Other long-term assets	419	(413)
Accounts payable	232	(2,666)
Accrued employee compensation and benefits	612	(1,089)
Accrued expenses and other current liabilities	680	(1,452)
Deferred revenue	201	(470)
Excess tax benefits from stock option exercises		(45)
Income taxes payable	37	629
Other long-term liabilities	(1,283)	(189)
Net cash provided by (used for) operating activities	(2,469)	4,136
Cash flows provided by (used for) investing activities:		
Purchase of short-term investments	(7,700)	(926)
Proceeds from sale or maturity of short-term investments	9,783	8,400
Purchase of long-term investments	(7,081)	(10,626)
Proceeds from sale or maturity of long-term investments	2,607	2,000
Purchase of property and equipment	(3,029)	(668)
Decrease (increase) in restricted cash	(171)	2,699
Net cash provided by (used for) investing activities	(5,591)	879
Cash flows provided by (used for) financing activities:		
Proceeds from exercise of common stock options	418	1,206
Excess tax benefits from stock option exercises		45
Principal payments on capital lease obligation	(527)	(4)
Net cash provided by (used for) financing activities	(109)	1,247
Effect of exchange rate changes on cash and cash equivalents	(114)	1,563
Net increase (decrease) in cash and cash equivalents	(8,283)	7,825
Cash and cash equivalents, beginning of period	43,851	55,698
Cash and cash equivalents, end of period	\$ 35,568	\$ 63,523



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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, the United Kingdom, Hungary and the Netherlands, and global delivery centers in Hyderabad and Chennai, India and Colombo, Sri Lanka.

**(2) Unaudited Interim Financial Information**

*Basis of Presentation*

The accompanying unaudited consolidated financial statements included herein have been prepared by Virtusa in accordance with U.S. generally accepted accounting principles and Article 10 of Regulation S-X under the Securities and Exchange Act of 1934, as amended, and should be read in conjunction with the Company's audited consolidated financial statements (and notes thereto) for the fiscal year ended March 31, 2010 included in the Company's Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission, or SEC, on May 27, 2010. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States have been condensed or omitted pursuant to such SEC rules and regulations. In the opinion of the Company's management, all adjustments considered necessary for a fair presentation of the accompanying unaudited consolidated financial statements have been included, and all material adjustments are of a normal and recurring nature. Operating results for the interim periods are not necessarily indicative of results that may be expected to occur for the entire fiscal year. Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation.

*Principles of Consolidation*

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

Use of Estimates

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including the recoverability of tangible assets, disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenue and expenses during the reported period. Management reevaluates these estimates on an ongoing basis. The most significant estimates relate to the recognition of revenue and profits based on the percentage of completion method of accounting for fixed-price contracts, share-based compensation, income taxes, including reserves for uncertain tax positions, deferred taxes and liabilities and intangible assets, contingent consideration and valuation of financial instruments including derivative contracts and investments. Management bases its estimates on historical experience and on various other factors and assumptions that are believed to be reasonable under the circumstances. The actual amounts may vary from the estimates used in the preparation of the accompanying consolidated financial statements.

Table of ContentsFair Value of Financial Instruments

At June 30, 2010 and March 31, 2010, the carrying amounts of the Company's financial instruments, which included cash and cash equivalents, accounts receivable, unbilled accounts receivable, restricted cash, accounts payable, accrued employee compensation and benefits, contingent consideration and other accrued expenses, approximate their fair values due to the short-term nature of the items. In addition, investment securities and derivative instruments are also financial instruments (see Note 6).

**(3) Net Income per Share**

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

	<b>Three Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Numerators:</b>		
Net income	\$ 3,052	\$ 2,629
<b>Denominators:</b>		
Weighted average common shares outstanding	23,504,271	22,918,858
Dilutive effect of employee stock options	874,251	773,916
Dilutive effect of stock appreciation rights	40,212	49,115
Weighted average shares - diluted	24,418,734	23,741,889
Net income per share - basic	\$ 0.13	\$ 0.11
Net income per share - diluted	\$ 0.13	\$ 0.11

During the three months ended June 30, 2010 and 2009, options to purchase 1,214,994 and 1,190,561 shares of common stock, respectively, were excluded from the calculations of diluted earnings per share as their effect would have been anti-dilutive.

**(4) Acquisition**

On November 4, 2009, the Company entered into a Stock Purchase Agreement (the "Stock Purchase Agreement") with InSource Holdings, Inc., a Connecticut corporation ( "InSource") and its shareholders, to acquire all of the issued and outstanding stock of InSource and each of its subsidiaries (the "InSource Acquisition"). The Company also completed the InSource Acquisition on November 4, 2009, and InSource is now a wholly-owned subsidiary of the Company. InSource is a privately-held technology consulting firm with domain expertise in the insurance and healthcare industries. The InSource Acquisition was consummated to expand Virtusa's service offerings in the insurance and health care industries.

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The InSource Acquisition has been accounted for using the purchase method of accounting. Under the terms of the Stock Purchase Agreement, the purchase price for the InSource Acquisition was \$7,250 in cash, subject to post-closing adjustments. Ten percent (10%), or \$725, of the purchase price was subject to a holdback by the Company for a period of 12 months as security for the sellers' indemnification obligations under the Stock Purchase Agreement. This amount is included in short term restricted cash as of June 30, 2010.

The purchase price was subject to adjustment after the closing for up to an additional \$500 in earn-out consideration based on the achievement of certain revenue and operating margin targets for InSource's calendar year and fourth quarter 2009. At December 31, 2009, the Company determined that InSource met 100% of the performance targets. The earn-out consideration was paid as of March 31, 2010. The purchase price is also subject to an adjustment that would reimburse the InSource sellers if their tax burden from a specified tax election made by the Company exceeds \$120. The Company estimated the fair value of the purchase price adjustment upon the InSource Acquisition related to this tax election at \$208. There was no change in the fair value at June 30, 2010. The fair value of the purchase price adjustment of \$208 is provisional pending receipt of the final sellers' tax burden.

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On February 1, 2010, the Company entered into an Asset Purchase Agreement (the "Asset Purchase Agreement") with ConVista Consulting LLC, a privately held Virginia limited liability corporation ("ConVista"), to acquire all of assets of ConVista ("ConVista Acquisition"). The Company also completed the ConVista Acquisition on February 1, 2010.

The ConVista Acquisition has been accounted for using the purchase method of accounting. Under the terms of the Asset Purchase Agreement, the purchase price for the ConVista Acquisition was \$24,846 in cash, subject to post-closing adjustments. Ten percent (10%), or \$2,500, of the purchase price was subject to a holdback by the Company for a period of 12 months as security for the sellers' indemnification obligations under the Asset Purchase Agreement. This amount is included in short term restricted cash as of June 30, 2010.

The purchase price was subject to adjustment after the closing for up to an additional \$2,000 in earn-out consideration based on the achievement of certain revenue and operating margin targets for the fiscal year ending March 31, 2011. The Company determined the fair value of the contingent consideration upon the closing of ConVista Acquisition based on the probability of ConVista attaining the specified performance targets and assigned a fair value of \$1,620 to the purchase price. As of March 31 and June 30, 2010, the present value of the contingent consideration was \$1,664 and \$1,734 respectively. The change in the present value of \$70 was recorded to selling, general and administration expenses during the three months ended June 30, 2010.

The following unaudited, pro forma information assumes the InSource Acquisition and ConVista Acquisition occurred at the beginning of the periods presented. The pro forma results of the acquisitions were combined as the InSource Acquisition was not material to the consolidated financial results.

	<b>Three Months Ended June 30, 2009 (Unaudited)</b>	
Revenue	\$	44,376
Net Income (1)	\$	3,721

(1) Pro forma net income for the three months ended June 30, 2009 does not include amortization expense or acquisition related bonuses.

**Intangible Assets**

The following are details of the Company's intangible asset carrying amounts acquired as a result of InSource and ConVista acquisitions, at June 30, 2010 and accumulated amortization at June 30, 2010:

	<b>Estimated Useful Life</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Amount</b>
<b>Amortizable intangible assets:</b>				
Customer relationships	7.9	\$ 10,700	\$ 615	\$ 10,085
Partner relationships	6.0	700	47	653

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Trademark	2.0		100		33		67
Backlog	1.0		1,800		735		1,065
	6.9	\$	13,300	\$	1,430	\$	11,870

The components included in the gross carrying amounts at June 30, 2010 reflect the InSource Acquisition on November 4, 2009, and ConVista Acquisition on February 1, 2010. The intangible assets are being amortized on a straight-line basis over their estimated useful lives.

Table of Contents**Goodwill:**

The Company has one reportable segment at June 30, 2010. The following are details of the changes in goodwill balance at June 30, 2010:

	<b>Amount</b>
Balance at April 1, 2010	\$ 19,090
Goodwill arising from acquisitions	
Balance at June 30, 2010	\$ 19,090

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

The Company performed the annual assessment of its goodwill during the fourth quarter of the fiscal year ended March 31, 2010, and determined that the estimated fair value of its reporting unit exceeded its carrying value and therefore goodwill was not impaired. The Company will continue to evaluate whether events or circumstances have occurred that indicate that the estimated remaining useful life of its long lived assets, including intangible assets, may warrant revision or that the carrying value of these assets may be impaired. There was no indication of impairment during the three months ended June 30, 2010.

**(5) Investment Securities**

At June 30, 2010 and March 31, 2010, all of the Company's investment securities were classified as available-for-sale or trading and were carried on its balance sheet at their fair market value. A fair market value hierarchy based on three levels of inputs was used to measure each security (see Note 6).

The following is a summary of investment securities at June 30, 2010:

	<b>Amortized Cost</b>		<b>Gross Unrealized Gains</b>		<b>Gross Unrealized Losses</b>		<b>Fair Value</b>
<b>Available-for-sale securities:</b>							
Corporate bonds:							
Current	\$ 14,128	\$	74	\$	(16)	\$	14,186
Non-current	10,059		16		(10)		10,065
Auction-rate securities:							
Non-current	900				(36)		864
Agency and short-term notes:							
Current	3,609		15				3,624
Non-current	9,204		10		(1)		9,213
Municipal bonds:							



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Current	1,210	1		1,211
Non-current	1,799	2	(3)	1,798
Time deposits:				
Current	10,333			10,333
Total available-for-sale securities	51,242	118	(66)	51,294
<b>Trading securities:</b>				
Auction-rate securities (current)	2,617	431		3,048
<b>Total investments</b>	\$ 53,859	\$ 549	(66) \$	54,342

The following is a summary of investment securities at March 31, 2010:

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	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available-for-sale securities:</b>				
Corporate bonds:				
Current	\$ 6,663	\$ 68	\$	\$ 6,731
Non-current	14,372	73	(14)	14,431
Auction-rate securities:				
Non-current	900		(30)	870
Agency bonds:				
Current	7,619	30		7,649
Non-current	7,200	12		7,212
Municipal bonds:				
Current	1,210	4		1,214
Non-current	1,805		(9)	1,796
Time deposits:				
Current	5,773			5,773
Total available-for-sale securities	45,542	187	(53)	45,676
<b>Trading securities:</b>				
Auction-rate securities (current)	5,501	952		6,453
<b>Total investments</b>	<b>\$ 51,043</b>	<b>\$ 1,139</b>	<b>\$ (53)</b>	<b>\$ 52,129</b>

The Company evaluates investments with unrealized losses to determine if the losses are other than temporary. The Company has determined that the gross unrealized losses at June 30, 2010 and March 31, 2010 are temporary. In making this determination, the Company considered the financial condition, credit ratings and near-term prospects of the issuers, the underlying collateral of the investments, the magnitude of the losses as compared to the cost and the length of time the investments have been in an unrealized loss position. Additionally, the Company does not intend to sell such investments, and it is more likely than not the Company will not be required to sell such investments prior to the recovery of its amortized cost basis, except as disclosed in Note 6.

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**Virtusa Corporation and Subsidiaries**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

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

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

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

- Level 1 Quoted prices in active markets for identical assets or liabilities.
  
- Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
  
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

An entity is allowed to elect to record financial assets and financial liabilities at fair value upon their initial recognition on a contract-by-contract basis. In the fiscal year ended March 31, 2010, the Company elected the fair value option to account for the Put Option (as defined and described in this Note 6 below) related to certain of the Company's auction-rate securities.

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The following table summarizes the Company's financial assets and liabilities measured at fair value on a recurring basis at June 30, 2010:

	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
<b>Cash equivalents:</b>				
Money market mutual funds	\$ 3,938	\$	\$	\$ 3,938
<b>Investments:</b>				
Available-for-sale securities - current	29,354			29,354
Available-for-sale securities - non-current	21,076		864	21,940
Trading securities - current			3,048	3,048
Derivative instruments - current		1,273		1,273
Derivative instruments - non-current		51		51
<b>Other current assets:</b>				
Put option			127	127
<b>Total assets</b>	<b>\$ 54,368</b>	<b>\$ 1,324</b>	<b>\$ 4,039</b>	<b>\$ 59,731</b>
<b>Liabilities:</b>				
Derivative instruments - current	\$	\$ 201	\$	\$ 201
Derivative instruments - non-current		194		194
Contingent consideration		\$	1,734	1,734
<b>Total liabilities</b>	<b>\$</b>	<b>\$ 395</b>	<b>\$ 1,734</b>	<b>\$ 2,129</b>

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In November 2008, the Company entered into an agreement (the "Agreement") with UBS AG, the investment firm that had sold the Company auction-rate securities at a par value of \$6,675. Under the Agreement, the Company (1) received the right to sell (the "Put Option") these auction-rate securities back to the investment firm at par, at the Company's sole discretion, any time during the period from June 30, 2010 through July 2, 2012, and (2) provided the investment firm the right to purchase these auction-rate securities or sell these securities on the Company's behalf at par any time after the execution of the Agreement through July 2, 2012. During the three months ended June 30, 2010, the Company sold certain auction rate securities, subject to the Put Option under the Agreement, of \$3.5 million at par. On July 1, 2010 the Company sold the remaining auction rate securities, subject to the Put Option of \$3.2 million at par (See Note 12).

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

Level 3 assets as listed in the table above include auction-rate securities whose underlying assets are generally student loans which are substantially backed by the U.S. federal government. In February 2008, auctions began to fail for these securities and each auction since then has failed. The Company classifies its investment in auction-rate securities as short and long-term investments, reflecting the fact that the Company's auction-rate securities have underlying final maturities of greater than one year and based on the Company's intent and ability to sell the securities within one year. These investments were recorded at fair value at June 30, 2010 and March 31, 2010.

The following table provides a summary of changes in fair value of the Company's Level 3 financial assets at June 30, 2010:

	<b>Level 3 Assets</b>
Balance at April 1, 2010	\$ 7,545
Redemption of auction-rate securities	(3,500)
Total unrealized gains (losses):	
Included in other accumulated other comprehensive income	(6)
Balance at June 30, 2010	\$ 4,039

During the three months ended June 30, 2010, the Company recognized a gain on sale of auction-rate securities, which were fully offset by the loss recognized on the Put Option.

The Company determines the fair value of the contingent consideration related to the ConVista Acquisition based on the probability of ConVista attaining certain revenue and operating margin targets for the fiscal year ending March 31, 2011. The following table provides a summary of changes in fair value of the Company's Level 3 financial liabilities as of June 30, 2010:

**Level 3  
Liabilities**

Balance at April 1, 2010	\$	1,664
Recognized in earnings		70
Balance at June 30, 2010	\$	1,734

**(7) Derivative Financial Instruments**

The Company evaluates its foreign exchange policy on an ongoing basis to assess its ability to address foreign exchange exposures on its consolidated balance sheets, statements of income and consolidated statement of cash flows from all foreign currencies, including most significantly the U.K. pound sterling, Indian rupee and Sri Lankan rupee. The Company enters into hedging contracts in accordance with its foreign exchange policy (as approved by the Company's audit committee and board of directors) which permits hedging of material, known foreign currency exposures. Currently, the Company maintains three hedging programs, each with varying contract types, duration and purposes. The Company's Cash

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Flow Program is designed to mitigate the impact of volatility in the U.S. dollar equivalent of the Company's Indian rupee denominated expenses over a rolling 24 month period. The Cash Flow Program transactions currently meet the criteria for hedge accounting as cash flow hedges. The Company's Balance Sheet Program involves the use of 30-day derivative instruments designed to mitigate the monthly impact of foreign exchange gains/losses on certain intercompany balances and payments. The Company's U.K. Revenue and Cost Program involves the purchase of derivative instruments with maturities of up to 90 days designed to mitigate the impact of foreign exchange on U.K. pound sterling denominated revenue and costs in the quarter in which such instruments are purchased. The Balance Sheet Program and the U.K. Revenue and Cost Program do not meet the criteria for hedge accounting and all changes in the fair value of the derivatives purchased under these programs are reflected in the Company's consolidated statement of income and are included in foreign exchange gains (losses) each period.

Changes in fair value of the designated cash flow hedges for our Cash Flow Program are recorded as a component of accumulated other comprehensive income (loss) (AOCI), net of tax until the forecasted hedged transactions occur and are then recognized in the consolidated statement of income. The Company evaluates hedge effectiveness at the time a contract is entered into, as well as on an ongoing basis. If and when hedge relationships are discontinued because the forecasted transaction is deemed probable of not occurring by the end of the originally specified period or within an additional two-month period of time thereafter, any related derivative amounts recorded in equity are reclassified to earnings. There were no gains (losses) that were reclassified from AOCI into earnings as a result of forecasted transactions that were considered probable of not occurring for the three month period ended June 30, 2010 and 2009.

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

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

The U.S. dollar notional equivalent market value, which consists of the notional value and net unrealized gain or loss, of all outstanding foreign currency derivative contracts was \$41,985 and \$43,173, at June 30, 2010 and March 31, 2010, respectively. Unrealized net gains related to these contracts which are expected to be reclassified from AOCI to earnings during the next 12 months are \$1,072 at June 30, 2010. At June 30, 2010, the maximum outstanding term of any derivative instrument was 21 months.

The following tables set forth the fair value of derivative instruments included in the consolidated balance sheets at June 30, 2010 and March 31, 2010:

**Derivatives designated as hedging instruments**

	June 30, 2010	March 31, 2010
<b>Foreign currency exchange contracts:</b>		

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Other current assets	\$	1,273	\$	2,402
Other long-term assets	\$	51	\$	591
Accrued expenses and other current liabilities	\$	201	\$	
Long-term liabilities	\$	194	\$	

The following tables set forth the effect of the Company's foreign currency exchange contracts on the consolidated financial statements of the Company for the three months ended June 30, 2010 and 2009:

Derivatives Designated as Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in AOCI on Derivatives (Effective Portion) Three Months Ended June 30,	
	2010	2009
Foreign currency exchange contracts		