MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades NSO to Caa2, concludes review; outlook negative

22 Nov 2021

Frankfurt am Main, November 22, 2021 -- Moody's Investors Service ("Moody's") has today downgraded the corporate family rating (CFR) to Caa2 from B3 rating under review for downgrade and the probability of default rating (PDR) to Caa2-PD from B3-PD rating under review for downgrade of NorthPole Newco S.a r.l. (NSO or the company), the top entity of the restricted group of Israeli-based cyber security and intelligence software provider NSO Group. Concurrently, Moody's has downgraded to Caa2 from B3 rating under review for downgrade of the $300 million senior secured first lien term loan B1 (TLB1) and €177 million senior secured first lien term loan B2 (TLB2) facilities both maturing in March 2025 and the $30 million senior secured revolving credit facility (RCF) maturing in March 2024. The outlook on all ratings has been changed to negative from ratings under review. This concludes the review for downgrade initiated on July 30, 2021.

RATINGS RATIONALE

The downgrade to Caa2 with a negative outlook reflects the weakening liquidity profile with an increased risk of a breach of the maintenance covenant which might lead to an event of default if not cured or waived beforehand. The recently announced trading restrictions will possibly lead to a further revenue contraction in 2021 and beyond, resulting in rising leverage metrics and a further weakening of the liquidity profile of NSO as well an increasing refinancing risk. The company has a relatively low share of recurring revenues and is, unlike many other software companies, highly dependent on new license sales which we believe can become increasingly difficult given the actions taken against NSO.

NSO's Caa2 CFR reflects its high Moody's-adjusted leverage of around 6.5x expected in 2021, its product and customer concentration, and susceptibility to cyberattacks as well as ongoing lawsuits. NSO's free cash flow generation was negative in 2020 driven by the lower revenues as well as a shareholder distribution and we expect negative FCF in 2021. In addition, the recurring revenue base is lower than that of its enterprise software peers and remains dependent upon the conversion to and renewal of maintenance contracts with a comparably low duration of 12 months, although we acknowledge its high renewal rates of over 90%.

NSO's Caa2 CFR reflects as positives the group's medium-term performance potential from its unique product offering, evidenced in the solid performance in the past few years and characterized by high EBITDA margins despite business interruptions from the coronavirus pandemic in 2020. The large addressable market in which the group operates, the limited known competition and the material barriers to entry also support NSO's credit quality.

RATING OUTLOOK

The negative outlook reflects the high risk that NSO might not be in compliance with the maintenance covenant under the recent documentation and not receive lenders consent to waive or amend the covenant levels or to adjust the size of the current liquidity facility. In addition, it reflects the high uncertainty of the company's ability to sell new licenses amidst recent trading restrictions and a shortfall in liquidity.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

For a positive rating action NSO should demonstrate a solid operating performance with significant new licence sales while maintaining solid Moody's adjusted EBITDA-margins, positive free cash flow as well as compliance with all covenants under the debt documentation. In addition, a positive rating action would require a resolution of the recent trading restrictions and an adequate liquidity profile.

Conversely, NSO's ratings could come under negative pressure if Moody's adjusted gross debt to EBITDA remains sustainably above 6.5x, ongoing negative FCF/debt and any sign of a weakening of the group's liquidity position. Non-compliance with covenants under the debt documentation would also lead to negative pressure.

LIQUIDITY ANALYSIS

We view NSO's liquidity as weak based on the risk of a covenant breach in 2021. As of June 2021, unrestricted cash was $29 million while the $30 million RCF was fully drawn.

The group has one net leverage-based maintenance covenant, with tight headroom as of June 2021. The sequential step down to 4.0x at year end 2021 creates significant pressure amidst the recent performance. We therefore see a high risk of a covenant breach that might lead to a default.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

NSO is facing allegations over the inappropriate use of its surveillance software by certain customers and trade restrictions have been implemented by public authorities which raises concerns over the company's control mechanisms and sales approach which we consider a social consideration.

In addition, Governance considerations include the track record of the company being owned by a private equity company with a tolerance for high leverage.

STRUCTURAL CONSIDERATION

The TLB1, the TLB2 and RCF are the only financial debt instruments in the capital structure; hence, they are rated in line with the CFR. The temporary shareholder loan of $14 million that has been granted in Q2 2020 is treated as 100% debt and ranks pari passu with the TLB1, the TLB2 and RCF in the absence of the documentation.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Software Industry published in August 2018 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1130740 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

PROFILE

NorthPole Newco S.a r.l. is a provider of cybersecurity and intelligence software solutions to government agencies. Its offering is focused on mobile end point and location capabilities, as well as tactical or field solutions and lawful interception for high-value targets. NSO operates primarily out of Israel, Bulgaria and Cyprus, with close to 750 employees who serve more than 60 customers in over 35 countries. In 2020, NSO reported revenue of $243 million and Moody's-adjusted EBITDA of €99 million. NSO is majority owned by funds ultimately controlled and managed by Berkeley Research Group.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1288235 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the UK and is endorsed by Moody's Investors Service Limited, One Canada Square, Canary Wharf, London E14 5FA under the law applicable to credit rating agencies in the UK. Further information on the UK endorsement status and on the Moody's office that issued the credit rating is available on www.moodys.com.

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