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S&P Global Ratings

Sapiens International Corporation N.V.

June 28, 2022

Research Update

Rating Raised To 'ilAA-' On Growth In Operations, Improved Financial Ratios; Outlook Stable

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Rating Action Overview

- In 2021 and in the first quarter of 2022, Sapiens International Corporation N.V (“Sapiens" or "the Company") registered revenue and profit growth due to organic growth, notably in Europe and APAC, and due to mergers and acquisitions performed by the company in 2020, mainly the consolidation of Germany-based Sum.Como and Nordic Tia Technology.
- Alongside the growth in the past three years, the Company’s debt position recently decreased due to Series B bonds maturity repayments. We therefore see an improvement in the Company's financial ratios as reflected in adjusted debt to EBITDA of about 1.7x in 2021, in the 1.5x-2.0x range commensurate with a positive rating action, and in adjusted FFO (funds from operations) to debt of about 51.7% in 2021, beyond the 40%-45% range commensurate with an upgrade.
- Under our base case scenario we anticipate that the Company’s organic growth will continue in 2022-2023, alongside a decrease in debt. We therefore expect the Company’s adjusted debt to EBITDA to be about 1.5x and its adjusted FFO to debt to be 45%-60% in the next two years.
- On June 28, 2022, we raised our ratings on Sapiens International Corporation N.V. and on its bond series (Series B) to 'ilAA-' from 'ilA+'.
- The stable outlook reflects our assessment that the Company will maintain its position in the software solutions market in North America, EMEA (Europe, Middle East and Africa) and APAC (Asia Pacific). We also expect the Company to maintain its growth alongside acquisitions of companies in similar/tangent areas while maintaining stable operating performance. The outlook also reflects our assessment that in the next 12 months the Company will maintain adjusted debt to EBITDA of about 1.5x and adjusted FFO to debt of about 45%-60%, commensurate with the current rating.

Rating Action Rationale

The upgrade on Sapiens is mainly due to growth in the Company’s operations and improved financial ratios. In 2021, the Company's revenue grew by about 20.4% to about $461 million, due to mergers and acquisitions performed by the company in 2020, mainly the merger of Germany-based Sum.Como and Nordic Tia Technology, alongside organic growth with an emphasis on its operations in Europe and APAC. Accordingly, the Company's adjusted EBITDA grew by about 21.7% to about

$91 million. At the same time, the Company's adjusted debt decreased to about $152 million due to the repayment of Series B bond maturities. As a result, the Company's gross debt to EBITDA was about 1.7x in 2021, compared with about 2.4x in 2020.

We anticipate continued organic growth in the next two years alongside a decrease in debt. In our base scenario, we assume an increase of about 5%-10% in the Company's sales in 2022 following continued synergy with mergers and acquisitions made in 2020 and due to onboarding of a number of new customers, notably in Europe and APAC in life and elementary insurance. At the same time, we expect a decrease in debt according to the repayment schedule of Series B bonds. We therefore expect the Company's adjusted debt to EBITDA to be about 1.5x and its adjusted FFO to debt to be 45%-60% in the next two years, commensurate with the current rating.

In addition, we assume that the Company will distribute a dividend of $25 million - $35 million per year in two semi-annual installments and that it will continue to make small to medium-sized acquisitions in the coming years.

Outlook

The stable outlook reflects our assessment that the Company will maintain its position in the software solutions market in North America, EMEA (Europe, Middle East and Africa) and APAC (Asia Pacific). We also expect the Company to maintain its growth alongside acquisitions of companies in similar/tangent areas while maintaining stable operating performance. The outlook also reflects our assessment that in the next 12 months the Company will maintain adjusted debt to EBITDA of about 1.5x and adjusted FFO to debt of about 45%-60%, commensurate with the current rating.

Downside Scenario

We may lower the rating if the Company's competitive position is undermined. This could happen if market conditions worsen, leading to a deterioration in the Company's operating performance and to continued or material decline in profitability. The rating will also come under pressure if the Company materially increases its financial debt in order to finance acquisitions or large dividend distributions to shareholders, such that it fails to consistently meet the coverage ratios commensurate with the current rating, or if its liquidity profile weakens.

Upside Scenario

We may consider a positive rating action if Sapien's business risk profile materially improves, as reflected, among other things, by a higher market share in its regions of operation, materially improved profitability and a wider client base and product variety compared with peers.

Company Description

Sapiens International Corporation N.V. ("Sapiens") is engaged in the development and marketing of global software solutions for financial markets and in particular for insurance companies, adapted to the segments of general insurance, life insurance and pension, reinsurance, etc. Sapiens has been working with international insurance companies and banks for years, and serves more than 600 insurance companies in North America, Europe, Israel and Asia.

The controlling shareholder (44%) in Sapiens is Formula Systems (1985) Ltd. ("Formula", ilA+/Stable) which, through subsidiaries, is engaged in the development, marketing and distribution of software and software tools and the provision of software services for IT systems. The remaining shares are held by the public. The Company's shares are traded on the Tel Aviv Stock Exchange and on NASDAQ.

Base Case Scenario

Our base case scenario is underpinned by the following assumptions:

- About 5%-10% sales growth in 2022, due to organic growth, notably in Europe and APAC in life and elementary insurance, and due to synergy with mergers and acquisitions performed last year.
- R&D expenditures of about 11%-12% of total expenses in 2022-2023.
- Adjusted EBITDA margin of about 17.5%-18.5% in 2022-2023.
- Dividend distribution in the amount of about $25 million - $35 million per year in two semi-annual installments, in accordance with the Company's dividend distribution policy (about 40% of non-GAAP net profit).

Key Metrics

Financial Metric	2021A	2022E	2023E
Debt/EBITDA	1.7x	1.4x-1.6x	1.0x-1.5x
FFO/debt	51.7%	60%-45%	60%-45%

A - actual. E – Estimate.

Liquidity

We assess Sapiens's liquidity as adequate. We expect the ratio between the Company's sources and uses will exceed 1.2x in the next 12 months. This assessment reflects the Company's cash on hand, positive operating cash flow, debt maturities, capital expenditure, acquisitions and dividend distributions. At the same time, we estimate that the Company has limited ability to withstand tail risk without refinancing, but we believe it has reasonable access to financial institutions, which mitigates this risk.

In our base case scenario we assume the main sources at the Company's disposal in the 12 months starting April 1, 2022, to be:

- About $206 million in cash and cash equivalents (including short-term bank deposits).
- Cash FFO of about $70 million - $80 million.

Our assumptions regarding the Company's main uses for this period are:

- Debt maturities of about $20 million.
- Capital expenditure (capex) of about $10 million - $15 million.
- Acquisitions of about $5 million - $10 million.
- Dividend distribution of about $25 million - $35 million.

Covenant Analysis

We expect the Company to maintain sufficient headroom on all its covenants in the medium term. Under the terms of its bonds, the Company must maintain consolidated equity attributable to its shareholders (excluding minority interests) of at least $120 million. It must also maintain a ratio not exceeding 65% between net financial debt and net CAP on a consolidated basis, and a net financial debt to EBITDA ratio not exceeding 5.5x.

Environmental, Social, And Governance

ESG Credit Indicators: E-2, S-2, G-2

ESG factors have an overall neutral influence on our credit analysis of Sapiens International Corporation N.V.

Modifiers

Diversification/portfolio effect: Neutral

Capital structure: Neutral

Liquidity: Neutral

Financial policy: Neutral

Management and governance: Neutral

Comparable ratings analysis: Neutral

Recovery Analysis

Rationale

- We are raising our rating on Sapiens International Corporation N.V.'s unsecured Series B bonds to 'ilAA-', identical to the issuer rating, The recovery rating for this series is '3', reflecting our assessment that in the case of a hypothetical default, recovery prospects would be 50%-70%.
- Our recovery prospects assessment is constrained to the 50%-70% range despite the simplified waterfall, according to which the value available for unsecured debtors exceeds total unsecured debt, due to our assessment that on the path to default the Company will replace unsecured debt by secured or senior debt.

Simulated default assumptions

- Simulated year of default: 2027
- A deep recession in the countries of operation, alongside failed M&A activity and the loss of several significant customers, will significantly hurt the Company's operating performance.
- The Company will continue operating as a going concern, an assessment supported by its long-term signed contracts with clients and by the high costs of replacing existing chip suppliers.

Simplified Waterfall

- EBITDA on emergence: about $14.5 million
- Industry EBITDA multiple: 6.5x
- Gross enterprise value as going concern: about $94 million
- Administrative and operating costs: 5%
- Enterprise value available for unsecured debt: about $89 million
- Total unsecured debt: about $60 million
- Recovery expectations for unsecured debt: 50%-70% (constrained as noted above)
- Recovery rating for unsecured debt (1 to 6): 3

All debt amounts include six months' prepetition interest.

Mapping Recovery Percentages To Recovery Ratings			
Recovery expectations (%)	**Description**	**Recovery rating**	**Notching above/below issuer rating**
100%	Full recovery	1+	+3 notches
90%-100%	Very high recovery	1	+2 notches
70%-90%	Substantial recovery	2	+1 notch
50%-70%	Meaningful recovery	3	0 notches
30%-50%	Average recovery	4	0 notches
10%-30%	Modest recovery	5	-1 notch
0%-10%	Negligible recovery	6	-2 notches

Recovery ratings are capped in certain countries to adjust for reduced creditor recovery prospects in these jurisdictions. Recovery ratings on unsecured debt issues are generally also subject to caps (see Step 6, paragraphs 90-98 of Recovery Rating Criteria For Speculative-Grade Corporate Issuers, December 7, 2016, for further detail). ICR--Issuer credit rating.

Related Criteria And Research

- Principles Of Credit Ratings, February 16, 2011
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, November 13, 2012
- Methodology: Industry Risk, November 19, 2013
- Country Risk Assessment Methodology And Assumptions, November 19, 2013
- Corporate Methodology, November 19, 2013
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, December 16, 2014
- Recovery Rating Criteria For Speculative-Grade Corporate Issuers, December 7, 2016
- Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Group Rating Methodology, July 1, 2019
- S&P Global Ratings Definitions, November 10, 2021

Ratings List

Sapiens International Corporation N.V.	Rating	Date when the rating was first published	Last date when the rating was updated
Issuer rating(s)			
Long term	ilAA-/Stable	13/08/2017	27/07/2021
Issue rating(s)			
Senior Unsecured Debt			
Series B	ilAA-	12/09/2017	27/07/2021
Issuer Credit Rating history			
Long term			
June 28, 2022	ilAA-/Stable		
August 13, 2017	ilA+/Stable		
Additional details			
Time of the event	28/06/2022 09:05		
Time when the event was learned of	28/06/2022 09:05		
Rating requested by	Issuer		