

## Verint Systems Inc.

(NASDAQ: VRNT)

Company Update

### Sector Perform

Above Average Risk

#### Daniel Meron, Analyst

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Price: 37.81      Price Target: 42.00  
 52-Wk High: 43.17      52-Wk Low: 29.37  
 Float (MM): 10.8      Debt to Cap: 2.0%  
 Shares Out (MM): 33.3      Market Cap (MM): 1,259  
 Dividend: 0.00      Yield: 0.0%  
 Tr. 12 ROE: 11.10%      Est 3-Yr EPS Gr: 30.00%  
 Trading Vol. (MM): 0.184  
 Institutional Own.: 38%

(FY Jan)	2004A	2005E	2006E	2007E
EPS	0.82	1.03	1.35	1.68
Prev.				
P/E	46.11x	36.71x	28.01x	22.51x
Revenue Net (MM)	249.80	307.10	374.40	439.50
Prev.			371.00	
MktCap/Rev	5.04x	4.10x	3.36x	2.86x

EPS	Q1	Q2	Q3	Q4
2004	0.18A	0.20A	0.21A	0.23A
2005	0.23A	0.25A	0.26A	0.28E
2006	0.30E	0.33E	0.34E	0.38E
Revenue Net (MM)				
2004	56.60A	60.20A	64.00A	69.00A
2005	72.00A	74.70A	78.20A	82.10E
2006	89.60E	92.00E	94.60E	98.20E
Prev.	88.90E	91.20E	93.70E	97.20E

diluted, ex. one time

All values in USD unless otherwise noted.

Priced as of prior trading day's market close, EST (unless otherwise stated).

### Verint Fortifying Solid Positioning

#### Event

Verint acquires CM-Insight for \$5.8m cash and earn-out ; F4Q05E preview + introducing FY07E estimates.

#### Investment Opinion

- **Verint continues enhancing solution offering with another tactical move, acquiring CM-Insight to round-out Enterprise offering (30%-mix).** We believe CM-Insight deal will bolster Verint's Enterprise services group and presence in UK and EMEA. UK-based, privately-held CM-Insight was established 1998 as consultancy group for contact centers, and employs 23 people. We estimate CM-Insight run-rate at ~\$4m, implying fair ~1.5x price/sales. We expect smooth integration as Verint and CM-Insight cooperated before. CM-Insight features 25 customers, mainly UK-based: British-Telecom, BBC, Marks&Spencer, Eirtel, UK National-Rail, Sainsbury, Microsoft, Lexus, Toyota, Virgin, and others. This deal follows acquisitions of MultiVision (video-recording) and Opus (enterprise- performance) in September-2005, where we believe integration is coming along well.
- **Our recent checks indicate increased interest in enterprise analytics and Verint move corresponds with management upbeat guidance for enterprise division to grow in high-teens.** These trends bode well for all industry players, including NICE.
- **We believe homeland security demand continues to be strong.** Our recent discussions with video recoding and analytics players indicate market maintains 20-30% annual growth though smaller, specialized vendors may show higher rates. We believe Verint and NICE have the resources to drive consolidation in this fragmented market. However, valuations are fairly high in hot areas like real-time-analytics and Network-Video-Recording.
- **We believe Verint is maintaining healthy momentum and expect company to meet our in line 4Q05 numbers** of \$82m in revenue and \$0.28 EPS (report due early-March). Following the CM-Insight deal we are tweaking our FY06 revenue higher while leaving EPS unchanged. We believe management 2006 guidance may turn conservative, driving our street-high estimates. **We are introducing FY07E, modeling 17% revenue growth to \$440m and EPS rising 26% to \$1.70.**
- We believe underlying business trends are solid and management executes on-plan. **Our notion is VRNT is a good play on strong industry trends for long-term oriented investors and advise taking seats on dips towards low-to-mid 30's.**

## Valuation

Verint shares garner P/E of 37x our FY05E EPS estimates, 28x FY06E numbers and 23x our newly introduced FY07E earnings. This is in line with average valuation afforded to peers like Witness (WITS, OP / AAR), March Networks (TSE: MN, OP / AAR), NICE (NICE, OP / AAR) and other enterprise analytics and homeland security players that garner average P/E of 36x over FY05 numbers and 29x FY06E EPS.

**Our \$42 (unchanged) target is based on 30x FY06E EPS.** Our multiple is in line with Verint's 3-5 year EPS growth rate outlook and is in line with recent multiple afforded to these shares, and tad ahead of peers, due to our assessment of execution and market positioning.

We believe underlying business trends are solid and management executes on-plan. **Our notion is VRNT is a good play on strong industry trends for long-term oriented investors and advise taking seats on dips towards the low 30's.**

### Companies mentioned:

**NICE Systems:** (NASDAQ-NICE, Outperform, \$51.08, Above-Average-Risk)

**Witness Systems:** (NASDAQ-WITS, Outperform, \$22.74, Above-Average-Risk) covered by Enterprise Applications Analyst Brad Whitt

**March Networks:** (TSX-MN, Outperform \$26.54, Above-Average-Risk) covered by Technology Analyst Steve Arthur

## Price Target Impediment

Potential impediments to the stock's achieving our price target include:

- **Change in government budgets for homeland security**, and related changes in regulation.
- **Verint depends on getting and maintaining security clearance to work with different government bodies.** The Company also is subject to getting technology export license in Israel and Germany and any change in policy may adversely affect it.
- **IT cycle and the extent of acceptance of advanced multimedia content analysis.**
- **Controlling interest of Comverse Technology** (NASDAQ: CMVT, \$25.48, SP / AAR) with ~60% stake.
- **Macro backdrop, competition, technology shifts, execution, dependency on channel partners and other usual suspects.**

## Company Description

Verint provides solutions for communications interception (=wiretapping), digital video security and surveillance and enterprise business intelligence. Digital Security and Surveillance division accounts for 69% of revenue and supplies government bodies, public organizations and telecom providers with solutions to enhance homeland security through recording and analysis of multimedia communications. Enterprise Business Intelligence division, at 31% of revenue, provides enterprises with tools to improve customer service through recording and analysis of contact center interaction, as well as video surveillance systems to secure the organization and lower shrinkage.

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	FY 2004A	1Q05A Apr	2Q05A Jul	3Q05A Oct	4Q05E Jan	FY 2005E	1Q06E Apr	2Q06E Jul	3Q06E Oct	4Q06E Jan	FY 2006E	FY 2007E
Digital Security & Surveillance	164,888	49,554	51,594	53,829	56,500	211,477	62,700	64,000	65,600	67,600	259,900	306,700
% of revenue	66%	69%	69%	69%	69%	69%	70%	70%	69%	69%	69%	70%
Q/Q		5%	4%	4.3%	5%		11%	2%	3%	3%		
Y/Y	29%	34%	31%	30%	20%	28%	27%	24%	22%	20%	23%	18%
Enterprise Business Intelligence	84,936	22,485	23,115	24,409	25,600	95,609	26,900	28,000	29,000	30,600	114,500	132,800
% of revenue	34%	31%	31%	31%	31%	31%	30%	30%	31%	31%	31%	30%
Q/Q		3%	3%	5.6%	5%		2%	4%	3%	5%		
Y/Y	32%	14%	11%	8%	17%	13%	20%	21%	19%	20%	20%	16%
Revenue	249,824	72,039	74,709	78,238	82,100	307,086	89,600	92,000	94,600	98,200	374,400	439,500
Q/Q		4%	4%	5%	5%		9%	3%	3%	4%		
Y/Y	30%	27%	24%	22%	19%	23%	24%	23%	21%	20%	22%	17%
Cost of sales	110,586	31,411	32,374	33,182	34,600	131,567	37,800	38,700	39,700	41,000	157,200	180,000
Gross profit	139,238	40,628	42,335	45,056	47,500	175,519	51,800	53,300	54,900	57,200	217,200	259,500
Gross margin	55.7%	56.4%	56.7%	57.6%	57.9%	57.2%	57.8%	57.9%	58.0%	58.2%	58.0%	59.0%
Research and development, net	31,961	9,374	9,622	10,039	10,500	39,535	11,400	11,600	11,800	12,000	46,800	53,600
% of revenue	12.8%	13.0%	12.9%	12.8%	12.8%	12.9%	12.7%	12.6%	12.5%	12.2%	12.5%	12.2%
Selling, general and administrative	81,239	23,241	23,656	25,683	26,700	99,280	29,100	29,500	30,100	30,900	119,600	135,600
% of revenue	32.5%	32.3%	31.7%	32.8%	32.5%	32.3%	32.4%	32.1%	31.8%	31.5%	31.9%	30.9%
Operating Expenses, ex. one time	113,200	32,615	33,278	35,722	37,200	138,815	40,500	41,100	41,900	42,900	166,400	189,200
% of revenue	45.3%	45.3%	44.5%	45.7%	45.3%	45.2%	45.2%	44.7%	44.3%	43.7%	44.4%	43.0%
Y/Y / Q/Q	31%	3%	2%	7%	4%	23%	9%	1%	2%	2%	20%	14%
Operating Income (ex. one time)	26,038	8,013	9,057	9,334	10,300	36,704	11,300	12,200	13,000	14,300	50,800	70,300
Operating margin	10.4%	11.1%	12.1%	11.9%	12.5%	12.0%	12.6%	13.3%	13.7%	14.6%	13.6%	16.0%
Q/Q		9%	9%	-2%	5%		1%	5%	4%	6%		
Y/Y	51%	36%	46%	36%	46%	41%	41%	35%	39%	39%	38%	38%
% of pre tax income	88%	83%	84%	82%	83%	83%	87%	87%	87%	87%	87%	90%
NOPAT (Net Operating Income After Tax)	23,546	6,365	7,024	7,175	7,931	28,454	8,701	9,394	10,010	11,011	39,077	52,444
Interest and other income (expense), net	3,618	1,690	1,721	2,077	2,100	7,588	1,700	1,900	2,000	2,100	7,700	7,900
% of pre tax income	12%	17%	16%	18%	17%	17%	13%	13%	13%	13%	13%	10%
Pre-tax income, ex one time	29,656	9,703	10,778	11,411	12,400	44,292	13,000	14,100	15,000	16,400	58,500	78,200
Income tax provision	2,838	1,996	2,419	2,640	2,900	9,955	3,000	3,200	3,500	3,800	13,500	19,900
% of pre tax income	10%	21%	22%	23%	23%	22%	23%	23%	23%	23%	23%	25%
Net Income (ex. one time)	26,818	7,707	8,359	8,771	9,500	34,337	10,000	10,900	11,500	12,600	45,000	58,300
Net margin	10.7%	10.7%	11.2%	11.2%	11.6%	11.2%	11.2%	11.8%	12.2%	12.8%	12.0%	13.3%
Q/Q		2%	8%	5%	8%		5%	9%	6%	10%		
Y/Y	50%	30%	30%	27%	26%	28%	30%	30%	31%	33%	31%	30%
EPS, diluted (ex. one time)	0.82	0.23	0.25	0.26	0.28	1.03	0.30	0.33	0.34	0.38	1.35	1.68
Q/Q		2%	9%	4%	8%		6%	9%	5%	9%		
Y/Y	35%	27%	28%	25%	24%	26%	29%	29%	30%	32%	30%	25%
Diluted Weighted average shares	32,627	33,082	33,029	33,333	33,400	33,211	33,300	33,400	33,500	33,600	33,450	34,600

\* Ex. One time items and impact of FASB 123  
Source: RBC Capital Markets and Company Reports

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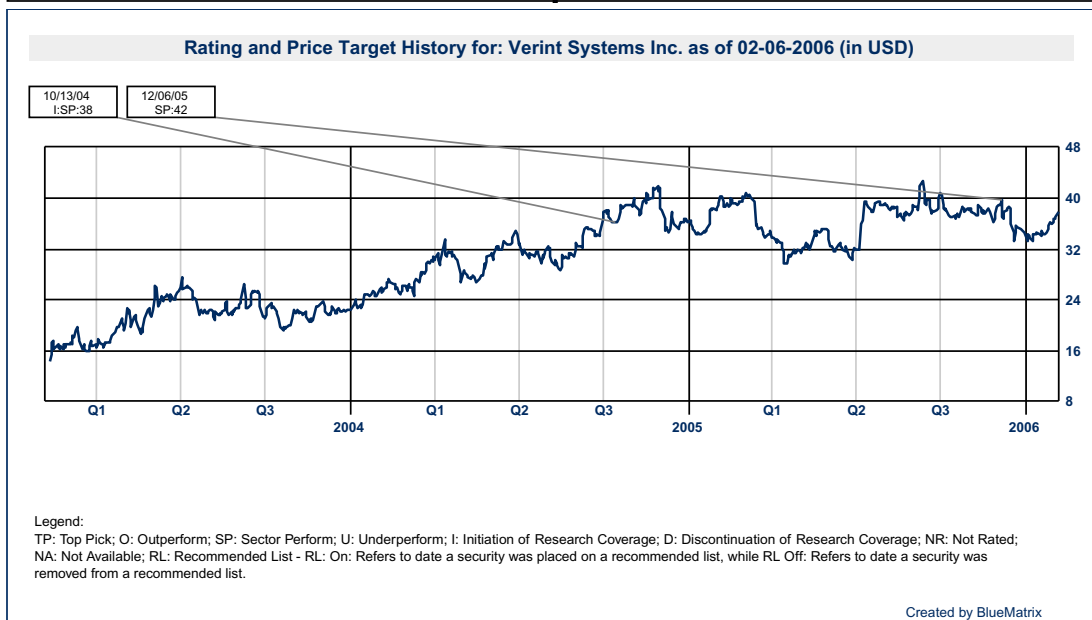
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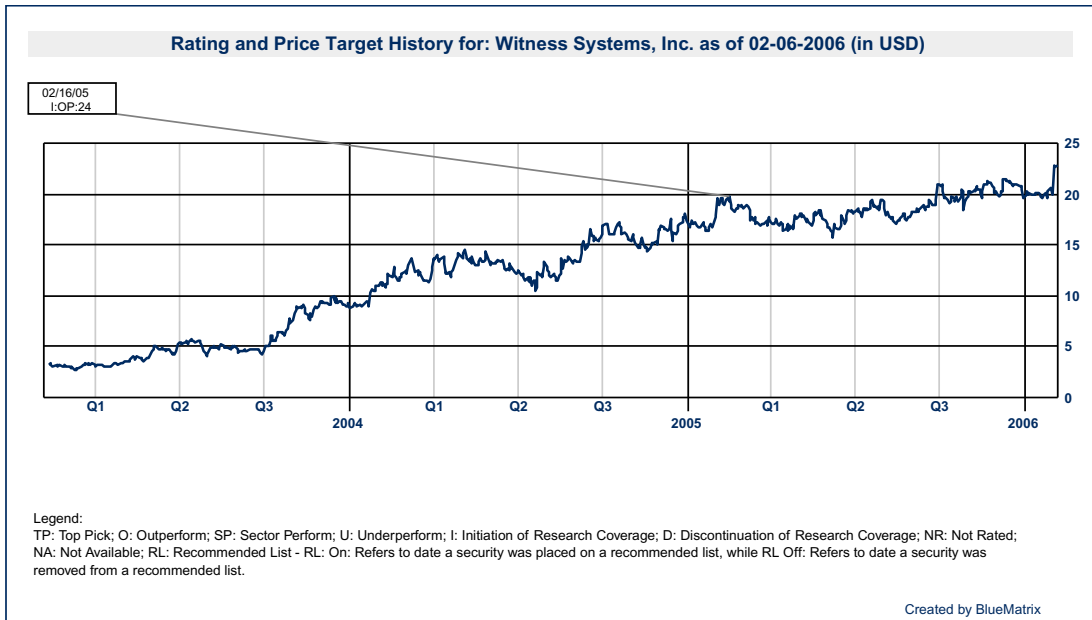
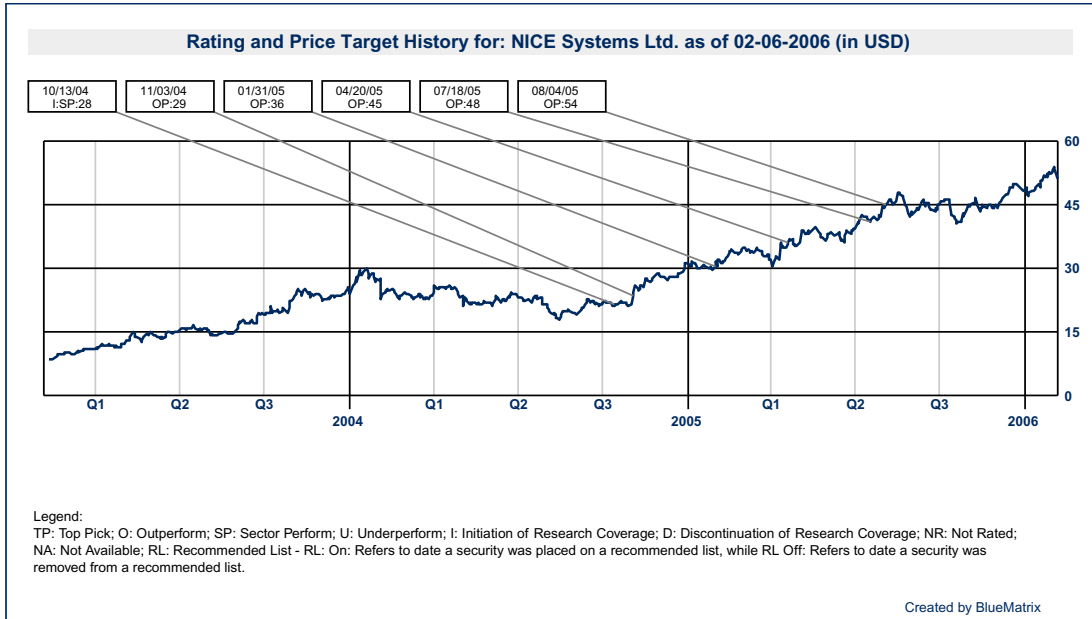
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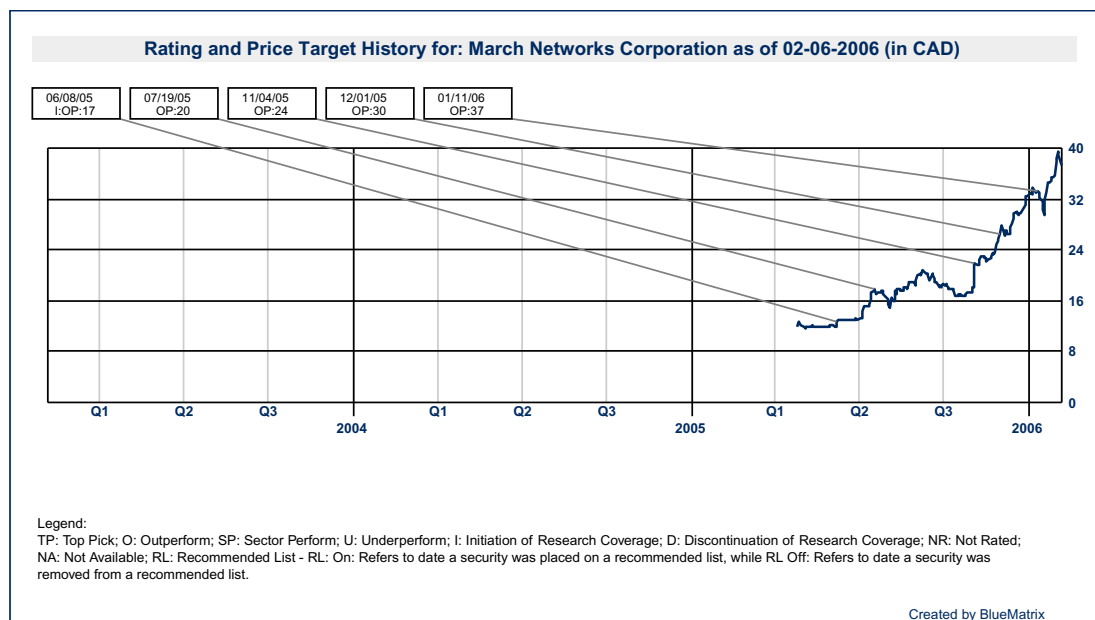
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