

Verint Systems

(VRNT^{5,8} \$38.02) Market Perform

VRNT Reports Record Q2'05 Revenues and a Security Company Acquisition; Reducing Rating to Market Perform

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- VRNT reported Q2'05 results that beat our top line estimate and met our EPS forecast. Revenues were \$74.7 million, up 24.2% year-over-year and 3.7% sequentially. Our estimate was for revenues of \$73.7 million and consensus was \$74.1 million. Proforma EPS was \$0.25, up 25.0% y-o-y and 8.7% sequentially. This was inline with our estimate and the Street consensus. Revenues in the Digital Security & Surveillance (DSS) segment were \$51.6 million, up 31.4% y-o-y and 4.1% sequentially, and beat our \$49.5 million forecast. Revenues in the Enterprise Business Intelligence (EBI) segment were \$23.1 million, up 10.5% y-o-y and 2.8% sequentially, but below our \$24.2 million forecast. This bears watching, as growth in the segment declined for the third consecutive quarter.

- The gross margin was 56.7%, vs. 55.8% in Q2'04, but slightly below our 57.1% estimate. While the GM improved 90 basis points y-o-y, it was below the average improvement the Company has shown y-o-y during the past six quarters. Total operating expenses increased to \$33.3 million, vs. \$27.4 million in Q2'04, in-line with our estimate. Proforma income from operations was \$9.1 million, up 46.8% y-o-y, and the operating margin rose to 12.1% from 10.3% in the year-earlier period. This demonstrates the operating leverage in VRNT's model, despite lower than expected growth in the GM.

- Management announced a new acquisition, the second in the past week. VRNT has agreed to acquire the networked video security business from MultiVision (SGX: MVIS.SI/NR), for approximately \$48 million in cash, in order to expand Verint's reach into the Asia Pacific region. The transaction is expected to close in three months and will be non-dilutive.

- Visibility remains strong as overall backlog is greater than one quarter's worth of revenues. The balance sheet is healthy, with \$264.9 million of cash and cash equivalents and working capital of \$214.9. Management issued Q3'05 guidance and raised 2005 forecasts. Q3'05 revenues are forecast at \$77 million and EPS of \$0.26 (we are at \$77.3 million in revenues and EPS of \$0.27). Full year 2005 revenue guidance is raised to \$303-\$306 million (up from \$296-\$300 million) and EPS to \$1.02- \$1.05 (up from \$1.02). The increased 2005 guidance is partially reliant on the closing of the MultiVision acquisition before the end of the fiscal year.

- Verint signed 10 new international customers for mass transit security, cementing its position as a leading vendor in the market. We believe that the Company also has a shot at being selected as the networked video solution for the \$212 million MTA award that a consortium led by Lockheed Martin recently won.

- This was a record revenue quarter for the Company and the 15th consecutive quarter of revenue growth, margin expansion and operating income growth. However, we have some concerns about the slower revenue growth in the EBI segment, the lower than forecast GM, and greater reliance on acquisitions to support growth. We do think the long-term outlook is bright, particularly in the DSS segment for transportation security. However, we would expect to see some weakness following the inline Q2'05 results and the strong run-up following the London train bombings, and would look to re-enter the stock in the low to mid \$30s.

Key Data

52-Week Range	\$42.22 - \$29.37
Weighted Average Shares (MM)	33.0
Float (MM)	12.9
% Held Institutionally	38.0%
Market Capitalization (MM)	\$1,255.8
Average Daily Volume (000)	175.9
Revenues - LTM (MM)	\$279.8
Total Debt (MM)	\$0
Cash per Share	\$7.89
Long-Term Growth Rate	30%

Fiscal Year Ends: Dec.	2004A	2005E	2006E
Revenue (MM)	\$249.8	\$304.7	\$352.2
Previous Revenue (MM)		\$303.1	
Earnings per Share			
	Q1	\$0.18	\$0.23A
	Q2	\$0.20	\$0.25A
	Q3	\$0.21	\$0.27
	Q4	\$0.23	\$0.31
Year	\$0.82	\$1.05	\$1.31
P/E	46.4X	36.2X	29.0X
Shares Fully Diluted (MM)	32.6	33.0	34.7



Verint is a leading provider of analytic software solutions for Communications Interception, Digital Video Security and Enterprise Business Intelligence. Its software generates "actionable intelligence" from voice, video and Internet communications. Clients include The Department of Defense, the U.S. Navy, the Pentagon, Washington Dulles Airport, Sprint, Cingular Wireless, Home Depot, Target, FedEx and Citibank.

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Sep 8, 2005

2005 Second Quarter Highlights

Digital Security and Surveillance: Digital Security and Surveillance revenues increased 31% y-o-y, 4.1% sequentially and represented 69% of Q2'05 total revenues. Verint announced the signing of the definitive agreement to acquire MultiVIsion's Networked Video Security Business, a Hong-Kong based company, to expand its digital security and surveillance business in the Asia Pacific region. The Company also announced a number of new contracts for the deployment of video surveillance for mass transit systems in the U.S. and abroad. Verint has established itself as a market leader in this space, which has attracted considerable political interest and funding following the bombing of the London Underground in July. This is a greenfield market opportunity, as there is the need for security infrastructure upgrades in mass transit systems across the globe, and the political will to get it done. Finally, four new contracts were signed with service providers for the Company's communications interception (wiretapping) solution. Electronic surveillance for wired, wireless and IP networks continues to be a primary means of intelligence collection across the globe (for both the law enforcement and intelligence communities) and Verint is the market leader in this space.

New contracts and milestones include:

- VRNT introduced Nextiva™, its next generation, enterprise-class video management and analytics platform to transform video into actionable intelligence. Nextiva combines enterprise and security data with mission-critical video, leveraging existing investments in IT infrastructure, security and business systems. The system will be formally launched at the ASIS security conference next week in Orlando.
- VRNT was awarded a contract with the PATH Transit System which serves New York and New Jersey for a networked video solution.
- The Company announced that it received orders from 10 foreign countries for the deployment of its networked video solution in mass transit systems.
- The Port of Houston, the largest port in the U.S. for foreign cargo shipments, awarded VRNT a contract to provide its networked video solution for perimeter and passenger terminal security.
- The Company received four new contracts for its communications interception solution (wiretapping) from both U.S. and foreign service providers.

Enterprise Business Intelligence: EBI revenues increased 11% y-o-y, 2.8% sequentially and represented 31% of total revenues. Verint announced the completion of its acquisition of Opus Group as an addition to its business intelligence product portfolio. While this will not materially affect revenues, it will be neutral to 2005 results and add to VRNT's data analytics platform. New contracts and milestones include:

- John Hancock's Annuity Division deployed ULTRA™ Analytics to enhance its customer-centric programs and enable John Hancock to identify and understand important issues that impact the effectiveness of their customer service operations.
- Edward Jones Brokerage purchased the ULTRA™ Analytics solution to improve the contact center operations at its branches.
- 21st Century Insurance and Alabama Gas purchased the ULTRA™ Analytics platform for its contact center operations.

Q2'05 Results

	Six Months Ended July 31,		Three Months Ended July 31,	
	2004	2005	2004	2005
Sales	\$116,805	\$146,748	\$60,167	\$74,709
Cost of sales	52,222	63,785	26,620	32,374
Gross Profit	64,583	82,963	33,547	42,335
Operating Expenses				
Research and development, net	14,680	18,996	7,889	9,622
Selling, general and administrative	37,806	46,897	19,474	23,656
Income from operations	12,097	17,070	6,184	9,057
Interest and other income, net	1,447	3,411	865	1,721
Income before income tax provision	13,544	20,481	7,049	10,778
Income tax provision	1,187	4,416	611	2,419
Net income	\$12,357	\$16,065	\$6,438	\$8,359
	=====	=====	=====	=====
Earnings per share:				
Basic	\$0.40	\$0.51	\$0.21	\$0.26
	=====	=====	=====	=====
Diluted	\$0.38	\$0.49	\$0.20	\$0.25
	=====	=====	=====	=====
Weighted average shares:				
Basic	30,567	31,558	30,732	31,611
Diluted	32,331	33,044	32,457	33,029

Source: Verint Systems

Balance Sheet

ASSETS	January 31, 2005	July 31, 2005 (Unaudited)
CURRENT ASSETS:		
Cash, cash equivalents, bank time deposits and short-term investments	\$240,414	\$264,944
Accounts receivable, net	39,072	40,171
Inventories	17,267	21,041
Prepaid expenses and other current assets	9,880	10,326
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TOTAL CURRENT ASSETS	\$306,633	\$336,482
PROPERTY AND EQUIPMENT, net	17,540	18,307
INTANGIBLE ASSETS, net	12,026	9,638
GOODWILL	49,625	49,630
OTHER ASSETS	13,154	14,498
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TOTAL ASSETS	\$398,978	\$428,555
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	\$68,399	\$78,936
Advance payments from customers	41,853	42,613
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TOTAL CURRENT LIABILITIES	110,252	121,549
LONG-TERM LIABILITIES	5,351	4,762
	-----	-----
TOTAL LIABILITIES	115,603	126,311
STOCKHOLDERS' EQUITY	283,375	302,244
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TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$398,978	\$428,555
	=====	=====

Source: Verint Systems

Earnings Model

Verint Systems

(dollars in thousands)	FY 2002A	FY 2003A	Apr-04 Q1A	Jul-04 Q2A	Oct-04 Q3A	Jan-05 Q4A	FY 2004A	Apr-05 Q1A	Jul-05 Q2A	Oct-05 Q3E	Jan-06 Q4E	FY 2005E	FY 2006E
Revenues													
Digital Security & Surveillance	\$98,300	\$128,196	\$36,950	\$39,288	\$41,460	\$47,265	\$164,963	\$49,599	\$51,632	\$51,400	\$54,250	\$206,881	\$240,050
Enterprise Business Intelligence	59,500	64,548	19,688	20,879	22,529	21,765	84,861	22,440	23,077	25,908	26,350	97,775	112,150
Total Revenues	157,800	192,744	56,638	60,167	63,989	69,030	249,824	72,039	74,709	77,308	80,600	304,656	352,200
Cost of Revenues	78,100	89,302	25,602	26,620	28,160	30,204	112,774	31,411	32,374	33,050	33,500	130,335	148,950
Gross Profit	79,700	103,442	31,036	33,547	35,829	38,826	137,050	40,628	42,335	44,258	47,100	174,321	203,250
Operating Expenses													
Research & Development	17,357	23,233	6,791	7,889	8,409	8,872	31,961	9,374	9,622	9,650	10,000	38,646	42,150
Selling, General & Admin.	52,314	63,020	18,332	19,474	20,544	22,889	83,070	23,241	23,656	24,850	25,650	97,397	108,850
Non-Recurring Charges	0	0	0	0	0	0	0	0	0	0	0	0	0
Total Operating Expenses	69,671	86,253	25,123	27,363	28,953	31,761	115,031	32,615	33,278	34,500	35,650	136,043	151,000
Operating Income	\$10,029	\$17,189	\$5,913	\$6,184	\$6,876	\$7,065	\$22,019	\$8,013	\$9,057	\$9,758	\$11,450	\$38,278	\$52,250
Interest and Other Income (Expenses)	2,266	2,670	582	865	932	1,239	3,618	1,690	1,721	1,550	1,600	6,561	4,500
Pretax Income	\$12,295	\$19,859	\$6,495	\$7,049	\$7,808	\$8,304	\$25,637	\$9,703	\$10,778	\$11,308	\$13,050	\$44,839	\$56,750
Income Taxes (Benefit)	2,170	1,921	576	611	905	746	1,930	1,996	2,419	2,262	2,610	9,287	11,350
Net Earnings	\$10,125	\$17,938	\$5,919	\$6,438	\$6,903	\$7,558	\$23,707	\$7,707	\$8,359	\$9,046	\$10,440	\$35,552	\$45,400
Diluted Net EPS	\$0.43	\$0.61	\$0.18	\$0.20	\$0.21	\$0.23	\$0.82	\$0.23	\$0.25	\$0.27	\$0.31	\$1.05	\$1.31
Weighted Avg. Diluted Shares	23,450	29,396	32,209	32,457	32,766	33,077	32,627	33,082	33,029	33,429	33,829	33,342	34,750

Verint Systems Inc. Analysis

	FY 2002A	FY 2003A	Apr-04 Q1A	Jul-04 Q2A	Oct-04 Q3A	Jan-05 Q4A	FY 2004A	Apr-05 Q1A	Jul-05 Q2A	Oct-05 Q3E	Jan-06 Q4E	FY 2005E	FY 2006E
Percent of Revenue													
Digital Security & Surveillance	62.3%	66.5%	65.2%	65.3%	64.8%	68.5%	66.0%	68.9%	69.1%	66.5%	67.3%	67.9%	68.2%
Enterprise Business Intelligence	37.7%	33.5%	34.8%	34.7%	35.2%	31.5%	34.0%	31.1%	30.9%	33.5%	32.7%	32.1%	31.8%
Gross Margin	50.5%	53.7%	54.8%	55.8%	56.0%	56.2%	54.9%	56.4%	56.7%	57.2%	58.4%	57.2%	57.7%
Research & Development	11.0%	12.1%	12.0%	13.1%	13.1%	12.9%	12.8%	13.0%	12.9%	12.5%	12.4%	12.7%	12.0%
Selling, General & Admin.	33.2%	32.7%	32.4%	32.4%	32.1%	33.2%	33.3%	32.3%	31.7%	32.1%	31.8%	32.0%	30.9%
Total Operating Expenses	44.2%	44.8%	44.4%	45.5%	45.2%	46.0%	46.0%	45.3%	44.5%	44.6%	44.2%	44.7%	42.9%
Operating Margin	6.4%	8.9%	10.4%	10.3%	10.7%	10.2%	8.8%	11.1%	12.1%	12.6%	14.2%	12.6%	14.8%
Pretax Margin	7.8%	10.3%	11.5%	11.7%	12.2%	12.0%	10.3%	13.5%	14.4%	14.6%	16.2%	14.7%	16.1%
Tax Rate	17.6%	9.7%	8.9%	8.7%	11.6%	9.0%	7.5%	20.6%	22.4%	20.0%	20.0%	20.7%	20.0%
Net Margin	6.4%	9.3%	10.5%	10.7%	10.8%	10.9%	9.5%	10.7%	11.2%	11.7%	13.0%	11.7%	12.9%
Year-to-Year Change													
Digital Security & Surveillance	38.6%	30.4%	27.4%	25.9%	26.0%	34.7%	28.7%	34.2%	31.4%	24.0%	14.8%	25.4%	16.0%
Enterprise Business Intelligence	-1.0%	8.5%	27.7%	33.1%	39.9%	25.5%	31.5%	14.0%	10.5%	15.0%	21.1%	15.2%	14.7%
Total Revenues	20.3%	22.1%	27.5%	28.3%	30.6%	31.7%	29.6%	27.2%	24.2%	20.8%	16.8%	21.9%	15.6%
Research & Development	nm	33.9%	27.3%	38.6%	41.3%	41.9%	37.6%	38.0%	22.0%	14.8%	12.7%	20.9%	9.1%
Selling, General & Admin	nm	20.5%	25.0%	27.3%	28.0%	34.6%	31.8%	26.8%	21.5%	21.0%	12.1%	17.2%	11.8%
Operating Incomes	nm	71.4%	69.0%	49.6%	54.3%	38.5%	28.1%	35.5%	46.5%	41.9%	62.1%	73.8%	36.5%
Net Income	nm	77.2%	68.5%	61.9%	47.9%	30.7%	32.2%	30.2%	29.8%	31.0%	38.1%	50.0%	27.7%
Diluted Net EPS	nm	41.3%	32.0%	44.7%	42.7%	25.3%	34.6%	26.8%	27.6%	28.4%	35.1%	29.8%	22.5%
Quarter-to-Quarter Change													
Digital Security & Surveillance			5.3%	6.3%	5.5%	14.0%		4.9%	4.1%	-0.4%	5.5%		
Enterprise Business Intelligence			13.5%	6.0%	7.9%	-3.4%		3.1%	2.8%	12.3%	1.7%		
Total Revenues			8.0%	6.2%	6.4%	7.9%		4.4%	3.7%	3.5%	4.3%		
Research & Development			8.6%	16.2%	6.6%	5.5%		5.7%	2.6%	0.3%	3.6%		
Selling, General & Admin			7.8%	6.2%	5.5%	11.4%		1.5%	1.8%	5.0%	3.2%		
Operating Incomes			15.9%	4.6%	11.2%	2.7%		13.4%	13.0%	7.7%	17.3%		
Net Income			2.4%	8.8%	7.2%	9.5%		2.0%	8.5%	8.2%	15.4%		
Diluted Net EPS			0.8%	7.9%	6.2%	8.5%		2.0%	8.6%	6.9%	14.0%		

Investment Risks

Ownership by Comverse Technology. Comverse owns approximately 63% of Verint's common stock and has control of Verint's board of directors. Kobi Alexander is Chairman of both Verint and Comverse and Verint's CEO and CFO both held senior positions at Comverse before the Verint spin-off. While we don't see any operational conflict of interest for the companies, we do believe that the major risk of the Comverse ownership is the dilution and stock price pressure caused by any stock sales. This concern is somewhat mitigated by the fact that Comverse has not sold any stock since the Verint spin-off. Comverse currently has over \$2 billion in cash on its balance sheet and it behooves Comverse to continue to consolidate Verint's earnings.

Operations in Israel. Since the establishment of the State of Israel in 1948, there have been a number of armed conflicts between Israel and its Arab neighbors, and the state of hostility has led to security and economic problems for Israel. Verint maintains significant operations in Israel and benefits from government-funded R&D and tax breaks. Any change in policy would adversely affect the company.

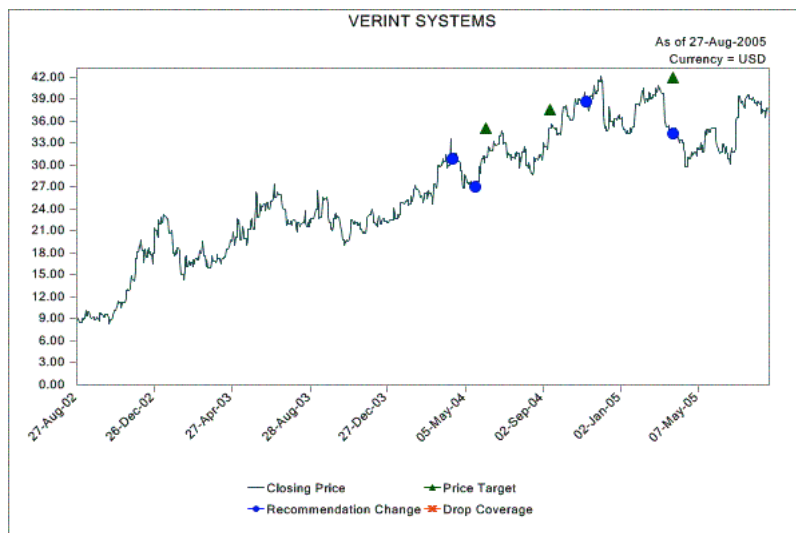
Government Security Spending. Verint's sales growth has been directly impacted by government legislation, such as the USA Patriot Act, that has led to increased spending on security products and enhanced the powers of surveillance and wiretapping on the part of government agencies. The current presidential administration has clearly positioned itself in favor of continued strengthening of monitoring and surveillance activities. Any change in such policies would likely negatively impact Verint's ability to sustain its sales growth.

Reliance on Resellers for Distribution. Sales through system integrators, VARs and distributors accounted for 51% of sales in FY 2002, up from 38% in FY 2001. Verint has stated its intention to continue to build its distribution strategy. Verint's sales growth and profitability depend on its ability to maintain and grow its distribution network.

Export Licensing Requirements. Verint is required to have licenses from the Israeli and German governments in order to export components manufactured in those countries. These products accounted for approximately 22% of FY 2002 revenues. While it is unlikely that either country discontinue these licenses, any disruption would adversely affect the Company.

Proxy Agreement with the Department of Defense. As a provider of communications interception solutions to U.S. government agencies, Verint is required by the National Industrial Security Program to maintain facility security clearances and to be insulated from foreign ownership, control or influence. Verint maintains a U.S. subsidiary, Verint Technology that maintains a proxy agreement with the U.S. government and the DoD in order to be in compliance with these regulations. If the proxy agreement were ever terminated, Verint's sales to the U.S. government would suffer.

Foreign Currency Exchange. The majority of Verint's sales are denominated in U.S. dollars while its labor expenses in Germany, the U.K. and Israel are incurred in local currencies. Unfavorable currency fluctuations would impact Verint's profitability.



VERINT SYSTEMS

Currency = USD			Currency = USD		
Date	Closing Price	Recommendation Change	Date	Closing Price	Price Target
28-Mar-2005	34.35	BUY	28-Mar-2005	34.35	42.00
05-Nov-2004	38.62	MARKET PERFORM	10-Sep-2004	35.07	37.50
18-May-2004	27.00	BUY	03-Jun-2004	30.25	35.00
14-Apr-2004	30.79	MARKET PERFORM			

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- Buy: 12 months, estimated 20% or more appreciation
- Market Perform: Performance in line with the market averages anticipated.
- Under Perform: 12 months, estimated underperformance of 20% or more

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	% of CEUT Universe with this rating	% of rating tier for which CEUT provided IB services
Buy	43%	53%
Market Perform	53%	44%
Under Perform	1%	0%

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- 3 - The research analyst or a member of his/her household received compensation in the past 12 months from this company.
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- 6 - CEUT has managed or co-managed a public offering and/or private placement of securities for this company in the past 12 months.
- 7 - CEUT has received compensation for investment banking services from this company in the past 12 months.
- 8 - CEUT expects to receive, or intends to seek, compensation for investment banking services from this company in the next three months.
- 9 - This company is, or during the past 12 months prior to distribution was, a client of CEUT.
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