

UBS Investment Research
Verint Systems Inc.
Rating **Reduce 1**
Prior: Neutral 1
Price target **US\$31.50**
Unchanged
Price **US\$36.66**

RIC: VRNT.O BBG: VRNT US

11 October 2004
Stock Too Expensive; Reduce 1
■ Stock up 19% since the end of August

Verint is now trading at 35.8x our 2005 EPS estimate. By way of comparison, Verint peers NICE and Witness are trading at multiples of 16.6x and 30.0x 2005e EPS respectively.

■ Downgrade driven solely by expected returns

Our downgrade from Neutral-1 is driven solely by the expected return and is not indicative of our opinion regarding business trends at Verint. On the contrary we believe business continues to track well. We do note, however, the increased insider activity on the sell-side (Bloomberg) in recent weeks.

■ Small free float and sector investor interest aid valuation

We believe that the relatively small free float of about 13.6m shares (CMVT owns c18.6m) and investors interest to invest in companies benefiting from growth in spending on homeland security are two of the reasons the share trades at a premium to the broader tech index.

■ Valuation: Reiterate \$31.5 PT

Our \$31.5 price target is based on a 2005e PE of 30x which is in-line with our 2005 estimated EPS growth rate.

Trading data

52-wk. range	US\$38.00-19.07
Market cap.	US\$1.08bn
Shares o/s	29.5m
Free float	30%
Avg. daily volume ('000)	95
Avg. daily value (US\$m)	3.1

Balance sheet data 01/05E

Shareholders' equity	US\$0.28bn
P/BV (UBS)	6.9x
Net cash (debt)	US\$0.25bn

Forecast returns

Forecast price appreciation	-14.1%
Forecast dividend yield	0.0%
Forecast stock return	-14.1%
Market return assumption	7.6%
Forecast excess return	-21.7%

EPS (UBS, US\$)

	01/05E			01/04
	From	To	Cons.	Actual
Q1	-	0.18	0.18	0.14
Q2	-	0.20	0.17	0.14
Q3E	-	0.21	0.21	0.15
Q4E	-	0.22	0.22	0.18
01/05E	-	0.82	0.81	
01/06E	-	1.03	1.02	

Highlights (US\$m)	01/03	01/04	01/05E	01/06E	01/07E
Revenues	158	193	248	286	-
EBIT	10	17	26	35	-
Net income (UBS)	10	18	27	34	-
EPS (UBS, US\$)	0.43	0.61	0.82	1.03	-
Net DPS (UBS, US\$)	0.00	0.00	0.00	0.00	-

Profitability & Valuation	5-yr hist. av.	01/04	01/05E	01/06E	01/07E
EBIT margin %	-	8.9	10.6	12.1	-
ROIC (EBIT) %	-	-238.0	<-500	187.5	-
EV/EBITDA x	-	12.9	24.5	18.7	-
PE (UBS) x	-	35.1	44.8	35.8	-
Net dividend yield %	-	0.0	0.0	0.0	-

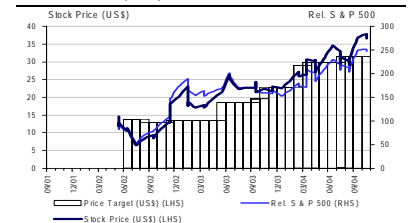
Source: Company accounts, Thomson Financial, UBS estimates. UBS EPS is stated before goodwill, exceptionals and other special items. Valuations: based on an average share price that year, (E): based on a share price of US\$36.66 on 08 Oct 2004

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Performance (US\$)


Source: UBS

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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 2

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All about valuation

While we continue to believe that Verint's business is on track, following recent price appreciation the stock is now trading at 35.8x our estimated '05 EPS. This is significantly higher than at peers NICE and Witness as shown in the table below.

We believe that this kind of valuation is unwarranted and are subsequently downgrading the stock from a Neutral-1 to a Reduce-1 rating. Our \$31.5 PT based on a 30x 2005e EPS multiple remains unchanged.

Table 1: Comparative Valuation – VRNT versus Peers (\$)

	Last Price	04e EPS	05e EPS	04e PE	05e PE
NICE	21.79	1.10	1.36	20.3	16.6
Witness Systems	16.12	0.35	0.54	46.3	30.0
Verint	33.00	0.82	1.03	44.9	35.8

Source: UBS estimates for NICE and VRNT, consensus for WITS

■ Verint Systems Inc.

Verint Systems provides systems combining software and hardware which address the following applications: communication interception (wire-tapping), digital video security and surveillance, and enterprise business intelligence. The company's systems collect, retain and analyse all forms of analog and digital information, including voice, fax, video, email, internet and data transmissions.

■ Statement of Risk

VRNT has two main businesses one selling homeland security solutions and the other selling CRM solution to the enterprise. While spending on security is increasing it is also dependent in many cases on government budgets which could be delayed or postponed. In contrast, enterprise spending which was relatively weak in 2002 and 2003 has improved in 2004. Significant changes in these two industries will have an impact on Verint's financial results.

■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

Required Disclosures

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UBS Investment Research: Global Equity Ratings Definitions and Allocations

UBS rating	Definition	UBS rating	Definition	Rating category	Coverage ¹	IB services ²
Buy 1	FSR is > 10% above the MRA, higher degree of predictability	Buy 2	FSR is > 10% above the MRA, lower degree of predictability	Buy	41%	33%
Neutral 1	FSR is between -10% and 10% of the MRA, higher degree of predictability	Neutral 2	FSR is between -10% and 10% of the MRA, lower degree of predictability	Hold/Neutral	50%	33%
Reduce 1	FSR is > 10% below the MRA, higher degree of predictability	Reduce 2	FSR is > 10% below the MRA, lower degree of predictability	Sell	9%	27%

1: Percentage of companies under coverage globally within this rating category.

2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS; as of 30 September 2004.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (an approximation of the equity risk premium).

Predictability Level The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Rating/Return Divergence (RRD) This qualifier is automatically appended to the rating when stock price movement has caused the prevailing rating to differ from that which would be assigned according to the rating system and will be removed when there is no longer a divergence, either through market movement or analyst intervention.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.

UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.

Core Banding Exceptions (CBE): Exceptions to the standard +/-10% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned table in the relevant research piece.

Companies mentioned

Company Name	Reuters	Rating	Price
Verint Systems Inc. ^{4,16}	VRNT.O	Reduce 1	US\$36.66

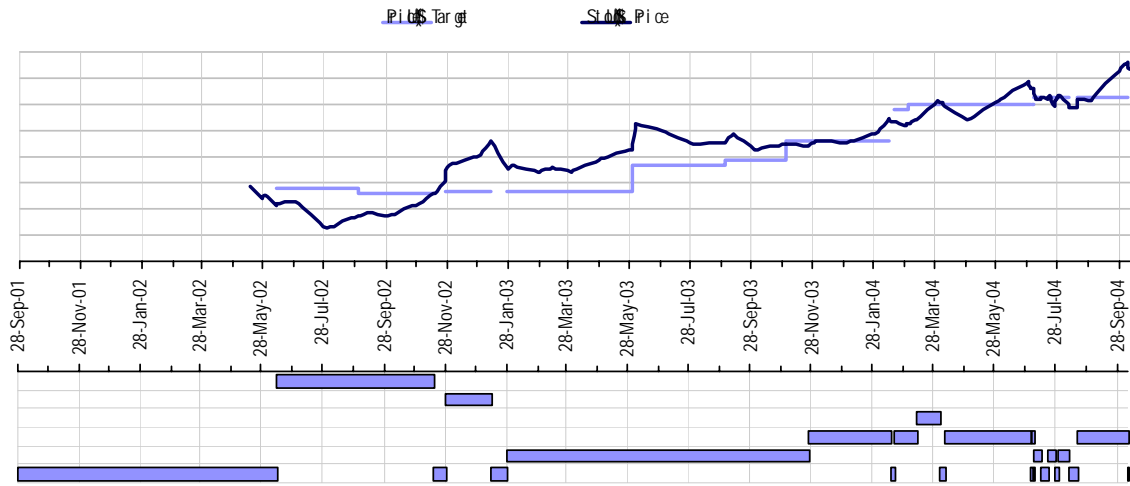
Price(s) as of 8 October 2004. Source: UBS.

4. Within the past three years, UBS AG, its affiliates or subsidiaries has received compensation for investment banking services from this company.

16. UBS Securities LLC makes a market in the securities and/or ADRs of this company.

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Verint Systems Inc. (US\$)



Source: UBS; as of 8 October 2004.

Note: On October 13, 2003, UBS adopted new definition criteria for its rating system. (See 'UBS Investment Research: Global Equity Ratings Definitions and Allocations' table for details.) Between January 11 and October 12, 2003, the UBS ratings and their definitions were: Buy 1: Excess return potential > 15%, smaller range around price target; Buy 2: Excess return potential > 15%, larger range around price target; Neutral 1: Excess return potential between -15% and 15%, smaller range around price target; Neutral 2: Excess return potential between -15% and 15%, larger range around price target; Reduce 1: Excess return potential < -15%, smaller range around price target; Reduce 2: Excess return potential < -15%, larger range around price target. Prior to January 11, 2003, the UBS ratings and definitions were: Strong Buy: Greater than 20% excess return potential, high degree of confidence; Buy: Positive excess return potential; Hold: Low excess return potential, low degree of confidence; Reduce: Negative excess return potential; Sell: Greater than 20% negative excess return potential, high degree of confidence. Under both ratings systems, excess return is defined as the difference between the FSR and the one-year local market interest rate.

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