June 25, 2008

ACTION

Sell

Check Point Software Tech. (CHKP)

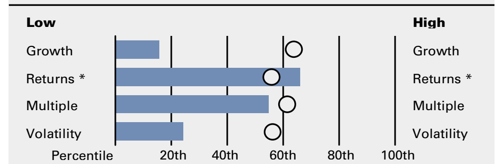
Return Potential: (7%)

Revenue and margin headwinds cap upside; Reiterate Sell

Source of opportunity

We are reiterating our Sell rating on shares of Check Point. While it's still too early to have a call on 2Q results, we believe that the stock currently faces several top-line and bottom-line headwinds which will cap estimates and hence limit stock performance. From an EPS perspective: (1) Exposure to appreciating currencies is notable; and, (2) Tax rate increases likely weigh on EPS and cashflow growth. From a revenue point of view: (1) Check Point's core market – firewall/VPNs is a relative slow grower, and we view Cisco as a share gainer; (2) An early lead in end-point encryption is dissipating quickly; and, (3) Benefits from CES program largely exhausted.

Investment Profile: Check Point Software Tech.



* Returns = Return on Capital For a complete description of the investment profile measures please refer to the disclosure section of this document.

Catalyst

Given Check Point's higher valuation relative to security stalwart Symantec (Symantec trades at 10.7X FY09 Adj. FCF, below Check Point at 12.8X), we recommend selling shares of Check Point to buy shares of Symantec. We have also made minor changes to our estimates in light of the top line and margin issues we discuss. Our EPS estimates in 2Q are unchanged at $0.41, on lower margins but slightly better revenue growth. Our FY08, FY09, and FY10 EPS estimates are now $1.73, $1.80, and $1.89 (ex- ESOs), respectively, compared to $1.73, $1.81 and $1.92, previously. Including ESOs our estimates are $1.57, $1.63, and $1.71.

Key data	Current
Price ($)	23.59
12 month price target ($)	22.00
Market cap ($ mn)	5,175.5

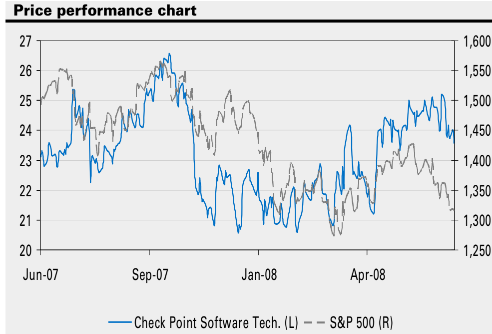
	12/07	12/08E	12/09E	12/10E
Revenue ($ mn) New	**730.9**	**804.1**	**836.1**	**869.4**
Revenue ($ mn) Old	730.9	791.3	807.5	838.8
EPS ($) New	**1.43**	**1.57**	**1.63**	**1.71**
EPS ($) Old	1.43	1.57	1.64	1.75
P/E (X)	16.5	15.1	14.5	13.8
EV/EBITDA (X)	11.5	10.1	8.9	8.0
ROE (%)	18.1	17.0	15.3	14.3

	3/08	6/08E	9/08E	12/08E
EPS ($)	0.38	0.37	0.39	0.42

Valuation

Based on historical and target P/E multiples, current EV/adjFCF/growth multiples, and DCF analysis, we are lowering our 12-month price target to $22.00 from $23.50, 7% downside from current levels.

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(2.4)	5.1	0.6
Rel. to S&P 500	0.3	19.7	15.0

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 6/24/2008 close.

Key risks

Key risks to our price target include ongoing optimism around the Protect Data acquisition, stock buybacks putting large cash balance to work, and an unexpected return to healthy growth in the core Network Security software business.

INVESTMENT LIST MEMBERSHIP

Americas Sell List

Coverage View: Neutral

Israel:
Software

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Check Point Software Tech.: Summary financials

Profit model ($ mn)	12/07	12/08E	12/09E	12/10E
Total revenue	730.9	804.1	836.1	869.4
Cost of goods sold	(53.8)	(72.9)	(84.0)	(87.1)
SG&A	(229.8)	(240.8)	(248.6)	(258.2)
R&D	(76.7)	(91.5)	(96.0)	(100.0)
Other operating profit/(expense)	0.0	0.0	0.0	0.0
ESO expense	(43.9)	(43.9)	(44.4)	(45.1)
EBITDA	**375.3**	**404.5**	**412.7**	**427.2**
Depreciation & amortization	(48.5)	(49.5)	(49.6)	(48.2)
EBIT	**326.7**	**355.0**	**363.1**	**379.0**
Net interest income/(expense)	49.7	56.2	57.6	60.5
Income/(loss) from associates	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
Pretax profits	**376.5**	**411.2**	**420.7**	**439.5**
Provision for taxes	(54.0)	(71.0)	(77.0)	(85.7)
Minority interest	0.0	0.0	0.0	0.0
Net income pre-preferred dividends	**322.5**	**340.2**	**343.7**	**353.8**
Preferred dividends	0.0	0.0	0.0	0.0
Net income (pre-exceptionals)	**322.5**	**340.2**	**343.7**	**353.8**
Post tax exceptionals	(77.7)	(60.4)	(60.4)	(60.4)
Net income (post-exceptionals)	**244.8**	**279.7**	**283.3**	**293.4**
EPS (basic, pre-except) ($)	**1.45**	**1.58**	**1.65**	**1.71**
EPS (diluted, pre-except) ($)	**1.43**	**1.57**	**1.63**	**1.71**
EPS (basic, post-except) ($)	**1.10**	**1.30**	**1.36**	**1.42**
EPS (diluted, post-except) ($)	**1.09**	**1.29**	**1.34**	**1.42**
Common dividends paid	--	--	--	--
DPS ($)	0.00	0.00	0.00	0.00
Dividend payout ratio (%)	0.0	0.0	0.0	0.0

Growth & margins (%)	12/07	12/08E	12/09E	12/10E
Sales growth	27.1	10.0	4.0	4.0
EBITDA growth	28.3	7.8	2.0	3.5
EBIT growth	18.5	8.6	2.3	4.4
Net income (pre-except) growth	13.6	5.5	1.1	2.9
EPS growth	20.2	9.3	3.9	3.9
Gross margin	92.6	90.9	90.0	90.0
EBITDA margin	51.3	50.3	49.4	49.1
EBIT margin	44.7	44.1	43.4	43.6

Cash flow statement ($ mn)	12/07	12/08E	12/09E	12/10E
Net income	281.1	316.0	319.6	329.6
D&A add-back (incl. ESO)	82.6	85.8	85.9	84.5
Minority interest add-back	0.0	0.0	0.0	0.0
Net (inc)/dec working capital	17.2	31.9	31.3	34.8
Other operating cash flow	(9.2)	0.0	0.0	0.0
Cash flow from operations	**371.6**	**428.6**	**437.1**	**448.9**
Capital expenditures	(16.7)	(11.1)	(11.6)	(12.0)
Acquisitions	(595.0)	0.0	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
Cash flow from investing	**(611.7)**	**(11.1)**	**(11.6)**	**(12.0)**
Dividends paid (common & pref)	0.0	0.0	0.0	0.0
Inc/(dec) in debt	0.0	0.0	0.0	0.0
Other financing cash flows	(185.1)	(201.5)	(201.5)	(201.5)
Cash flow from financing	**(168.3)**	**(201.5)**	**(201.5)**	**(201.5)**
Total cash flow	**(408.4)**	**216.0**	**224.0**	**235.3**

Balance sheet ($ mn)	12/07	12/08E	12/09E	12/10E
Cash & equivalents	897.5	1,001.8	1,244.3	1,479.6
Accounts receivable	201.5	184.5	190.5	121.7
Inventory	0.0	0.0	0.0	0.0
Other current assets	24.4	41.8	61.8	64.2
Total current assets	**1,123.4**	**1,228.0**	**1,496.5**	**1,665.5**
Net PP&E	56.9	58.2	64.0	69.1
Net intangibles	825.0	814.4	814.4	814.4
Total investments	344.0	458.5	458.5	458.5
Other long-term assets	24.9	13.0	13.4	13.4
Total assets	**2,374.3**	**2,572.1**	**2,846.9**	**3,021.0**
Accounts payable	197.7	238.7	246.5	191.3
Short-term debt	0.0	0.0	0.0	0.0
Other current liabilities	273.7	171.8	221.3	245.0
Total current liabilities	**471.4**	**410.5**	**467.8**	**436.3**
Long-term debt	0.0	0.0	0.0	0.0
Other long-term liabilities	14.4	16.7	16.7	0.0
Total long-term liabilities	**14.4**	**16.7**	**16.7**	**0.0**
Total liabilities	**517.3**	**427.2**	**484.5**	**436.3**
Preferred shares	**0.0**	**0.0**	**0.0**	**0.0**
Total common equity	**1,857.0**	**2,144.9**	**2,362.4**	**2,584.7**
Minority interest	**0.0**	**0.0**	**0.0**	**0.0**
Total liabilities & equity	**2,374.3**	**2,572.1**	**2,846.9**	**3,021.0**

Additional financials	12/07	12/08E	12/09E	12/10E
Net debt/equity (%)	(48.3)	(46.7)	(52.7)	(57.2)
Interest cover (X)	--	--	--	--
Inventory days	NM	NM	NM	NM
Receivable days	85.7	87.6	81.8	65.5
BVPS ($)	7.04	8.44	11.19	12.49
ROA (%)	14.5	13.8	12.7	12.1
CROCI (%)	35.4	29.3	27.3	27.4
Dupont ROE (%)	**17.4**	**15.9**	**14.5**	**13.7**
Margin (%)	44.1	42.3	41.1	40.7
Turnover (X)	0.3	0.3	0.3	0.3
Leverage (X)	1.3	1.2	1.2	1.2
Free cash flow per share ($)	1.59	1.94	2.04	2.11
Free cash flow yield (%)	6.8	8.2	8.6	8.9

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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EXPECTED NEWS FLOW/EVENTS

DATE	EVENT	COMMENT
Week of July xxx	Check Point's 2QFY08 earnings report	We expect in-line results and guidance. Hardware sales and currency headwinds limit margin improvements. Top-line growth restricted by market share losses, penetration of installed base with updated maintenance contracts, and loss of first-mover advantage in data security.
July 30, 2008	Symantec 1QFY09 earnings report	We expect 1Q results, forward guidance to be in line with our current estimates.

Source: Company data, Goldman Sachs Research estimates
The prices in the body of this report are based on the market close of June 24, 2008.

We view risk to estimates to the downside; Sell shares of Check Point to Buy Symantec

Risks to Revenue: Revenue headwinds in a slow growth market

- **Cisco continues to gain share in the Firewall/VPN market. Maturity of space caps overall growth in this area.** The majority of Check Point's product offerings target the slower growth Firewall/VPN arena which grew just 6.5% in 2007. Our, and industry research, underscores Cisco's slow but steady ability to consolidate market share. As customers look to "secure products not security products" the ability to bundle with networking equipment is attractive. Thus, we view medium term top-line growth for Check Point as capped in the mid-single digit range.
- **Growth from the Collaborative Enterprise Support (CES) program should slow as installed base becomes fully penetrated.** We estimate that Check Point's updates, maintenance and services business grew about 18% organically last year, up from 12% in 2006 (CES was launched in 2Q 2006) with growth coming from an increase in maintenance and services revenues from the company's Collaborative Enterprise Support program. We believe that the installed base is becoming penetrated here, and we should see services revenue growth pullback closer to the company's lower license revenue growth rate expectations.

- **PointSec engine not as powerful as originally thought. Competition playing catch-up and willing to be aggressive on price.** When Check Point purchased Protect Data over a year ago, the company's PointSec product was growing revenue at 96% a year. In 2007, Protect Data's revenue (as contributed to Check Point) grew approximately 5% year over year. While this is partially due to Check Point exiting the third party reselling business which they inherited with PointSec, as well the deferred revenue write-down associated with the acquisition, growth has slowed significantly. In this time, other small vendors in this area have been purchased and plugged into larger sales forces, such as SafeBoot, which was purchased by McAfee. McAfee has shown a willingness to be aggressive on price to gain market share.
- **Check Point's top-line growth in Europe may slow if dollar stabilizes.** Check Point prices its products in US dollars. As the dollar has declined against the euro over the past few years, we believe this has driven an uptake in demand for Check Point. As we see this reverse (the euro is down 2.0% against the dollar since the company gave 2Q guidance) we should see demand lessen in Europe as products become more expensive in euro terms.

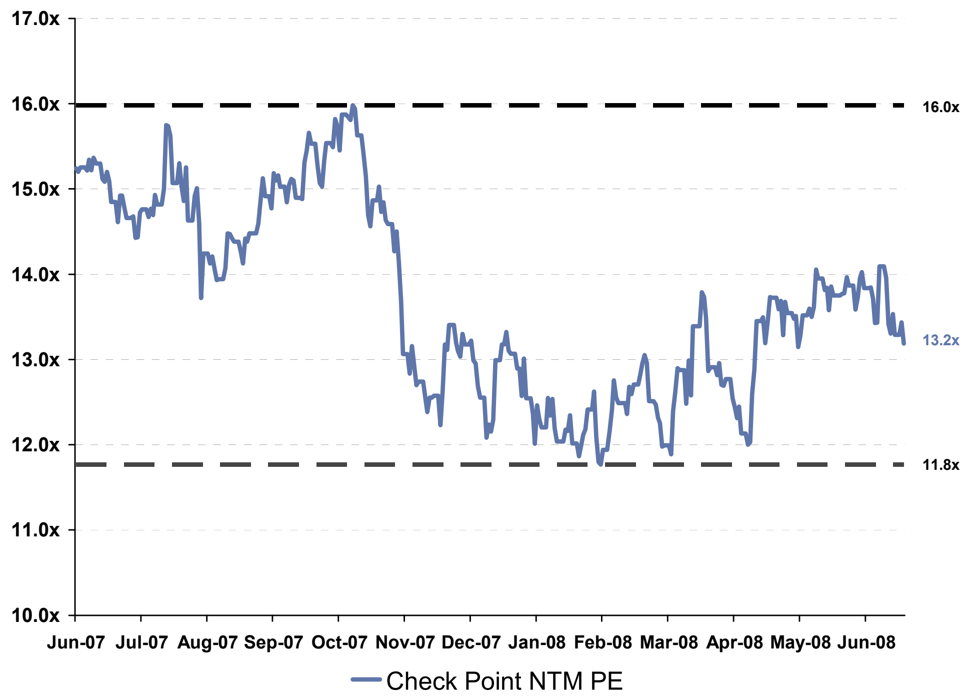
Risks to EPS: Greater proportion of low margin appliance revenue coupled with appreciating shekel pressuring earnings

- **Margins already industry best at 50%, risk to downside in our view.** Check Point's margins are impressive and the company deserves credit for running a lean, mean machine making use of R&D in lower cost jurisdictions such as Israel. However, in our view this forms part of a bear case as we see little room for margin expansion and hence at best earnings growth will be in line with revenue and more likely could lag as lower gross margin appliances become a bigger percentage of sales and currency fluctuations continue to weigh heavily.
  - **Gross margins likely to decline as appliance sales become a greater portion of sales.** While a software vendor traditionally, as the industry has shifted to more custom-built security appliances, Check Point moved into the appliance market a few years ago and appliance sales as a percentage of total revenue has been increasing. These appliances are lower margin sales and accounted for 30% of new product licenses in 1Q CY2008. We estimate as appliances become about 50% of product and license revenues, average gross margins for products and licenses will fall to about 84% from 88% currently.
  - **Exchange rate fluctuations causing expenses to rise.** In the past year, the Israeli shekel has appreciated about 25% against the dollar. About 42% of Check Point's employees are located in Israel and are paid in shekels. The company's latest filing suggests about 35% of operating expenses are paid in shekels and krona. While near-term, futures contracts can hedge against this appreciation, longer term, higher Israeli costs will likely cap margins at best and could even start eroding margins.
- **Increased tax rate likely over next several years; outstanding issue with Israeli Tax Authority still to be resolved.** Check Point's current tax rate of approximately 17% benefits from Israeli tax incentives which reduce corporate tax rates for companies who invest in production facilities in Israel. Check Point's current benefits are scheduled to expire incrementally through 2016. While new laws may be enacted which would give Check Point the ability to maintain its low tax rate, we believe the risk here remains that rates will increase. Additionally, the Israeli Tax Authority has disagreed with Check Point's treatment of cash which is held and managed by the company's wholly owned subsidiary in Singapore. The Tax Authority is asking for payments of $162mn in back taxes and $84mn in interest on those back

taxes, which if Check Point is found to be at fault would result in payments totaling about 5% of the company's market cap. Our biggest concern here is not the cash outflow, more the potential hike in the tax rate providing a headwind to cashflow and EPS growth.

Risks to valuation: Check Point now trades at a premium to other security stalwarts

Exhibit 1: Check Point NTM PE over the past 12 months
(Based on consensus NTM PE estimates)



Source: FactSet.

- **Check Point is trading in the middle of its 52-week NTM PE multiple trading range** and above security companies of comparable growth, despite sizable risks to estimates
- Based on our sensitivity analysis, we believe that upside to the stock is capped at about 11% while near term downside could be as much as 16%.

Exhibit 2: Check Point financial sensitivity analysis
$ millions, except per-share data

	Check Point Sensitivity Analysis			
	Base Case		Downside Case	
	CY08E	CY09E	CY08E	CY09E
Product & License	$339	$350	$336	$344
Software subscriptions	318	333	315	327
Support & Training	147	153	146	150
Total Revenue	$804	$836	$797	$821
Cost of Goods Sold	$73	$84	$80	$91
R&D	92	96	99	102
S&M	206	212	204	208
G&A	35	37	42	45
Operating Income	$399	$408	$371	$375
% Operating Margin	*49.6%*	*48.7%*	*46.6%*	*45.7%*
Other Income	$56	$58	$56	$58
Pre-Tax Income	$455	$465	$428	$433
Taxes	$79	$85	$73	$82
Tax Rate	*17.3%*	*18.3%*	*17.1%*	*19.0%*
Net Income	$376	$380	$355	$351
EPS	**$1.73**	**$1.80**	**$1.63**	**$1.66**
% Growth		*3.8%*		*1.7%*
WASO	217	211	217	211
Product & License	9%	3%	8%	2%
Software subscriptions	10%	5%	9%	4%
Support & Training	11%	4%	10%	3%
Total Revenue	10%	4%	9%	3%
COGS as a % of Revenue	9%	10%	10%	11%
R&D as a % of Revenue	11%	11%	12%	12%
S&M as a % of Revenue	26%	25%	26%	25%
G&A as a % of Revenue	4%	4%	5%	5%
Tax Rate	17%	18%	17%	19%

	Implied Price Per Share	
CY09 PE	CY2009	
Multiple	Base Case	Downside Case
Peak Check Point Multiple		
14.5x	**$26.10**	**$24.08**
% Upside (Downside) to Current	*11%*	*2%*
Current Check Point Multiple		
13.1x	**$23.59**	**$21.77**
% Upside (Downside) to Current	*0%*	*-8%*
Trough Check Point Multiple		
12.0x	**$21.60**	**$19.93**
% Upside (Downside) to Current	*-8%*	*-16%*

Source: Company data, Goldman Sachs Research estimates.

Risk to Our negative thesis: PointSec kicks into gear

- **The main risk to our negative thesis is that the pent up demand and customer interest in PointSec finally results in a realization of the product**

pipeline. Near-term IT departments appear to be taking more of a wait-and-see approach to deploying end-point encryption. In our view, the competitive landscape is still evolving with McAfee (via safeBoot) and Symantec (via a partnership with GuardianEdge) playing fast catch-up in an area that should be more in their bailiwick. Vista also includes some embedded encryption via BitLocker, although enterprise adoption of the operating system has been very anemic.

- **Check Point's top-line growth continues to benefit from the addition of a hardware component to sales.** As Check Point sells a greater portion of its products as appliances, its revenue growth benefits from the hardware component, while its gross margins are negatively affected. If investors focus on revenue growth and ignore the margin impact from this shift then the stock may see additional tailwinds.
- **Check Point has lots of dry powder with which to repurchase shares.** Check Point holds $1.3bn or about 25% of its market cap in cash. If the company chooses to use this cash to repurchase shares instead of making additional acquisitions, it would likely be a positive for shares.

Adjusting estimates based on concerns around currency impacts and mix shift

For the June quarter and FY2008 we are leaving EPS estimates constant at $0.41 and $1.73, respectively, given concerns around expense headwinds. From a revenue perspective we are tweaking our revenue estimates up slightly to account for ongoing hardware sales. Our revised June-quarter and FY2008 revenue estimates are $196 million and $804 million up 3% and 2% respectively from $191 million and $791 prior.

- We are currently estimating total product revenues to be up 9% for FY2008 and ticking down to 3% growth in FY2009 as the demand benefit from a weakening dollar abate, and hardware sales are annualized out.
- We are currently estimating data security will come in at $104 mn for the year, representing 26% yoy growth. This business has suffered from some initial teething trouble with the European salesforce, which the company has now worked through. Nevertheless, with competition rising from McAfee (SafeBoot), Ultimaco and at the low-end BitLocker we are veering to a more conservative view of growth rates.
- Management guided revenues for the June quarter to $190 million-$200 million, or 11% year-over-year growth, at the midpoint of the range. Our revenue number is currently $196mn, near the midpoint of this range.

Our EPS estimate for the June quarter excluding ESOs is $0.41. For FY2008, our EPS estimate (excluding ESOs) is $1.73 (including ESOs, FY2008 EPS estimate is $1.57). Management guided for June-quarter non-GAAP EPS of $0.40-$0.44, while the Street is currently anticipating $0.43. For full year Street is estimating $1.78.

Exhibit 3: Estimates changed
$ million, except per-share data

	2Q 2008	FY2008E	FY2009E	FY2010E
Revenue				
GS Revised Ests	$196	$804	$836	$869
YoY Growth rates		*10%*	*4%*	*4%*
Prior Ests	191	791	808	839
YoY Growth rates		*8%*	*2%*	*4%*
EPS - excl ESOs				
GS Revised Ests	$0.41	$1.73	$1.80	$1.89
Prior Ests	$0.41	1.73	1.81	1.92
EPS - incl ESOs				
GS Revised Ests	$0.37	$1.57	$1.63	$1.71
Prior Ests	0.37	1.57	1.64	1.75

Source: Company data, Goldman Sachs Research estimates.

Currency Impact: Little negative impact to margins near-term, however long-term negative effects of shekel appreciation will be difficult to avoid

- **Recent appreciation of the dollar against the euro could cause demand destruction in Europe.** Over the past quarter, the dollar has appreciated 2.0% against the euro, making products priced in dollars look more expensive to European buyers. If the dollar continues to appreciate, we could see additional demand destruction in European geographies.
- **In addition Check Point's exposure to currency such as the Israeli shekel provides a strong headwind to margins.** In order to limit the company's liabilities due to exchange rate fluctuations, Check Point enters into 12-month forward contracts for currencies it has large exposures to, such as the Israeli shekel. Since April 17th, when Check Point issued its 2Q and full year guidance, the shekel has appreciated a further 2.4% against the dollar, and is up 25% YoY. Over that same time period, the euro has depreciated about 2.0% (but is still up 16% YoY) and the Swedish krona has depreciated about 2.0% (but up is 14% YoY). See Exhibit 4 for full details.

Exhibit 4: Change in exchange rates since guidance was issued
Denominated in US dollars / Foreign Currency

Currency	Exchange Rate on 4/17/2008[1]	Current Exchange Rate	% Change	YoY % Change
Israeli Shekel	$0.288	$0.295	2.4%	25.4%
Euro	$1.590	$1.559	-2.0%	15.9%
Swedish Krona	$0.169	$0.166	-2.0%	13.9%

1) US dollars / Foreign Currency

Source: FactSet and Goldman Sachs Research.

- **Forward currency contracts mitigate some of this headwind but these too carry a cost.** We do not believe that Check Point will have a significant adverse impact to margins from foreign exchange movements in the coming quarter, given the fact that the company enters into forward currency contracts to hedge fluctuations, and the major currencies that the company pays its expenses in have not moved dramatically vis a vis the dollar. That said, in 2007, about 42% of the company's 1,900 employees were located in Israel and as future currency contracts annualize out, we believe that the expenses associated with these employees will rise, negatively impacting the company's operating margins.

Losing the (low growth) market share battle to Cisco as customers shift to suite providers

- **Check Point continues to see market erosion to Cisco.** 2007 firewall/VPN appliance market information from Gartner indicates that Check Point continues to lose market share to large appliance vendor Cisco. While the shift is not dramatic, it does underscore ongoing gradual erosion for Check Point's products. In our view this shift is driven by buyers' preference for one-stop-shopping, as well as increased performance requirements. We use the Check Point with Nokia and Crossbeam revenue number as this more accurately reflects market share, since Check Point software is typically sold on top of hardware. Check Point UTM revenues are grouped in the "Other" category, and despite their rapid growth, our conversations indicate that and gains here are not large enough to counteract declines in the core business.
- **Our recent CSO surveys show that customers are looking to purchase more and more of their solutions from just one vendor.** Cisco is increasingly becoming this vendor, as it becomes a more credible player in both the firewall and UTM markets. In our most recent CSO survey, suite vendors Oracle, EMC, and Cisco topped the list of vendors that are gaining spending share. 40% of existing Cisco customers expected to spend more with the company in the coming year and 86% of the 50 CSOs surveyed were Cisco customers, more than any other security vendor.
- **Our reseller checks indicate that Cisco firewalls are becoming "good enough" when compared to products from companies such as Check Point and Secure Computing.** This is worrisome for point security solution providers, as buying from one vendor also reduces complexity and integration woes in the data center, increasing overall security. We expect to continue to see Check Point lose share to Cisco, forcing the company's top line growth in the core firewall/VPN market to be below the 6%-7% range of the overall market.

Exhibit 5: Worldwide Firewall/VPN Appliances Market
($ millions)

	Vendor Revenue 2007	Vendor Mkt. Share	2007 Rank	Vendor Revenue 2006	Vendor Mkt. Share	Change in Mkt. Share	Revenue Growth '07/'06
Cisco	$990.1	35.5%	1	$872.0	33.3%	2.2%	13.5%
Check Point with Nokia/Crossbeam	**509.2**	**18.3%**	**2**	**490.9**	**18.8%**	**-0.5%**	**3.7%**
Juniper Networks	230.3	8.3%	3	224.8	8.6%	-0.3%	2.4%
SonicWALL	124.9	4.5%	4	121.5	4.6%	-0.2%	2.8%
Secure Computing	99.0	3.6%	5	100.4	3.8%	-0.3%	-1.4%
WatchGuard	77.2	2.8%	6	59.8	2.3%	0.5%	29.2%
Others	755.3	27.1%		747.7	28.6%	-1.5%	1.0%
Total	2,785.9	100.0%		2,617.0	100.0%		6.5%

Note: "Others" includes Check Point on other hardware and UTM-1 devices and is not large enough to make the company a share gainer.

Source: Gartner and Goldman Sachs Research.

Increasing contribution from appliance sales likely a negatively impact to margins

- **Increasing hardware component of sales is causing gross margins to fall.** Check Point has historically sold high margin software, allowing channel partners to install the software on hardware, predominantly a Nokia platform, and sell the full solution to customers. Increasingly, however, customers are demanding integrated appliances such as Check Point's UTM-1 offering, which offers integrated anti-virus, anti-spyware, and web filtering features in addition to typical firewall capabilities. This type of integration requires Check Point to sell an appliance, which includes a lower margin hardware component in addition to the higher margin software.
- **Product and License gross margins have fallen 6% since 4Q FY'06 as appliances have become a bigger % of the mix.** In 4Q FY'06, product and license gross margins were in the 94% range (sales of UTM-1 appliances were relatively small at that stage). In the latest quarter (1Q FY'08), when management commented that appliance sales were about 30% of new product and license sales, gross margins had dipped 600bps to 88%. Assuming 70% of product sales are still at a 94% gross margin, this implies a 74% gross margin on appliance sales. If appliances become 50% of total product and license sales, this will bring product and license margins down another 400bps to 84%. (See Exhibit 6) Given that Product and License revenues comprise about 40-45% of total revenues, this should have about a 2% negative impact on total operating margins over time.

Exhibit 6: Impact of additional appliance sales on product and license gross margin
($ millions)

	4Q FY'06	1Q FY'08	Future
% Software Revenue	100%	70%	50%
Software Gross Margin %	*94%*	*94%*	*94%*
% Integrated Appliance Revenue	0%	30%	50%
Appliance Gross Margin %	*74%*	*74%*	*74%*
Blended Product and License Gross Margin	**94%**	**88%**	**84%**

Source: Gartner and Goldman Sachs Research.

High growth in maintenance and services revenues have helped support margins, but growth here is likely to slow as installed base is fully penetrated

- **In 2006, Check Point introduced its Collaborative Enterprise Support program which provides customers with improved support.** Certified Collaborative Support Providers provide the first line of support for customers and if they are unable to adequately help, the request is passed to Check Point's global, 24-7 Technical Assistance Centers for additional support. The CES program has resulted in an increase in high margin maintenance and services revenues for the company as existing customers have signed up on full CES contracts.
- **Over time, as the customer base is penetrated, maintenance and services growth should slow closer to that of license revenue line.** In the last quarter, maintenance and services revenue grew 17% year over year, adding significantly to

top-line growth. In 2007, we estimate that maintenance and services revenues grew 18% organically yoy, above the 2006 growth rate of 12% yoy (CES was implemented in 2Q 2006). Additionally, on an organic TTM basis, we believe that maintenance and services has grown at 18% yoy.

PointSec Update: Check Point attacking the right space, but giving up first mover advantage

- **Our recent conversations with VARs imply that there is significant interest in Check Point's PointSec products, but customers are holding off with purchases for now.** Additionally, 78% of respondents in our recent survey of 50 CSOs viewed endpoint management and encryption as the key area of spending within the next 12 months.
- **We believe that this purchasing delay could be long enough for Check Point to surrender a good portion of its first mover advantage here.** Customers we have spoken with have said that adding another vendor foot print to their endpoint would likely increase complexity and hinder device performance. By consolidating DLP and encryption solutions to a company such as McAfee or Symantec, which already has a footprint on the endpoint, customers can sidestep at least some of these performance and complexity issues. While in our latest CSO survey Check Point was still the most considered encryption/data leakage protection, the lead over competitor Symantec was just 4% or 2 CSO responses. (See exhibit 7)

Exhibit 7: 50 CSOs were asked: When making your endpoint encryption/data leakage protection solution choice, which vendors have you considered or will you consider?

	Apr-08
Check Point (PointSec)	**52%**
Symantec (Vontu)	**48%**
McAfee (SafeBoot)	**28%**
EMC (Tablus)	**24%**
Trend Micro	**18%**
Code Green	**10%**

Source: Goldman Sachs Security Spending Survey.

Valuation above Symantec, despite top and bottom line headwinds and in-line cash flow growth

- **Check Point trades at a premium to Symantec on a cash flow basis.** From a valuation perspective, Check Point shares trade at a 13.6X and 13.1X 2008 and 2009 P/E (ex-ESOs), compared to security stalwart Symantec at 13.5X and 12.6X, respectively. On an EV/adjusted FCF basis, the disparity is greater, with Check Point trading at 12.8X 2008 and 2009 estimates, above Symantec at 11.6X and 10.7X, respectively. We estimate a 4% Adj. FCF CAGR for both Symantec and Check Point over the next 3 years.

- **The risk to Check Point's estimates is to the downside.** We believe that in contrast to Check Point, the risk to Symantec's estimates is to the upside, with product cycles kicking in (in our recent CSO survey, 32% of Symantec customers expected to upgrade to Symantec Endpoint Protection 11.0 (SEP11) in the next 12 months). Additionally, the company has rolled out new sales force incentives to help drive greater license revenue growth and continues to look at cost savings on the operating expense lines.
- **We would sell Check Point and buy Symantec, rated Buy.** Given the lower valuation, (16% lower 2009 Adj. FCF multiple), lower risk to estimates and similar growth profiles, we would recommend Buying shares of Symantec and Selling shares of Check Point through the volatile summer trading season. Our 12 month price target for Symantec is $23, based on a triangulation of P/E, EV/adjusted FCF/growth, and DCF. Key risks include ongoing M&A integration issues, competition from larger security & IT incumbents, and declining antivirus pricing.

Exhibit 8: Check Point Software summary financials
($ millions, except per-share data)

	2007				2008E				2009E				Fiscal / Calendar Years			
	Mar	Jun	Sep	Dec	Mar	Jun-E	Sep-E	Dec-E	Mar-E	Jun-E	Sep-E	Dec-E	2007	2008E	2009E	2010E
Revenues:																
Product & License	$66.0	$73.3	$76.9	$93.5	$77.4	$80.4	$82.7	$98.5	$80.6	$83.2	$85.5	$101.0	$309.8	$339.0	$350.3	$362.0
Updates, maintenance and services	$97.9	$102.9	$107.1	$113.2	$114.2	$115.3	$117.1	$118.5	$119.7	$121.0	$122.0	$123.1	$132.7	$147.2	$152.6	$158.2
Total revenues	**$164.0**	**$176.2**	**$184.0**	**$206.7**	**$191.6**	**$195.7**	**$199.8**	**$217.0**	**$200.3**	**$204.2**	**$207.5**	**$224.1**	**$730.9**	**$804.1**	**$836.1**	**$869.4**
QOQ Growth	*2%*	*7%*	*4%*	*12%*	*-7%*	*2%*	*2%*	*9%*	*-8%*	*2%*	*2%*	*8%*				
YOY Growth	*23%*	*27%*	*29%*	*29%*	*17%*	*11%*	*9%*	*5%*	*5%*	*4%*	*4%*	*3%*	*27%*	*10%*	*4%*	*4%*
Total Cost of Rev	$10.6	$12.4	$14.6	$16.3	$15.5	$17.4	$18.6	$21.4	$19.3	$20.2	$21.0	$23.5	$53.8	$72.9	$84.0	$87.1
Gross Profit	**$153.4**	**$163.8**	**$169.4**	**$190.4**	**$176.0**	**$178.3**	**$181.2**	**$195.6**	**$181.0**	**$184.0**	**$186.5**	**$200.6**	**$677.0**	**$731.2**	**$752.1**	**$782.3**
Gross Margin	*93.6%*	*92.9%*	*92.1%*	*92.1%*	*91.9%*	*91.1%*	*90.7%*	*90.1%*	*90.4%*	*90.1%*	*89.9%*	*89.5%*	*92.6%*	*90.9%*	*90.0%*	*89.0%*
Operating expenses:																
R & D	$17.9	$19.7	$18.7	$20.4	$21.6	$22.6	$22.6	$24.7	$23.0	$23.3	$24.5	$25.2	$76.7	$91.5	$96.0	$100.0
S & M	47.7	49.4	46.9	52.5	48.3	50.9	51.0	56.0	50.6	51.0	52.0	58.0	196.5	206.2	211.6	220.0
G & A	8.6	6.9	7.6	10.1	8.0	8.7	8.9	9.0	9.0	9.2	9.3	9.5	33.3	34.6	37.0	38.3
Total Operating Expenses	74.2	76.0	73.1	83.1	77.9	82.2	82.5	89.7	82.6	83.5	85.8	92.7	306.4	332.3	344.6	358.2
Operating income	**$79.2**	**$87.7**	**$96.3**	**$107.4**	**$98.1**	**$96.1**	**$98.7**	**$105.9**	**$98.4**	**$100.5**	**$100.7**	**$107.9**	**$370.6**	**$398.8**	**$407.5**	**$424.1**
Operating margin	*48%*	*50%*	*52%*	*52%*	*51%*	*49%*	*49%*	*49%*	*49%*	*49%*	*49%*	*48%*	*51%*	*50%*	*49%*	*49%*
Other income, net	$13.1	$11.6	$11.6	$13.4	$14.6	$13.2	$13.8	$14.6	$13.6	$14.0	$14.6	$15.4	$49.7	$56.2	$57.6	$60.5
Pretax income	$92.2	$99.4	$107.9	$120.8	$112.7	$109.3	$112.5	$120.5	$112.0	$114.5	$115.3	$123.3	$420.3	$455.1	$465.1	$484.6
Pretax margin	*56%*	*56%*	*59%*	*58%*	*59%*	*56%*	*56%*	*56%*	*56%*	*56%*	*56%*	*55%*	*58%*	*57%*	*56%*	*56%*
Taxes	$13.6	$13.7	$15.9	$18.3	$19.4	$19.0	$19.5	$20.8	$20.5	$21.0	$21.1	$22.6	$61.6	$78.6	$85.1	$94.5
Tax rate	*15%*	*14%*	*15%*	*15%*	*17%*	*17%*	*17%*	*17%*	*18%*	*18%*	*18%*	*18%*	*15%*	*17%*	*18%*	*20%*
Net income	$78.6	$85.7	$91.9	$102.5	$93.4	$90.4	$93.0	$99.7	$91.5	$93.6	$94.2	$100.7	$358.7	$376.4	$380.0	$390.1
EPS	**$0.35**	**$0.38**	**$0.41**	**$0.46**	**$0.43**	**$0.41**	**$0.43**	**$0.46**	**$0.43**	**$0.44**	**$0.45**	**$0.48**	**$1.59**	**$1.73**	**$1.80**	**$1.89**
YOY Growth	*13%*	*20%*	*20%*	*16%*	*23%*	*9%*	*5%*	*1%*	*1%*	*6%*	*4%*	*4%*	*17%*	*9%*	*4%*	*5%*
ESO expense (post tax)	$8.3	$8.6	$8.3	$8.8	$9.1	$9.1	$9.1	$9.1	$9.1	$9.1	$9.1	$9.1	$36.3	$36.3	$36.3	$36.3
EPS including ESO expense	**$0.31**	**$0.34**	**$0.37**	**$0.42**	**$0.38**	**$0.37**	**$0.39**	**$0.42**	**$0.39**	**$0.40**	**$0.40**	**$0.44**	**$1.43**	**$1.57**	**$1.63**	**$1.71**
Avg shares (millions)	227.7	226.2	225.0	223.0	219.4	217.9	216.4	214.9	213.4	211.9	210.4	208.9	225.5	217.1	211.1	206.9
	2007				**2008E**				**2009E**				**Fiscal / Calendar Years**			
Balance sheet/Cashflow metrics	Mar	Jun	Sep	Dec	Mar	Jun-E	Sep-E	Dec-E	Mar-E	Jun-E	Sep-E	Dec-E	2007	2008E	2009E	2010E
Cash flow from operations	**$110.0**	**$81.5**	**$88.8**	**$91.3**	**$142.9**	**$92.7**	**$91.3**	**$101.8**	**$141.5**	**$99.5**	**$91.8**	**$102.3**	**$371.6**	**$428.6**	**$437.1**	**$448.9**
	-2%	***-7%***	***18%***	***17%***	***30%***	***14%***	***3%***	***11%***	***-1%***	***7%***	***1%***	***1%***	***2%***	***15%***	***2%***	***3%***
Free cash flow	**$105.6**	**$75.9**	**$86.2**	**$87.2**	**$140.9**	**$89.7**	**$88.3**	**$98.5**	**$138.5**	**$96.4**	**$88.7**	**$98.9**	**$354.9**	**$417.5**	**$425.6**	**$436.9**
YoY growth rate	***-5%***	***57%***	***17%***	***17%***	***33%***	***18%***	***2%***	***13%***	***-2%***	***7%***	***0%***	***0%***	***11%***	***18%***	***2%***	***3%***
Free cash flow per share	**$0.46**	**$0.34**	**$0.38**	**$0.39**	**$0.64**	**$0.41**	**$0.41**	**$0.46**	**$0.65**	**$0.46**	**$0.42**	**$0.47**	**$1.57**	**$1.92**	**$2.02**	**$2.11**
	2007				**2008E**				**2009E**							
	Mar	Jun	Sep	Dec	Mar	Jun-E	Sep-E	Dec-E	Mar-E	Jun-E	Sep-E	Dec-E	**2007E**	**2008E**	**2009E**	**2010E**
DSO	74	68	64	88	71	63	63	77	63	63	63	77	88	77	77	NA
Deferred Revenue	$238.4	$236.2	$227.2	$273.7	$278.4	$272.9	$261.9	$293.4	$305.1	$305.1	$286.8	$318.4	$273.7	$293.4	$318.4	$330.4
Seq. change in deferred rev	17%	-1%	-4%	20%	2%	-2%	-4%	12%	4%	0%	-6%	11%	34%	7%	9%	4%
Cash	$1,122	$1,150	$1,205	$1,242	$1,319	$1,363	$1,407	$1,460	$1,554	$1,605	$1,649	$1,703	$1,242	$1,460	$1,703	$1,938
Debt	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Net cash	$1,122	$1,150	$1,205	$1,242	$1,319	$1,363	$1,407	$1,460	$1,554	$1,605	$1,649	$1,703	$1,242	$1,460	$1,703	$1,938
Net cash per share	$4.93	$5.09	$5.36	$5.57	$6.01	$6.26	$6.50	$6.80	$7.28	$7.58	$7.84	$8.15	$5.51	$6.72	$8.06	$9.37

Source: Company data, Goldman Sachs Research estimates.

Reg AC

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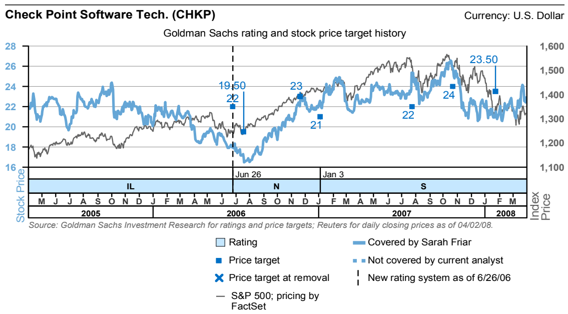

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Current Investment List (CIL). We expect stocks on this list to provide an absolute total return of approximately 15%-20% over the next 12 months. We only assign this designation to stocks rated Outperform. We require a 12-month price target for stocks with this designation. Each stock on the CIL will **automatically** come off the list after 90 days unless renewed by the covering analyst and the relevant Regional Investment Review Committee.

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