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United States of America

Technology

Software

Verint Systems Inc (VRNT - \$ 38.80) 1-Overweight

Earnings Review/Sales Analysis

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In line Quarter and Outlook

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Investment Conclusion

Given the recent run in the stock, we expect shares of Verint to modestly trade down following in line 3Q results and guidance that was in line with our and consensus expectations, after adjusting for recent acquisitions. We would look for pullbacks into the mid thirties to add to positions.

Summary

- Verint reported in line 3Q results of \$78.2M (+22% y/y) vs our estimates of \$77.0M and \$0.26.
- Results driven by 30% growth in core security business (DSS), while EBI was only up 8% sequentially.
- Mgmt guided Q4 revenues of \$82M and EPS of \$0.28. Accordingly, we are increasing our revenue estimate to \$82M (+19%) from \$80.8M and maintaining EPS of \$0.28.
- Mgmt guided FY05 revenues of \$307M and EPS of \$1.03-\$1.04. Increasing revenue to \$307M (+23% y/y) from \$304.5M and maintaining EPS of \$1.03.
- Verint introduced FY06 guidance of \$365-\$375M and EPS of \$1.30. We are raising our revenue estimate to \$373M, from \$360M, to reflect revenue from the MultiVision acquisition. Increasing EPS to \$1.30 from \$1.25.

Stock Rating

Target Price

New: 1-Overweight	New: \$ 40.00
Old: 1-Overweight	Old: \$ 40.00

Sector View: 1-Positive

EPS (\$) (FY Jan)

	2005		2006		2007		% Change	
	Actual	Old	New	St. Est.	Old	New	2006	2007
1Q	0.18A	0.23E	0.23E	0.23A	0.29E	0.30E	28%	30%
2Q	0.20A	0.25A	0.25A	0.25A	0.30E	0.32E	25%	28%
3Q	0.21A	0.26E	0.26A	0.26E	0.32E	0.33E	24%	27%
4Q	0.23A	0.28E	0.28E	0.30E	0.34E	0.35E	22%	25%
Year	0.82A	1.03E	1.03E	1.04E	1.25E	1.30E	26%	26%
P/E			37.7			29.8		

Market Data

Market Cap (Mil.)	1284
Shares Outstanding (Mil.)	33.30
Float (%)	N/A
Dividend Yield	N/A
Convertible	No
52 Week Range	43.17 - 29.37

Financial Summary

Revenue FY06 (Mil.)	373.0
Five-Year EPS CAGR	20.0
Return on Equity	10.60
Current BVPS	8.50
Debt To Capital (%)	0.00

Stock Overview



INVESTMENT CONCLUSION

Given the recent run in the stock, we expect shares of Verint to modestly trade down following in line 3Q results and guidance that was in line with our and consensus expectations, after adjusting for recent acquisitions. We would look for pullbacks into the mid thirties to add to positions. For FY06, we are raising our revenue and EPS estimates to \$373 million (+22% y/y) and \$1.30 from \$360 million and \$1.25. The increase in revenue is entirely a reflection of expected contribution from the MultiVision acquisition. Our forecast implies organic topline growth of approximately 15% and total revenue growth of 22% while assuming that the DSS business can sustain growth in the high teens and EBI in the low double digits. We remain bullish on the secular growth outlook for advanced security technologies in both the networked video surveillance and lawful interception markets, growth markets that have enabled Verint to sustain growth of 20%+ over the past four years. Our 12-month price target of \$40 represents a P/E of 30x our C06 EPS estimate of \$1.30, a slight premium to the earnings growth rate of 26%. Verint's balance sheet remains strong with over \$7.21 per share. We look for potential upside from recent increase in activity

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in mass transit vertical and improvements in the EBI business which management is expecting to accelerate over next 12 months as potential sources of upside to our estimates. We maintain our 1-Overweight rating.

Q3 Earnings Summary: Verint reported inline 3Q results of \$78.2 million (+22% y/y) and \$0.26 pro-forma vs. our \$77.0 million and \$0.26 estimate. The quarter was driven by strong performance in the core Digital Security Surveillance (DSS) business which grew 29.8% y/y and represented 68.7% of total revenue. Enterprise Business Intelligence (EBI) continued to decelerate and posted y/y growth of 8.3%, representing 31.3% of total revenue. Management expects EBI growth to accelerate to 20% over the next 12 months based on a review of the current activity in the pipeline. The security business continued to show strong growth driven and sustained by heightened security awareness among government and corporate sectors, especially in light of recent terrorist activity. This activity has apparently led to broader adoption for Verint's video surveillance solutions and has led to several incremental million dollar deals. For example, Verint is seeing high demand for their network video solutions from mass transit customers around the world and has served deployments in various stages of implementation. Recent mass transit wins include a multi-million dollar order for a mass transit system in a major metropolitan area in the Asia-Pacific region, a contract with King's Cross Station in the UK, a deal with Metro Valencia in Spain, and an order in New York. Recent video surveillance government contracts include a deal with US Department of Defense and a new UK government order. Verint also signed a multi-million dollar expansion communications and interceptions solutions order with an international law enforcement customer.

Geographically, revenues from the Americas were 48% of total revenues (-0.5% y/y), while EMEA contributed 35% (+29.7% y/y), and the ROW contributed the remaining 17% (+159.8% y/y). Gross margins of 57.6% came in ahead of our 56.9% expectation due to the increase in software value-added solutions. Operating margins of 11.9% declined 20 basis points q/q on high SG&A expenses (+8.6% q/q) and was below our 12.5% expectation. DSOs of 45 were down from 48 last quarter and below long-term target of 60-80 days. Cash flow from operations was \$9 million. On a TTM, cash flow from operations was \$53.7 million. Advanced payments were down \$0.8 million (-2% q/q). Verint ended the quarter with backlog in excess of one quarter of revenue, unchanged from the prior quarter.

Guidance: For 4Q, Verint is forecasting revenue of \$82 million (+19% y/y) and pro-forma EPS of \$0.28. (Consensus: \$82 million and \$0.30). Management slightly raised FY05 revenue guidance to \$307 million from \$303-\$306 million and narrowed the EPS guidance range to \$1.03-\$1.04 from \$1.02-\$1.05. (Consensus: \$306 million and \$1.04). Management provided a relatively upbeat outlook on FY06, suggesting organic growth of 15% and total growth of 22% driven by continued strong demand in DSS and acceleration in EBI. Verint introduced FY06 guidance of \$365-375 million in revenue and \$1.30 in EPS, inline with consensus estimates of \$365 million and \$1.31 and \$0.05 ahead of our EPS estimate. However, revenue guidance was slightly below consensus and our expectation after adjusting for the MultiVision acquisition.

Changes to forecast: We are slightly raising our Q4 revenue estimate to \$82 million (+19% y/y), from \$80.8 million, and maintaining EPS of \$0.28, in line with management guidance. Accordingly, we are raising our FY05 revenue estimate to \$307.0 million (+23% y/y) from \$304.5 million and maintaining our EPS estimate of \$1.03. Management introduced FY06 guidance of \$365-\$375 million and \$1.30. With the MultiVision acquisition expected to close in January, we estimate a contribution of \$4.0-\$4.5 million per quarter. For FY06, we are increasing our revenue estimate to \$373.0 million (+22% y/y) from \$360.0 million, and raising our EPS estimate to \$1.30 from \$1.25. Our estimates assume approximately \$18 million in acquisition-related revenue, implying organic growth rate of approximately 15%.

	Fiscal Year 2005				Fiscal Year 2006				Fiscal Year End: January		
	Apr-05A	Jul-05A	Oct-05A	Jan-06E	Apr-06E	Jul-06E	Oct-06E	Jan-07E	2004A	2005E	2006E
Net Revenue	72.0	74.7	78.2	82.0	86.8	91.0	95.1	100.1	249.8	307.0	373.0
Cost of sales	31.4	32.4	33.2	34.6	36.5	38.0	39.8	41.6	110.6	131.6	155.9
R&D	9.4	9.6	10.0	10.7	11.5	12.0	12.8	13.4	32.0	39.7	49.7
SG&A	23.2	23.7	25.7	26.4	28.0	29.3	30.6	32.2	81.2	99.0	120.1
Total operating expenses	32.6	33.3	35.7	37.1	39.4	41.3	43.5	45.6	113.2	138.7	169.8
Total non-operating expenses	-	-	1.5	6.0	6.0	6.0	6.0	5.8	8.5	7.5	23.8
Operating Income (pro forma)	8.0	9.0	9.3	10.3	10.9	11.7	11.9	12.8	26.0	36.7	47.3
Operating Income (GAAP)	8.0	9.0	7.9	4.3	4.9	5.7	5.9	7.0	17.5	29.3	23.5
Interest Income	1.7	1.7	2.1	2.0	2.0	2.1	2.2	2.2	3.6	7.5	8.5
Pre-tax income (pro forma)	9.7	10.7	11.4	12.3	12.9	13.8	14.1	15.0	29.6	44.2	55.8
Pre-tax income (GAAP)	9.7	10.7	9.9	6.3	6.9	7.8	8.1	9.2	21.1	36.7	32.0
Income Tax (pro forma)	2.0	2.4	2.6	2.8	2.8	3.0	3.1	3.3	2.8	9.9	12.3
Income Tax (GAAP)	1.8	2.2	2.2	1.5	1.5	1.7	1.8	2.0	2.0	7.7	7.0
Net income (pro forma)	7.7	8.3	8.8	9.5	10.1	10.7	11.0	11.7	26.9	34.3	43.5
Net income (GAAP)	7.9	8.5	7.7	4.9	5.4	6.0	6.3	7.2	19.1	29.0	25.0
EPS (pro forma)	0.23	0.25	0.26	0.28	0.30	0.32	0.33	0.35	0.82	1.03	1.30
EPS (GAAP)	0.20	0.22	0.23	0.15	0.16	0.18	0.19	0.21	0.58	0.80	0.75
Shares Outstanding	33.1	33.0	33.3	33.3	33.4	33.4	33.5	33.5	32.6	33.2	33.5
MARGIN ANALYSIS											
Gross profit	56.4%	56.7%	57.6%	57.8%	58.0%	58.2%	58.2%	58.4%	55.7%	57.1%	58.2%
Operating Income	11.1%	12.1%	11.9%	12.6%	12.6%	12.8%	12.5%	12.8%	10.4%	12.0%	12.7%
Profit Margin	10.7%	11.1%	11.2%	11.6%	11.6%	11.8%	11.6%	11.7%	10.7%	11.2%	11.7%
YEAR TO YEAR CHANGE											
Net Revenue	27.2%	24.1%	22.3%	18.9%	20.5%	21.8%	21.5%	22.0%	29.6%	22.9%	21.5%
Operating Income	35.5%	46.3%	35.7%	47.0%	36.5%	28.8%	27.4%	24.0%	48.4%	41.2%	28.8%
Net Income	30.2%	27.9%	27.0%	26.1%	31.0%	28.9%	25.3%	23.5%	47.0%	27.7%	26.9%
EPS	26.8%	25.6%	24.9%	25.0%	29.7%	27.3%	24.7%	22.7%	33.1%	25.5%	25.9%
QUARTER TO QUARTER CHANGE											
Net Revenue	4.4%	3.7%	4.7%	4.8%	5.9%	4.8%	4.5%	5.3%	-	-	-
Operating Income	31.7%	12.9%	3.2%	10.7%	14.0%	6.5%	2.0%	7.8%	-	-	-
Net Income	2.4%	7.9%	5.4%	8.1%	6.4%	6.3%	2.4%	6.6%	-	-	-
EPS	2.4%	8.1%	4.5%	8.1%	6.3%	6.1%	2.3%	6.4%	-	-	-
PERCENT OF NET REVENUE											
Cost of sales	43.6%	43.3%	42.4%	42.2%	42.0%	41.8%	41.8%	41.6%	44.3%	42.9%	41.8%
R&D	13.0%	12.9%	12.8%	13.0%	13.2%	13.2%	13.5%	13.4%	12.8%	12.9%	13.3%
SG&A	32.3%	31.7%	32.8%	32.2%	32.2%	32.2%	32.2%	32.2%	32.5%	32.2%	32.2%
Total operating expenses	45.3%	44.5%	45.7%	45.2%	45.4%	45.4%	45.7%	45.6%	45.3%	45.2%	45.5%
Effective Tax Rate (Benefit)	20.6%	22.5%	23.1%	23.1%	22.0%	22.0%	23.0%	23.0%	9.4%	21.0%	22.0%

Source: Lehman Brothers estimates

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Company Description:

Verint Systems is a leading provider of analytic software solutions for communications interception, digital video security and surveillance, and enterprise business intelligence.

Important Disclosures:

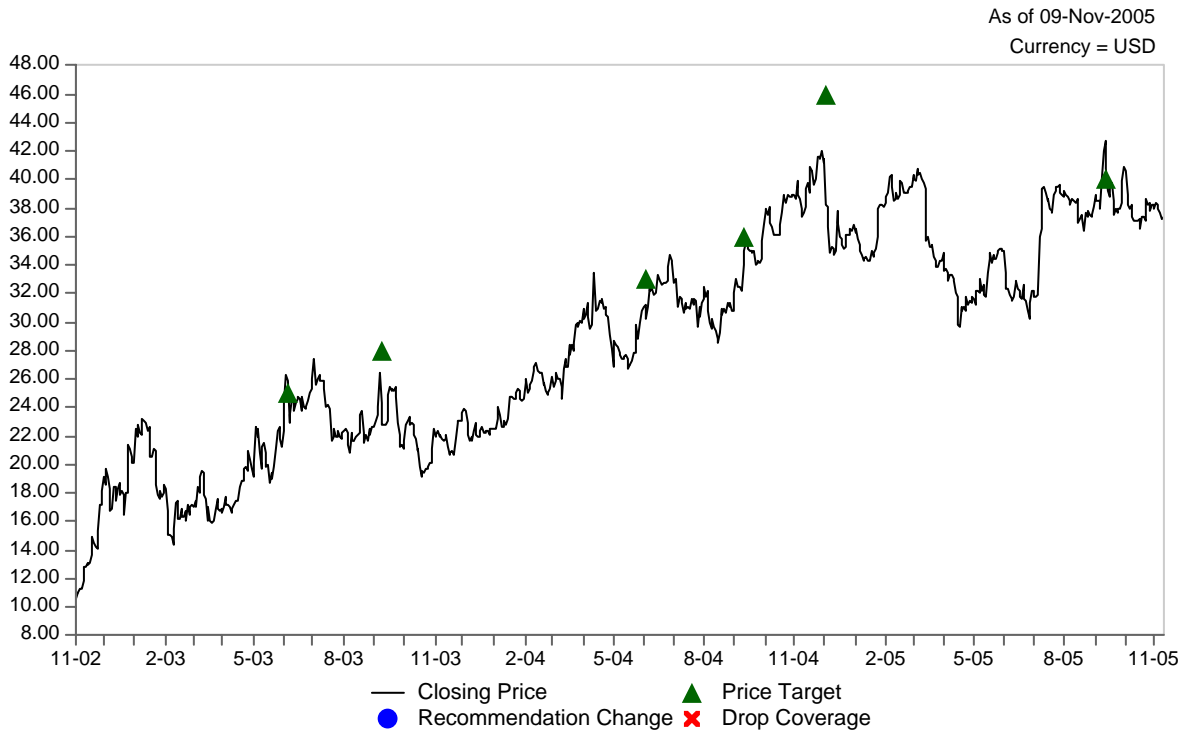
Verint Systems Inc (VRNT)

\$ 38.80 (05-Dec-2005)

1-Overweight / 1-Positive

Rating and Price Target Chart:

VERINT SYSTEMS INC



Source: FactSet

Currency=\$

Date	Closing Price	Rating	Price Target
13-Sep-05	40.73		40.00
02-Dec-04	38.26		46.00
09-Sep-04	34.00		36.00
03-Jun-04	30.25		33.00

Date	Closing Price	Rating	Price Target
09-Sep-03	24.42		28.00
05-Jun-03	25.87		25.00

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Valuation Methodology: Our 12 month price target of \$40 represents a P/E of 30x our C06 EPS estimate of \$1.30, a slight premium to the earnings growth rate of 26%.

Risks Which May Impede the Achievement of the Price Target: Verint may be impacted by delays in domestic homeland security budget appropriations and/or other government spending issues in 2003. The company typically enters into large contracts with customers, and their ability to enter into such deals in any given quarter may impact our estimates. Sustained weakness in IT spending may impact the call center customer interaction software business.

Important Disclosures Continued:

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Company Name	Ticker	Price (05-Dec-2005)	Stock / Sector Rating
Verint Systems Inc	VRNT	\$ 38.80	1-Overweight / 1-Positive

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Autodesk Inc (ADSK)	BEA Systems (BEAS)
BMC Software (BMC)	Check Point Software (CHKP)
Citrix Systems (CTXS)	Cognos Inc. (COGN)
Computer Associates (CA)	Entrust Technologies (ENTU)
Hyperion Solutions (HYSL)	Internet Security Systems (ISSX)
Intuit Inc. (INTU)	Lawson Software (LWSN)
McAfee, Inc. (MFE)	Mercury Interactive (MERQ)
Microsoft Corp (MSFT)	NetIQ Corp (NTIQ)
Oracle Corp (ORCL)	RSA Security (RSAS)
SafeNet Inc. (SFNT)	SERENA Software (SRNA)
SonicWALL, Inc (SNWL)	Sybase Inc (SY)
Symantec Corp (SYMC)	Verint Systems Inc (VRNT)
VeriSign Inc (VRSN)	

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In addition to the stock rating, we provide sector views which rate the outlook for the sector coverage universe as 1-Positive, 2-Neutral or 3-Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

Stock Rating

1-Overweight - The stock is expected to outperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.

2-Equal weight - The stock is expected to perform in line with the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.

3-Underweight - The stock is expected to underperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.

RS-Rating Suspended - The rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Lehman Brothers is acting in an advisory capacity in a merger or strategic transaction involving the company.

Sector View

1-Positive - sector coverage universe fundamentals/valuations are improving.

2-Neutral - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

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