

VERINT SYSTEMS INC
Form 10-Q
June 09, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
EXCHANGE ACT OF 1934**

For the quarterly period ended April 30, 2004

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

Commission File Number: 000-49790

Verint Systems Inc.

(Exact name of registrant as specified in its charter)

Delaware 11-3200514
(State or
other (I.R.S.
jurisdiction of Employer
incorporation
or Identification
organization) No.)

**330 South
Service
Road,
Melville, NY 11747**
(Address of
principal
executive
offices) (Zip Code)

(631) 962-9600

(Registrant's telephone number, including area code)

Not Applicable

Former name, former address and former fiscal year,
if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Edgar Filing: VERINT SYSTEMS INC - Form 10-Q

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares of Common Stock, par value \$0.001 per share,
outstanding as of June 4, 2004 was 30,638,776

TABLE OF CONTENTS

PART I
Financial Information

	<u>Page</u>	
<u>ITEM 1.</u>	<u>Financial Statements.</u>	
<u>1.</u>	<u>Condensed Consolidated Balance Sheets as of January 31, 2004 and April 30, 2004</u>	3
<u>2.</u>	<u>Condensed Consolidated Statements of Income for the Three Months Ended April 30, 2003 and April 30, 2004</u>	4
<u>3.</u>	<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended April 30, 2003 and April 30, 2004</u>	5
<u>4.</u>	<u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>ITEM 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	13
<u>ITEM 3.</u>	<u>Quantitative and Qualitative Disclosures about Market Risk.</u>	26
<u>ITEM 4.</u>	<u>Controls and Procedures.</u>	26

PART II
Other Information

<u>ITEM 6.</u>	<u>Exhibits and Reports on Form 8-K.</u>	27
<u>SIGNATURES</u>		28

FORWARD-LOOKING STATEMENTS

From time to time, the Company makes forward-looking statements. Forward-looking statements include financial projections, statements of plans and objectives for future operations, statements of future economic performance, and statements of assumptions relating thereto. Forward-looking statements are often identified by future or conditional words such as will, plans, expects, believes, seeks, estimates, or anticipates, or by variations of such words or by similar expressions.

The Company may include forward-looking statements in its periodic reports to the Securities and Exchange Commission on Forms 10-K, 10-Q, and 8-K, in its annual report to stockholders, in its proxy statements, in its press releases, in other written materials, and in statements made by employees to analysts, investors, representatives of the media, and others.

By their very nature, forward-looking statements are subject to uncertainties, both general and specific, and risks exist that predictions, forecasts, projections and other forward-looking statements will not be achieved. Actual results may differ materially due to a variety of factors, including without limitation those discussed under "Certain Trends and Uncertainties" and

elsewhere in this report. Investors and others should carefully consider these and other uncertainties and events, whether or not the statements are described as forward-looking.

Forward-looking statements made by the Company are intended to apply only at the time they are made, unless explicitly stated to the contrary. Moreover, whether or not stated in connection with a forward-looking statement, the Company makes no commitment to revise or update any forward-looking statements in order to reflect events or circumstances after the date any such statement is made. If the Company were in any particular instance to update or correct a forward-looking statement, investors and others should not conclude that the Company would make additional updates or corrections thereafter.

PART I

ITEM 1. Financial Statements.

VERINT SYSTEMS INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(In thousands, except share data)

<u>ASSETS</u>	January 31, 2004*	April 30, 2004 (Unaudited)
CURRENT ASSETS:		
Cash and cash equivalents	\$ 200,716	\$ 184,808
Short-term investments	27,997	23,700
Accounts receivable, net	33,654	33,963
Inventories, net	15,833	12,957
Prepaid expenses and other current assets	6,007	7,304
	<hr/>	<hr/>
TOTAL CURRENT ASSETS	284,207	262,732
PROPERTY AND EQUIPMENT, net	14,129	15,748
INTANGIBLE ASSETS	16,415	50,611
OTHER ASSETS	13,955	12,914
	<hr/>	<hr/>
TOTAL ASSETS	\$ 328,706	\$ 342,005
	<hr/>	<hr/>

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:		
Accounts payable and accrued expenses	\$ 50,301	\$ 49,942
Advance payments from customers	26,701	34,374
Convertible note	2,200	
Current maturities of long-term bank loan	441	356
	<hr/>	<hr/>
TOTAL CURRENT LIABILITIES	79,643	84,672
LONG-TERM LIABILITIES	4,395	4,958
	<hr/>	<hr/>

Edgar Filing: VERINT SYSTEMS INC - Form 10-Q

ASSETS	January 31, 2004*	April 30, 2004
TOTAL LIABILITIES	84,038	89,630
STOCKHOLDERS EQUITY:		
Common stock, \$0.001 par value authorized, 120,000,000 shares; issued and outstanding, 30,098,732 and 30,698,612 shares	30	31
Additional paid-in capital	262,472	269,064
Unearned stock compensation	(1,615)	(1,512)
Accumulated deficit	(16,917)	(15,403)
Accumulated other comprehensive income	698	195
TOTAL STOCKHOLDERS EQUITY	244,668	252,375
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 328,706	\$ 342,005

*The Condensed Consolidated Balance Sheet as of January 31, 2004 has been summarized from the Company's audited Consolidated Balance Sheet as of that date.

The accompanying notes are an integral part of these financial statements.

VERINT SYSTEMS INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Income
(Unaudited)
(In thousands, except per share data)

	Three months ended	
	2003	April 30, 2004
Sales	\$ 44,415	\$ 56,638
Cost of sales	20,912	25,757
Gross profit	23,503	30,881
Operating expenses:		
Research and development, net	5,335	6,791
Selling, general and administrative	14,669	18,594
In-process research and development		3,154
Write-down of capitalized software		1,481
Income from operations	3,499	861
Interest and other income, net	515	582
Income before income tax provision	4,014	1,443
Income tax provision	502	(71)

	Three months ended April 30,	
Net income	\$ 3,512	\$ 1,514
Earnings per share:		
Basic	\$ 0.15	\$ 0.05
Diluted	\$ 0.14	\$ 0.05

The accompanying notes are an integral part of these financial statements.

VERINT SYSTEMS INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

	Three months ended April 30,	
	2003	2004
Cash flows from operating activities:		
Net cash from operations after adjustment for non-cash items	\$ 6,149	\$ 9,006
Changes in operating assets and liabilities:		
Accounts receivable	(5,493)	(287)
Inventories	26	2,876
Prepaid expenses and other current assets	387	(1,297)
Accounts payable and accrued expenses	2,548	(3,310)
Advance payments from customers	573	7,673
Other, net	487	(512)
Net cash provided by operating activities	4,677	14,149
Cash flows from investing activities:		
Cash paid for a business combination		(35,599)
Purchases of property and equipment	(1,711)	(1,867)
Capitalization of software development costs	(1,081)	(1,092)
Maturities and sales of investments, net		4,249
Net cash used in investing activities	(2,792)	(34,309)
Cash flows from financing activities:		
Net repayments of bank loans	(42,049)	(130)
Proceeds from issuance of common stock in connection with exercise of stock options and employee stock purchase plan	1,064	4,382
Net cash provided by (used in) financing activities	(40,985)	4,252

	Three months ended April 30,	
Net decrease in cash and cash equivalents	(39,100)	(15,908)
Cash and cash equivalents, beginning of period	133,933	200,716
	<u> </u>	<u> </u>
Cash and cash equivalents, end of period	<u>\$ 94,833</u>	<u>\$ 184,808</u>

The accompanying notes are an integral part of these financial statements.

5

VERINT SYSTEMS INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

Verint Systems Inc. (Verint and, together with its subsidiaries, the Company) is engaged in providing analytic software-based solutions for communications interception, digital video security and surveillance, and enterprise business intelligence. The Company is a majority-owned subsidiary of Comverse Technology, Inc. (Comverse Technology).

The accompanying financial information should be read in conjunction with the audited financial statements, including the notes thereto, for the annual period ended January 31, 2004. The financial information included herein is unaudited; however, such information reflects all adjustments (consisting solely of normal recurring adjustments) which are, in the opinion of the Company s management, necessary for a fair statement of the results for the interim periods presented herein. The Company s results of operations for the three month period ended April 30, 2004 are not necessarily indicative of the Company s results to be expected for the full year. The condensed consolidated balance sheet as of January 31, 2004 has been summarized from the Company s audited consolidated balance sheet as of that date. Certain amounts in prior periods have been reclassified to conform to the manner of presentation in the current periods.

2. Stock-Based Employee Compensation

The Company applies the intrinsic-value based method prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for its stock-based employee compensation. Accordingly, stock-based employee compensation cost is recognized only when employee stock options are granted with exercise prices below the fair market value at the date of grant. Any resulting stock-based employee compensation cost is recognized ratably over the associated service period, which is generally the option vesting period. During the three months ended April 30, 2003 and 2004, the Company recognized stock-based employee compensation cost in the condensed consolidated statements of income of approximately \$13,000 and \$11,000, respectively, relating to certain employee stock options granted with exercise prices below the fair market value at the date of grant. As of April 30, 2004, 36,532 employee stock options were outstanding with exercise prices below the fair market value at the date of the grant. All other employee stock options have been granted at exercise prices equal to fair market value on the date of grant, and, accordingly, no compensation expense has been recognized by the Company in the consolidated statement of income.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation for all periods:

6

Edgar Filing: VERINT SYSTEMS INC - Form 10-Q

	Three months ended April 30,	
	2003	2004
	(In thousands, except per share data)	
Net income, as reported	\$ 3,512	\$ 1,514
Less: Stock-based employee compensation cost determined under the fair value method, net of related tax effects	1,090	1,740
Pro forma net income (loss)	\$ 2,422	\$ (226)
Earnings (loss) per share:		
Basic as reported	\$ 0.15	\$ 0.05
Basic pro forma	\$ 0.10	\$ (0.01)
Diluted as reported	\$ 0.14	\$ 0.05
Diluted pro forma	\$ 0.10	\$ (0.01)

3. **Inventories**

The composition of inventories at January 31, 2004 and April 30, 2004 is as follows:

	January 31, 2004	April 30, 2004
	(In thousands)	
Raw materials	\$ 7,169	\$ 4,844
Work in process	2,186	1,896
Finished goods	6,478	6,217
	\$ 15,833	\$ 12,957

4. **Research and Development Expenses**

A significant portion of the Company's research and development operations are located in Israel where the Company derives substantial benefits from participation in programs sponsored by the Government of Israel for the support of research and development activities conducted in that country. The Company's research and development activities include projects partially funded by the Office of the Chief Scientist of the Ministry of Industry and Trade of the State of Israel (the "OCS") under which the OCS reimburses a portion of the Company's research and development expenditures under approved project budgets. The Company is currently involved in several ongoing research and development projects supported by the OCS. The Company accrues royalties to the OCS for the sale of products incorporating technology developed in these projects up to the amount of such funding, plus interest in certain circumstances. In addition, under the terms of the applicable funding agreements, products resulting from projects funded by the OCS may not be manufactured outside of Israel without government approval. During the three month periods ended April 30,

Edgar Filing: VERINT SYSTEMS INC - Form 10-Q

2003 and 2004, reimbursement from the OCS amounted to approximately \$1.2 million and \$ 0.9 million, respectively. The Company recorded \$0.0 and \$0.2 million as other reimbursements of research and development expenses for the three month periods ended April 30, 2003 and 2004, respectively.

7

5. Earnings Per Share

The computation of basic earnings per share is based on the weighted average number of outstanding common shares. Diluted earnings per share further assumes the issuance of common shares for all potentially dilutive issuances of stock. The calculation for earnings per share for the three month periods ended April 30, 2003 and 2004 was as follows:

	Three Months ended					
	April 30, 2003			April 30, 2004		
	Net Income	Shares	Per Share Amount	Net Income	Shares	Per Share Amount
	(In thousands, except per share data)					
Basic EPS						
Net Income	\$ 3,512	23,708	\$ 0.15	\$ 1,514	30,400	\$ 0.05
Effect of Dilutive Securities						
Stock Options		1,391			1,809	
Convertible Note		137				
	\$ 3,512	25,236	\$ 0.14	\$ 1,514	32,209	\$ 0.05
Diluted EPS						

6. Comprehensive Income

For the three month periods ended April 30, 2003 and 2004, total comprehensive income was approximately \$3,880,000 and \$ 1,011,000, respectively. The elements of comprehensive income include net income, unrealized losses on available for sale securities and foreign currency translation adjustments.

7. Related Party Transactions and Balances

Corporate Services Agreement The Company recorded expenses of approximately \$143,750 and \$156,250 for the three month periods ended April 30, 2003 and 2004, respectively, for the services provided by the Company's parent, Comverse Technology, under the Corporate Services Agreement between the Company and Comverse Technology.

Enterprise Resource Planning Software Sharing Agreement The Company recorded \$25,000 and \$52,000 for the three month periods ended April 30, 2003 and 2004, respectively, for support services rendered by Comverse Ltd., a subsidiary of Comverse Technology, under the Enterprise Resource Planning Software Sharing Agreement between the Company and Comverse Ltd.

Satellite Services Agreement The Company recorded expenses of approximately \$422,000 and \$643,000 for the three month periods ended April 30, 2003 and 2004, respectively, for services rendered by Comverse, Inc., a subsidiary of Comverse Technology, and its subsidiaries under the Satellite Services Agreement between the Company and Comverse, Inc.

Transactions with an Affiliate The Company sold products and services to Verint Systems (Singapore) PTE LTD, an affiliated systems integrator in which the Company holds a 50% equity interest, amounting to approximately \$1,649,000 and \$730,000, during the three month periods ended April 30, 2003 and 2004, respectively. In addition, the Company was charged with installation, support, marketing and office service fees by that affiliate amounting to approximately \$202,000 and \$151,000 for the three month periods ended April 30, 2003 and 2004, respectively.

Transactions with Other Subsidiaries of Converse Technology The Company charges subsidiaries of Converse Technology for services relating to the use of the Company's facilities and employees. Charges to these subsidiaries were approximately \$33,000 and \$21,000 for the three month periods ended April 30, 2003 and 2004, respectively.

Related Party Balances Related party balances included in the condensed consolidated balance sheets are as follows (in thousands):

	<u>January 31, 2004</u>	<u>April 30, 2004</u>
Included in accounts receivable, net	\$ 1,824	\$ 809
Included in accounts payable and accrued expenses	\$ 1,178	\$ 1,031

8. Convertible Note

On February 1, 2002, the Company acquired the digital video recording business of Lanex LLC (Lanex). The Lanex business provides digital video recording solutions for security and surveillance applications. The purchase price consisted of \$9,510,000 in cash and a \$2,200,000 convertible note issued by the Company. The note was non-interest bearing and matured on February 1, 2004. On February 1, 2004, the note was converted into 136,985 shares of the Company's common stock at a conversion price of \$16.06 per share.

9. Acquisition

On March 31, 2004, the Company acquired certain assets and assumed certain liabilities of the government surveillance business of ECtel Ltd. (ECtel). The acquisition is expected to provide the Company with additional communications interception capabilities for the mass collection and analysis of voice and data communications. These technologies will be integrated into the Company's existing product offerings. The purchase price was \$35 million. The Company incurred transaction costs, consisting primarily of professional fees, amounting to approximately \$1,067,000, in connection with this acquisition.

The acquisition was accounted for using the purchase method. The purchase price was allocated to the assets and liabilities of ECtel based on the estimated fair value of those assets and liabilities as of March 31, 2004. The results of operations of ECtel have been included in the Company's results of operations since March 31, 2004. Identifiable intangible assets consist of sales backlog, acquired technology, customer relationships, and non-competition agreements and have estimated useful lives of up to ten years. Purchased in-process research and development represents the value assigned to research and development projects of the acquired business that were commenced but not completed at the date of acquisition, for which technological feasibility had not been established and which have no alternative future use in research and development activities or otherwise. In accordance with Statement of Financial Accounting Standards

Edgar Filing: VERINT SYSTEMS INC - Form 10-Q

No. 2, Accounting for Research and Development Costs, as interpreted by FASB Interpretation No. 4, amounts assigned to purchased in-process research and development meeting the above criteria must be charged to expense at the acquisition date. At the acquisition date, it was estimated that the purchased in-process research and development was approximately 40% complete and it was expected that the remaining 60% would be completed during the ensuing year. The fair value of the purchased in-process research and development was determined by an independent valuation using the income approach, which reflects the projected free cash flows that will be generated by the purchased in-process research and development projects and discounting the projected net cash flows back to their present value using a discount rate of 21%.

As a result of the acquisition of the government surveillance business of ECtel, the Company had certain capitalized software development costs that became impaired due to the existence of duplicative technology and, accordingly, were written-down to their net realizable value at the date of acquisition. Such impairment charge amounted to \$1,481,000.

The following is a summary of the allocation of the purchase price for this acquisition:

	(In thousands)
Purchase price	\$ 35,000
Acquisition costs	1,067
	<hr/>
Total purchase price	\$ 36,067
	<hr/>
Fair value of assets acquired	\$ 1,417
Fair value of liabilities assumed	(3,282)
In-process research and development	3,154
Sales backlog	854
Acquired technology	5,307
Customer relationships	1,382
Non-competition agreements	2,221
Goodwill	25,014
	<hr/>
Total purchase price	\$ 36,067
	<hr/>

The summary unaudited pro forma condensed consolidated results of operations, assuming the acquisition had occurred at the beginning of the periods, would have reflected consolidated revenues of approximately \$49,633,000 and \$56,667,000, net income (loss) of approximately \$4,436,000 and (\$415,000) basic earnings (loss) per share of \$0.19 and (\$0.01) and diluted earnings (loss) per share of \$0.18 and (\$0.01) for the three months periods ended April 30, 2003 and 2004, respectively. These pro forma results are not necessarily indicative of what would have occurred if the acquisition had been in effect for the period presented. In addition, the pro forma results are not necessarily indicative of the results that will occur in the future and do not reflect any potential synergies that might arise from the combined operations.

10. Intangible Assets

The composition of intangible assets at January 31, 2004 and April 30, 2004 is as follows:

Useful Life

Edgar Filing: VERINT SYSTEMS INC - Form 10-Q

		January 31, 2004	April 30, 2004
		(In thousands)	
Sales backlog	Up to 3 years	\$ 557	\$ 1,399
Acquired technology	5 years	1,345	6,632
Customer relationships	5 years	302	1,674
Non-competition agreements	3 to 10 years	1,105	3,300
Trade names	3 years	198	195
Goodwill	Indefinite	14,364	39,152
		<u>17,871</u>	<u>52,352</u>
Accumulated amortization		(1,456)	(1,741)
		<u>\$ 16,415</u>	<u>\$ 50,611</u>

Amortization of intangible assets for the three months ended April 30, 2003 and 2004 was \$69,000 and \$314,000, respectively.

Estimated amortization expense for each of the five succeeding fiscal years is as follows:

Year Ending January 31,	(In thousands)
2005	\$2,701
2006	\$2,278
2007	\$1,967
2008	\$1,752
2009	\$1,601

11. Business Segment Information

The Company operates in one business segment providing actionable intelligence solutions. The Company's solutions collect, retain, and analyze voice, fax, video, email, Internet and data transmissions from voice, video and IP networks for the purpose of generating actionable intelligence for decision makers to take more effective action. The Company manages its business on a geographic basis. Summarized financial information for the Company's reportable geographic segments is presented in the following table. Sales in each geographic segment represents sales originating from that segment.

	United States	Israel	United Kingdom	Other	Reconciling Items	Consolidated Totals
	(In thousands)					
Three months ended April 30, 2003:						
Sales	\$ 21,172	\$ 20,253	\$ 6,064	\$ 2,227	\$ (5,301)	\$ 44,415
Costs and expenses	(19,418)	(17,037)	(5,776)	(2,910)	4,225	(40,916)

Edgar Filing: VERINT SYSTEMS INC - Form 10-Q

	United States	Israel	United Kingdom	Other	Reconciling Items	Consolidated Totals
Operating income (loss)	\$ 1,754	\$ 3,216	\$ 288	\$ (683)	\$ (1,076)	\$ 3,499

**Three months ended
April 30, 2004:**

Sales	\$ 25,950	\$ 21,612	\$ 7,511	\$ 8,073	\$ (6,508)	\$ 56,638
Costs and expenses	(23,857)	(23,952)	(7,649)	(6,950)	6,631	(55,777)
Operating income (loss)	\$ 2,093	\$ (2,340)	\$ (138)	\$ 1,123	\$ 123	\$ 861

Total assets by country of domicile consist of:

	January 31, 2004	April 30, 2004
(In thousands)		
United States	\$ 221,823	\$ 232,079
Israel	98,867	100,590
Other	34,919	35,079
Reconciling items	(26,903)	(25,743)
	\$ 328,706	\$ 342,005

Reconciling items consist of the following:

Sales elimination of inter-company revenues.

Operating income elimination of inter-company operating income.

Total assets elimination of inter-company receivables.

12. Employee Restricted Stock

In December 2003, the Company granted 72,700 shares of restricted stock to certain key employees of the Company. Unearned stock compensation of approximately \$1,672,000 was recorded based on the fair market value of the Company's common stock at the date of grant, or \$23.00 per share. Unearned stock compensation is shown as a separate component of stockholders' equity and is being amortized to expense over the four-year vesting period of the restricted stock. Amortization of unearned stock compensation for the three months ended April 30, 2004 was approximately \$103,000 and was included in selling, general and administrative expenses in the consolidated statement of operations. The restricted stock has all the rights and privileges of the Company's common stock, subject to certain restrictions and forfeiture provisions. At April 30, 2004, all 72,700 shares were subject to restriction.

**ITEM 2. Management's Discussion and Analysis
of Financial Condition and Results of Operations.**

CRITICAL ACCOUNTING POLICIES

Our discussion of results of operations and financial condition relies on our consolidated financial statements that are prepared based on certain critical accounting policies that require management to make judgments and estimates that are subject to varying degrees of uncertainty. We believe that investors need to be aware of these policies and how they impact our financial statements as a whole, as well as our related discussion and analysis presented herein. While we believe that these accompanying policies are based on sound measurement criteria, actual future events can and often do result in outcomes that can be materially different from these estimates or forecasts. The accounting policies and related risk described in our Annual Report on Form 10-K for the year ended January 31, 2004 are those that depend most heavily on these judgments and estimates. As of April 30, 2004, there have been no material changes to any of the critical accounting policies contained therein.

RESULTS OF OPERATIONS

Three Month Period Ended April 30, 2004 Compared to Three Month Period Ended April 30, 2003

Sales. Sales for the three month period ended April 30, 2004 increased by approximately \$12.2 million, or 28%, as compared to the three month period ended April 30, 2003. This increase was attributable to higher sales volume of both products and services for both the Company's security and business intelligence solutions. Sales to international customers represented approximately 54% of sales for the three month period ended April 30, 2004 as compared to approximately 55% for the three month period ended April 30, 2003.

Cost of Sales. Cost of sales for the three month period ended April 30, 2004 increased by approximately \$4.8 million, or 23%, as compared to the three month period ended April 30, 2003. This increase was mainly attributable to an increase in material costs and overhead expenses of approximately \$2.9 million due to higher sales volumes, an increase in salaries and fringe benefits of approximately \$1.0 million, mainly due to increased service headcount, and an increase in other expenses of approximately \$0.9 million, mainly due to increased subcontracting, royalties and amortization expenses. Gross margins increased to 54.5% in the three month period ended April 30, 2004 from 52.9% in the three month period ended April 30, 2003.

Research and Development Expenses, net. Research and development expenses, net, for the three month period ended April 30, 2004 increased by approximately \$1.5 million, or 27%, as compared to the three month period ended April 30, 2003. This increase was attributable to an increase in salaries and fringe benefits of approximately \$1.3 million, mainly due to higher headcount, and an increase in other research and development expenses of approximately \$0.2 million. Capitalization of software development costs amounted to approximately \$1.1 million in the three month periods ended April 30, 2003 and 2004. Reimbursement of research and development expenses amounted to approximately \$1.2 million and approximately \$1.1 million for the three month periods ended April 30, 2003 and 2004, respectively. Research and development expenses, net, as a percentage of sales, were 12% for the three month periods ended April 30, 2004 and 2003.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the three month period ended April 30, 2004 increased by approximately \$3.9 million, or 27%, as compared to the three month period ended April 30, 2003. This increase was attributable to an increase in compensation and benefits for existing personnel and increase in headcount to support the increased level of sales of approximately \$2.2 million, an increase in travel expenses of approximately \$0.3 million, an increase of approximately \$0.2 million in amortization expenses, an increase of approximately \$0.2 million in subcontracting expenses, an increase of approximately \$0.2 million in professional service fees, an increase of approximately \$0.2 million in rent and utility expenses and an increase in other expenses of approximately \$0.6 million. Selling, general and administrative expenses as a percentage of sales decreased to 32.8% for the three month period ended April 30, 2004 from 33.0% for the three month period ended April 30, 2003.

In-Process Research and Development. In the three month period ended April 30, 2004, purchased in-process research and development of approximately \$3.2 million, resulting from the purchase of ECtel's government surveillance business, was charged to expense at the acquisition (see also Note 9).

Write-Down of Capitalized Software. As a result of the acquisition of ECtel's government surveillance business, the Company had certain capitalized software development costs that became impaired due to the existence of duplicative technology and, accordingly, were written-down to their net realizable value at the date of acquisition. Such impairment charge amounted to approximately \$1.5 million, and was recorded in the three month period ended April 30, 2004.

Edgar Filing: VERINT SYSTEMS INC - Form 10-Q

Interest and Other Income, net. Net interest and other income for the three month period ended April 30, 2004 increased by approximately \$0.1 million as compared to the three month period ended April 30, 2003. This increase was attributable to increased interest income and realized gains on the sale of securities of approximately \$0.4 million, due to an increase in interest bearing cash balances and short-term investments. This increase was partially offset by decreased gains from the Company's share in the profits of an affiliate of approximately \$0.3 million.

Income Tax Provision. Income tax provision for the three month period ended April 30, 2004, decreased by approximately \$0.6 million as compared to the three month period ended April 30, 2003. The decrease was attributable to lower taxable income, due to one-time expenses recorded in the three month period ended April 30, 2004, as a result of the purchase of ECtel's government surveillance business. The overall effective tax rate decreased to reflect a tax benefit of (4.9)% for the three month period ended April 30, 2004 compared to an effective tax rate of 12.5% for the three month period ended April 30, 2003. The tax benefits recorded reflect the one-time charges and the use of net operating losses carry forwards in certain tax jurisdictions.

Net Income. Net income for the three month period ended April 30, 2004 decreased by approximately \$2.0 million, or 57%, as compared to the three month period ended April 30, 2003. As a percentage of sales, net income was approximately 2.7% in the three month period ended April 30, 2004 as compared to approximately 7.9% in the three month period ended April 30, 2003. The decrease resulted primarily from the factors described above.

LIQUIDITY AND CAPITAL RESOURCES

As of April 30, 2004, the Company had cash and cash equivalents of approximately \$184.8 million, short-term investments of \$23.7 million and a working capital of approximately \$178.1 million. As of January 31, 2004, the Company had cash and cash equivalents of approximately \$200.7 million, short-term investments of \$28.0 million and working capital of approximately \$204.6 million. The decrease in the balances described above from January 31, 2004 as compared to April 30, 2004 resulted primarily from cash used to purchase ECtel's government surveillance business.

Operating activities for the three month periods ended April 30, 2003 and 2004, after adjustment for non-cash items, provided cash of approximately \$6.1 million, and \$9.0 million, respectively. Other changes in operating assets and liabilities provided (used) cash of approximately \$(1.5) million and \$5.1 million for the three month periods ended April 30, 2003 and 2004, respectively. This resulted in cash provided by operating activities of approximately \$4.7 million and \$14.1 million for the three month periods ended April 30, 2003 and 2004, respectively.

Investing activities for the three month periods ended April 30, 2003 and 2004, used cash of approximately \$2.8 million and \$34.3 million, respectively. For the three month period ended April 30, 2003 these amounts include additions to property and equipment of approximately \$1.7 million, and capitalization of software development costs of approximately \$1.1 million. For the three month period ended April 30, 2004 these amounts include cash paid for the acquisition of ECtel's government surveillance business of approximately \$35.6 million, additions to property and equipment of approximately \$1.9 million, and capitalization of software development costs of approximately \$1.1 million, partially offset by cash provided by maturities and sales of short-term investments of approximately \$4.2 million.

14

Financing activities for the three month periods ended April 30, 2003 and 2004, provided (used) cash of approximately \$(41.0) million and \$4.3 million, respectively. For the three month periods ended April 30, 2003 and 2004 proceeds from the issuances of common stock provided cash of approximately \$1.0 million and \$4.4 million, respectively. Repayments, net, of bank loans and other debt used cash of approximately \$42.0 million and \$0.1 million in the three month periods ended April 30, 2003 and 2004, respectively.

On February 1, 2002, the Company acquired the digital video recording business of Lanex. The Lanex business provides digital video recording solutions for security and surveillance applications. The purchase price consisted of \$9.5 million in cash and a \$2.2 million convertible note issued by the Company to Lanex. The note was non-interest bearing and matured on February 1, 2004. On February 1, 2004, the note was converted into 136,985 shares of the Company's common stock at a conversion price of \$16.06 per share.

Edgar Filing: VERINT SYSTEMS INC - Form 10-Q

On March 31, 2004, the Company acquired certain assets and assumed certain liabilities of the government surveillance business of ECtel. The purchase price consisted of \$35 million. In connection with this acquisition, the Company incurred transaction costs, consisting primarily of professional fees, amounting to approximately \$1.1 million (see also Note 9).

The Company believes that its current cash balances and potential cash flows from operations will be sufficient to meet the Company's anticipated cash needs for working capital, capital expenditures and other activities for at least the next 12 months. Thereafter, if current sources are not sufficient to meet the Company's needs, the Company may seek additional debt or equity financing. In addition, although there is no present understanding, commitment or agreement with respect to any acquisition of other businesses, products, or technologies, the Company may in the future consider such transactions. In the event the Company pursues such acquisitions, its current cash balances and potential cash flow from operations may not be sufficient to consummate such acquisitions. As a result, the Company may require additional debt or equity financing and could have a decrease of its working capital.

CERTAIN TRENDS AND UNCERTAINTIES

The Company's primary business is providing software-based analytic solutions for communications interception, networked video security and networked video and contact center business intelligence. Recent legislative and regulatory actions have provided greater surveillance powers to law enforcement agencies, imposed strict requirements on communications service providers to facilitate interception of communications over public networks, and increased the security measures being implemented at public facilities such as airports. However, the Company cannot be assured that these legislative and regulatory actions will result in increased demand for or purchasing of solutions such as those offered by the Company or, if it does, that such solutions will be purchased from the Company. If demand for or purchasing of the Company's solutions does not increase as anticipated, the Company may not be able to sustain or increase profitability on a quarterly or annual basis.

It is difficult for the Company to forecast the timing of revenues from product sales because customers often need a significant amount of time to evaluate its products before purchasing them and, in the case of governmental customers, sales are dependent on budgetary and other bureaucratic processes. The period between initial customer contact and a purchase by a customer may vary from three months to more than one year. During the evaluation period, customers may defer or scale down proposed orders of the Company's products for various reasons, including: (i) changes in budgets and purchasing priorities; (ii) reduced need to upgrade existing systems; (iii) deferrals in anticipation of enhancements or new products; (iv) introduction of products by its competitors; and (v) lower prices offered by its competitors.

15

The Company faces aggressive competition from numerous and varied competitors in all areas of its business, and many of its customers make decisions to purchase based largely on price considerations. The Company may have to lower the prices of many of its products and services to stay competitive or increase efficiencies in the provision of services, while at the same time trying to maintain or improve revenue and gross margin. If the Company cannot proportionately decrease its cost structure on a timely basis in response to competitive price pressures, its margin and therefore its profitability could be adversely affected. Further, the Company invests a significant amount into research and development, which the Company views as necessary for its long-term competitiveness. If, to decrease its costs structure, the Company reduces its investment in research and development, the Company may adversely impact its long-term competitiveness in an effort to maintain or improve its revenue, income and gross margin in the short-term. In addition, if the Company's pricing and other factors are not sufficiently competitive, or if there is an adverse reaction to its product decisions, it may lose market share in certain areas, which could adversely affect its revenue and prospects. Even if Verint is able to maintain or increase market share for a particular product, revenue could decline due to increased competition from other types of products or because the product is in a maturing industry.

The Company derives a significant amount of its revenues from various government contracts worldwide. The Company expects that government contracts will continue to be a significant source of its revenues for the foreseeable future. The Company's business generated from government contracts may be materially and adversely affected if: (i) its reputation or relationship with government agencies is impaired; (ii) it is suspended or otherwise prohibited from contracting with a domestic or foreign government or any significant law enforcement agency; (iii) levels of government expenditures and authorizations for law enforcement and security related programs decrease, remain constant or shift to programs in areas where it does not provide products and services; (iv) it is prevented from entering into new government contracts or extending existing government contracts based on violations or suspected violations of laws or regulations, including those related to procurement; (v) it is not granted security clearances that are required to sell its products to domestic or foreign governments or such security

Edgar Filing: VERINT SYSTEMS INC - Form 10-Q

clearances are revoked; (vi) there is a change in government procurement procedures; or (vii) there is a change in political climate that adversely affects the Company's existing or prospective relationships.

The Company's quarterly operating results are difficult to predict and may fluctuate significantly in the future, which in turn may result in volatility in its stock price. The following factors, among others, many of which are outside its control, can cause fluctuations in operating results and stock price volatility: (i) the size, timing, terms and conditions of orders from and shipments to its customers; (ii) unanticipated delays or problems in releasing new products; (iii) the timing and success of its customers' deployment of its products and services; and (iv) the amount and timing of its investments in research and development activities.

While Verint has no single customer that is material, the Company has many significant customers and receives multi-million dollar orders from time to time. The deferral or loss of one or more significant orders or a delay in an expected implementation of such an order could materially and adversely affect the Company's operating results in any fiscal quarter, particularly if there are significant sales and marketing expenses associated with the deferred, lost or delayed sales. The Company bases its current and future expense levels on its internal operating plans and sales forecasts, and its operating costs are, to a large extent, fixed. As a result, the Company may not be able to sufficiently reduce its costs in any quarter to compensate for an unexpected near-term shortfall in revenues.

16

Verint has continued to expand its gross margins primarily as a result of reducing hardware as a part of its product offerings. This gross margin expansion has contributed to the growth of Verint's net income at a rate greater than the growth of its revenue. Verint's ability to continue to expand gross margins in this manner is largely contingent upon customers obtaining the hardware necessary to operate Verint's software solutions from another vendor. If customers insist that Verint provide all necessary hardware, Verint may not be able to continue to expand gross margins at the rate that it has or at all, which would reduce the rate of growth of Verint's net income. If the rate of growth of Verint's net income is reduced, it could materially and adversely affect the share price of Verint's stock.

The market for the Company's business intelligence solutions has been adversely affected by the global economic slowdown and the decline in information technology spending, which has caused many companies to reduce or, in extreme cases, entirely eliminate, information technology spending. While there exists some evidence in the market that information technology spending is increasing, the rate of this spending by its customers in the near term remains uncertain and the Company is uncertain whether it will be able to increase or maintain its revenues. Although the Company was profitable for fiscal 2002 and 2003, it has incurred operating and net losses every other year since 1997. If sales do not increase as anticipated or if expenses increase at a greater pace than revenues, the Company may not be able to sustain or increase profitability on a quarterly or annual basis.

The markets for the Company's security and business intelligence products are still emerging. The Company's growth is dependent on, among other things, the size and pace at which the markets for its products develop. If the markets for its products decrease, remain constant or grow slower than the Company anticipates, the Company will not be able to maintain its growth. Continued growth in the demand for the Company's products is uncertain as, among other reasons, its existing customers and potential customers may: (i) not achieve a return on their investment in its products; (ii) experience technical difficulty in utilizing its products; or (iii) use alternative solutions to achieve their security, intelligence or business objectives. In addition, as the Company's enterprise business intelligence products are sold primarily to contact centers, slower than anticipated growth or a contraction in the number of contact centers will have a material adverse effect on the Company's ability to maintain its growth.

The markets for the Company's products are characterized by rapidly changing technology and evolving industry standards. The introduction of products embodying new technology and the emergence of new industry standards can render the Company's existing products obsolete and unmarketable and can exert price pressures on existing products. It is critical to the Company's success for it to be able to anticipate changes in technology or in industry standards and to successfully develop and introduce new, enhanced and competitive products on a timely basis. The Company cannot be assured that it will successfully develop new products or introduce new applications for existing products, that new products and applications—such as the Company's content analytical software—will achieve market acceptance or that the introduction of new products or technological developments by its competitors will not render its products obsolete. The Company's inability to develop products that are competitive in technology and price and meet customer needs could have a material adverse effect on its business, financial condition and results of operations.

The global market for analytical solutions for security and business applications is intensely competitive, both in the number and breadth of competing companies and products and the manner in which products are sold. For example, the Company often competes for customer contracts through a competitive bidding process that subjects it to risks associated with: (i) the frequent need to bid on programs in advance of the completion of their design, which may result in unforeseen technological difficulties and cost overruns; and (ii) the substantial time and effort, including design, development and marketing activities, required to prepare bids and proposals for contracts that may not be awarded to the Company.

17

A significant portion of the Company's revenues are generated by sales made through strategic and technology partners, distributors, value added resellers and systems integrators. In addition, many of these sales channels also partner with the Company's competitors and may even offer the products of the Company and its competitors when presenting bids to certain customers. The Company's ability to achieve revenue growth depends to some extent on maintaining and adding to these sales channels. If the Company's relationships with these sales channels deteriorate or terminate, the Company may lose important sales and marketing opportunities.

The Company's competitors may be able to develop more quickly or adapt faster to new or emerging technologies and changes in customer requirements, or devote greater resources to the development, promotion and sale of their products. Some of the Company's competitors have, in relation to it, longer operating histories, larger customer bases, longer standing relationships with customers, greater name recognition and significantly greater financial, technical, marketing, customer service, public relations, distribution and other resources. New competitors continue to emerge and there continues to be consolidation among existing competitors which may reduce the Company's market share. In addition, some of the Company's customers may in the future decide to develop internally their own solutions instead of purchasing them from the Company. Increased competition could force the Company to lower its prices or take other actions to differentiate its products.

On March 31, 2004, the Company completed its \$35 million acquisition of certain assets and liabilities of ECtel comprising its communications interception business. This business posted significant losses for fiscal 2003, as well as significant reduction in revenues from fiscal 2002 to fiscal 2003. In addition, the integration of this business into the Company's business is going to require a significant amount of management time and attention. Further, the revenues from this business are concentrated in a few customers. Additionally, this business has technologies and products which will have to be integrated with the Company's product offerings.

There is no assurance that the Company will be able to:

successfully integrate this business into the Company's communications interception business, including operations, research and development, facilities and related matters

retain and integrate employees joining the Company with the acquired business, including maintaining employee morale

continue to successfully operate its own business while management time and attention is diverted to integrating this business

improve upon the financial results of this business, or even perform as well, or that this business will not materially and adversely affect the Company's financial results

integrate the technology of this business or complete the R&D programs

ensure that the customers of this business or the Company's own customers will be confident in the Company's ability to adequately deliver products and services

18

ensure ECTel's performance of contractual obligations to the Company related to post-acquisition operations, which, if not performed, could detract from the benefits of the acquisition realized by the Company.

Many of the Company's government contracts contain provisions that give the governments party to those contracts rights and remedies not typically found in private commercial contracts, including provisions enabling the governments to: (i) terminate or cancel existing contracts for convenience; (ii) in the case of the U.S. government, suspend the Company from doing business with a foreign government or prevent the Company from selling its products in certain countries; (iii) audit and object to the Company's contract-related costs and expenses, including allocated indirect costs; and (iv) change specific terms and conditions in the Company's contracts, including changes that would reduce the value of its contracts. In addition, many jurisdictions have laws and regulations that deem government contracts in those jurisdictions to include these types of provisions, even if the contract itself does not contain them. If a government terminates a contract with the Company for convenience, the Company may not recover its incurred or committed costs, any settlement expenses or profit on work completed prior to the termination. If a government terminates a contract for default, the Company may not recover those amounts, and, in addition, it may be liable for any costs incurred by a government in procuring undelivered items and services from another source. Further, an agency within a government may share information regarding the Company's termination with other government agencies. As a result, the Company's on-going or prospective relationships with such other government agencies could be impaired.

The Company must comply with domestic and foreign laws and regulations relating to the formation, administration and performance of government contracts. These laws and regulations affect how the Company does business with government agencies in various countries and may impose added costs on its business. For example, in the United States the Company is subject to the Federal Acquisition Regulations, which comprehensively regulate the formation, administration and performance of federal government contracts, and to the Truth in Negotiations Act, which requires certification and disclosure of cost and pricing data in connection with contract negotiations. The Company is subject to similar regulations in foreign countries as well.

If a government review or investigation uncovers improper or illegal activities, the Company may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or debarment from doing business with government agencies, which could materially and adversely affect its business, financial condition and results of operations. In addition, a government may reform its procurement practices or adopt new contracting rules and regulations that could be costly to satisfy or that could impair the Company's ability to obtain new contracts.

The Company's products are often used by customers to compile and analyze highly sensitive or confidential information and data, including information or data used in intelligence gathering or law enforcement activities. The Company may come into contact with such information or data when it performs support or maintenance functions for its customers. While the Company has internal policies, procedures and training for employees in connection with performing these functions, even the perception that such potential contact may pose a security risk or that any of the Company's employees has improperly handled sensitive or confidential information and data of a customer could harm its reputation and could inhibit market acceptance of its products.

The Company's subsidiary, Verint Technology Inc. (Verint Technology) which markets, sells and supports its communications interception solutions to various U.S. government agencies, is required by the National Industrial Security Program to maintain facility security clearances and to be insulated from foreign ownership, control or influence. To comply with the National Industrial Security Program requirements, in January 1999 the Company, Verint Technology, Comverse Technology and the Department of Defense entered into a proxy agreement with respect to the ownership and operations of Verint Technology, which agreement was superceded in May 2001 to comply with the Department of Defense's most recent requirements. Under the proxy agreement, the Company, among other things, appointed three individuals who are U.S. citizens holding the requisite security clearances as holders of proxies to vote the Verint Technology stock. The proxy holders have the power to exercise all prerogatives of ownership of Verint Technology. These three individuals are responsible for the oversight of Verint Technology's security arrangements.

The proxy agreement may be terminated and Verint Technology's facility security clearance may be revoked in the event of a breach of the proxy agreement, or if it is determined by the Department of Defense that termination is in the national interest. If

Edgar Filing: VERINT SYSTEMS INC - Form 10-Q

Verint Technology's facility security clearance is revoked, the Company may lose all or a substantial portion of its sales to U.S. government agencies and its business, financial condition and results of operations would be harmed. In addition, concerns about the security of the Company or its products can materially and adversely affect Verint Technology's sales to U.S. government agencies.

As the communications industry continues to evolve, governments may increasingly regulate products that monitor and record voice, video and data transmissions over public communications networks, such as the Company's solutions. For example, products which the Company sells in the United States to law enforcement agencies and which interface with a variety of wireline, wireless and Internet protocol networks, must comply with the technical standards established by the Federal Communications Commission pursuant to the Communications Assistance for Law Enforcement Act and products that it sells in Europe must comply with the technical standards established by the European Telecommunications Standard Institute. The adoption of new laws governing the use of the Company's products or changes made to existing laws could cause a decline in the use of its products and could result in increased expenses for the Company, particularly if it is required to modify or redesign its products to accommodate these new or changing laws.

The Company is required to obtain export licenses from the Israeli and German governments to export some of its products that it develops or manufactures in these countries. The Company cannot be assured that it will be successful in obtaining or maintaining the licenses and other authorizations required to export its products from applicable governmental authorities. The Company's failure to receive or maintain any required export license or authorization would hinder its ability to sell its products and could materially and adversely affect its business, financial condition and results of operations.

As part of the Company's growth strategy, it intends to pursue new strategic alliances. The Company considers and engages in strategic transactions from time to time and may be evaluating alliances or joint ventures at any time. The Company competes with other analytic solution providers for these opportunities. The Company cannot be assured that it will be able to effect these transactions on commercially reasonable terms or at all. If the Company enters into these transactions, it also cannot be sure that it will realize the benefits it anticipates.

The Company's products involve sophisticated hardware and software technology that performs critical functions to highly demanding standards. The Company cannot be assured that current or future products will not develop operational problems, which could have a material adverse effect on it. The Company offers complex products that may contain undetected defects or errors, particularly when first introduced or as new versions are released. The Company may not discover such defects or errors until after a product has been released and used by the customer. Significant costs may be incurred to correct undetected defects or errors in the Company's products and these defects or errors could result in future lost sales. In addition, defects or errors in the Company's products may result in product liability claims, which could cause adverse publicity and impair their market acceptance.

20

The Company incorporates software that it licenses from third parties in the vast majority of its products. If the Company loses or is unable to maintain any software licenses, it could incur additional costs or experience unexpected delays until equivalent software can be developed or licensed and integrated into its products.

While the Company occasionally files patent applications, it cannot be assured that patents will be issued on the basis of such applications or that, if such patents are issued, they will be sufficiently broad to protect its technology. In addition, the Company cannot be assured that any patents issued to it will not be challenged, invalidated or circumvented.

In order to safeguard its unpatented proprietary know-how, trade secrets and technology, the Company relies primarily upon trade secret protection and non-disclosure provisions in agreements with employees and others having access to confidential information. The Company cannot be assured that these measures will adequately protect it from improper disclosure or misappropriation of its proprietary information.

While the Company implements sophisticated security measures, third parties may attempt to breach its security or inappropriately use its products through computer viruses, electronic break-ins and other disruptions. If successful, confidential information, including passwords, financial information, or other personal information may be improperly obtained and the Company may be subject to lawsuits and other liability. Even if the Company is not held liable, such security breaches could harm its reputation, and even the perception of security risks, whether or not valid, could inhibit market acceptance of its

products with both government and commercial purchasers.

The information technology industry is characterized by frequent allegations of intellectual property infringement. In the past, third parties have asserted that certain of the Company's products infringe their intellectual property and similar claims may be made in the future. Any allegation of infringement against the Company could be time consuming and expensive to defend or resolve, result in substantial diversion of management resources, cause product shipment delays, or force it to enter into royalty or license agreements rather than dispute the merits of such allegation. If patent holders or other holders of intellectual property initiate legal proceedings against the Company, it may be forced into protracted and costly litigation. The Company may not be successful in defending such litigation and it may not be able to procure any required royalty or license agreements on terms acceptable to it, or at all.

The Company generally indemnifies its customers with respect to infringement by its products of the proprietary rights of third parties. Third parties may assert infringement claims against the Company's customers. These claims may require the Company to initiate or defend protracted and costly litigation, regardless of the merits of these claims. If any of these claims succeed, the Company may be forced to pay damages or may be required to obtain licenses for the products its customers use. If the Company cannot obtain all necessary licenses on commercially reasonable terms, its customers may be forced to stop using, or, in the case of value added resellers, selling, its products.

Although the Company generally uses standard parts and components in its products, it does use some non-standard parts and equipment. The Company relies on non-affiliated suppliers for the supply of certain standard and non-standard components and on manufacturers of assemblies that are incorporated in all of its products. The Company does not have long term supply or manufacturing agreements with all of these suppliers and manufacturers. If these suppliers or manufacturers experience financial, operational, manufacturing capacity or quality assurance difficulties, or if there is any other disruption in its relationships with these suppliers or manufacturers, the Company will be required to locate alternative sources of supply. The Company's inability to obtain sufficient quantities of these components, if and as required in the future, entails the following risks: (i) delays in delivery or shortages in components could interrupt and delay manufacturing and result in cancellations of orders for its products; (ii) alternative suppliers could increase component prices significantly and with immediate effect; (iii) it may not be able to develop alternative sources for product components; (iv) it may be required to modify its products, which may cause delays in product shipments, increased manufacturing costs and increased product prices; and (v) it may be required to hold more inventory than it otherwise might in order to avoid problems from shortages or discontinuance.

The Company may in the future pursue acquisitions of businesses, products and technologies, or the establishment of joint venture arrangements. The negotiation of potential acquisitions or joint ventures as well as the integration of an acquired or jointly developed business, technology or product could result in a substantial diversion of management resources. Future acquisitions could result in potentially dilutive issuances of equity securities, the incurrence of debt and contingent liabilities, amortization of certain identifiable intangible assets, research and development write-offs and other acquisition-related expenses. These investments may be made in immature businesses with unproven track records and technologies. Such investments have a high degree of risk, with the possibility that the Company may lose the total amount of its investments, or more than its total investment if such businesses have liabilities not identified by the Company. The Company may not be able to identify suitable investment candidates, and, even if it does, it may not be able to make those investments on acceptable terms, or at all. In addition, the Company also may fail to successfully integrate acquired businesses with its operations or successfully realize the intended benefits of any acquisition. Due to rapidly changing market conditions, the Company may find the value of its acquired technologies and related intangible assets, such as goodwill, as recorded in its financial statements, to be impaired, resulting in charges to operations. The Company may also fail to retain the acquired or merged company's key employees and customers.

The Company depends on the continued services of its executive officers and other key personnel. In addition, the Company may need to attract and retain a substantial number of new employees, particularly sales and marketing personnel and technical personnel, who understand and have experience with its products and services. If the Company is unable to attract and retain qualified employees, its ability to grow could be impaired. Competition for personnel for certain positions in the Company's industry is intense, and the Company has in the past and may in the future experience difficulty in recruiting qualified personnel due to the market demand for their services. The Company has also experienced difficulty in locating qualified candidates within desired geographic locations and on occasion it has had to relocate personnel to fill positions in locations where it could not attract qualified experienced personnel.

The Company conducts significant sales and research and development operations in foreign countries, including Israel, Germany, the United Kingdom and Canada, and it intends to continue to expand its operations internationally. The Company's business may suffer if it is unable to successfully expand and maintain foreign operations. The Company's foreign operations are, and any future foreign expansion will be, subject to a variety of risks, many of which are beyond its control, including risks associated with: (i) foreign currency fluctuations; (ii) customizing products for foreign countries; (iii) political and economic instability in foreign countries; (iv) potentially adverse tax consequences of operating in foreign countries; (v) legal uncertainties regarding liability, export and import restrictions, tariffs and other trade barriers; (vi) compliance with local laws and regulations, including labor laws, employee benefits, currency restrictions and other requirements; (vii) hiring qualified foreign employees; and (viii) difficulty in accounts receivable collection and longer collection periods.

22

To date, most of the Company's sales have been denominated in U.S. dollars, while a significant portion of its expenses, primarily labor expenses in Israel, Germany, the United Kingdom and Canada, are incurred in the local currencies of these countries. As a result, the Company is exposed to the risk that fluctuations in the value of these currencies relative to the U.S. dollar could increase the dollar cost of its operations in Israel, Germany, the United Kingdom, or Canada, and would therefore have a material adverse effect on its results of operations.

In addition, since a portion of the Company's sales are made in foreign currencies, primarily the British pound and the Euro, fluctuation in the value of these currencies relative to the U.S. dollar could decrease its revenues and materially and adversely affect its results of operations. In addition, the Company's costs of operations have at times been negatively affected by changes in the cost of its operations in Israel, resulting from changes in the value of the New Israeli Shekel relative to the U.S. dollar.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and the continued state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. While Israel has signed peace accords with both Egypt and Jordan, since October 2000, there has been a significant increase in violence, primarily in the West Bank and Gaza Strip, and Israel has experienced terrorist incidents within its borders. During this period, negotiations between Israel and representatives of the Palestinian Authority have been sporadic and have failed to result in peace. The Company could be materially and adversely affected by hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners, or a significant downturn in the economic or financial condition of Israel. In addition, the sale of products manufactured in Israel may be materially and adversely affected in certain countries by restrictive laws, policies or practices directed toward Israel or companies having operations in Israel. The continuation or exacerbation of violence in Israel or the outbreak of violent conflicts involving Israel may impede the Company's ability to sell its products and may otherwise materially and adversely affect it.

In addition, many of the Company's Israeli employees are required to perform annual compulsory military reserve duty in Israel and are subject to being called to active duty at any time under emergency circumstances. The absence of these employees may have a material adverse effect on the Company's operations.

The Company receives conditional grants from the Government of Israel through the Office of the Chief Scientist of the Ministry of Industry and Trade, or the OCS, for the financing of a portion of its research and development expenditures in Israel. The terms of these conditional grants limit the Company's ability to manufacture products, and prohibit it from transferring technologies, outside of Israel if such products or technologies were developed using these grants. Even if the Company receives approval to manufacture products developed using these conditional grants outside of Israel, it may be required to pay a significantly increased amount of royalties on an accelerated basis to the Government of Israel, depending on the manufacturing volume that is performed outside of Israel. This restriction may impair the Company's ability to outsource manufacturing or engage in similar arrangements for those products or technologies. In addition, if the Company fails to comply with any of the conditions imposed by the OCS, it may be required to refund any grants previously received together with interest and penalties, and it may be subject to criminal charges. In recent years, the Government of Israel has accelerated the rate of repayment of OCS grants and may further accelerate them in the future. The Company currently pays royalties of between 3% and 5% (or 6% under certain circumstances) of associated product revenues (including service and other related revenues) to the Government of Israel for repayment of benefits received under this program. Such royalty payments by the Company are currently required to be made until the government has been reimbursed the amounts received by it, linked to the U.S. dollar, plus, for amounts received under projects approved by the OCS after January 1, 1999, interest on such amounts at a rate equal to the 12-month LIBOR rate in effect on January 1 of the year in which approval is obtained. As of April 30, 2004, the Company has received approximately \$53.6 million in cumulative grants and has recorded approximately \$22.9 million in cumulative royalties to the OCS. Further, the Government of Israel has reduced the benefits available under these programs in

recent years and these programs may be discontinued or curtailed in the future. In addition, the Company expects that OCS grants as a percentage of its consolidated research and development expenses will decrease in future periods due to an expected increase in the portion of research and development activities that will not be reimbursed by the OCS and an expected increase in research and development activities outside of Israel. The continued reduction in these benefits or the termination of the Company's eligibility to receive these benefits may materially and adversely affect the Company's business, financial condition and results of operations.

23

The Company's investment programs in manufacturing equipment and leasehold improvements at its facility in Israel has been granted approved enterprise status and it is therefore eligible for tax benefits under the Israeli Law for Encouragement of Capital Investments. The Government of Israel may reduce or eliminate the tax benefits available to approved enterprise programs such as the programs provided to the Company. The Company cannot be assured that these tax benefits will be continued in the future at their current levels or at all. If these tax benefits are reduced or eliminated, the amount of taxes that the Company pays in Israel will increase. In addition, if the Company fails to comply with any of the conditions and requirements of the investment programs, the tax benefits it has received may be rescinded and it may be required to refund the amounts it received as a result of the tax benefits, together with interest and penalties.

Comverse Technology beneficially owns a majority of the Company's outstanding shares of common stock. Consequently, Comverse Technology effectively controls the outcome of all matters submitted for stockholder action, including the composition of the Company's board of directors and the approval of significant corporate transactions. Through its representation on the Company's board of directors, Comverse Technology has a controlling influence on the Company's management, direction and policies, including the ability to appoint and remove its officers. As a result, Comverse Technology may cause the Company to take actions which may not be aligned with the Company's interests or those of its other stockholders. For example, Comverse Technology may prevent or delay any transaction involving a change in control or in which stockholders might receive a premium over the prevailing market price for their shares.

The Company receives insurance, legal and certain administrative services from Comverse Technology under a corporate services agreement. The Company's enterprise resource planning software is maintained and supported by Comverse Ltd., a subsidiary of Comverse Technology, under an enterprise resource planning software sharing agreement. The Company also obtains personnel and facility services from Comverse, Inc. under a satellite services agreement. If these agreements are terminated, the Company may be required to obtain similar services from other entities or, alternatively, it may be required to hire qualified personnel and incur other expenses to obtain these services. The Company may not be able to hire such personnel or to obtain comparable services at prices and on terms as favorable as it currently has under these agreements.

The Company has entered into a business opportunities agreement with Comverse Technology that addresses potential conflicts of interest between Comverse Technology and the Company. This agreement allocates between Comverse Technology and the Company opportunities to pursue transactions or matters that, absent such allocation, could constitute corporate opportunities of both companies. As a result, the Company may lose valuable business opportunities. In general, the Company is precluded from pursuing opportunities offered to officers or employees of Comverse Technology who may also be its directors, officers or employees unless Comverse Technology fails to pursue these opportunities.

24

Seven of the Company's thirteen directors are officers and/or directors or employees of Comverse Technology, or otherwise affiliated with Comverse Technology. These directors have fiduciary duties to both companies and may have conflicts of interest on matters affecting both the Company and Comverse Technology and in some circumstances may have interests adverse to the Company. The Company's Chairman, Kobi Alexander, is the chairman of Comverse Technology. This position with Comverse Technology imposes significant demands on Mr. Alexander's time and presents potential conflicts of interest.

Prior to the Company's initial public offering in May 2002, it was included in the Comverse Technology consolidated group for federal income tax purposes and did not file its own federal income tax return. Following the Company's initial public offering,

it ceased to be included in the Comverse Technology consolidated group for federal income tax purposes. To the extent Comverse Technology or other members of the group fail to make any federal income tax payments required of them by law in respect of years for which Comverse Technology filed a consolidated federal income tax return which included the Company, the Company would be liable for the shortfall. Similar principles apply for state income tax purposes in many states. In addition, by virtue of its controlling ownership and its tax sharing agreement with the Company, Comverse Technology effectively controls all of the Company's tax decisions for periods ending prior to the completion of its initial public offering. For periods during which the Company was included in the Comverse Technology consolidated group for federal income tax purposes, Comverse Technology has sole authority to respond to and conduct all federal income tax proceedings and audits relating to the Company, to file all federal income tax returns on its behalf and to determine the amount of its liability to, or entitlement to payment from, Comverse Technology under its tax sharing agreement. Despite this agreement, federal law provides that each member of a consolidated group is liable for the group's entire tax obligation and the Company could, under certain circumstances, be liable for taxes of other members of the Comverse Technology consolidated group.

The trading price of the Company's shares of common stock has been affected by the factors disclosed in this section as well as prevailing economic and financial trends and conditions in the public securities markets. Share prices of companies in technology-related industries, such as the Company's, tend to exhibit a high degree of volatility. The announcement of financial results that fall short of the results anticipated by the public markets could have an immediate and significant negative effect on the trading price of the Company's shares in any given period. Such shortfalls may result from events that are beyond the Company's immediate control, can be unpredictable and, since a significant proportion of its sales during each fiscal quarter tend to occur in the latter stages of the quarter, may not be discernible until the end of a financial reporting period. These factors may contribute to the volatility of the trading value of the Company's shares regardless of its long-term prospects. The trading price of the Company's shares may also be affected by developments, including reported financial results and fluctuations in trading prices of the shares of other publicly-held companies in its industry generally, and its business segment in particular, which may not have any direct relationship with its business or prospects.

In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. The Company could be the target of similar litigation in the future. Securities litigation could result in the expenditure of substantial costs, divert management's attention and resources, harm the Company's reputation in the industry and the securities markets and reduce its profitability.

Terrorist attacks and other acts of war, and any response to them, may lead to armed hostilities and such developments would likely cause instability in financial markets. Armed hostilities and terrorism may directly impact the Company's facilities, personnel and operations which are located in the United States, Canada, Israel, Europe, the Far East, Australia and South America, as well as those of its clients. Furthermore, severe terrorist attacks or acts of war may result in temporary halts of commercial activity in the affected regions, and may result in reduced demand for its products. These developments could have a material adverse effect on the Company's business and the trading price of its common stock.

25

The Company's board of directors' ability to designate and issue up to 2,500,000 shares of preferred stock and to issue additional shares of common stock could adversely affect the voting power of the holders of common stock, and could have the effect of making it more difficult for a person to acquire, or could discourage a person from seeking to acquire, control of the Company. If this occurs, investors could lose the opportunity to receive a premium on the sale of their shares in a change of control transaction.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk.

Refer to Item 7A in the Company's Annual Report on Form 10-K for a discussion about the Company's exposure to market risks.

ITEM 4. Controls and Procedures.

(a) The Company's management evaluated, with the participation of the Company's principal executive and principal financial officers, the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), as of April 30, 2004. Based on their evaluation, the Company's principal executive and principal financial officers concluded that the Company's disclosure controls and procedures were effective as of April 30, 2004.

ITEM 4. Controls and Procedures.

(b) There has been no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the Company's fiscal quarter ended April 30, 2004, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

Other Information

ITEM 6. Exhibits and Reports on Form 8-K.

(a) Exhibit Index.

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification Chief Financial Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K.

We furnished the following reports on Form 8-K during the quarter ended April 30, 2004:

<u>Date Furnished</u>	<u>Item No.</u>	<u>Description</u>
February 9, 2004	Item 5	Attached as an exhibit our press release announcing the acquisition of certain assets.
March 10, 2004	Item 12	Attached as an exhibit our fourth quarter and 2003 earnings release.
March 31, 2004	Item 5	Attached as exhibits our press release announcing the acquisition of certain assets and the related Asset Purchase Agreement.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VERINT SYSTEMS INC.

Dated: June 8, 2004

By: /s/ Dan Bodner

Dan Bodner
President and Chief Executive Officer
Principal Executive Officer

By: /s/ Igal Nissim

Dated: June 8, 2004

Igal Nissim
Vice President and Chief Financial Officer
Principal Financial Officer

28
