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VERINT SYSTEMS INC
Form 10-Q
December 15, 2003

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

FORM 10-Q

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

For the quarterly period ended October 31, 2003

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
(State or other jurisdiction of
incorporation or organization)

11-3200514
(I.R.S. Employer
Identification No.)

330 South Service Road, Melville, NY
(Address of principal executive offices)

11747
(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).

Yes No

The number of shares of Common Stock, par value \$0.001 per share,
outstanding as of December 10, 2003 was 29,963,806.

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PART I

ITEM 1. Financial Statements.

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

| | January 31, 2003* ----- | October 31, 2003 ----- (Unaudited) |
|---|-------------------------------|---|
| ASSETS ----- | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 133,933 | \$ 223,686 |
| Accounts receivable, net | 27,279 | 33,533 |
| Inventories | 8,866 | 15,621 |
| Prepaid expenses and other current assets | 4,079 | 6,714 |
| | ----- | ----- |
| TOTAL CURRENT ASSETS | 174,157 | 279,554 |
| PROPERTY AND EQUIPMENT, net | 12,965 | 13,787 |
| OTHER ASSETS | 19,928 | 30,582 |
| | ----- | ----- |
| TOTAL ASSETS | \$ 207,050 ===== | \$ 323,923 ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY ----- | | |
| CURRENT LIABILITIES: | | |
| Accounts payable and accrued expenses | \$ 43,622 | \$ 55,687 |
| Advance payments from customers | 19,013 | 22,612 |
| Current maturities of long-term bank loans | 42,199 | 431 |
| Convertible note | -- | 2,200 |
| | ----- | ----- |
| TOTAL CURRENT LIABILITIES | 104,834 | 80,930 |
| LONG-TERM BANK LOANS | 1,678 | 1,821 |
| CONVERTIBLE NOTE | 2,200 | -- |
| OTHER LIABILITIES | 2,172 | 2,751 |
| | ----- | ----- |
| TOTAL LIABILITIES | 110,884 | 85,502 |
| | ----- | ----- |
| STOCKHOLDERS' EQUITY: | | |
| Common stock, \$0.001 par value - authorized, 120,000,000 shares; issued and outstanding, 23,665,717 and 29,950,351 shares | 24 | 30 |
| Additional paid-in capital | 130,748 | 260,242 |
| Accumulated deficit | (34,855) | (22,699) |
| Cumulative translation adjustment | 249 | 848 |
| | ----- | ----- |
| TOTAL STOCKHOLDERS' EQUITY | 96,166 | 238,421 |
| | ----- | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 207,050 ===== | \$ 323,923 ===== |

*The Condensed Consolidated Balance Sheet as of January 31, 2003 has been summarized from the Company's audited Consolidated Balance Sheet as of that date.

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

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

| | Nine months ended October 31, | | Three months ended October 31, | |
|-------------------------------------|----------------------------------|-----------|-----------------------------------|-----------|
| | 2002 | 2003 | 2002 | 2003 |
| Sales | \$115,458 | \$140,319 | \$ 40,671 | \$ 49,012 |
| Cost of sales | 57,701 | 65,238 | 19,749 | 22,560 |
| Gross profit | 57,757 | 75,081 | 20,922 | 26,452 |
| Operating expenses: | | | | |
| Research and development, net | 12,594 | 16,979 | 4,464 | 5,952 |
| Selling, general and administrative | 38,139 | 46,014 | 13,741 | 16,044 |
| Income from operations | 7,024 | 12,088 | 2,717 | 4,456 |
| Interest and other income, net | 1,310 | 1,813 | 637 | 878 |
| Income before income taxes | 8,334 | 13,901 | 3,354 | 5,334 |
| Income tax provision | 1,646 | 1,745 | 595 | 667 |
| Net income | \$ 6,688 | \$ 12,156 | \$ 2,759 | \$ 4,667 |
| Earnings per share: | | | | |
| Basic | \$ 0.31 | \$ 0.45 | \$ 0.12 | \$ 0.16 |
| Diluted | \$ 0.29 | \$ 0.42 | \$ 0.11 | \$ 0.15 |

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

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

| | Nine months ended October 31, | |
|---|----------------------------------|------------|
| | 2002 | 2003 |
| | ----- | ----- |
| Cash flows from operating activities: | | |
| Net cash from operations after adjustment for non-cash items | \$ 12,999 | \$ 20,237 |
| Changes in operating assets and operating liabilities: | | |
| Accounts receivable | 3,942 | (5,439) |
| Inventories | 360 | (6,090) |
| Prepaid expenses and other current assets | (219) | (1,864) |
| Accounts payable and accrued expenses | 7,858 | 10,573 |
| Advance payments from customers | 523 | 3,599 |
| Other, net | (251) | (790) |
| | ----- | ----- |
| Net cash provided by operating activities | 25,212 | 20,226 |
| | ----- | ----- |
| Cash flows from investing activities: | | |
| Cash paid for a business combination | (9,706) | (6,115) |
| Purchases of property and equipment | (2,920) | (4,815) |
| Capitalization of software development costs | (3,685) | (3,324) |
| | ----- | ----- |
| Net cash used in investing activities | (16,311) | (14,254) |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Net repayments of bank loans | (93) | (42,617) |
| Net proceeds from the issuances of common stock | 65,655 | 126,398 |
| | ----- | ----- |
| Net cash provided by financing activities | 65,562 | 83,781 |
| | ----- | ----- |
| Net increase in cash and cash equivalents | 74,463 | 89,753 |
| Cash and cash equivalents, beginning of period | 49,860 | 133,933 |
| | ----- | ----- |
| Cash and cash equivalents, end of period | \$ 124,323 | \$ 223,686 |
| | ===== | ===== |

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

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

1. Basis of Presentation

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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. ("CTI").

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, 2003. 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 and nine month periods ended October 31, 2003 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, 2003 has been summarized from the Company's audited consolidated balance sheet as of that date. Certain prior periods amounts have been reclassified to conform to the manner of presentation in the current periods.

2. Public Offering

In June 2003, the Company completed a public offering of 5,750,000 shares of its common stock at a price of \$23.00 per share. The shares offered included 149,731 shares issued to Smartsight Networks Inc.'s ("Smartsight") former shareholders in connection with its acquisition (see also note 11). The net proceeds of the offering were approximately \$122.2 million. The Company intends to use the net proceeds of that offering to finance the growth of its business and for general corporate purposes. The Company may also use a portion of the proceeds for acquisitions or other investments.

3. 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

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employee compensation cost is recognized ratably over the associated service period, which is generally the option vesting period. The Company recognized stock-based employee compensation cost in the condensed consolidated statements of income of approximately \$16,000 and \$48,000 in the three month and nine month periods ended October 31, 2002, respectively, and \$13,000 and \$40,000 in the three month and nine month periods ended October 31, 2003, respectively. These costs were recognized in connection with certain employee stock options granted with exercise prices below the fair market value at the date of grant. As of October 31, 2003, 42,174 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

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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:

| | Nine Months Ended October 31, | | Three Months Ended October 31, | |
|--|---------------------------------------|-----------|-----------------------------------|----------|
| | 2002 | 2003 | 2002 | 2003 |
| | ---- | ---- | ---- | ---- |
| | (In thousands, except per share data) | | | |
| Net income, as reported | \$ 6,688 | \$ 12,156 | \$ 2,759 | \$ 4,667 |
| Less: Stock-based employee compensation cost determined under the fair value method, net of related tax effects | 3,132 | 3,863 | 1,123 | 1,482 |
| Pro forma net income | \$ 3,556 | \$ 8,293 | \$ 1,636 | \$ 3,185 |
| Earnings per share: | | | | |
| Basic - as reported | \$ 0.31 | \$ 0.45 | \$ 0.12 | \$ 0.16 |
| Basic - pro forma | \$ 0.16 | \$ 0.31 | \$ 0.07 | \$ 0.11 |
| Diluted - as reported | \$ 0.29 | \$ 0.42 | \$ 0.11 | \$ 0.15 |
| Diluted - pro forma | \$ 0.15 | \$ 0.29 | \$ 0.07 | \$ 0.10 |

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4. Inventories

The composition of inventories at January 31, 2003 and October 31, 2003 is as follows:

| | |
|---------------------|-----------------|
| January 31, 2003 | October 2003 |
| ----- | ----- |

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(In thousands)

| | | |
|-----------------|----------|-----------|
| Raw materials | \$ 5,337 | \$ 7,701 |
| Work in process | 1,405 | 1,843 |
| Finished goods | 2,124 | 6,077 |
| | ----- | ----- |
| | \$ 8,866 | \$ 15,621 |
| | ===== | ===== |

5. Research and Development Expenses

The Company's research and development activities include projects partially funded by the Office of the Chief Scientist of the Ministry of Industry, Trade and Labor 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. 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. The Company is currently involved in several ongoing research and development projects supported by the OCS. Reimbursements from the OCS amounted to approximately \$1.4 million and \$3.9 million, in the three month and nine month periods ended October 31, 2002, respectively, and \$0.8 million and \$3.0 million in the three month and nine month periods ended October 31, 2003, respectively.

6. 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 and nine month periods ended October 31, 2002 and 2003 was as follows:

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| | Three Months ended | | | | |
|--------------------|---------------------------------------|--------|---------------------|------------------|--------|
| | October 31, 2002 | | | October 31, 2003 | |
| | Net Income | Shares | Per Share Amount | Net Income | Shares |
| | (In thousands, except per share data) | | | | |
| Basic EPS | | | | | |
| Net Income | \$ 2,759 | 23,434 | \$ 0.12 | \$ 4,667 | 29,877 |
| | | | ===== | | |
| Effect of Dilutive | | | | | |

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| Securities | | | | | |
|------------------|----------|--------|---------|----------|-------|
| ----- | | | | | |
| Stock Options | | 660 | | | 1,61 |
| Convertible Note | | 137 | | | 13 |
| | ----- | ----- | | ----- | ----- |
| Diluted EPS | \$ 2,759 | 24,231 | \$ 0.11 | \$ 4,667 | 31,62 |
| | ===== | ===== | ===== | ===== | ===== |

| Nine Months ended | | | | | |
|---------------------------------------|----------|-----------|------------------|--------|-----------|
| ----- | | | | | |
| October 31, 2002 | | | October 31, 2003 | | |
| Net | Shares | Per Share | Net | Shares | Per Share |
| Income | | Amount | Income | | Amount |
| (In thousands, except per share data) | | | | | |
| Basic EPS | | | | | |
| Net Income | \$ 6,688 | 21,706 | \$ 12,156 | 26,89 | \$ 0.31 |
| | | | | | ===== |
| Effect of Dilutive Securities | | | | | |
| ----- | | | | | |
| Stock Options | | 1,134 | | | 1,61 |
| Convertible Note | | 137 | | | 13 |
| | ----- | ----- | | ----- | ----- |
| Diluted EPS | \$ 6,688 | 22,977 | \$ 12,156 | 28,64 | \$ 0.29 |
| | ===== | ===== | ===== | ===== | ===== |

7. Comprehensive Income

Total comprehensive income was approximately \$2,608,000 and \$5,424,000 for the three month periods ended October 31, 2002 and October 31, 2003, respectively, and approximately \$6,014,000 and \$12,755,000 for the nine month periods ended October 31, 2002 and October 31, 2003, respectively. The elements of comprehensive income include net income and foreign currency translation adjustments.

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8. Workforce Reduction, Restructuring and Impairment Charges

During the year ended January 31, 2002, the Company took steps to better align its cost structure with the business environment, to improve the efficiency of its operations and to increase its profitability. These steps included reductions in the Company's workforce and the consolidation of its facilities in the United Kingdom, which were announced in April and December 2001. As of October 31, 2003, the Company has paid all its accrued liabilities related to this workforce reduction and facilities consolidation.

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A roll-forward of the accrued liabilities for the workforce reduction and facilities consolidation costs from January 31, 2003 is as follows:

| | Accrual Balance at January 31, 2003 ---- | Cash Payments ----- (In thousands) | Accrual Balance at October 31, 2003 ---- |
|-------------------------------------|--|---|--|
| Severance and related Facilities | \$ 26 189 ----- | \$ 26 189 ----- | \$ 0 0 ----- |
| Total | \$ 215 ===== | \$ 215 ===== | \$ 0 ===== |

Severance and related costs consist primarily of severance payments to terminated employees and fringe related costs associated with severance payments, other termination costs and legal and consulting costs.

Facilities costs consist primarily of contractually obligated lease liabilities and operating expenses related to facilities vacated in the United Kingdom as a result of the facilities consolidation.

9. Related Party Transactions and Balances

Corporate Services Agreement - The Company recorded expenses of approximately \$131,000 and \$144,000 for the three month periods ended October 31, 2002 and 2003, respectively, and \$394,000 and \$432,000 for the nine month periods ended October 31, 2002 and October 31, 2003, respectively, for the services provided by the Company's parent, CTI, under the Corporate Services Agreement between the Company and CTI.

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Enterprise Resource Planning Software Sharing Agreement - The Company recorded \$25,000 for each of the three month periods ended October 31, 2002 and 2003, and \$75,000 for each of the nine month periods ended October 31, 2002 and 2003, for support services rendered by Comverse Ltd., a subsidiary of CTI, under the Enterprise Resource Planning Software Sharing Agreement between the Company and Comverse Ltd..

Satellite Services Agreement - The Company recorded expenses of approximately \$405,000 and \$505,000 for the three month periods ended October 31, 2002 and 2003, respectively, and \$1,502,000 and \$1,366,000, for the nine month periods ended October 31, 2002 and 2003, respectively, for services rendered by Comverse, Inc., a subsidiary of CTI, and its subsidiaries under the Satellite Services Agreement between the Company and Comverse, Inc.

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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 \$196,000 and \$94,000, during the three month periods ended October 31, 2002 and 2003, respectively, and \$696,000 and \$3,266,000, during the nine month periods ended October 31, 2002 and October 31, 2003, respectively. In addition, the Company was charged with installation, support, marketing and office service fees by that affiliate amounting to approximately \$72,000 and \$172,000 for the three month periods ended October 31, 2002 and 2003, respectively, and \$283,000 and \$502,000, for the nine month periods ended October 31, 2002 and 2003, respectively.

Transactions with Other Subsidiaries of CTI - The Company charges subsidiaries of CTI for services relating to the use of the Company's facilities and employees. Charges to these subsidiaries were approximately \$44,000 and \$32,000 for the three month periods ended October 31, 2002 and 2003, respectively, and \$132,000 and \$97,000 for the nine month periods ended October 31, 2002 and October 31, 2003, respectively.

The Company also purchased products and services from other subsidiaries of CTI in the ordinary course of business. Purchases from these subsidiaries were approximately \$0 and \$3,000 for the three month periods ended October 31, 2002 and 2003, respectively, and \$0 and \$14,000 for the nine month periods ended October 31, 2002 and 2003, respectively.

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

| | January 31, 2003 ---- | October 31, 2003 ---- |
|--|-----------------------------|-----------------------------|
| Included in accounts receivable, net | \$ 1,750 ===== | \$ 1,729 ===== |
| Included in accounts payable and accrued expenses | \$ 1,157 ===== | \$ 867 ===== |

10. Employee Stock Purchase Plan

The Company adopted its 2002 Employee Stock Purchase Plan, which was amended and restated on May 22, 2003, under which all employees who have completed three months of employment are entitled, through payroll deductions of amounts up to 10% of their base salary, to purchase shares of the Company's common stock at 85% of the lesser of the market price at the offering commencement date or the offering termination

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date. The number of shares available under this Employee Stock Purchase Plan is 1,000,000, of which 100,637 had been issued as of October 31, 2003.

11. Acquisitions

On May 21, 2003, the Company acquired all of the issued and outstanding shares of Smartsight, a Canadian corporation that develops IP-based video edge devices and software for wireless video transmission. The purchase price consisted of approximately \$7,144,000 in cash and 149,731 shares of the Company. Shares issued as part of the purchase price were accounted for with value of approximately \$3,063,000, or \$20.46 per share. In connection with this acquisition, the Company incurred transaction costs, consisting primarily of professional fees amounting to approximately \$263,000.

The acquisition was accounted for using the purchase method. The purchase price was allocated to the assets and liabilities of Smartsight based on the estimated fair value of those assets and liabilities as of May 1, 2003. Identifiable intangible assets consist of sales backlog, acquired technology, trade name, customer relationships and non-competition agreements and have an estimated useful life of up to five years. The results of operations of Smartsight have been included in the Company's results of operations since May 1, 2003.

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

| | (In thousands) |
|-----------------------------------|----------------|
| Purchase price | \$ 10,207 |
| Acquisition costs | 263 |
| | ----- |
| Total purchase price | \$ 10,470 |
| | ===== |
| | |
| Fair value of net assets acquired | \$ 1,880 |
| Identifiable intangible assets | 2,077 |
| Goodwill | 6,513 |
| | ----- |
| Total purchase price | \$ 10,470 |
| | ===== |
| | |
| Purchase price paid in cash | \$ 7,407 |
| Shares issued | 3,063 |
| | ----- |
| Total purchase price | \$ 10,470 |
| | ===== |

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 \$42,778,000, net income of approximately \$3,318,000,

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basic earnings per share of \$0.14 and diluted earnings per share of \$0.14 for the three month period ended October 31, 2002. For the nine month periods ended October 31, 2002 and 2003 the summary unaudited pro forma condensed consolidated results of operations would have reflected revenues of approximately \$119,617,000 and \$141,982,000, net income of approximately \$7,493,000 and \$12,365,000, basic earnings per share of \$0.35 and \$0.46 and diluted earnings per share of \$0.33 and \$0.43, 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.

12. Business Segment Information

The Company is engaged in providing analytic solutions for communications interception, digital video security and surveillance, and enterprise business intelligence. The Company operates in one business segment and 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.

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| | United States | Israel | United Kingdom | Other | Reconciling Items | Consolidat Totals |
|--|------------------|-----------|-------------------|------------|----------------------|----------------------|
| ----- | | | | | | |
| Three months ended October 31, 2002: ----- | (In thousands) | | | | | |
| Sales | \$ 22,729 | \$ 14,545 | \$ 6,563 | \$ 2,040 | \$ (5,206) | \$ 40,671 |
| Costs and expenses | (20,237) | (14,323) | (5,807) | (3,131) | 5,544 | (37,954) |
| ----- | | | | | | |
| Income (loss) from operations | \$ 2,492 | \$ 222 | \$ 756 | \$ (1,091) | \$ 338 | \$ 2,717 |
| ===== | | | | | | |
| Three months ended October 31, 2003: ----- | | | | | | |
| Sales | \$ 27,218 | \$ 17,535 | \$ 5,838 | \$ 4,883 | \$ (6,462) | \$ 49,012 |
| Costs and expenses | (22,387) | (16,394) | (6,002) | (5,647) | 5,874 | (44,556) |
| ----- | | | | | | |
| Income (loss) from operations | \$ 4,831 | \$ 1,141 | \$ (164) | \$ (764) | \$ (588) | \$ 4,456 |
| ===== | | | | | | |

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| | United States | Israel | United Kingdom | Other | Reconciling Items | Co |
|---|----------------|-----------|----------------|------------|-------------------|----|
| ----- | | | | | | |
| Nine months ended October 31, 2002: ----- | (In thousands) | | | | | |
| Sales | \$ 63,444 | \$ 46,032 | \$ 18,144 | \$ 7,083 | \$ (19,245) | |
| Costs and expenses | (59,835) | (42,001) | (17,054) | (8,880) | 19,336 | |
| ----- | | | | | | |
| Income (loss) from operations | \$ 3,609 | \$ 4,031 | \$ 1,090 | \$ (1,797) | \$ 91 | |
| ===== | | | | | | |
| | | | | | | |
| Nine months ended October 31, 2003: ----- | | | | | | |
| Sales | \$ 71,012 | \$ 58,733 | \$ 17,978 | \$ 12,136 | \$ (19,540) | |
| Costs and expenses | (62,314) | (50,779) | (19,045) | (14,018) | 17,925 | |
| ----- | | | | | | |
| Income (loss) from operations | \$ 8,698 | \$ 7,954 | \$ (1,067) | \$ (1,882) | \$ (1,615) | |
| ===== | | | | | | |
| | | | | | | |
| Total Assets: | | | | | | |
| October 31, 2002 | \$ 116,414 | \$ 82,301 | \$ 7,608 | \$ 6,078 | \$ (12,805) | |
| ===== | | | | | | |
| October 31, 2003 | \$ 218,385 | \$ 98,355 | \$ 10,788 | \$ 23,317 | \$ (26,922) | |
| ===== | | | | | | |

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.

13. Bank Loan

In February 2003, the Company repaid a bank loan of \$42 million.

14. Effect of New Accounting Pronouncements

In August 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 establishes accounting standards for recognition and measurement of a liability for an asset retirement obligation and the associated asset retirement cost. SFAS No. 143 applies to legal obligations associated with the retirement of a tangible long-lived asset that result from the acquisition, construction, development and/or normal operation of a long-lived asset. This Statement is

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effective for fiscal years beginning after June 15, 2002. The adoption of SFAS No. 143 did not have a material effect on the Company's condensed consolidated financial statements.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145, among other things, rescinds SFAS No. 4, which required all gains and losses from the extinguishments of debt to be classified as an extraordinary item and amends SFAS No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. The rescission of SFAS No. 4 is effective for fiscal years beginning after May 15, 2002. The remainder of the statement is generally effective for transactions occurring after May 15, 2002. The adoption of SFAS No. 145 did not have a material effect on the Company's condensed consolidated financial statements.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is generally effective for derivative instruments, including derivative instruments embedded in certain contracts, entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have a material effect on the Company's condensed consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150

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establishes standards for how to classify and measure certain financial instruments with characteristics of both liabilities and equity. The statement is effective for financial instruments entered into or modified after May 31, 2003. The adoption of SFAS No. 150 did not have a material effect on the Company's condensed consolidated financial statements.

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

RESULTS OF OPERATIONS

Nine Month and Three Month Periods Ended October 31, 2003
Compared to Nine Month and Three Month Periods Ended October 31, 2002

Sales. Sales for the nine month and three month periods ended October 31, 2003 increased by approximately \$24.9 million (22%) and \$8.3 million (21%), respectively, as compared to the nine month and three month periods ended October 31, 2002. This increase was attributable to a higher sales volume of both product and services. Sales to international customers represented approximately 50% and 44% of sales for the nine month and three month periods ended October 31, 2003 as compared to approximately 50% and 52% for

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the nine month and three month periods ended October 31, 2002.

Cost of Sales. Cost of sales for the nine month and three month periods ended October 31, 2003 increased by approximately \$7.5 million (13%) and \$2.8 million (14%), respectively, as compared to the nine month and three month periods ended October 31, 2002. The increase in the nine month and three month periods ended October 31, 2003 was attributable to an increase in materials and overhead costs of approximately \$3.4 million and \$1.5 million, respectively, an increase in salaries and fringe benefits of approximately \$2.5 million and \$0.7 million, respectively, an increase in subcontractors and consultants of approximately \$1.0 million and \$0.3 million, respectively, and an increase in other operations costs including royalties of approximately \$0.6 million and \$0.3 million, respectively. Gross margins increased to approximately 53.5% and 54.0%, in the nine month and three month periods ended October 31, 2003, respectively, from approximately 50.0% and 51.4%, in the nine month and three month periods ended October 31, 2002, respectively.

Research and Development Expenses, net. Research and development expenses, net, for the nine month and three month periods ended October 31, 2003 increased by approximately \$4.4 million (35%), and \$1.5 million (33%), respectively, as compared to the nine month and three month periods ended October 31, 2002. This net increase was attributable to an increase in salaries and fringe benefits of approximately \$2.7 million and \$0.8 million, respectively, an increase in subcontractors and consultants of approximately \$0.6 million and \$0.3 million, respectively, a decrease in government reimbursements of approximately \$0.7 million and

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\$0.5 million, respectively, and an increase (decrease) in other research and development expenses of \$0.4 million and (\$0.1) million, respectively. Research and development expenses, net, as a percentage of sales, increased to approximately 12% for the nine month and three month periods ended October 31, 2003 from approximately 11% for the nine month and three month periods ended October 31, 2002.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the nine month and three month periods ended October 31, 2003 increased by approximately \$7.9 million (21%), and \$2.3 million (17%), respectively, as compared to the nine month and three month periods ended October 31, 2002. This increase was attributable to an increase in salaries and fringe benefits, primarily to sales and marketing personnel, amounting to approximately \$4.4 million and \$1.9 million, respectively, an increase in marketing expenses of approximately \$1.3 million and \$0.5 million, respectively, an increase in subcontractors and consultants of approximately \$1.1 million and \$0.3 million, respectively, an increase in bad debt expenses of approximately \$0.5 million and \$0.0 million, respectively, and an increase in other selling, general and administrative expenses of approximately \$1.3 million and \$1.1 million, respectively. This increase was partially offset by a decrease in agent commissions of approximately \$0.7 million and \$1.5 million, respectively. Selling, general and administrative expenses as a percentage of sales was approximately 33% for the nine month and three month periods ended October 31, 2003 compared with approximately 33% and 34%, respectively, for the nine month and three month periods ended October 31, 2002.

Interest and Other Income, net. Net interest and other income for the nine month and three month periods ended October 31, 2003 increased by approximately \$0.5 million and \$0.2 million, respectively, as compared to

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the nine month and three month periods ended October 31, 2002. The increase of approximately \$0.5 million for the nine month period ended October 31, 2003 as compared to the nine month period ended October 31, 2002, was attributable to increased interest income of approximately \$0.3 million, decreased interest expense of approximately \$0.3 million, increased gains from the Company's share in the profit of an affiliate of approximately \$0.7 million and decreased other expense of approximately \$0.8 million mainly due to a write-down of a certain investment in the nine month period ended October 31, 2002. These changes were offset by decreased foreign currency gains of approximately \$1.6 million. The increase of approximately \$0.2 million for the three month period ended October 31, 2003, as compared to the three month period ended October 31, 2002, was attributable to increased gains from the Company's share in the profit of an affiliate of approximately \$0.2 million and an increased foreign currency gain of approximately \$0.1 million offset by increased interest expense of approximately \$0.1 million.

Income Tax Provision. Income tax provision for the nine month and three month periods ended October 31, 2003, increased by approximately \$0.1 million for each such period as compared to the nine month and three month periods ended October 31, 2002. This increase was primarily attributable to increased taxable income. The overall effective tax rate decreased to approximately 13% for the nine month and three month periods ended October 31, 2003,

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from approximately 20% and 18% for the nine month and three month periods ended October 31, 2002, respectively. The decreased effective tax rate is mainly attributable to preferential tax rates in Israel and to the use of net operating losses carry forwards in certain tax jurisdictions.

Net Income. Net income for the nine month and three month periods ended October 31, 2003 increased by approximately \$5.5 million (82%) and \$1.9 million (69%), respectively, as compared to the nine month and three month periods ended October 31, 2002. As a percentage of sales, net income was approximately 8.7% and 9.5% in the nine month and three month periods ended October 31, 2003, respectively, as compared to approximately 5.8% and 6.8% in the nine month and three month periods ended October 31, 2002, respectively. The increase resulted primarily from the factors described above.

LIQUIDITY AND CAPITAL RESOURCES

As of October 31, 2003, the Company had cash and cash equivalents of approximately \$223.7 million and working capital of approximately \$198.6 million, including net proceeds of approximately \$122.2 million, following the completion of the Company's secondary public offering in June 2003. As of January 31, 2003, the Company had cash and cash equivalents of approximately \$133.9 million and working capital of \$69.3 million.

Operating activities for the nine month periods ended October 31, 2002 and 2003, after adjustment for non-cash items, provided cash of approximately \$13.0 million, and \$20.2 million, respectively. Other changes in operating assets and liabilities provided cash of approximately \$12.2 million and \$0.0 million for the nine month periods ended October 31, 2002 and 2003, respectively. This resulted in cash provided by operating activities of approximately \$25.2 million and \$20.2 million for the nine month periods ended October 31, 2002 and 2003, respectively.

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Investing activities for the nine month periods ended October 31, 2002 and 2003, used cash of approximately \$16.3 million and \$14.3 million, respectively. For the nine month period ended October 31, 2002 these amounts include cash paid for a business combination of approximately \$9.7 million, purchases of property and equipment of approximately \$2.9 million, and capitalization of software development costs of approximately \$3.7 million. For the nine month period ended October 31, 2003 these amounts include cash paid for a business combination of approximately \$6.1 million, purchases of property, equipment and proprietary technology of approximately \$4.8 million and capitalization of software development costs of approximately \$3.3 million.

Financing activities for the nine month periods ended October 31, 2002 and 2003 provided cash of approximately \$65.6 million and \$83.8 million, respectively. For the nine month periods ended October 31, 2002 and 2003 net proceeds from the issuances of common stock in connection with the Company's public offerings of common stock in May 2002 and June 2003, the exercise of stock options, and shares issued from the employee stock purchase plan provided

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cash of approximately \$65.7 million and \$126.4 million, respectively. Net repayments of bank loans and other debt used cash of approximately \$0.1 million and \$42.6 million in the nine month periods ended October 31, 2002 and 2003, respectively.

On February 1, 2002, the Company's wholly-owned subsidiary, Loronix, acquired the digital video recording business of Lanex, LLC. The Lanex business provides digital video recording solutions for security and surveillance applications. The purchase price consisted of approximately \$9.5 million in cash and a \$2.2 million convertible note issued by the Company to Lanex. The note is non-interest bearing and matures on February 1, 2004. The holders of the note may elect to convert the note, in whole or in part, into shares of the Company's common stock at a conversion price of \$16.06 per share. The note is guaranteed by CTI.

On May 21, 2003, the Company acquired all of the issued and outstanding shares of Smartsight Networks Inc., a Canadian corporation that develops IP-based video edge devices and software for wireless video transmission. The purchase price consisted of approximately \$7.1 million in cash and 149,731 shares of the Company with a value of approximately \$3.1 million.

In June 2003, the Company completed a public offering of 5,750,000 shares of its common stock at a price of \$23.00 per share. The shares offered included 149,731 shares issued to Smartsight Networks Inc.'s former shareholders in connection with its acquisition. The net proceeds of the offering were approximately \$122.2 million. The Company intends to use the net proceeds of that offering to finance the growth of its business and for general corporate purposes. The Company may also use a portion of the proceeds for acquisitions or other investments.

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. If current sources are not sufficient to meet the Company's needs, the Company may seek additional debt or equity financing. 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, which may require additional debt or equity financing and could result in a decrease of the Company's working capital. There can be no assurance that such additional financing would be available on acceptable terms, if at all.

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CERTAIN TRENDS AND UNCERTAINTIES

The Company's primary business is providing analytic solutions for communications interception, digital video security and surveillance, and enterprise 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

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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.

The market for the Company's enterprise business intelligence products 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, eliminate altogether, information technology spending. If the Company's customers do not increase their spending on information technology or if such spending declines, its revenues from sales of its enterprise business intelligence products may decrease. The information technology spending of 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 for the first three quarters of fiscal 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.

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.

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

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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 clearances are revoked; or (vi) there is a change in government procurement procedures.

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,

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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.

The deferral or loss of one or more significant sales 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 or lost 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.

The markets for the Company's digital security and surveillance and enterprise 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 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

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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,

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including design, development and marketing activities, required to prepare bids and proposals for contracts that may not be awarded to the Company.

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.

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 it's the Company's contract-related costs and expenses, including allocated indirect costs; and (iv) change specific terms and conditions in its 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.

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

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government agencies, which could materially and adversely affect its business, financial condition and results of operations. In addition, a government may reform its

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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 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 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,

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financial condition and results of operations.

The Company's ability to achieve revenue growth depends to some extent on adding new partners to expand its sales channels, as well as leveraging its relationships with existing partners. If the Company's relationships with these value added resellers, systems integrators and strategic and technology partners deteriorate or terminate, the Company may lose important sales and marketing opportunities.

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.

The Company incorporates in the vast majority of its products software that it licenses from third parties. 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.

The Company's products are often used by customers to compile and analyze highly sensitive or confidential information and data. The Company may come into contact with such information or data when it performs support or maintenance functions for its customers. While it has internal policies,

procedures and training for employees in connection with performing these functions, even the perception that any of its employees has improperly handled

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sensitive or confidential information and data of a customer could harm its reputation and could inhibit market acceptance of its products.

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)

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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.

In May 2003, the Company acquired SmartSight. If the Company is unable to

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successfully integrate SmartSight with its business, it may be unable to realize the anticipated benefits of this acquisition. The Company may experience technical difficulties that could delay the integration of SmartSight's products into the Company's solutions, resulting in business disruptions.

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 in the past the Company has experienced 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

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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.

To date, most of the Company's sales have been denominated in U.S. dollars,

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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 and 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 more recently 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.

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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

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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 October 31, 2003, the Company has received approximately \$51 million in cumulative grants and has recorded approximately \$21 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.

The Company's investment programs in manufacturing equipment and leasehold improvements at its facility in Israel have 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.

CTI beneficially owns a majority of the Company's outstanding shares of common stock. Consequently, CTI effectively controls the outcome of all matters submitted for stockholder

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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, CTI has a controlling influence on the Company's management, direction and policies, including the ability to appoint and remove its officers. As a result, CTI 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 CTI under a corporate services agreement. The Company's enterprise resource planning software is maintained and supported by Comverse, Ltd., a subsidiary of CTI, 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

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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 CTI that addresses potential conflicts of interest between CTI and the Company. This agreement allocates between CTI 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 CTI who may also be its directors, officers or employees unless CTI fails to pursue these opportunities.

Six of the Company's thirteen directors are officers and/or directors or employees of CTI, or otherwise affiliated with CTI. These directors have fiduciary duties to both companies and may have conflicts of interest on matters affecting both the Company and CTI and in some circumstances may have interests adverse to the Company. The Company's Chairman, Kobi Alexander, is the chairman of CTI. This position with CTI 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 CTI 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 CTI consolidated group for federal income tax purposes. To the extent CTI 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 CTI 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, CTI 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 CTI consolidated group for federal income tax purposes, CTI

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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, CTI 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 CTI 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

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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, 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.

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.

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FORWARD-LOOKING STATEMENTS

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 Registration Statement on Form S-3 filed with the Securities and Exchange Commission, in its press releases, in other written materials, and in statements made by employees to analysts, investors, representatives of the media, and others.

Forward-looking statements include information concerning the Company's possible or assumed future results of operations, business strategies, financing plans, competitive position, potential growth opportunities and the effects of competition and regulation. Forward-looking statements include all statements that are not historical facts. These statements can be identified by the use of forward-looking terminology, such as the words "believes," "expects," "anticipates," "intends," "plans," "estimates," "may" or "might" or other similar expressions.

Forward-looking statements involve significant risks, uncertainties and assumptions. Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, actual results may differ materially from those expressed in these forward-looking statements. Undue reliance should not be placed on any forward-looking statements. The Company does not have any intention or obligation to update forward-looking statements, even if new information becomes available or other events occur in the future. Many important factors, in addition to those discussed in the section entitled "Certain Trends and Uncertainties" and elsewhere, could cause the Company's

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results to differ materially from those expressed or suggested in forward-looking statements.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk.

The Company is exposed to market risk from changes in foreign currency exchange rates that could impact its results of operations and financial condition. The Company considers the foreign currency exchange rate risk, in particular that of the U.S. dollar versus the British pound, the Euro and the New Israeli Shekel, to be its primary market risk exposure. From time to time, the Company may enter into material foreign currency exchange contracts or other derivative instruments to reduce its exposure to the foreign currency exchange risks. In the future, the Company may use foreign currency exchange contracts and other derivative instruments to reduce its exposure to this risk.

The Company currently maintains its surplus cash in short-term, interest-bearing investment-grade instruments or bank deposits. The Company does not expect that a 100 basis point increase nor decrease from current interest rates would have a material effect on its financial position, results of operations or cash flows.

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ITEM 4. Controls and Procedures.

As of the end of the period covered by this report, the Company conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, 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 (the "Exchange Act")). Based on this evaluation, the principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There was no change in the Company's internal control over financial reporting during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

Other Information

ITEM 4. Submission of Matters to a Vote of Security Holders.

The 2003 Annual Meeting of the Stockholders of the Company (the "Meeting") was held on August 12, 2003. The total number of outstanding shares of Common Stock entitled to vote at the Meeting was 29,719,735 and there were present at the Meeting in person or by proxy 28,736,896 shares of the Company's Common Stock, which number constituted a quorum for the Meeting, and were entitled to vote and acted as follows with respect to the following proposals:

Approved, (1) by a vote of 25,461,909 votes cast in favor of the election

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of Kobi Alexander as a director, 3,274,987 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item; (2) by a vote of 25,459,707 votes cast in favor of the election of Dan Bodner as a director, 3,277,189 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item; (3) by a vote of 25,281,696 votes cast in favor of the election of Paul Baker as a director, 3,455,200 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item; (4) by a vote of 27,654,950 votes cast in favor of the election of Victor DeMarines as a director, 1,081,946 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item; (5) by a vote of 25,472,577 votes cast in favor of the election of David Kreinberg as a director, 3,264,319 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item; (6) by a vote of 25,292,658 votes cast in favor of the election of David Ledwell as a director, 3,444,238 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item; (7) by a vote of 27,671,174 votes cast in favor of the election of Kenneth

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Minihan as a director, 1,065,722 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item; (8) by a vote of 27,865,193 votes cast in favor of the election of Larry Myers as a director, 871,703 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item; (9) by a vote of 25,247,858 votes cast in favor of the election of Igal Nissim as a director, 3,489,038 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item; (10) by a vote of 25,470,130 votes cast in favor of the election of Harris Oliner as a director, 3,266,766 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item; (11) by a vote of 25,514,930 votes cast in favor of the election of Paul Robinson as a director, 3,221,966 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item; (12) by a vote of 27,646,974 votes cast in favor of the election of Howard Safir as a director, 1,089,922 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item; and (13) by a vote of 25,290,211 votes cast in favor of the election of William Sorin as a director, 3,446,685 votes were cast against, holders of 0 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item.

Approved, by a vote of 28,293,721 votes cast in favor of the ratification of the Company's 2003 Employee Stock Purchase Plan, with 438,480 votes cast against, holders of 4,695 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item.

Approved, by a vote of 28,004,612 votes cast in favor of the ratification of the Deloitte & Touche LLP, with 693,604 votes cast against, holders of 38,680 shares indicated that they abstained from voting on this matter and holders of 0 shares indicated no-vote on this item.

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

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(a) Exhibit Index.

- 31.1 Certification of the Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-14(a)
- 31.2 Certification of the Chief Financial Officer pursuant to Securities Exchange Act Rule 13a-14(a)
- 32.1 Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350*
- 32.2 Certification Chief Financial Officer pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350*

* These exhibits are being "furnished" with this periodic report and are not deemed "filed" with the Securities and Exchange Commission and are not incorporated by reference in any filing of the Company under the Securities Act of 1933 or the Securities Exchange

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Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation by reference language in any such filings.

(b) Reports on Form 8-K.

On September 8, 2003, the Company filed a Form 8-K that was accompanied by a press release reporting the Company's financial results from the second fiscal quarter of 2003.

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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: December 12, 2003 By: /s/Dan Bodner

Dan Bodner
President and Chief Executive Officer
Principal Executive Officer

Dated: December 12, 2003 By: /s/Igal Nissim

Igal Nissim
Vice President and Chief Financial Officer
Principal Financial Officer

