VERINT SYSTEMS INC
Form 10-Q
December 12, 2005

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

FORM 10-Q

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

For the quarterly period ended October 31, 2005

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.

[X] Yes [_] No

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

[X] Yes [_] No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

[ ] Yes [X] No

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares of Common Stock, par value $0.001 per share, outstanding as of December 8, 2005 was 32,186,637.

TABLE OF CONTENTS

PART I
Financial Information

FORWARD-LOOKING STATEMENTS

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

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

By their very nature, forward-looking statements are subject to uncertainties, both general and specific, and risks exist that predictions, forecasts, projections and other forward-looking statements will not be achieved. Actual results may differ materially due to a variety of factors, including without limitation those discussed under "Certain Trends and Uncertainties" and elsewhere in this report. Investors and others should carefully consider these and other uncertainties and events, whether or not the statements are described as forward-looking.

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

PART I

ITEM 1. FINANCIAL STATEMENTS.

VERINT SYSTEMS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

ASSETS	JANUARY 31, 2005*	
CURRENT ASSETS:		
Cash and cash equivalents	$ 45,100	$
Bank time deposits	-	
Short-term investments	195,314	
Accounts receivable, net	39,072	
Inventories	17,267	
Prepaid expenses and other current assets	9,880	
TOTAL CURRENT ASSETS	306,633	
PROPERTY AND EQUIPMENT, net	17,540	
INTANGIBLE ASSETS, net	12,026	
GOODWILL	49,625	
OTHER ASSETS	13,154	
TOTAL ASSETS	$ 398,978	$
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	$ 68,399	$
Advance payments from customers	41,853	
TOTAL CURRENT LIABILITIES	110,252	
LONG-TERM LIABILITIES	5,351	
TOTAL LIABILITIES	115,603	
STOCKHOLDERS' EQUITY:		
Common stock, $0.001 par value - authorized, 120,000,000 shares; issued and outstanding 31,577,587 and 32,181,356 shares	32	

Additional paid-in capital	282,364
Unearned stock compensation	(3,395)
Retained earnings	2,155
Accumulated other comprehensive income	2,219
TOTAL STOCKHOLDERS' EQUITY	283,375
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 398,978

*The Condensed Consolidated Balance Sheet as of January 31, 2005 has been summarized from the Company's audited Consolidated Balance Sheet as of that date.

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

4

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,	
	2004	2005	2004	2005
Sales	$ 180,794	$ 224,986	$ 63,989	$ 78,238
Cost of sales	82,098	99,860	29,235	34,360
Gross profit	98,696	125,126	34,754	43,878
Operating expenses:				
Research and development, net	23,089	29,035	8,409	10,039
Selling, general and administrative	59,704	74,217	21,290	26,272
In-process research and development	3,154	-	-	-
Write-down of capitalized software	1,481	-	-	-
Income from operations	11,268	21,874	5,055	7,567
Interest and other income, net	2,379	5,361	932	1,982
Income before income tax provision	13,647	27,235	5,987	9,549
Income tax provision	1,282	6,257	807	2,241
Net income	$ 12,365	$ 20,978	$ 5,180	$ 7,308
Earnings per share:				
Basic	$ 0.40	$ 0.66	$ 0.17	$ 0.23
Diluted	$ 0.38	$ 0.63	$ 0.16	$ 0.22

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

5

VERINT SYSTEMS INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(IN THOUSANDS)

	NINE MONTHS EN[DED] OCTOBER 31 2004	
Cash flows from operating activities:		
Net income	$ 12,365	$
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,258	
In process research and development	3,154	
Other, net	2,531	
Cash flows from investing activities:		
Acquisitions, net of cash acquired	(45,389)	(
Purchases of property and equipment	(5,135)	
Proceeds from sale of property and equipment	-	
Capitalization of software development costs	(3,163)	
Increase in short-term investments and bank time deposits, net	(12,000)	(
Other	-	
Net cash used in investing activities	(65,687)	(
Cash flows from financing activities:		
Borrowing/(Repayment) of bank loans	489	
Proceeds from issuance of common stock in connection with exercise of stock options and employee stock purchase plan	11,034	
Net cash provided by financing activities	11,523	
Net increase (decrease) in cash and cash equivalents	(14,921)	
Cash and cash equivalents, beginning of period	77,516	
Cash and cash equivalents, end of period	$ 62,595	$

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

6

VERINT SYSTEMS INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION

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

In presenting the accompanying unaudited condensed consolidated financial statements, management makes estimates and assumptions that affect the amounts reported and related disclosures. Estimates, by their nature, are based on judgments and available information. Accordingly, actual results could differ from those estimates. In management's opinion, the condensed consolidated financial statements contain all normal recurring adjustments necessary for a fair presentation of interim results reported in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). The results of operations reported for interim periods are not necessarily indicative of the results of operations for the entire year or any subsequent interim period. Certain reclassifications have been made to prior period amounts to conform to the current period presentation. These financial statements should be read in conjunction with Verint's 2004 Annual Report on Form 10-K filed on April 18, 2005.

2. STOCK-BASED EMPLOYEE COMPENSATION

The Company applies the intrinsic-value based method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. 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, and 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 $11,000 and $33,000, during each of the three month and nine month periods ended October 31, 2004, respectively, and $0 and $22,000, during each of the three month and nine month periods ended October 31, 2005, respectively, relating to certain employee stock options granted with exercise prices below the fair market value at the date of grant. As of October 31, 2005, 11,730 employee stock options were outstanding with exercise prices below the fair market value at the date of the grant. All other employee stock options have been granted at exercise prices equal to fair market value on the date of grant, and accordingly, no compensation expense has been recognized by the Company related to these options in the accompanying condensed consolidated statement of income.

The Company estimated the fair value of employee stock options utilizing the Black-Scholes option valuation model, using appropriate assumptions, as required by U.S. GAAP. The Black-Scholes model was developed for use in estimating the fair value of traded options and does not consider the non-traded nature of employee stock options, vesting and trading restrictions, lack of transferability or the ability of employees to forfeit the options prior to expiry. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of the Company's employee stock options.

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, 2004	2005	2
	(In thousands, except per share data)		
Net income, as reported	$ 12,365	$ 20,978	$
Less: Stock-based employee compensation cost determined under the fair value method, net of related tax effects	5,613	7,038	
Pro forma net income	$ 6,752	$ 13,940	$
Earnings per share:			
Basic - as reported	$ 0.40	$ 0.66	$
Basic - pro forma	$ 0.22	$ 0.44	$
Diluted - as reported	$ 0.38	$ 0.63	$
Diluted - pro forma	$ 0.21	$ 0.42	$

3. SHORT-TERM INVESTMENTS

The Company classifies all short-term investments as available for sale, accounted for at fair value, with the resulting unrealized gains or losses included in accumulated other comprehensive income.

In connection with the preparation of its Annual Report on Form 10-K for the year ended January 31, 2005, the Company concluded that it was appropriate to classify investments in Auction Rate Securities ("ARS") as short-term investments. ARS generally have long-term stated maturities; however, these investments have characteristics similar to short-term investments because at pre-determined intervals, generally every 7 to 90 days, there is a new auction process at which these securities are reset to current interest rates. Previously, such investments had been classified as cash and cash equivalents due to their liquidity and pricing reset feature. As of October 31, 2005, the Company held approximately $183,925,000 of investments in ARS that are classified as short-term investments. Accordingly, the Company has revised the classification to report these securities as short-term investments in its Condensed Consolidated Balance Sheet for all periods prior to January 31, 2005, and has reclassified approximately $145,053,000 of investments in ARS as of October 31, 2004, that were previously included in cash and cash equivalents as short-term investments.

The Company has also revised the presentation of the Condensed Consolidated Statements of Cash Flows for the nine months ended October 31, 2004 to reflect the changes in ARS as investing activities rather than as a component of cash and cash equivalents, which is consistent with the presentation for the year ended January 31, 2005. In the previously reported Condensed Consolidated Statements of Cash Flows for the nine months ended October 31, 2004, net cash provided by investing activities related to these short-term investments of approximately $21,853,000 were included in cash and cash equivalents.

This change in classification does not affect previously reported cash flows from operations or from financing activities in the Consolidated Statements of Cash Flows or previously reported Consolidated Statements of Income for any period.

4. INVENTORIES

The composition of inventories at January 31, 2005 and October 31, 2005 is as follows:

	JANUARY 31, 2005	OCTOBER 31, 2005
	(In thousands)	
Raw materials	$ 6,067	$ 9,236
Work in process	4,179	4,791
Finished goods	7,021	6,859
	$ 17,267	$ 20,886

5. RESEARCH AND DEVELOPMENT EXPENSES

A significant portion of the Company's research and development operations are located in Israel, where the Company derives substantial benefits from participation in programs sponsored by the Government of Israel for the support of research and development activities conducted in that country. The Company's research and development activities include projects partially funded by the Office of the Chief Scientist of the Ministry of Industry and Trade of the State of Israel (the "OCS") under which the OCS reimburses a portion of the Company's research and development expenditures under approved project budgets. The Company is currently involved in several ongoing research and development projects supported by the OCS. The Company accrues royalties to the OCS for the sale of products incorporating technology developed in these projects up to the amount of such funding, plus interest in certain circumstances. The terms of the applicable funding agreements limit the Company's ability to manufacture products, or transfer technologies, outside of Israel if such products or technologies were developed under these funding agreements. Reimbursement from the OCS amounted to approximately $775,000 and $2,379,000 in the three month and nine month periods ended October 31, 2004, respectively, and approximately $1,285,000 and $3,020,000 in the three month and nine month periods ended October 31, 2005, respectively. As of October 31, 2005, the Company has received approximately $59.7 million in cumulative grants and has recorded approximately $30.6 million in cumulative royalties to the OCS. The Company recorded other reimbursements of research and development expenses amounting to approximately $146,000 and $788,000 for the three month and nine month periods ended October 31, 2004 respectively, and $280,000 and $810,000 for the three month and nine month periods ended October 31, 2005, respectively.

9

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, 2004 and 2005, respectively, was as follows:

	THREE MONTHS ENDED			
	OCTOBER 31, 2004			
	Net Income	Shares	Per Share Amount	Net Income
	(In thousands, except per share dat			
BASIC EPS				
Net Income	$ 5,180	31,036	$ 0.17	$ 7,308
EFFECT OF DILUTIVE SECURITIES				
Stock Options		1,657		
Restricted shares		73		
DILUTED EPS	$ 5,180	32,766	$ 0.16	$ 7,308

	NINE MONTHS ENDED			
	OCTOBER 31, 2004			
	Net Income	Shares	Per Share Amount	Net Income
	(In thousands, except per share dat			
BASIC EPS				
Net Income	$ 12,365	30,725	$ 0.40	$ 20,978
EFFECT OF DILUTIVE SECURITIES				
Stock Options		1,683		
Restricted shares		73		

DILUTED EPS	$ 12,365	32,481	$ 0.38	$ 20,978

7. COMPREHENSIVE INCOME

Total comprehensive income was approximately $7,372,000 and $7,580,000 for the three months ended October 31, 2004 and 2005, respectively, and approximately $14,229,000 and $20,368,000 for the nine month periods ended October 31, 2004 and 2005, respectively. The elements of comprehensive income include net income, unrealized gains and losses on available for sale securities and foreign currency hedges, and foreign currency translation adjustments.

10

8. RELATED PARTY TRANSACTIONS AND BALANCES

CORPORATE SERVICES AGREEMENT - The Company recorded expenses of approximately $156,000 for both three month periods ended October 31, 2004 and 2005, and approximately $469,000 for both nine month periods ended October 31, 2004 and 2005, for the services provided by the Company's parent, Comverse Technology, under the Corporate Services Agreement between the Company and Comverse Technology.

ENTERPRISE RESOURCE PLANNING SOFTWARE SHARING AGREEMENT - The Company recorded approximately $36,000 and $46,000 for the three months ended October 31, 2004 and 2005, respectively, and approximately $130,000 and $119,000 for the nine months ended October 31, 2004 and 2005, respectively, for support services rendered by Comverse Ltd., a subsidiary of Comverse Technology, under the Enterprise Resource Planning Software Sharing Agreement between the Company and Comverse Ltd.

SATELLITE SERVICES AGREEMENT - The Company recorded expenses of approximately $866,000 and $801,000 for the three months ended October 31, 2004 and 2005, respectively, and approximately $2,341,000 and $2,359,000 for the nine months ended October 31, 2004 and 2005, respectively, for services rendered by Comverse, Inc., a subsidiary of Comverse Technology, and its subsidiaries, under the Satellite Services Agreement between the Company and Comverse, Inc.

TRANSACTIONS WITH AN AFFILIATE - The Company sold products and services to Verint Systems (Singapore) PTE LTD, an affiliated systems integrator in which the Company holds a 50% equity interest, amounting to approximately $667,000 and $1,817,000, during the three months ended October 31, 2004 and 2005, respectively, and approximately $1,419,000 and $5,954,000, during the nine months ended October 31, 2004 and 2005, respectively. In addition, the Company was charged with installation, support, marketing and office service fees by that affiliate amounting to approximately $167,000 and $615,000 for the three months ended October 31, 2004 and 2005, respectively, and approximately $501,000 and $998,000 for the nine months ended October 31, 2004 and 2005, respectively.

TRANSACTIONS WITH OTHER SUBSIDIARIES OF COMVERSE TECHNOLOGY - The Company charges subsidiaries of Comverse Technology for services relating to the use of the Company's facilities and employees. Charges to these subsidiaries were approximately $18,000 and $26,000 for the three month periods ended October 31, 2004 and 2005, respectively, and approximately $60,000 and $63,000 for the nine month periods ended October 31, 2004 and 2005, respectively.

From time to time the Company sells products and services to other subsidiaries of Comverse Technology in the ordinary course of business. During the three and nine month periods ended October 31, 2004 the Company recorded no sales to subsidiaries of Comverse Technology. Sales to these subsidiaries were approximately $0 and $67,000 for the three and nine month periods ended October 31, 2005, respectively.

RELATED PARTY BALANCES - Related party balances included in the condensed consolidated balance sheets are as follows (in thousands):

	JANUARY 31, 2005	OCTOBER 31, 2005
Included in accounts receivable	$ -	$ 1,624
Included in advance payments from customers	$ 767	$ -
Included in accounts payable and accrued expenses	$ 1,387	$ 1,212

9. CONVERTIBLE NOTE

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

10. ACQUISITIONS

On September 1, 2005, the Company, through a newly-formed subsidiary, acquired certain of the assets and liabilities of The Opus Group, LLC ("Opus"), a privately-held provider of performance analytics solutions for contact centers and back office operations. The acquisition extends the Company's ability to help its customers generate actionable intelligence and enhance the effectiveness of their contact center and back office operations. The purchase price consisted of $12 million in cash at closing and additional earn-out payments over two years based on certain profitability targets. The Company incurred transaction costs, consisting primarily of professional fees, amounting to approximately $156,000, in connection with this acquisition.

The acquisition was accounted for using the purchase method. The purchase price was allocated to the assets and liabilities of Opus based on the estimated fair value of those assets and liabilities as of September 1, 2005. Identifiable intangible assets consist of sales backlog, trade name, customer relationships and non-competition agreements and have an estimated useful life of up to five years. The results of operations of Opus have been included in the Company's results of operations since September 1, 2005.

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

	(IN THOUSANDS)
Purchase price	$ 12,000
Acquisition costs	156
Total purchase price	$ 12,156
Fair value of assets acquired	$ 1,764
Fair value of liabilities assumed	(1,257)
Sales backlog	965
Customer relationships	435
Trade name	740
Non-competition agreements	65
Goodwill	9,444
Total purchase price	$ 12,156

12

The value allocated to goodwill in Opus will be deducted for income tax purposes.

On September 2, 2004, the Company, through a subsidiary, acquired all of the outstanding stock of RP Sicherheitssysteme GmbH ("RP Security"), a company in the business of developing and selling mobile digital video security solutions for transportation applications. RP Security, headquartered in Flensburg, Germany, was founded in 1999 and has approximately 50 employees. The purchase price consisted of approximately $9,028,000 in cash and 90,144 shares of the Company's common stock. Shares issued as part of the purchase price were accounted for with value of approximately $2,977,000, or $33.03 per share. In addition, the shareholders of RP Security are entitled to receive earn-out payments over the three year period following the closing based on the Company's worldwide sales, profitability and backlog of mobile video products in the transportation market during that period. For the period ending January 31, 2005, the shareholders of RP earned approximately $455,000. In connection with this acquisition, the Company incurred transaction costs, consisting primarily of professional fees, amounting to approximately $520,000.

The acquisition was accounted for using the purchase method. The purchase price was allocated to the assets and liabilities of RP Security based on the estimated fair value of those assets and liabilities as of September 2, 2004. 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 RP Security have been included in the Company's results of operations since September 2, 2004.

The following is a summary of the allocation of the purchase price of the RP Security acquisition:

(IN THOUSANDS)

Purchase price paid in cash	$ 9,028
Shares issued	2,977
Earn-out payable	455
Acquisition costs	520
Total purchase price	$ 12,980

Fair value of assets acquired	$ 3,339
Fair value of liabilities assumed	(2,536)
Sales backlog	1,673
Acquired technology	194
Customer relationships	494
Non-competition agreements	150
Trade name	47
Goodwill	9,619
Total purchase price	$ 12,980

The value allocated to goodwill in RP Security is not deductible for income tax purposes.

As a result of the acquisition of RP Security, the Company wrote down certain inventory and accounts receivable balances that became impaired due to the existence of duplicative technology and, accordingly, were written-down to their net realizable value at the date of acquisition. Such write-down amounted to $899,000 and is included in cost of sales and selling, general and administrative expenses.

13

On March 31, 2004, the Company acquired certain assets and assumed certain liabilities of the government surveillance business of ECtel Ltd. ("ECtel"), which provided the Company with additional communications interception capabilities for the mass collection and analysis of voice and data communications. The purchase price was approximately $35 million in cash. The Company incurred transaction costs, consisting primarily of professional fees, amounting to approximately $1,107,000, in connection with this acquisition.

The acquisition was accounted for using the purchase method. The purchase price was allocated to the assets and liabilities of ECtel based on the estimated fair value of those assets and liabilities as of March 31, 2004. The results of operations of ECtel have been included in the Company's results of operations since March 31, 2004. Identifiable intangible assets consist of sales backlog, acquired technology, customer relationships, and non-competition agreements and have estimated useful lives of up to ten years. Purchased in-process research and development represents the value assigned to research and development projects of the acquired business that were commenced but not completed at the date of acquisition, for which technological feasibility had not been established and which have no alternative future use in research and development activities or otherwise. In accordance with Statement of Financial Accounting Standards No. 2, "Accounting for Research and Development Costs," as interpreted by FASB Interpretation No. 4, amounts assigned to purchased in-process research and development meeting the above criteria must be charged to expense at the acquisition date. At the acquisition date, it was estimated that the purchased in-process research and development was approximately 40% complete and it was expected that the remaining 60% would be completed during the ensuing year. The fair value of the purchased in-process research and development was determined with the assistance of an independent appraisal specialist using the income approach, which reflects the projected free cash flows that will be generated by the purchased in-process research and development projects and discounting the projected net cash flows back to their present value using a discount rate of 21%.

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

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

	(IN THOUSANDS)
Purchase price	$ 35,000
Acquisition costs	1,107
Total purchase price	$ 36,107
Fair value of assets acquired	$ 1,417
Fair value of liabilities assumed	(3,282)
In-process research and development	3,154
Sales backlog	854
Acquired technology	5,307
Customer relationships	1,382
Non-competition agreements	2,221
Goodwill	25,054
Total purchase price	$ 36,107

The value allocated to goodwill in ECtel will be deducted for income tax purposes.

The summary unaudited pro forma condensed consolidated results of operations for the three months ended October 31, 2004, assuming the acquisitions of RP Security and Opus had occurred at the beginning of the period, would have reflected consolidated revenues of approximately $66,277,000, net income of approximately $4,809,000, basic earnings per share of $0.15 and diluted earnings per share of $0.15. The summary unaudited pro forma condensed consolidated results of operations for the nine months ended October 31, 2004, assuming the acquisitions of RP Security, ECtel and Opus had occurred at the beginning of the period, would have reflected consolidated revenues of approximately $189,752,000, net income of approximately $8,850,000, basic earnings per share of $0.29 and diluted earnings per share of $0.27.

The summary unaudited pro forma condensed consolidated results of operations for the three months ended October 31, 2005, assuming the acquisition of Opus had occurred at the beginning of the period, would have reflected consolidated revenues of approximately $78,921,000, net income of approximately $7,000,000, basic earnings per share of $0.22 and diluted earnings per share of $0.21. The summary unaudited pro forma condensed consolidated results of operations for the nine months ended October 31, 2005, assuming the acquisition of Opus had occurred at the beginning of the period, would have reflected consolidated revenues of approximately $233,288,000, net income of approximately $21,880,000, basic earnings per share of $0.69 and diluted earnings per share of $0.66.

These pro forma results are not necessarily indicative of what would have occurred if the acquisitions 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.

11. INTANGIBLE ASSETS

The composition of intangible assets at January 31, 2005 and October 31, 2005 is as follows:

	USEFUL LIFE	JANUARY 31, 2005	O
		(In thousands)	
Sales backlog	Up to 3 years	$ 3,249	$
Acquired technology	3 to 5 years	6,902	
Customer relationships	5 years	2,239	
Non-competition agreements	1.5 to 10 years	3,540	
Trade names	1 to 3 years	255	
		16,185	
Less accumulated amortization		4,159	
		$ 12,026	$

Amortization of intangible assets was approximately $817,000 and $1,518,000 for the three months ended October 31, 2004 and 2005, respectively, and approximately $1,858,000 and $3,791,000 for the nine months ended October 31, 2004 and 2005, respectively.

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

YEAR ENDING JANUARY 31,	(In thousands)
2006	$ 5,430
2007	$ 3,191
2008	$ 2,043
2009	$ 1,817
2010	$ 820

12. GOODWILL

Changes in goodwill for the year ended January 31, 2005 ("fiscal 2004"), and for the nine months ended October 31, 2005, are as follows:

	(In thousands)
BALANCE AT JANUARY 31, 2004	$ 14,364
Acquisition of ECtel	25,054
Acquisition of RP Security	9,164
Foreign exchange translation and other	1,043
BALANCE AT JANUARY 31, 2005	49,625
Earn-out for RP security purchase	455
Acquisition of Opus	9,444
Foreign exchange translation and other	(262)
BALANCE AT OCTOBER 31, 2005	$ 59,262

13. BUSINESS SEGMENT INFORMATION

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

	UNITED STATES	ISRAEL	UNITED KINGDOM	CANADA	GERMANY	
THREE MONTHS ENDED OCTOBER 31, 2004:				(IN THOUSANDS)		
Sales	$ 35,481	$ 22,144	$ 7,807	$ 4,107	$ 2,926	$
Costs and expenses	(29,098)	(22,063)	(8,422)	(4,365)	(3,879)	
Operating income (loss)	$ 6,383	$ 81	$ (615)	$ (258)	$ (953)	$
THREE MONTHS ENDED OCTOBER 31, 2005:						
Sales	$ 31,811	$ 33,255	$ 8,439	$ 7,332	$ 6,676	$
Costs and expenses	(30,873)	(28,301)	(8,905)	(6,258)	(6,129)	
Operating income						

(loss)	$ 938	$ 4,954	$ (466)	$ 1,074	$ 547	$

	UNITED STATES	ISRAEL	UNITED KINGDOM	CANADA	GERMANY	
NINE MONTHS ENDED OCTOBER 31, 2004:				(IN THOUSANDS)		
Sales	$ 90,975	$ 68,008	$ 22,878	$ 14,361	$ 7,904	$
Costs and expenses	(79,139)	(68,500)	(23,648)	(11,557)	(9,283)	
Operating income (loss)	$ 11,836	$ (492)	$ (770)	$ 2,804	$ (1,379)	$
NINE MONTHS ENDED OCTOBER 31, 2005:						
Sales	$ 95,297	$ 95,554	$ 24,481	$ 22,071	$ 21,158	$
Costs and expenses	(88,717)	(83,067)	(24,751)	(19,243)	(20,049)	
Operating income (loss)	$ 6,580	$ 12,487	$ (270)	$ 2,828	$ 1,109	$

Total assets by country of domicile consist of:

	JANUARY 31, 2005	OCTOBER 31, 2005
	(IN THOUSANDS)	
United States	$ 264,975	$ 281,534
Israel	117,017	151,944
United Kingdom	12,684	13,949
Canada	19,828	25,482
Germany	27,598	26,810
Other	2,540	1,692
Reconciling items	(45,664)	(50,270)
	$ 398,978	$ 451,141

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.

17

14. EMPLOYEE RESTRICTED STOCK

In December 2003 and 2004, the Company granted 72,700 and 65,000 shares of restricted stock, respectively, to certain key employees of the Company. Unearned stock compensation of approximately $1,672,000 and $2,282,000 was recorded for 2003 and 2004, respectively, based on the fair market value of the Company's common stock at the date of grant, or $23.00 and $35.11 per share. Unearned stock compensation is shown as a separate component of stockholders' equity and is being amortized to expense over the four-year vesting period of the restricted stock. Amortization of unearned stock compensation was approximately $105,000 and $249,000 for the three months ended October 31, 2004 and 2005, respectively, and approximately $314,000 and $739,000 for the nine months ended October 31, 2004 and 2005, respectively, and was included in selling, general and administrative expenses in the condensed consolidated statements of income. The restricted stock has all the rights and privileges of the Company's common stock, subject to certain restrictions and forfeiture provisions. At October 31, 2005, all 137,700 shares were subject to restriction.

15. RECENT ACCOUNTING PRONOUNCEMENTS

In April 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections," requiring retrospective application as the required method for reporting a change in accounting principle, unless impracticable or a pronouncement includes specific transition provisions. This statement also requires that a change in depreciation, amortization, or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. This statement carries forward the guidance in APB Opinion No. 20, "Accounting Changes," for the reporting of the correction of an error and a change in accounting estimate. This statement is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154 is not expected to have a material effect on the Company's condensed consolidated financial statements.

In December 2004, the FASB issued Statement of Financial Accounting Standard ("SFAS") No. 123 (revised 2004), "Share-Based Payment", ("SFAS No.123(R)") which revises SFAS No. 123 and supersedes APB No. 25. In April 2005, the SEC amended Regulation S-X to modify the date for compliance with SFAS No. 123(R). The provisions of SFAS No. 123(R) must be applied beginning with the fiscal year beginning on or after June 15, 2005, which for the Company is February 1, 2006 (the "Effective Date"). SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the applicable vesting period. Pro forma disclosure of the income statement effects of share-based payments is no longer an alternative. Beginning on the Effective Date, the Company must (i) expense all options granted after the Effective Date over the applicable vesting period, and (ii) expense the non-vested portions of existing option grants going forward over their remaining vesting period. Compensation expense for the non-vested portions of existing option grants as of the Effective Date will be recorded based on the fair value of the awards previously calculated in developing the pro forma disclosures in accordance with the provisions of SFAS No. 123. Under SFAS No. 123(R), the Company is required to adopt a fair value-based method for measuring the compensation expense related to employee stock and stock options awards; this will lead to substantial additional compensation expense. Any such expense, although it will not affect the Company's cash flows, will have a material negative impact on the Company's reported results of operations.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Non-monetary Assets - an amendment of APB Opinion No. 29." SFAS No. 153 amends APB No. 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for reporting periods beginning after June 15, 2005. The adoption of SFAS No. 153 is not expected to have a material effect on the Company's condensed consolidated financial statements.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs - an amendment of ARB No. 43, Chapter 4." SFAS No. 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) by requiring that such items be recognized as current-period charges regardless of whether they meet the ARB No. 43, Chapter 4 criterion of "so abnormal." In addition, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of SFAS No. 151 is not expected to have a material effect on the Company's condensed consolidated financial statements.

In March 2004, the Emerging Issues Task Force ("EITF") of the FASB reached a consensus on EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments", which provides additional guidance for assessing impairment losses on investments. Additionally, EITF 03-1 includes new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF 03-1; however the disclosure requirements were effective for annual periods ending after June 15, 2004. The Company will evaluate the impact of EITF 03-1 once final guidance is issued, however the adoption of EITF 03-1 in its current form is not expected to 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.

CRITICAL ACCOUNTING POLICIES

Our discussion of results of operations and financial condition relies on our consolidated financial statements that are prepared based on certain critical accounting policies that require management to make judgments and estimates that are subject to varying degrees of uncertainty. We believe that investors need to be aware of these policies and how they impact our financial statements as a whole, as well as our related discussion and analysis presented herein. While we believe that these accounting policies are based on sound measurement criteria, actual future events can and often do result in outcomes that can be materially different from these estimates or forecasts. The accounting policies and related risks described in our Annual Report on Form 10-K for the year ended January 31, 2005 are those that depend most heavily on these judgments and estimates. As of October 31, 2005, there have been no material changes to any of the critical accounting policies contained therein.

RESULTS OF OPERATIONS

SUMMARY OF RESULTS

Consolidated results of operations in dollars and as a percentage of sales for each of the three month and nine month periods ended October 31, 2004 and 2005 were as follows:

	THREE MONTHS ENDED OCTOBER 31, 2004	% OF SALES	THREE MONTHS ENDED OCTOBER 31, 2005
Sales	$ 63,989	100.0%	$ 78,238
Cost of Sales	29,235	45.7%	34,360
Gross profit	34,754	54.3%	43,878
Operating expenses:			
Research and development, net	8,409	13.1%	10,039
Selling, general and administrative	21,290	33.3%	26,272
Income from operations	5,055	7.9%	7,567
Interest and other income, net	932	1.5%	1,982
Income before income tax provision	5,987	9.4%	9,549
Income tax provision	807	1.3%	2,241
Net income	$ 5,180	8.1%	$ 7,308

20

	NINE MONTHS ENDED OCTOBER 31, 2004	% OF SALES	NINE MONTHS ENDED OCTOBER 31, 2005
Sales	$ 180,794	100.0%	$ 224,986
Cost of Sales	82,098	45.4%	99,860
Gross profit	98,696	54.6%	125,126
Operating expenses:			
Research and development, net	23,089	12.8%	29,035
Selling, general and administrative	59,704	33.0%	74,217

In-process research and development	3,154	1.7%	-	
Write-down of capitalized software	1,481	0.8%	-	
Income from operations	11,268	6.2%	21,874	
Interest and other income, net	2,379	1.3%	5,361	
Income before income tax provision	13,647	7.5%	27,235	
Income tax provision	1,282	0.7%	6,257	
Net income	$ 12,365	6.8%	$ 20,978	

NINE MONTH AND THREE MONTH PERIODS ENDED OCTOBER 31, 2005
COMPARED TO NINE MONTH AND THREE MONTH PERIODS ENDED OCTOBER 31, 2004

SALES. Sales for the nine month and three month periods ended October 31, 2005 increased by approximately $44.2 million, or 24.4%, and $14.2 million, or 22.3%, respectively, as compared to the nine month and three month periods ended October 31, 2004. This increase reflected an increase in both sales of products of approximately $31.1 million and $7.9 million and service revenue of approximately $13.1 million and $6.3 million, in the nine month and three month periods ended October 31, 2005 as compared to the nine month and three month periods ended October 31, 2004, respectively, and was attributable to higher sales volume of both the Company's security and business intelligence solutions. For the nine month and three month periods ended October 31, 2005, the Company generated approximately 47% and 48%, respectively, of its sales from the Americas region, 35% for both periods from the Europe, Middle East and Africa region ("EMEA"), and 18% and 17%, respectively, from the Asia Pacific region ("APAC").

The Company sells its products in multiple configurations and the price of any particular product varies depending on the configuration of the product sold. Due to the variety of customized configurations for each product that the Company sells, it is unable to quantify the effects of a change in the price of any particular product and/or a change in the number of products sold on its revenues. Sales to international customers as a percentage of total sales represented approximately 58% and 59%, respectively, for the nine month and three month periods ended October 31, 2005, as compared to approximately 51% and 48%, respectively, for the nine month and three month periods ended October 31, 2004.

21

COST OF SALES. Cost of sales consists primarily of material and overhead costs, operation and service personnel costs, amortization of capitalized software and purchased intangible assets, and royalties. Cost of sales for the nine month and three month periods ended October 31, 2005 increased by approximately $17.8 million, or 21.6%, and $5.1 million, or 17.5%, respectively, as compared to the nine month and three month periods ended October 31, 2004. This increase was attributable to an increase in material and overhead costs of approximately $9.7 million and $1.4 million, respectively, due to higher sales volumes, an increase in personnel related costs of approximately $1.7 million and $0.8 million, respectively, primarily as a result of an increase in the number of service department personnel and increased personnel compensation, an increase in subcontracting expenses of approximately $2.8 million and $0.8 million, respectively, an increase in depreciation and amortization expenses of approximately $1.8 million and $0.6 million, and an increase in other expenses of approximately $1.8 million and $1.5 million, respectively, mainly due to increased travel and royalties expenses. Gross margins increased to 55.6% and 56.1%, respectively, in the nine month and three month periods ended October 31, 2005, from 54.6% and 54.3%, respectively, in the nine month and three month periods ended October 31, 2004.

RESEARCH AND DEVELOPMENT EXPENSES, NET. Research and development ("R&D") expenses consist primarily of personnel and subcontracting expenses and allocated overhead, net of certain software development costs that are capitalized as well as reimbursement under government and other programs. Software development costs are capitalized upon the establishment of technological feasibility and until related products are available for general release to customers. Research and development expenses, net, for the nine month and three month periods ended October 31, 2005 increased by approximately $5.9 million and $1.6 million, respectively, or 25.8% and 19.4%, respectively, as compared to the nine month and three month periods ended October 31, 2004. The increase was attributable to an increase in personnel related costs amounting to approximately $3.9 million and $1.0 million, respectively, and an increase of approximately $2.0 million and $0.6 million, respectively, in other expenses. Capitalization of software development costs amounted to approximately $3.2 million and $1.1 million for the nine month and three month periods ended October 31, 2004 respectively, and approximately $3.0 million and $0.9 million for the nine month and three month periods ended October 31, 2005, respectively. Reimbursement of research and development expenses amounted to approximately $3.2 million and $0.9 million for the nine month and three month periods ended October 31, 2004 respectively, and $3.8 million and $1.6 million for the nine month and three month periods ended October 31, 2005, respectively. Research and development expenses, net, as a percentage of sales, was 12.9% and 12.8% for the nine month and three month periods ended October 31, 2005, respectively, compared to 12.8% and 13.1% , respectively, for the nine month and three month periods ended October 31, 2004.

Historically, the Company has received more reimbursement for R&D expenses partially funded by the Office of the Chief Scientist of the Ministry of Industry and Trade of the State of Israel (the "OCS") in a given fiscal year than it has had to pay to the OCS in royalties during that fiscal year. More recently, however, the Company has been paying, and continues to expect to pay, more in royalties to the OCS than it receives in reimbursement from the OCS for R&D expenses in a given fiscal year. In fiscal year 2004 and in the nine months ended October 31, 2005, the Company recorded a net expense of $1.6 million and $1.1 million, respectively, representing the difference between OCS royalties accrued and reimbursement received from OCS. As of October 31, 2005, the Company has received approximately $59.7 million in cumulative grants and has recorded approximately $30.6 million of cumulative royalties to the OCS. The Company continues to evaluate whether to participate in a program offered by the OCS to pay a lump sum royalty amount for past amounts received from the OCS and has started preliminary discussions with the OCS in that regard. The Company believes it could reach agreement with the OCS regarding participating in such program as early as the first calendar quarter of 2006. Assuming the Company elects to participate in this program it may be required to pay as much as the difference between the cumulative grants received and the cumulative royalties paid plus interest and other charges. This would significantly reduce or eliminate the Company's net income for a given fiscal year and might cause the Company to report a loss for the fiscal year in which the program is entered into which would have a material adverse effect on the Company's operating results.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses consist primarily of personnel costs and related expenses, sales and marketing expenses, including travel and agent commission, and other administrative expenses. Selling, general and administrative expenses for the nine month and three month periods ended October 31, 2005 increased by approximately $14.5 million, or 24.3% and $5.0 million, or 23.4%, respectively, as compared to the nine month and three month periods ended October 31, 2004. This increase was attributable to an increase in compensation and benefits for existing personnel and increase in headcount to support the increased level of sales amounting to approximately $8.5 million and $3.0 million, respectively, an increase in agent commissions of approximately $2.1 million and $1.7 million, respectively, an increase in rent and utility expenses of approximately $1.5 million and $0.8 million, respectively, and an increase (decrease) in other expenses of approximately $2.4 million and ($0.5 million), respectively. Selling, general and administrative expenses as a percentage of sales increased to 33.0% and 33.6%, for the nine month and three month periods ended October 31, 2005, from 33.0% and 33.3% for the nine month and three month periods ended October 31, 2004.

IN-PROCESS RESEARCH AND DEVELOPMENT. In the nine month period ended October 31, 2004, purchased in-process research and development of approximately $3.2 million, resulting from the purchase of ECtel's government surveillance business, was charged to expense at the date of acquisition (see also Note 10 of the Notes to the Condensed Consolidated Financial Statements).

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

INTEREST AND OTHER INCOME, NET. Net interest and other income for the nine month and three month periods ended October 31, 2005 increased by approximately $3.0 million and $1.0 million, respectively, as compared to the nine month and three month periods ended October 31, 2004. This increase was attributable to increased interest income of approximately $3.6 million and $1.2 million, respectively, due to an increase in interest rates and an increase in interest bearing short-term investments, partially offset by a decrease in income from the Company's minority interest in its Singapore affiliate of $0.3 million and $0.1 million, an increase in foreign currency losses and other items of approximately $0.3 million and $0.1 million.

INCOME TAX PROVISION. Income tax provision of approximately $6.3 million and $2.2 million, respectively, was recorded for the nine month and three month periods ended October 31, 2005 as compared to approximately $1.3 million and $0.8 million recorded in the nine month and three month periods ended October 31, 2004, respectively. The overall effective tax rate increased to 23.0% and 23.5%, for the nine month and three month periods ended October 31, 2005, respectively, as compared to an effective tax rate of 9.4% and 13.5% for the nine month and three month periods ended October 31, 2004, respectively. The increase in tax provision for the nine month and three month periods ended October 31, 2005 was mainly attributable to the significant reduction of the Company's net operating loss carry forwards in the United States by the end of fiscal 2004, which caused the Company to record income tax provision for the profits of its U.S. operations. The Company expects its effective tax rate for the fiscal year ended January 31, 2006 ("fiscal 2005") to increase significantly as compared to fiscal 2004. The Company's effective tax rate for fiscal 2005 is expected to remain relatively low as compared to the U.S. federal tax rate. This reflects the use of net operating loss carry-forwards in certain tax jurisdictions as well as the tax benefits associated with qualified activities of the Company's Israeli subsidiary, which is entitled to favorable income tax rates under a program of the Israeli Government for "Approved Enterprise" investments in that country. To the extent that the Company continues to be profitable in certain tax jurisdictions, it will continue to use net operating loss carry forwards in these jurisdictions. When the Company ceases to have net operating loss carry forwards available to it in a tax jurisdiction, the Company's effective tax rate would increase in that jurisdiction.

NET INCOME. Net income for the nine month and three month periods ended October 31, 2005 increased by approximately $8.6 million, or 70%, and $2.1 million, or 41%, as compared to the nine month and three month periods ended October 31, 2004, respectively. As a percentage of sales, net income was approximately 9.3% in both the nine month and three month periods ended October 31, 2005, as compared to approximately 6.8% and 8.1% in the nine month and three month periods ended October 31, 2004, respectively. The change resulted primarily from the factors described above.

LIQUIDITY AND CAPITAL RESOURCES

As of October 31, 2005, the Company had cash and cash equivalents of approximately $58.0 million, bank time deposits of approximately $2.3 million, short-term investments of $206.2 million and working capital of approximately $215.5 million. As of January 31, 2005, the Company had cash and cash equivalents of approximately $45.1 million, short-term investments of $195.3 million and working capital of approximately $196.4 million.

Operating activities for the nine month period ended October 31, 2004 and 2005, after adjustment for non-cash items, provided cash of approximately $27.3 million and $34.8 million, respectively. Other changes in operating assets and liabilities provided cash of approximately $11.9 million and $5.6 million for the nine months ended October 31, 2004 and 2005, respectively. This resulted in cash provided by operating activities of approximately $39.2 million and $40.4 million for the nine months ended October 31, 2004 and 2005, respectively.

Investing activities for the nine months ended October 31, 2004 and 2005 used cash of approximately $65.7 million and $35.9 million, respectively. For the nine months ended October 31, 2004, these amounts include cash paid for the acquisition of ECtel's government surveillance business of approximately $36.1 million, cash paid for the acquisition of RP Security of approximately $9.3 million, purchase of property and equipment of approximately $5.1 million, capitalization of software development costs of approximately $3.2 million and net purchases of short-term securities of approximately $12.0 million. For the nine months ended October 31, 2005, these amounts include cash paid for the acquisition of Opus (net of cash acquired of approximately $0.6 million) of approximately $11.5 million, net purchases of short-term securities and bank time deposits of approximately $13.3 million, purchase of property and equipment of approximately $8.1 million, capitalization of software development costs of approximately $3.0 million, and other investments of approximately $0.4 million, net of proceeds from sale of property and equipment of approximately $0.3 million.

Financing activities for the nine month periods ended October 31, 2004 and 2005 provided cash of approximately $11.5 million and $8.4 million, respectively. For the nine month periods ended October 31, 2004 and 2005, proceeds from the issuances of common stock provided cash of approximately $11.0 million and $9.0 million, respectively. Net borrowings (repayments) of bank loans and other debt provided (used) cash of approximately $0.5 million and ($0.6) million in the nine month periods ended October 31, 2004 and 2005, respectively.

On September 1, 2005, the Company, through a newly-formed subsidiary, acquired certain of the assets and liabilities of The Opus Group, LLC, a privately-held provider of performance analytics solutions for contact centers and back office operations. The acquisition extends the Company's ability to help its customers generate actionable intelligence and enhance the effectiveness of their contact center and back office operations. The purchase price consisted of $12 million in cash at closing and additional earn-out payments over two years based on certain profitability targets.

On September 2, 2004, the Company, through a subsidiary, acquired all of the outstanding stock of RP Security, a company in the business of developing and selling mobile digital video security solutions for transportation applications. The Company paid approximately $9,028,000 in cash and 90,144 shares of the Company's common stock for RP Security. In addition, the shareholders of RP are entitled to receive earn-out payments over the three year period following the closing based on the Company's worldwide sales, profitability and backlog of mobile video products in the transportation market during that period. For the period ending January 31, 2005, the shareholders of RP earned approximately $455,000.

On August 20, 2004, the Company entered into a lease agreement for the lease of approximately 145,000 square feet of office and storage space for manufacturing, development, support and sales facilities in Herzlia, Israel for a term of ten years. Occupancy of the new building and rent payments commenced in October 2005. Annual rent payments are expected to be approximately $2.5 million. The new lease agreement replaced the lease agreement for the Company's prior building in Israel.

On March 31, 2004, the Company acquired certain assets and assumed certain liabilities of the government surveillance business of ECtel. The purchase price consisted of $35 million in cash. In connection with this acquisition, the Company incurred transaction costs, consisting primarily of professional fees, amounting to approximately $1.1 million (see also Note 10 of the Notes to the Condensed Consolidated Financial Statements).

The ability of the Company's Israeli subsidiary to pay dividends is governed by Israeli law, which provides that dividends may be paid by an Israeli corporation only out of its earnings as defined in accordance with the Israeli Companies Law of 1999, provided that there is no reasonable concern that such payment will cause such subsidiary to fail to meet its current and expected liabilities as they come due. In the event of a devaluation of the Israeli currency against the U.S. dollar, the amount in U.S. dollars available for payment of cash dividends out of prior years' earnings will decrease accordingly. Cash dividends paid by an Israeli corporation to U.S. resident corporate parents are subject to the Convention for the Avoidance of Double Taxation between Israel and the United States. Under the terms of the Convention, such dividends are subject to taxation by both Israel and the United States and, in the case of Israel, such dividends out of income derived in respect of a period for which an Israeli company is entitled to the reduced tax rate applicable to an Approved Enterprise are generally subject to withholding of Israeli income tax at source at a rate of 15%. The Israeli company is also subject to additional Israeli taxes in respect of such dividends, generally equal to the tax benefits previously granted in respect of the underlying income by virtue of the Approved Enterprise status.

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

RECENT DEVELOPMENTS

On September 7, 2005, the Company entered into a definitive agreement with MultiVision Intelligent Surveillance Limited ("MultiVision") to acquire substantially all of its networked video security business. Under the agreement, the Company would pay approximately $48 million, subject to certain adjustments. The consideration will consist of cash, provided that, the definitive agreement allows the Company, at its sole option, to substitute shares of Company common stock for up to 70% of the adjusted purchase price paid at closing. On November 1, 2005, the Company provided irrevocable notice to MultiVision that it would not issue shares of its common stock as part of the purchase price. The Company will therefore pay the full purchase price in cash. The acquisition is expected to close in January 2006, subject to a number of conditions, including approval by MultiVision's shareholders.

CERTAIN TRENDS AND UNCERTAINTIES

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

It is difficult for the Company to forecast the timing of revenues from product sales because customers often need a significant amount of time to evaluate its products before purchasing them and, in the case of governmental customers, sales are dependent on budgetary and other bureaucratic processes. The period between initial customer contact and a purchase by a customer may vary from three months to more than a 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 the Company's competitors; and (v) lower prices offered by the Company's competitors.

The Company faces aggressive competition from numerous and varied competitors in all areas of its business. Because of this aggressive competition and the fact that many of the Company's customers and potential customers make decisions to purchase largely based on price, the Company may have to lower the prices of many of its products and services or increase efficiencies and capacity. This can affect the Company because:

- the Company may not be able to maintain or improve revenue and gross margin with its current cost structure, and therefore its profitability could be materially and adversely affected.

- in the face of increased pricing pressure and an effort to maintain or improve revenue and gross margin, the Company may have to reduce costs. For example, the Company invests a significant amount in research and development, which the Company views as necessary for its long-term competitiveness. If, to decrease its cost structure, the Company reduces its investment in research and development, the Company may adversely impact its long-term competitiveness in an effort to maintain or improve its revenue and income in the short-term.

Even if the Company is able to maintain or increase market share for a particular product, revenue could decline due to increased competition from other types of products or because the product is in a maturing industry.

Because of the intensely competitive markets in which the Company operates, the Company's competitors may simply execute better than the Company and, resultantly, reduce the Company's market share. 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. Further, there has been significant consolidation among the Company's competitors, improving the competitive position of several of its competitors. If the Company's competitors are able to achieve a competitive position superior to that of the Company, the Company's market share and, therefore, results of operations, may be materially and adversely affected.

The Company's competitors may be able to more quickly develop or adapt to new or emerging technologies or respond to changes in customer requirements, or to devote greater resources to the development, promotion and sale of their products. 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 and partners may in the future decide to internally develop 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.

The global market for analytic solutions for security and business applications is competitive not only in the number and breadth of competing companies and products, but also in the manner in which products are sold. For example, the Company often competes for customer contracts through a competitive bidding process that subjects it to risks associated with: (i) the frequent need to bid on programs in advance of the completion of their design, which may result in unforeseen technological difficulties and cost overruns; and (ii) the substantial time and effort, including design, development and marketing activities, required to prepare bids and proposals for contracts that may not be awarded to the Company. Even where the Company is not involved in a competitive bidding process, due to the intense competition in the Company's markets and increasing customer demand for shorter delivery periods, the Company must in some cases begin implementation of a project before the corresponding order has been finalized, increasing the risk that the Company will have to write off expenses associated with orders that do not come to fruition.

Approximately half of the Company's revenues are generated by sales made through strategic and technology partners, distributors, value added resellers and systems integrators. In addition, many of these sales channels also partner with the Company's competitors and may even offer the products of both the Company and its competitors when presenting bids to customers. Further, competitors often seek to establish exclusive relationships with these sales channels or, at a minimum, to become a preferred partner for these channels. The Company's ability to achieve revenue growth depends to a significant extent on maintaining and adding to these sales channels. If the Company's relationships with these sales channels deteriorate or terminate, the Company may lose important sales and marketing opportunities.

The Company 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 the Company does not provide products and services; (iv) it is prevented from entering into new government contracts or extending existing government contracts based on violations or suspected violations of laws or regulations, including those related to procurement; (v) it is not granted security clearances that are required to sell its products to domestic or foreign governments or such security clearances are revoked; (vi) there is a change in government procurement procedures; or (vii) there is a change in political climate that adversely affects the Company's existing or prospective relationships.

The Company's quarterly operating results are difficult to predict and may fluctuate significantly in the future, which in turn may result in volatility in its stock price. The following factors, among others, many of which are outside the Company's control, can cause fluctuations in the Company's operating results and volatility in the Company's stock price: (i) the size, timing, terms and conditions of orders from and shipments to the Company's customers; (ii) unpredictability in the growth in the security and business intelligence markets; (iii) unanticipated delays or problems in releasing new products; (iv) continued fluctuation in the Company's tax rate; (v) the timing and success of its customers' deployment of the Company's products and services; (vi) the amount and timing of the Company's investments in research and development activities; (vii) costs associated with providing the Company's goods and services; (viii) the fluctuation of foreign currency exchange rates; and (ix) the impairment or devaluation of the Company's assets (for instance, intangibles or goodwill).

To the extent that the Company continues to be profitable in certain tax jurisdictions, it will continue to use available net operating loss carry forwards in these jurisdictions. When the Company ceases to have net operating loss carry forwards available to it in a tax jurisdiction, the Company's effective tax rate would increase in that jurisdiction. The Company's effective tax rate is expected to increase substantially for fiscal 2005 as compared to fiscal 2004, which could materially and adversely affect the Company's results of operations.

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

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

28

The Company has historically derived a significant portion of its sales from contracts for large system installations with major customers. The Company continues to emphasize sales to larger customers in its product development and marketing strategies. Contracts for large installations typically involve a lengthy and complex bidding and selection process, and the ability of the Company to obtain particular contracts is inherently difficult to predict. The timing and scope of these opportunities are difficult to forecast, and the pricing and margins may vary substantially from transaction to transaction. The Company's future operating results may accordingly exhibit a high degree of volatility and may also be more volatile than the Company has experienced in prior periods. The degree of dependence by the Company on large system orders, and the investment required to enable the Company to perform such orders, without assurance of continuing order flow from the same customers, increases the risk associated with the Company's business. In particular, in pursuit of major customers, the Company often engages in research and development activities specifically for these potential customers. If these potential customers ultimately decide not to purchase the Company's products, the Company may obtain little or no benefit from these research and development activities, as they may not be applicable to other customers. As a result, these costs may not be recovered by the Company and may materially and adversely affect the Company's financial results.

The Company's recent growth has strained its managerial and operational resources. The Company's continued growth may further strain its resources, which could hurt its business and results of operations. There can be no assurance that the Company's managers will be able to manage growth effectively. To manage future growth, the Company's management must continue to improve the Company's operational, IT and financial systems, procedures and controls and expand, train, retain and manage its employee base. If the Company's systems, procedures and controls are inadequate to support its operations, the Company's expansion could slow or come to a halt, and it could lose its opportunity to gain significant market share. Any inability to manage growth effectively could materially harm the Company's business, results of operations and financial condition.

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 pricing pressure on existing products. It is critical to the Company's success that it is able to:

- anticipate changes in technology or in industry standards;

- successfully develop and introduce new, enhanced and competitive products; and

- introduce these new and enhanced products on a timely basis with high quality.

The Company may not be able to successfully develop new products or introduce new applications for existing products. For example, the market for the Company's communications interception solutions has been characterized by new protocols as well as by increased use of encryption, and the Company's ability to compete in this market is dependent on its ability to introduce products that address these new developments. In addition, new products and applications introduced by the Company - such as the Company's content analytics software - may not achieve market acceptance or the introduction of new products or technological developments by its competitors may render the Company's products obsolete. If the Company is unable to introduce new products that address the needs of its customers or that achieve market acceptance, there may be a material and adverse impact on the Company's reputation with its customers and its financial results.

29

The Company's products are complex and involve sophisticated technology that performs critical functions to highly demanding standards. The Company's existing and future products may develop operational problems. In addition, when the Company introduces a product to the market or as it releases new versions of an existing product, the product may contain undetected defects or errors. The Company may not discover such defects, errors or other operational problems until after a product has been released and used by the customer. Significant costs may be incurred to correct undetected defects, errors or other operational problems in the Company's products, including product liability claims. In addition, defects or errors in the Company's products may result in questions regarding the integrity of its products, which could cause adverse publicity and impair their market acceptance, resulting in lost future sales.

The market for the Company's business intelligence solutions has been adversely affected in the past by significant declines in information technology spending and continues to be affected by fluctuations in information technology spending. Continued fluctuations in information technology spending may cause companies to reduce or, in extreme cases, eliminate, information technology spending. The rate of information technology spending by the Company's customers in the near term remains unclear and the Company is uncertain whether it will be able to increase or maintain its revenues. If sales do not increase as anticipated or if expenses increase at a greater pace than revenues, the Company may not be able to sustain or increase profitability on a quarterly or annual basis.

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

The Company depends on the continued services of its executive officers and other key personnel. In addition, in order to continue to grow effectively, the Company expects to need to attract and retain a substantial number of new employees, including managers, sales and marketing personnel and technical personnel, who understand and have experience with its products and services. The market for such personnel is intensely competitive in most if not all of the geographies in which the Company operates, and on occasion the Company has had to relocate personnel to fill positions in locations where it could not attract qualified experienced personnel. Further, the Company has in the past and may in the future experience difficulty in recruiting or retaining qualified personnel due to, for example, the market demand for their services or constraints on the Company's ability to use equity compensation due to recent changes in accounting rules. If the Company is unable to attract and retain qualified employees, its ability to grow could be impaired. Further, if the costs of attracting and retaining qualified personnel increase significantly, the Company's financial results could be materially and adversely affected.

The markets for the Company's security and business intelligence products are still emerging. The Company's growth is dependent on, among other things, the size and pace at which the markets for its products develop. If the markets for its products decrease, remain constant or grow slower than the Company anticipates, the Company will not be able to maintain its growth. In addition, in markets where the Company is a sole source supplier, the Company's growth may be adversely impacted if customers seek to and succeed in developing alternative sources for the Company's products. 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 or business intelligence objectives. In addition, as the Company's business intelligence products are sold primarily to contact centers, slower than anticipated growth or a contraction in the number or size of contact centers will have a material adverse effect on the Company's ability to maintain its growth.

On September 7, 2005, the Company entered into a definitive agreement with MultiVision to acquire substantially all of its networked video security business. The acquisition is subject to a number of conditions, including approval by MultiVision's shareholders. The Company anticipates that the acquisition will close in January 2006, however, there is no assurance that the transaction will be consummated by such time or at all. Failure to consummate the acquisition for any reason or significant delay in closing may cause the value of the Company's common stock to decline. In addition, if the transaction does not close, significant management time and effort will have been expended, and costs related to the transaction, such as legal and accounting fees, will still have to be paid, with no corresponding benefit to the Company.

On September 1, 2005, the Company, through a newly-formed subsidiary, acquired certain of the assets and liabilities of The Opus Group, LLC, representing the Company's first acquisition of a services-based business and its first acquisition in the contact center market.

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

- successfully integrate this business into the Company's business, including operations, facilities and related matters

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

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

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

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

On September 2, 2004, the Company acquired RP Security. If the Company is unable to successfully integrate RP Security 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 RP Security's products into the Company's solutions, resulting in business disruptions.

On March 31, 2004, the Company completed its acquisition of certain assets and liabilities of ECtel comprising its communications interception business. As a result of this acquisition, the Company and ECtel have a variety of ongoing contractual relationships related to providing certain resources to one another and fulfillment of certain obligations to former ECtel customers. If ECtel does not perform its post-acquisition contractual obligations to the Company, the Company may not continue to realize the benefits of the acquisition realized by the Company or have a negative impact on the Company's operations and the transitioning of ECtel's customers to the Company.

The Company's subsidiary, Verint Technology Inc. ("Verint Technology"), which markets, sells and supports its communications interception solutions to, among others, 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 superseded 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.

In addition to the clearances of Verint Technology, some of the Company's other subsidiaries maintain clearances in certain other countries in connection with the development, marketing and sale of its communications interception solutions. These clearances are reviewed from time to time by the applicable government agencies in these countries, and following review, these clearances are either maintained or deactivated. These clearances can be deactivated for many reasons, including that the clearing agencies in certain countries may object to the fact that the Company does business in certain other countries or the fact that the Company itself is a foreign corporation subject to foreign influence. If the Company's clearances are deactivated in any particular country, the Company may lose the ability to directly sell its communications interception solutions in that country for projects that require security clearances. Further, in order to continue to do classified business in that country, the Company may have to sell through local systems integrators or distributors with clearances. Additionally, any inability to obtain or maintain clearances in a particular country may affect the Company's ability to sell its communications interception solutions generally. Recently, a federal agency in a particular country deactivated the federal-level security clearances of the Company's subsidiary in that country, in part, because the subsidiary is controlled by a company and personnel not from that country. Any inability to obtain or maintain clearances can materially and adversely affect the Company's financial performance.

Whether or not the Company is able to maintain security clearances, law enforcement and intelligence agencies in certain countries may decline to purchase communications interception solutions not developed or manufactured in that country. As a result, because the Company's communications interception solutions are developed and manufactured either in Israel or Germany, there may be certain countries where some or all of the law enforcem