

VERINT SYSTEMS INC
Form 8-K
September 10, 2007

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

FORM 8-K

CURRENT REPORT

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

Date of Report (Date of earliest event reported): September 10, 2007

VERINT SYSTEMS INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction

of Incorporation)

0-49790
(Commission File Number)

11-3200514
(IRS Employer

Identification No.)

330 South Service Road, Melville, New York
(Address of Principal Executive Offices)

11747
(Zip Code)

Registrant's telephone number, including area code: (631) 962-9600

None

(Former Name or Former Address, if Changed Since Last Report)

Edgar Filing: VERINT SYSTEMS INC - Form 8-K

Check the appropriate box if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (*see* General Instruction A.2.):

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
 - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
 - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
 - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
-

Item 2.02 Results of Operations and Financial Condition.

On September 10, 2007, Verint Systems Inc. (the Company or Verint) issued a press release (the Press Release) announcing certain preliminary unaudited results for the fiscal quarter ended July 31, 2007. A copy of the Press Release is attached hereto as Exhibit 99.1 and is incorporated by reference into Items 2.02 and 7.01 in its entirety. The Press Release contains forward-looking statements regarding the Company. The Press Release also contains certain unaudited segmentation data for the Security and Workforce and Enterprise Optimization (formerly Business Intelligence) segments and non-GAAP (generally accepted accounting principles) financial measures which management believes provides useful information to investors.

Reconciliation of Non-GAAP Financial Measures

The Press Release incorporated by reference into this report contains certain non-GAAP financial measures which management believes provide useful information to investors. These measures are not in accordance with, or an alternative for, GAAP and may be different from non-GAAP measures used by other companies. The Company believes that this presentation of non-GAAP data and non-GAAP financial measures provides useful information to management and investors regarding financial and business trends relating to the Company's financial condition and result of operations. In addition, the Company's management uses these measures for reviewing the financial results of the Company and for budget purposes. The reconciliation of these non-GAAP measures to the most directly comparable GAAP financial measures is provided below.

Reconciliation of GAAP and non-GAAP Results

(In thousands)

	Three Months	
	Ended July 31, 2007	
	Revenue	Net Income (Loss)
GAAP Results	\$ 129,563	\$ (42,452)
Difference between contract value and fair value of Witness maintenance and professional services contracts ⁽¹⁾	7,469	7,469
Amortization of purchased intangible assets		7,690
Stock-based compensation		8,684
Comverse option investigation fees		4,695
One-time Special Bonus Program		5,749
Acquisition-related charges:		
In-process research and development		5,634
Integration expenses		4,752
Restructuring and asset impairment charges		5,361
Income tax effect of non-GAAP adjustments		(2,658)
Non-GAAP Results	\$ 137,032	\$ 4,924

⁽¹⁾ GAAP requires maintenance and professional services contracts existing at the purchase date to be reduced to fair value. Fair value is defined as cost plus a reasonable profit. Contract value represents the amount customers have paid, and will continue to pay as their maintenance contracts renew.

Reconciliation of GAAP and non-GAAP Revenue by Segment

(In thousands)

	Three Months Ended July 31, 2007		
	Security	Workforce and Enterprise Optimization	Total
GAAP Revenue	\$ 57,593	\$ 71,970	\$ 129,563
Difference between contract value and fair value of Witness maintenance and professional services contracts ⁽¹⁾		7,469	7,469

Non-GAAP Revenue	\$ 57,593	\$	79,439	\$ 137,032
------------------	-----------	----	--------	------------

⁽¹⁾ GAAP requires maintenance and professional services contracts existing at the purchase date to be reduced to fair value. Fair value is defined as cost plus a reasonable profit. Contract value represents the amount customers have paid, and will continue to pay as their maintenance contracts renew.

Item 7.01 Regulation FD Disclosure.

See Item 2.02 Results of Operations and Financial Condition above.

Explanatory Note

As described in greater detail in our previous filings, our majority stockholder, Comverse Technology, Inc. (Comverse) has preliminarily determined that the actual dates of measurement for certain past Comverse stock options granted to Verint employees when Verint was wholly-owned by Comverse differed for accounting purposes from the recorded grant dates for such awards. As a result, we have preliminarily determined to record a non-cash stock-based compensation expense for the fiscal years ended January 31, 2007, 2006 and 2005 of approximately \$0, \$31,000 and \$64,000, respectively. We expect this charge to be less than \$20 million in the aggregate for all periods. These figures exclude any tax expense or related payments, which have not yet been finalized but that are not expected to materially impact our liquidity or capital resources. Based on our own review of our own stock option practices, we believe that all stock options issued by us were granted at fair market value on the date of grant and the related accounting for these stock options in our publicly filed historical financial statements is correct.

In addition, as described in greater detail in our previous filings, Comverse is reviewing certain non-option related accounting matters, including possible revenue recognition errors, errors in recording of certain deferred tax assets, expense misclassification, misuse of accounting reserves, and misstatement of backlog. In light of the on-going expanded inquiry by Comverse, we commenced our own internal review into certain of these accounting matters, including accounting reserves, income statement expense reclassification and revenue recognition. These investigations are still on-going and there can be no assurance that the results will not have a material and adverse impact on our financial results, including those presented in the attached press release and incorporated by reference herein.

While substantial progress has been made in both the Comverse and Verint investigations, notably with respect to the options portion of these investigations, these reviews are not yet complete and we cannot be certain as to when they will be complete. Unfortunately, during the pendency of these investigations, we are not able to produce audited financial statements or file our regular periodic reports. We are, however, presenting in the attached press release certain preliminary quarterly unaudited financial results to our investors, subject to the caveats contained herein. Please read the information under the caption Cautionary Statements below which describes important risks associated with this financial information and with our Company and business generally.

Cautionary Statements

The following cautionary statements update and supersede any previous cautionary statements filed by the Company.

This report contains forward-looking statements under the Private Securities Litigation Reform Act of 1995. 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, intends, believes, seeks, estimates, or anticipates, or by variations of such words or by similar expressions. There can be no assurances that forward-looking statements will be achieved. By their very nature, forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of results to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Some of the important risks, uncertainties and other important factors that could cause actual results to differ materially are discussed below. Readers are cautioned not to place undue reliance on forward-looking statements, which reflect our management's view only as of the date of this report. 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, except as otherwise required under the federal securities laws. 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 except as otherwise required under the federal securities laws.

Cautionary Statements Related to Our Preliminary Financial Results, the Comverse Special Committee Investigation, Our Internal Review of Certain Related Matters and Our Continuing Relationship with Comverse.

The financial information contained in this report is unaudited and preliminary and is expected to change.

As discussed above under Explanatory Note, while substantial progress has been made in the on-going investigations, neither the Comverse Special Committee investigation nor our own internal review of certain related accounting matters is yet complete. As a result, accounting periods relating to the information contained in the Press Release attached hereto and incorporated by reference herein are still open and subject to further adjustments, and the financial information contained in the Press Release is preliminary, not complete, and expected to change.

All financial periods as to which we have not filed periodic reports remain open, i.e., subject to further adjustment, until we file the periodic report with respect to such period with the SEC. Verint last filed a periodic report with the SEC for the quarter ending October 31, 2005. For each open period since that time, we have made certain estimates and judgments related to contingent assets and liabilities. If estimates and judgments made in an earlier open period are revisited in a later period based on more current information, then the amounts recorded in an earlier open period may also need to be revised based on the more current information. Such changes to results in prior open periods, whether individually or in the aggregate, will affect the results, perhaps materially, of the current period, the earliest period as to which such result is applied, and all intervening periods.

The financial information contained in the Press Release also excludes any tax effects, including any possible disallowance of previous tax deductions, related to the foregoing, which tax effects have not yet been finalized. None of this information takes into account any potential impact of the adoption of FIN 48, a recent FASB interpretation regarding accounting for uncertainty in income taxes, which we are still in the process of implementing. Finally, none of this information has been audited or reviewed by our independent registered public accounting firm. Accordingly, this financial information (as well as our historical financial information) is expected to change, possibly materially, based on the final results of the Comverse Special Committee investigation or our internal review, the assessment of the tax impacts referred to above, and the completion of the restatement (and related audits) of our historical financial statements.

We have been adversely affected as a result of being a consolidated, controlled subsidiary of Comverse and may continue to be adversely affected in the future.

Our status as a majority-owned subsidiary of Comverse has materially and adversely affected us as a result of the Comverse Special Committee investigation. As a result of applicable accounting rules relating to our status as a consolidated subsidiary, we have been forced to wait for Comverse to conclude its investigation before we can file our delinquent annual, quarterly and periodic reports. The Comverse Special Committee investigation has resulted in both direct and indirect, financial and non-financial, effects on us which are discussed in greater detail below. These effects include, but are not limited to, the non-cash charge we are required to take as a result of the backdating of certain Comverse stock options granted to our employees while we were a wholly-owned subsidiary, the related tax expenses and tax liabilities as a result of the options situation, the diversion of our management's attention from our business, the need to restate our historical financial statements, our inability to timely make required filings during the pendency of the Comverse investigation, our failure to comply with Securities and Exchange Commission (SEC) annual, quarterly and periodic reporting requirements and NASDAQ marketplace rules, our resulting delisting from the NASDAQ Global Market, our inability to issue securities to the public market and limitations on our ability to issue equity to our employees, our inability to provide full financial results to the market, our increased cost of capital resulting from the foregoing (including in connection with the financing of our recent acquisition of Witness Systems, Inc. (Witness)), concern from customers, investors, employees and others regarding our financial results, status and potential liability, and the resulting risk of loss of business and of employee attrition, and declines in our stock price resulting from the foregoing. In addition, we have incurred significant expenses, including fees and expenses of outside counsel, accountants and other experts, in analyzing and reacting to the Comverse investigation and in undertaking our own internal reviews as a result of allegations raised that may affect Verint. We do not have any control over the actions or policies of Comverse or access, without Comverse's cooperation, to Comverse's books, records or other information. As a result, we cannot assure you that we will not become subject to other adverse effects from the actions of Comverse or its personnel in the future, whether in connection with the current Comverse investigation or otherwise.

We have been unable to remain current with the filing of our annual, quarterly and periodic reports with the SEC, and our efforts to become current have required and will continue to require substantial management time and attention as well as significant accounting and legal expense.

The Comverse Special Committee investigation and our own related internal review have caused us to postpone the filing of our annual, quarterly and periodic SEC reports and we believe it is likely we will continue to have to delay the filing of our outstanding and future reports for some time. The completion of our delinquent SEC filings will require substantial management time and attention as well as significant accounting and legal expense. Since neither the Comverse Special Committee investigation nor our own related internal review is complete, we are not in a position to provide anything other than preliminary unaudited information to our stockholders. Accordingly, the financial information we have provided is expected to change, perhaps materially, and any investment in our securities involves a high degree of risk.

We are subject to the risk of potential litigation and regulatory proceedings or actions in connection with the Comverse Special Committee investigation, our own related internal review and the related restatement of our historical financial statements.

Comverse and certain current and former officers and directors of Comverse have been named in a number of class action and/or shareholder derivative lawsuits in connection with the circumstances surrounding the Comverse Special Committee investigation, including Igal Nissim, our former Chief Financial Officer (CFO), in his former capacity as CFO of Comverse and Dan Bodner, our Chief Executive Officer (CEO), in his capacity as CEO of Verint (i.e., as the president of a significant subsidiary of Comverse). As of the date of this filing, one of the two derivative actions has been dismissed, and the class action suits continue to be pending and other suits may be filed in the future. We cannot assure you that Verint or other of our personnel will not be named in these or future lawsuits relating to the Comverse Special Committee investigation or our internal review of related issues or that these suits will not in the future allege wrongdoing at Verint or by Verint employees. Moreover, we cannot predict the outcome of any of these suits and an adverse result in one or more of them, particularly if it names us, Mr. Nissim, Mr. Bodner, or other of our personnel, could have a material adverse effect on our business, results of operation and financial condition.

On July 20, 2006, we announced that, in connection with the SEC's ongoing inquiry into Comverse's past stock option grants, we had received a letter requesting that we voluntarily provide to the SEC certain documents and information related to Verint's own stock option grants and practices. In the letter, the SEC noted that its request should not be construed as an indication by SEC staff that any violations of law had occurred or as an adverse reflection upon any person or security. We have voluntarily responded to this request and certain subsequent requests, and are cooperating with the SEC staff.

On August 9, 2006, criminal fraud charges were brought by the U.S. Attorney's office, and civil fraud charges were brought by the SEC, against Kobi Alexander, the former Chairman and CEO of Comverse, David Kreinberg, the former CFO of Comverse, and William Sorin, the former Senior General Counsel of Comverse, in connection with their respective actions at Comverse which came to light through the investigation into Comverse's historical option practices. Messrs. Alexander, Kreinberg and Sorin sat on the Company's Board of Directors until their resignations on April 28, 2006. On October 24, 2006, the SEC announced that it had settled its case against Mr. Kreinberg without Mr. Kreinberg admitting or denying the allegations in the complaint. On the same day, Mr. Kreinberg plead guilty to one criminal count of conspiracy to commit securities fraud, mail fraud and wire fraud, and one criminal count of securities fraud in the U.S. Attorney's case against him. On November 2, 2006, Mr. Sorin plead guilty to one criminal count of conspiracy to commit securities fraud, mail fraud and wire fraud in the U.S. Attorney's case against him. On January 10, 2007, the SEC announced that it had settled its case against Mr. Sorin without Mr. Sorin admitting or denying any charges. On May 10, 2007, Mr. Sorin was sentenced to a year and one day in prison in connection with the U.S. Attorney's case against him.

Although we cannot predict the path of the SEC inquiry or related Department of Justice (DOJ) investigation into Comverse's option and other accounting practices or whether we will receive further inquiries in relation to such investigations, either with respect to our own practices or otherwise, based on our internal review of our own option practices, we believe that all stock options issued by us were granted at fair market value on the date of grant and the related accounting for these stock options in our publicly filed historical financial statements is correct.

Companies that restate their financial statements sometimes face litigation claims and/or SEC proceedings following such a restatement. We could face monetary judgments, penalties or other sanctions which could adversely affect our financial condition and could cause our stock price to decline. Although we are not currently subject to any regulatory proceeding or litigation as a result of the Comverse Special Committee investigation, our resulting internal review or the anticipated restatement (other than the SEC voluntary production request described above), there is no assurance that formal regulatory investigations or proceedings will not be commenced by the SEC, DOJ, or other U.S. federal, state or foreign regulatory agencies. In addition, as noted above, we may in the future be subject to litigation or other proceedings or actions arising in relation to Comverse Special Committee investigation, our resulting internal review, or the restatement. Litigation and any potential regulatory proceeding or

action may be time consuming, expensive and distracting from the conduct of our business. An unfavorable outcome of any such litigation or regulatory proceeding or action could have a material adverse effect on our business, financial condition and results of operations.

We may not have sufficient insurance to cover our liability in any future litigation claims either due to coverage limits or as a result of insurance carriers seeking to deny coverage of such claims.

We face a variety of liability risks which we attempt to mitigate through third party insurance coverage, including liability for indemnification of (and advancement of expenses to) current and former directors, officers, and employees, under certain circumstances, pursuant to our certificate of incorporation, bylaws, other applicable agreements, and/or Delaware law.

Following the announcement of the Comverse Special Committee investigation, we sought and obtained our own director and officer liability insurance policy for our directors and officers. Prior to the announcement of this investigation, however, our directors and officers were included in a policy which covered all directors and officers of Comverse and its subsidiaries, which policy remains the sole source of insurance for our directors and officers in connection with the facts and circumstances surrounding the Comverse Special Committee investigation. This insurance coverage may not be adequate to cover any claims against us in connection with such matters and, if this insurance proves to be needed, it may not be available to us because the coverage limits may have been exhausted by Comverse in connection with the claims already pending against it and its personnel.

With respect to claims unrelated to the Comverse Special Committee investigation, we may find that the limits of our new coverage are not sufficient. In addition, the underwriters of our new coverage or our old shared coverage with Comverse may seek to rescind or otherwise deny coverage in certain circumstances based on the terms of the policy, in which case we would have to self-fund any indemnification amounts owed to directors and officers and bear any other uninsured liabilities.

If we do not have sufficient coverage under our new or historical insurance policies, or if our insurance underwriters are successful in rescinding or denying coverage to us, our business, results of operations and financial condition may be materially adversely affected.

Many members of our senior management team and our Board of Directors have been and will be required to devote a significant amount of time on matters relating to the Comverse Special Committee investigation, our own related internal review and the related restatement.

Our senior management and Board of Directors have been and will continue to be required to devote a significant amount of time on matters relating to the Comverse Special Committee investigation, our resulting internal review and the related restatement. If our senior management and Board of Directors are unable to devote the necessary time to developing and executing on our strategic business initiatives and running ongoing business operations, there may be a material adverse effect on our business, financial condition and results of operations.

We face challenges in hiring and retaining qualified personnel due to our filing status, the internal reviews, and the delisting from The NASDAQ Global Market.

We depend on our employees and on our ability to attract and retain highly qualified personnel. Given the long period of time during which we have been unable to file regular annual, quarterly and periodic reports with the SEC, the Comverse Special Committee investigation, our related internal review, the delisting of our common stock from the NASDAQ Global Market, and recent rumors in the market regarding Comverse's strategic plans, it has become more difficult for us to attract and retain key employees. In addition, because we remain delinquent in our filings, we are presently unable to register our securities for offer and sale, which limits our ability to use stock options and other equity-based awards to attract, retain, and provide incentives to our employees. In an effort to help address potential employee attrition issues, on February 5, 2007, we announced a significant cash retention program for employees other than executive officers and directors. Subsequently, on July 5, 2007, we announced that we had granted various time-based and performance-based equity awards under our 2004 Stock Incentive Compensation Plan, as amended, representing an aggregate of approximately 1.0 million shares of our common stock, to Verint's non-management employees around the world. In addition, on this same date, we also announced

certain time-based and performance-based equity awards to certain of our directors and executive officers. Notwithstanding this cash retention program and equity grants, the loss of the services of any of our key employees, the inability to attract or retain qualified personnel in the future, or delays in hiring required personnel, could disrupt our ability to effectively run our business.

Our previous inclusion in Comverse's consolidated tax group and our related tax sharing agreement with Comverse may expose us to additional tax liabilities.

Prior to our initial public offering in May 2002, we were included in the Comverse consolidated group for federal income tax purposes and did not file our own federal income tax return. Following our initial public offering, we ceased to be included in the Comverse consolidated group for federal income tax purposes, but we remained party to a tax sharing agreement with Comverse for prior periods. By virtue of its controlling ownership and its tax sharing agreement with us, Comverse effectively controls all of our tax decisions for periods ending prior to the completion of our initial public offering. For periods during which we were included in the Comverse consolidated group for federal income tax purposes, Comverse has sole authority to respond to and conduct all federal income tax proceedings and audits relating to us, to file all federal income tax returns on our behalf and to determine the amount of our liability to, or entitlement to payment from, Comverse under its tax sharing agreement.

As a result of the foregoing, if a tax deduction taken in the past by Comverse, such as the deduction available under Section 162(m) of the Internal Revenue Code for performance-based compensation, becomes disallowed in whole or in part as a result of the investigation into Comverse's historical option practices or otherwise, we could be liable to Comverse under the tax sharing agreement for a portion of this lost tax deduction. Moreover, if such a disallowance occurs, the amount of net operating losses that were allocated to us by Comverse at the time of our initial public offering could be reduced with retroactive effect, thereby exposing us to additional tax liability in the present.

In addition, notwithstanding the terms of the tax sharing agreement, federal law provides that each member of a consolidated group is liable for the group's entire tax obligation and we could, under certain circumstances, be liable for taxes of other members of the Comverse consolidated group. To the extent that Comverse or other members of the group fail to make any federal income tax payments required of them by law in respect of years for which Comverse filed a consolidated federal income tax return which included us, we would therefore be liable for the shortfall. Similar principles apply for state income tax purposes in many states.

We may be unable to obtain relisting of our common stock on a national securities exchange.

As a result of the delay in filing our annual, quarterly and periodic reports with the SEC, we were unable to comply with the listing standards of The NASDAQ Global Market and our common stock was suspended from trading effective February 1, 2007 and formally de-listed effective June 4, 2007. We intend to apply for the relisting of our common stock as soon as possible after we regain compliance with our SEC filings. There can be no assurance that we will be able to obtain relisting of our common stock on The NASDAQ Global Market or another national securities exchange. If we are not successful in relisting our common stock on a national securities exchange, the price of our common stock may be adversely affected.

We may conclude that we have one or more material weaknesses as a result of the Comverse Special Committee investigation, our ongoing internal review or otherwise.

As a result of facts and circumstances surrounding the Comverse Special Committee investigation and our own related internal review, we may conclude that we have one or more material weaknesses in our internal controls over financial reporting relating to our accounting for and disclosure of Comverse stock options granted to our employees or our other accounting practices. We also perform an annual assessment of our internal controls, which we update on a quarterly basis, which may also reveal material weaknesses in our internal controls. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. No assurance can be given that we will not find one or more material weaknesses or that, if found, we would be able to successfully implement revised internal controls and procedures or that any such revised controls and procedures would be effective in remedying such material weaknesses. In addition, we may be required to hire

additional employees to help implement these changes, and may experience higher than anticipated capital expenditures and operating expenses during the implementation of these changes and thereafter. If we identify one or more material weaknesses and are unable to implement effective remediation or if other material weaknesses develop, there could be a material adverse effect on our business, financial condition, results of operations, or common stock price.

Comverse can control our business and affairs, including our Board of Directors.

Because Comverse beneficially owns approximately 64% of our common stock (assuming the conversion of the preferred stock issued to Comverse in connection with the equity financing for the Witness acquisition), Comverse effectively controls the outcome of all matters submitted for stockholder action, including the composition of our Board of Directors and the approval of significant corporate transactions. Comverse has the ability, acting alone, to remove existing directors and/or elect new directors to our Board of Directors in order to fill the current vacancies. In addition, in connection with the equity financing for the Witness acquisition, Comverse has the right to appoint two additional directors to our Board of Directors under certain circumstances. As a consequence of its control over the composition of our Board of Directors, Comverse can also exert a controlling influence on our management, direction and policies, including the ability to appoint and remove our officers. For example, Comverse 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. In addition, as a result of Comverse's majority ownership, we have in the past relied on the controlled company exemption from certain requirements under Rule 4350(c)(5) of the listing standards of the National Association of Securities Dealers, Inc., and do not currently have an independent Nominating Committee, as non-controlled companies are required to have, though at present, we do have an independent Compensation Committee. If Comverse were to cease to beneficially own a majority of our outstanding Common Stock, we would no longer be permitted to rely on the controlled company exemption and would be required to have a majority independent Board of Directors, an independent nominating committee and an independent compensation committee when and if we become relisted on the NASDAQ Global Market.

Our directors that also hold positions with Comverse may have conflicts of interest with respect to matters involving both companies.

Three of our nine directors are officers and/or directors of Comverse. These directors have fiduciary duties to both companies and may have conflicts of interest on matters affecting both us and Comverse and in some circumstances may have interests adverse to ours.

We may lose business opportunities to Comverse that might otherwise be available to us.

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

We obtain certain key services from Comverse and its subsidiaries. If such services are terminated, we may be required to incur additional expenses to obtain similar services from other sources.

Although we recently completed the implementation of our own enterprise resource planning system and no longer share Comverse's system, we continue to receive certain insurance and certain administrative services from Comverse under a corporate services agreement. We also obtain personnel and facility services from Comverse, Inc. under a satellite services agreement. If these agreements are terminated, we may be required to obtain similar services from other entities or, alternatively, we may be required to hire qualified personnel and incur other expenses to obtain these services. We may not be able to hire such personnel or to obtain comparable services at prices and on terms as favorable as we currently have under these agreements.

Cautionary Statements Related to the Acquisition of Witness.

Although we expect that the Witness acquisition will result in benefits to us, we may not realize those benefits because of integration and other challenges.

Our ability to realize the anticipated benefits of the Witness acquisition will depend, in part, on our ability to continue to effectively integrate the business of Witness with our business. We may not be able to do so without substantial costs, delays or other difficulties. The combination of two independent companies is a complex, costly and time-consuming process. This ongoing process may disrupt the business of either or both of the companies, and may not result in the full benefits expected by us. The difficulties of combining the operations of the companies include, among others:

coordinating sales and marketing functions;

managing product convergence and coordinating research and development efforts;

integrating information, communications, financial and other systems;

maintaining and improving the quality of customer service that each business has historically provided and maintaining customer loyalty during a period of transition;

retaining key employees and maintaining morale;

consolidating corporate and administrative infrastructures;

the diversion of management's attention from ongoing business concerns and the need to dedicate additional management personnel to address integration obstacles; and

coordinating geographically separate organizations.

If we are not successful in integrating Witness into our operations, if the integration takes longer than anticipated, if Witness does not perform as we anticipate or if the integrated product and service offerings fail to achieve market acceptance, our operations, margins, sales and reputation could be adversely affected.

In addition, we have in the past and may in the future pursue other acquisitions of businesses or technologies or enter into other arrangements such as joint ventures, which may present similar challenges. Recent historical acquisitions include the networked video security business of MultiVision Intelligent Surveillance Limited, CM Insight Limited and Mercom Systems, Inc. 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 we may lose the total amount of our investments, or more than our total investment if such businesses come with unexpected liabilities. Due to rapidly changing market conditions, we may find the value of our acquired technologies and related intangible assets, such as goodwill, as recorded in our financial statements, to be impaired, resulting in charges to operations.

As a result of our acquisition of Witness, we are subject to claims by other companies that our software infringes their intellectual property and such claims could require us to incur substantial costs or prevent us from selling our software or services, which could have a material adverse effect on our business.

Edgar Filing: VERINT SYSTEMS INC - Form 8-K

A number of patent infringement claims have been asserted against Witness in lawsuits involving NICE Systems, Ltd., and two of NICE's wholly-owned subsidiaries, STS Software Systems Ltd. and NICE Systems, Inc. Following the recent completion of the Witness acquisition, we expect that NICE may also expand the scope of its claims in one or more of its suits. Witness has counter-claimed in each of the suits, all of which remain pending at the present time, however, we cannot assure you that we (including Witness) will be successful in defending against the claims that have been asserted or any other claims that may be asserted. We also cannot assure you that such claims will not have a material adverse effect on our business, financial condition, or operations.

- 9 -

Patent infringement litigation involves substantial costs and diversion of management resources. In addition, to the extent we are not successful in defending such claims, we may be subject to injunctions with respect to the use or sale of certain of our products or to liabilities for damages to the claimants or to customers to whom we have indemnification commitments, and we may be required to obtain licenses which may not be available on reasonable terms or at all.

See also Our intellectual property may not be adequately protected and Our products may infringe or may be alleged to infringe on the intellectual property rights of others, which could lead to costly disputes or disruptions and may require us to indemnify our customers for any damages they suffer below. For a more detailed discussion of the suits with NICE and its affiliates, please see Item 1, Legal Proceedings, of Part II of the Witness Systems, Inc. Form 10-Q for the quarter ended March 31, 2007.

As a result of our acquisition of Witness, we are subject to an SEC inquiry and litigation relating to certain of Witness stock option grants which remains pending and could have an adverse effect on our business, operating results and stock price and may divert the attention of our management and other key employees.

A formal inquiry by the SEC relating to Witness stock option granting practices is currently pending, as are derivative and class action litigation against Witness and certain former Witness officers and directors. In addition, these proceedings are likely to result in additional legal expense that may affect our results in future periods, and may also result in diversion of management attention and other resources, as well as fines, penalties, damages and other sanctions. The U.S. Attorney's Office for the Northern District of Georgia has also been given access to the documents and information provided by Witness to the SEC. Action by the SEC, the U.S. Attorney's Office or other governmental agencies could result in civil or criminal actions against us and/or certain of its former officers, directors and/or employees and might result in monetary and other sanctions.

The civil litigation described in the preceding paragraph includes allegations, among other, that certain former directors and officers of Witness improperly dated stock option grants to enhance their own profits on the exercise of such options or for other improper purposes. Although we and the other defendants intend to defend these claims vigorously, there are many uncertainties associated with any litigation, and we cannot assure you that these actions will be resolved without substantial costs and/or settlement charges. Witness had entered into indemnification agreements with each of these former directors and officers prior to the acquisition. Under those agreements, we are (with certain exceptions) required to indemnify each such director or officer against expenses, including attorneys' fees, judgments, fines and settlements, paid by such individual in connection with the pending litigation.

We have significant indebtedness as a result of the acquisition of Witness, which adversely affects our cash flows and could adversely affect our business.

In order to complete the Witness acquisition, we incurred \$650 million of new debt financing. Proceeds from the debt financing were used to fund a portion of the cash consideration paid to Witness stockholders. As of the date of this report, \$40 million of this debt has been prepaid.

Our leverage may have important consequences to our investors. For example, it may:

limit our ability to obtain additional debt financing in the future for working capital, capital expenditures, acquisitions or other general corporate purposes;

require us to dedicate a substantial portion of our cash flow from operations to debt service, reducing the availability of our cash flow to use for other purposes;

require us to repatriate cash for debt service from our foreign subsidiaries resulting in dividend tax costs or require us to adopt other sub-optimal tax structures to accommodate debt service payments; or

increase our vulnerability to economic downturns, limit our ability to capitalize on significant business opportunities and restrict our flexibility to react to changes in market or industry conditions.

Our ability to satisfy our debt obligations will depend upon our future operating performance, which will be affected by prevailing economic conditions and financial, business and other factors, many of which are beyond our control. We anticipate that our operating cash flow will be sufficient to meet our anticipated operating expenses and to service our debt obligations as they become due. If, however, we do not generate sufficient cash flow for these purposes we may be unable to service our indebtedness and may have to adopt alternative strategies that could include reducing or delaying capital expenditures, selling assets, restructuring or refinancing our indebtedness or seeking equity capital.

Our operations are restricted by the terms of our debt financing, which could adversely affect our business.

The terms of our debt financing include a number of restrictive covenants which restrict us and our subsidiaries. These covenants limit our and our subsidiaries' ability to, among other things:

incur additional indebtedness or liens or issue preferred stock;

pay dividends or make other distributions or repurchase or redeem our stock or subordinated indebtedness;

engage in transactions with affiliates;

engage in sale-leaseback transactions;

sell assets;

change our lines of business;

make investments, loans or advances; and

engage in consolidations, mergers, liquidations or dissolutions.

These covenants could limit our ability to plan for or react to market conditions, to meet our capital needs or to otherwise engage in transactions that might be considered beneficial to us. Our credit agreement also contains a financial covenant that requires us to maintain, on a consolidated basis, a Consolidated Total Debt to Consolidated EBITDA (each as defined in the credit agreement) leverage ratio of, initially, less than or equal to 6.00 to 1.00, with such required ratio decreasing over the term of the credit agreement to 2.00 to 1.00. Our ability to comply with the leverage ratio covenant is highly dependent on our ability to continue to grow revenues from quarter to quarter. We cannot assure you that we will be successful in growing our revenues sufficiently to continue to satisfy this covenant, particularly as we continue to focus significant efforts on the Witness integration and related customer and employee issues. In addition, as discussed in greater detail below, the continued shift of our business to the end of the quarter has increased the difficulty in accurately forecasting quarterly revenue numbers and therefore in predicting whether we will be in compliance with the leverage ratio at quarter end. Our ability to comply with the other covenants and requirements may be affected by events beyond our control and we may have to curtail some of our operations or growth plans to maintain compliance.

In the future, it is possible that our assets or cash flow might not be sufficient to fully repay borrowings under our outstanding debt instruments as and when due or that we may be unable to comply with the financial covenants and other requirements contained in our debt financing agreements, in which case an event of default could occur which could cause or permit holders of the debt to declare all amounts outstanding to be immediately due and payable. In such a case, we may not be able to refinance or restructure the debt owing under the debt financing, and if able to do so, it might be on unfavorable terms.

The rights of the holders of shares of our common stock are subject to, and may be adversely affected by, the rights of holders of the preferred stock that we issued to Comverse in connection with the Witness acquisition.

In connection with the Witness acquisition, we issued \$293 million of a new class of perpetual preferred stock to Comverse. As a result of the issuance of the preferred stock, holders of our common stock were diluted. In addition, the terms of the preferred stock include liquidation, dividend and other rights that are more favorable than the rights inuring to the holders of our common stock.

Cautionary Statements Related to Our Business and Industry

Intense competition in our markets and competitors with greater resources may limit our market share and growth.

We face aggressive competition from numerous and varied competitors in both of our markets, making it difficult to maintain market share and grow. Even if we are 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 we operate, our competitors may simply execute better than us, and thereby gain market share. Our 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. Some of our competitors have, in relation to us, 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. In particular, our markets have been characterized by the increasing presence of companies significantly larger than us, such as General Electric, Raytheon, IBM and Cisco. Further, there has been significant consolidation among our competitors, which has improved the competitive position of several of these companies, and new competitors continue to emerge in both of our markets. If our competitors are able to achieve a competitive position superior to us, our market share and, therefore, results of operations, may be materially and adversely affected. In addition, some of our customers and partners may in the future decide to internally develop their own solutions instead of purchasing them from us.

Competition may compel us to reduce our prices, offer more customer-favorable payment terms, and adjust our cost structure in order to retain market share. This may affect our cash flow, reduce our gross margins and inhibit our ability to grow.

Because of the intense competition in our markets and the fact that many of our customers make decisions to purchase largely based on price, we may have to accept less-favorable payment terms, lower the prices of many of our products and services, or increase efficiencies and capacity in order to remain competitive. This can affect us because:

we may not be able to maintain or improve revenue and gross margin with our current cost structure, and therefore our profitability could be materially and adversely affected; and

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

If the factors which drive demand for our solutions do not evolve as expected or do not favor our products, our results will suffer.

The market for many of our solutions is still evolving and, in the security market in particular, has been driven to a significant extent by legislative and regulatory actions, such as the Communications Assistance for Law Enforcement Act (CALEA) in the United States and standards established by the European Telecommunications Standards Institute (ETSI) in Europe, as well as initiatives to strengthen security for critical infrastructure such as airports. These actions and initiatives are still evolving, however, and are at all times subject to change based on

factors beyond our control, such as political climate, budgets and even current events. While we attempt to capitalize on these actions and initiatives through our product offerings and refinements thereto, we cannot assure you that we will be successful in these efforts, that our competitors will not do so more successfully than us, or that changes in these actions or initiatives or the underlying factors which affect them will not occur which will reduce or eliminate this demand. If any of the foregoing should occur, or if our markets do not grow as anticipated for any other reason, our results may suffer. In addition, changes to these actions or initiatives, including changes to technical requirements, may require us to modify or redesign our products in order to maintain compliance, which may subject us to significant additional expense.

Conversely, as the telecommunications industry continues to evolve, state, federal and foreign governments (including supranational governmental organizations such as the European Union) and industry associations may increasingly regulate the monitoring of telecommunications and telephone and Internet monitoring and recording products, such as our software. We believe that increases in regulation could come in a number of different forms, including regulations regarding privacy, protection of personal information such as Social Security numbers, credit card information and employment. For example, the State of California enacted the Database Security Breach Act, which requires any business that suffers a computer security breach to immediately notify customers in California if personal information has been compromised, and the payment card industry has adopted regulations that require additional security regarding the storage of consumers' credit card numbers. While these types of regulations should not impact our security products (which in many cases are designed to help customers comply with governmental mandates as described above), the adoption of these types of regulations or changes to existing regulations could cause a decline in the use of our contact center software and could result in increased expense for us as we modify this software to accommodate these regulations. Moreover, these regulations could subject our customers or us to liability. Whether or not these kinds of regulations are adopted, if we do not adequately address the privacy concerns of consumers, companies may be hesitant to use our contact center software. If any of these events occur, it could materially and adversely affect our business.

The industry in which we operate is characterized by rapid technological changes, and our continued success will depend upon our ability to anticipate and react to such changes.

The markets for our 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 our existing products obsolete and unmarketable and can exert pricing pressure on existing products. It is critical to our success that we are 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 with high quality and on a timely basis.

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

We must often demonstrate the benefits of our solutions to customers.

Many of our solutions, and the factors described above which help create markets for them, are complex. In many cases, it is necessary for us to educate our potential customers about the benefits and value of our solutions. This increases the difficulty of and time necessary to complete transactions. If we are unable to demonstrate to customers the benefits and value of our solutions, our results will suffer.

Our lengthy and variable sales cycle, focus on large customers and installations, short delivery windows required by customers, and increasingly back-loaded nature of our business makes it difficult for us to predict our operating results.

It is difficult for us to forecast the timing of revenues from product sales because customers often need a significant amount of time to evaluate our 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 our 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 our competitors; and (v) lower prices offered by our competitors.

In addition, we have historically derived a significant portion of our sales from contracts for large system installations with major customers and we continue to emphasize sales to larger customers in our product development and marketing strategies. Contracts for large installations typically involve a lengthy and complex bidding and selection process, and our ability 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. As a result, our future operating results may be volatile and vary significantly from period to period. Furthermore, if our professional services employees do not provide installation services effectively and efficiently, our customers may not use our installation services or may stop using our software. This could adversely impact our revenue and harm our reputation.

While we have no single customer that is material, we have many significant customers and receive 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 our operating results in any fiscal period, particularly if there are significant sales and marketing expenses associated with the deferred, lost or delayed sales.

In recent years, an increasing percentage of our quarterly revenues have come later in the quarter. This trend has only been amplified with the addition of the Witness business. In addition, an increasing percentage of our quarterly revenues have been coming in the form of book-ship business, where the customer places its order close to, or even on, the requested delivery date. This back-loading trend and trend of shorter periods between order date and delivery date has further complicated the process of accurately predicting revenues on a quarterly basis.

We base our current and future expense levels on our internal operating plans and sales forecasts, and our operating costs are, to a large extent, fixed. As a result, we may not be able to sufficiently reduce our costs in any period to compensate for an unexpected near-term shortfall in revenues.

Many of our sales are made by competitive bid which often require us to expend significant resources with no guaranty of recoupment.

Many of our sales, particularly in larger installations, are made by competitive bid. Successfully competing in competitive bidding situations subjects us 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; (ii) research and development to improve or refine our product in advance of winning the sale; and (iii) the substantial time, money, and effort, including design, development, and marketing activities, required to prepare bids and proposals for contracts that may not be awarded to us. If we do not ultimately win a bid, we may obtain little or no benefit from these expenditures and may not be able to recoup them on future projects.

Even where we are not involved in a competitive bidding process, due to the intense competition in our markets and increasing customer demand for shorter delivery periods, we must in some cases begin implementation of a project before the corresponding order has been finalized, increasing the risk that we will have to write off expenses associated with orders that do not come to fruition.

If we are unable to maintain our relationships with value added resellers, systems integrators and other third parties that market and sell our products, our business, financial condition, results of operations and ability to grow could suffer.

Approximately half of our revenues are generated by sales made through strategic and technology partners, distributors, value added resellers and systems integrators. Our ability to achieve revenue growth depends to a significant extent on maintaining and adding to these sales channels. If our relationships with these sales channels deteriorate or terminate, we may lose important sales and marketing opportunities. In pursuing new partnerships and strategic alliances, we must often compete for the opportunity with similar solution providers. Even if we are able to win such opportunities on terms we find acceptable, there is also no assurance that we will be able realize the benefits we anticipate. Our competitors often seek to establish exclusive relationships with these sales channels or, at a minimum, to become a preferred partner for these channels. Many of our channel partners also partner with our competitors and may even offer our products and those of our competitors as alternatives when presenting bids to end customers.

In addition, if an original equipment manufacturer that is part of our indirect sales channel experiences technical difficulties, our product sales through that channel may be adversely affected. When we sell our software through an original equipment manufacturer, or OEM, our software is embedded in the OEM's product, which we sometimes refer to as the "environment" for our software. When the OEM's product uses our software, there is a risk that the "environment" will fail or that it will not be fully compatible with our product. If this happens, our software may not function properly and sales of both the OEM product, and consequently, our product, may suffer.

Because we have significant foreign operations, we are subject to risks that could materially and adversely affect our business.

We have significant operations in foreign countries, including sales, research and development, customer support and administrative service. The countries in which we have our most significant foreign operations include Israel, Germany, the United Kingdom, Canada and China, and we intend to continue to expand our operations internationally. We believe our business may suffer if we are unable to successfully expand and maintain foreign operations. Our foreign operations are, and any future foreign expansion will be, subject to a variety of risks, many of which are beyond our control, including risks associated with: (i) foreign currency fluctuations; (ii) political, security and economic instability in foreign countries; (iii) changes in and compliance with local laws and regulations, including export control laws, tax laws, labor laws, employee benefits, currency restrictions and other requirements; (iv) differences in tax regimes and potentially adverse tax consequences of operating in foreign countries; (v) customizing products for foreign countries; (vi) legal uncertainties regarding liability, export and import restrictions, tariffs and other trade barriers; (vii) hiring qualified foreign employees; and (viii) difficulty in accounts receivable collection and longer collection periods. Any or all of these factors could materially affect our business or results of operations.

In addition, the tax authorities in the various jurisdictions in which we operate may review from time to time the pricing arrangements between us and our subsidiaries. An adverse determination by one or more tax authorities in this regard may have a material and adverse effect on our financial results. Restrictive laws, policies or practices in certain countries directed toward Israel or companies having operations in Israel may also limit our ability to sell some of our products.

In August 2005, the European Parliament Directive 2002/96/EC (dated 27 January 2003) on Waste Electrical and Electronic Equipment Directive, or the WEEE Directive, became effective in the European Union. The WEEE Directive requires producers of certain electrical and electronic equipment to be responsible for the future disposal costs of this equipment sold within the European Union. In July 2006, the European Parliament Directive 2002/95/EC (dated 27 January 2003) on Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment, or the RoHS Directive, became effective in the European Union. The RoHS Directive restricts the use of certain hazardous substances, including mercury, lead, cadmium, hexavalent chromium and certain flame retardants, in the construction of component parts of certain electrical and electronic equipment

sold within the European Union. We have made arrangements to comply with these directives, in each case, to the extent applicable to the hardware portion of our solutions. As part of our RoHS arrangements, we rely on our suppliers and manufacturing sub-contractors to provide compliant components and any material associated with the production processes. Ensuring compliance with these directives and coordinating compliance activities with suppliers will result in additional costs to us and may result in disruptions to operations. As of the date of this report, the Company estimates its aggregate compliance/remediation expenses have been approximately \$800,000. The Company believes that future costs to complete the transition to a fully RoHS-compliant product portfolio will be minor because the majority of the transition process has been completed. However, to the extent that any such costs are more significant than expected or that any future disruptions are more substantial than expected, our financial results could be materially and adversely affected.

Conditions in Israel may materially and adversely affect our operations and personnel and may limit our ability to produce and sell our products.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, which in the past and may in the future, lead to security and economic problems for Israel. In addition, Israel has faced and continues to face difficult relations with the Palestinians and the risk of terrorist violence from both Palestinian as well as foreign elements such as Hezbollah. Infighting among the Palestinians may also create security and economic risks to Israel. Current and future conflicts and political, economic and/or military conditions in Israel and the Middle East region have and may directly affect our operations in Israel. The continuation or exacerbation of violence in Israel or the outbreak of violent conflicts involving Israel may impede our ability to sell our products, engage in research and development, or otherwise adversely affect our business or operations. In addition, many of our Israeli employees in Israel are required to perform annual compulsory military service in Israel and are subject to being called to active duty at any time under emergency circumstances. The absence of these employees may have an adverse effect on our operations. Hostilities involving Israel may also result in the interruption or curtailment of trade between Israel and its trading partners or a significant downturn in the economic or financial condition of Israel.

We are dependent on contracts with governments for a significant portion of our revenues. These contracts expose us to additional business risks and compliance obligations.

We derive a significant amount of our revenues from various government contracts worldwide. We expect that government contracts will continue to be a significant source of our revenues for the foreseeable future. We 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 we do business with government agencies in various countries and may impose added costs on our business. Our business generated from government contracts may be materially and adversely affected if: (i) our reputation or relationship with government agencies is impaired; (ii) we are 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 we do not provide products and services; (iv) we are 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) we are not granted security clearances that are required to sell our products to domestic or foreign governments or such security clearances are deactivated; (vi) there is a change in government procurement procedures; or (vii) there is a change in political climate that adversely affects our existing or prospective relationships. If we, one of our directors, officers, or other senior managers, or our principal stockholder, Comverse, were to be charged by a U.S. governmental entity with a crime of dishonesty on either a criminal or a civil basis, we would become subject to investigation by one or more of our governmental agency customers and could, in an extreme case, be suspended or debarred from further contracting with the U.S. government. To date, the only persons who have been charged by a governmental entity in connection with the Comverse Special Committee investigation and related accounting reviews Kobi Alexander, David Kreinberg and William Sorin were former directors who had resigned from our Board several months prior to their indictments. To date, no current or former director, officer or other senior manager of Witness has been charged, either criminally or civilly, in connection with the review of Witness stock option granting practices or the inquiry by the SEC relating to the same.

Our government contracts contain provisions that are unfavorable to us.

Many of our 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 us from doing business with a foreign government or prevent us from selling our products in certain countries; (iii) audit and object to our contract-related costs and expenses, including allocated indirect costs; and (iv) change specific terms and conditions in our contracts, such as warranty provisions that would not be found in private commercial contracts. The effect of these provisions may be to significantly increase the cost to us of performing the contract or to defer our ability to recognize revenue from such contracts. In some cases, this may mean that we must begin recording expenses on a contract in advance of being able to recognize corresponding revenue.

In addition, many jurisdictions have laws and regulations that deem government contracts in those jurisdictions to include these types of provisions, even if the contracts themselves do not contain them. If a government terminates a contract with us for convenience, we may not recover our incurred or committed costs, any settlement expenses, or profit on work completed prior to the termination. If a government terminates a contract for default, we may not recover these amounts, and, in addition, we may be liable for any costs incurred by a government in procuring undelivered items and services from another source. Further, an agency within a government may share information regarding our termination with other government agencies. As a result, our on-going or prospective relationships with such other government agencies could be impaired.

Our proxy agreement with the U.S. Department of Defense limits our control over one of our subsidiaries. If this agreement is involuntarily terminated, we may be suspended from selling our communications interception products to the U.S. government.

Our subsidiary, Verint Technology, which, among other things, develops, markets, sells, and supports Verint's 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 we, Verint Technology, Comverse and the Department of Defense entered into a proxy agreement with respect to the ownership and operations of Verint Technology, which agreement was amended in May 2001 to comply with the Department of Defense's most recent requirements. In connection with the proxy agreement, we, among other things, appointed four 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 except that without obtaining our express written approval they may not authorize any individual sale or disposal of capital assets constituting a material amount of Verint Technology's assets.