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CLALFINANCE BROKERAGE

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NICE Systems

(Bloomberg Ticker : NICE US)

Nice performance, expensively priced stock
Downgraded to Underperform

The company's results in recent quarters have been iffy, and yet the stock trades at 20.4 times anticipated FY2010 results. The firm's hefty cash holding is yielding virtually nothing. The stock is expensive. Management hasn't offered guidance for either Q4 '09 or FY2010, and we believe the improved performance the consensus has penciled in will prove to be overly-optimistic. We're accordingly downgrading the stock to Underperform, while leaving our per-share price target intact at $30.

Outlook for 2010. Excluding the results of the three acquisitions made in 2009, we look for organic growth at a single digit pace for the year under way. Nice trades at a P/E multiple of 20.4, based on our forecast for 2010 net income and 19.4 times consensus earnings projections, which we believe overly optimistic.
As the global macro backdrop improves, IT budgets will continue rising, supported by more stringent regulatory standards, which should benefit Nice subsidiary Actimize, which operates in the financial services sector. However, even if the global crisis has been brought to heel, we believe Nice's enterprise-product customers will continue keeping expenses under tight rein, seeing that improved corporate results have been the result of cost cutbacks and strict cash-flow management, not top-line growth. A recent large security-segment transaction, totaling $55m, instills us with an element of confidence over Nice's 2010 results. But the company's current share price, in our judgment, is discounting a greater number of large transactions than we believe are likely to come to fruition.

Outlook for Q4. Management has refrained from providing guidance for the quarter under way, but has said that Q4 and FY2010 will see year-on-year growth. The new chief executive is now fully in control, but he could experience difficulties maintaining the tight budgetary expenditures that prevailed throughout 2009.

Cash horde. Nice has $518m on its books, representing $8.26 a share, even after the acquisition of Hexagon and Fortent for $84.5m, but not including the pending $22m acquisition of Orsus. Nice made only three small acquisitions during the global crisis, despite its substantial cash holding. With stock markets having come back substantially, the odds of a major acquisition have declined.

Dollar weakness. The dollar's decline against the shekel won't have a dramatic impact on the company's results in Q4 thanks to hedging the company has in place. But continued dollar weakness may create difficulties for the company, and could lead to additional cost cutting.

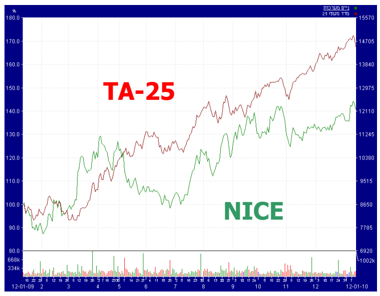
NICE M$ (NON GAAP)	4Q08	3Q09	4Q09E	2008	2009E
Total Revenue	**163.3**	**146.1**	**155.8**	**628.4**	**581.5**
YoY	12.1%	-10.4%	-4.6%	20.2%	-7.5%
Gross Profit	**106.8**	**91.79**	**99.9**	**409.4**	**368.1**
Gross margin	65.4%	62.8%	64.2%	65.1%	63.3%
YoY	13.2%	-13.1%	-6.4%	23.4%	-10.1%
Operting Income	**30.1**	**24.9**	**29.4**	**109.4**	**102.2**
Operting margin	18.4%	17.0%	18.9%	17.4%	17.6%
YoY	17.6%	-17.8%	-2.3%	25.4%	-6.5%
Net Income	**30.6**	**24.0**	**25.0**	**103.2**	**92.4**
Net margin	18.7%	16.4%	16.0%	16.4%	15.9%
YoY	27.0%	-10.2%	-18.3%	26.8%	-10.5%
Diluted EPS (without options)	**0.50**	**0.38**	**0.40**	**1.68**	**1.48**
YoY	**27.9%**	**-12.0%**	**-20.4%**	**16.3%**	**-11.5%**

Updates

- ☑ **Rating**
- ☐ **Price target**
- ☑ **Forecast**

Key figures

Rating	**Underperform**
Price target ($)	**30.0**
Current price ($)	**33.0**
Market cap (B' $)	2.1
12-mo. Change (ADR)	41%
12-mo. Change TA-25	68%
12-mo. high ($)	34.3
12-mo. low ($)	18.0
Daily volume (m' NIS)	23
Free float	99%
Non GAAP P/E 2009E	22.2
Non GAAP P/E 2010E	20.4
EV/EBITDA 09E	13.6
EV/EBITDA 10E	11.5
Previous rating	**Market Perform**
Previous PT ($)	**30**



NICE M$ (NON GAAP)	2007	2008	1Q09	2Q09	3Q09	4Q09E	2009E	2010E	2011E	2012E
Product	319.5	353.6	68.6	65.7	69.7	82.6	286.6	321.7	349.8	372.6
% of revenues	61.1%	56.3%	49.3%	46.7%	47.7%	53.0%	49.3%	49.9%	49.8%	49.8%
YoY	20.7%	10.7%	-19.5%	-26.1%	-20.8%	-9.8%	-19.0%	12.2%	8.7%	6.5%
Services	203.2	274.7	70.6	74.8	76.3	73.2	294.9	323.6	352.5	376.2
YoY	32.5%	35.2%	14.8%	12.6%	1.8%	1.9%	7.3%	9.7%	8.9%	6.7%
Total Revenue	**522.7**	**628.4**	**139.2**	**140.5**	**146.1**	**155.8**	**581.5**	**645.2**	**702.2**	**748.8**
YoY	25.0%	20.2%	-5.1%	-9.6%	-10.4%	-4.6%	-7.5%	11.0%	8.8%	6.6%
Gross Profit	**331.7**	**409.4**	**88.0**	**88.3**	**91.8**	**99.9**	**368.1**	**409.6**	**447.1**	**478.1**
Gross margin	63.5%	65.1%	63.2%	62.9%	62.8%	64.2%	63.3%	63.5%	63.7%	63.9%
YoY	31.3%	23.4%	-7.7%	-13.1%	-13.1%	-6.4%	-10.1%	11.3%	9.2%	7.0%
R&D	55.5	72.6	17.1	16.7	17.8	18.7	70.3	76.7	82.7	87.5
% R&D	10.6%	11.5%	12.3%	11.9%	12.2%	12.0%	12.1%	11.9%	11.8%	11.7%
S&M	114.0	141.1	32.0	32.6	33.5	35.4	133.4	144.1	154.8	162.8
% S&M	21.8%	22.5%	23.0%	23.2%	22.9%	22.7%	22.9%	22.3%	22.0%	21.7%
G&A	75.0	86.4	15.6	14.4	15.6	16.5	62.2	66.4	70.9	74.1
% G&A	14.3%	13.7%	11.2%	10.3%	10.7%	10.6%	10.7%	10.3%	10.1%	9.9%
Operating expenses	244.5	300.0	64.7	63.7	66.9	70.6	265.8	287.2	308.4	324.3
% of revenue	46.8%	47.7%	46.4%	45.4%	45.8%	45.3%	45.7%	44.5%	43.9%	43.3%
Operting Income	**87.2**	**109.4**	**23.3**	**24.6**	**24.9**	**29.4**	**102.2**	**122.3**	**138.7**	**153.8**
Operating margin	**16.7%**	**17.4%**	**16.8%**	**17.5%**	**17.0%**	**18.9%**	**17.6%**	**19.0%**	**19.8%**	**20.5%**
YoY	37.9%	25.4%	0.0%	-4.1%	-17.8%	-2.3%	-6.5%	19.7%	13.4%	10.9%
Financial income	14.8	15.8	2.8	1.8	1.6	1.5	7.7	6.8	6.8	6.8
Income before taxes	**102.0**	**125.2**	**26.1**	**26.4**	**26.5**	**30.8**	**109.9**	**129.2**	**145.5**	**160.6**
taxes	20.6	21.9	4.8	4.4	2.5	5.9	17.5	26.5	30.6	33.7
Tax rate	20.2%	17.5%	18.3%	16.6%	9.5%	19.0%	16.0%	20.5%	21.0%	21.0%
Net Income	**81.4**	**103.2**	**21.3**	**22.1**	**24.0**	**25.0**	**92.4**	**102.7**	**115.0**	**126.9**
Net margin	15.6%	16.4%	15.3%	15.7%	16.4%	16.0%	15.9%	15.9%	16.4%	16.9%
YoY	33.4%	26.8%	-3.1%	-7.9%	-10.2%	-18.3%	-10.5%	11.2%	11.9%	10.4%
Diluted EPS	**1.44**	**1.68**	**0.35**	**0.36**	**0.38**	**0.40**	**1.48**	**1.62**	**1.78**	**1.92**
YoY	**23.6%**	**16.3%**	**-3.0%**	**-7.9%**	**-12.0%**	**-20.4%**	**-11.5%**	**9.1%**	**9.8%**	**8.2%**
Number of shares (diluted)	56.3	61.6	61.6	61.8	62.8	63.0	62.3	63.5	64.8	66.1
One Time -Cash items					0.0	0.0	2.2	0.0	0.0	0.0
Working Capital					(5.7)	5.0	(16.3)	7.6	5.7	4.7
Depreciation					3.4	3.3	12.7	12.7	13.3	14.0
CAPEX					2.5	4.7	12.7	17.4	20.4	21.7
Acquisition					80.5	4.0	88.9	22.0	-	-
FCF	**84.6**	**87.5**	**28.3**	**20.0**	**(54.7)**	**17.2**	**10.8**	**61.5**	**95.4**	**107.7**

NICE DCF

		g				
	35.1	**2.0%**	**2.5%**	**3.0%**	**3.5%**	**4.0%**
WACC	**8.3%**	31.2	33.0	35.1	37.7	40.9
	8.8%	29.4	30.9	32.6	34.7	37.3
	9.3%	27.8	29.1	30.6	32.3	34.4
	9.8%	26.4	27.5	28.8	30.2	32.0
	10.3%	25.2	26.2	27.2	28.5	29.9

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a. Details on the author of the analysis

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b. Full disclosure by the author of this analysis

As far as he is aware, the author of this analysis does not have any conflict of interest at the time of its publication.

c. Notes on the analysis

1. Scale of recommendations
    - **Buy** – the stock is expected to out perform TA100 by 20% or more in 12 months.
    - **Outperform** - the stock is expected to out perform TA100 by 10% to 20% in 12 months.
    - **Marketperform** – the stock is expected to out perform/ under perform TA100 by 10 % in 12 months.
    - **Underperform** – the stock is expected to under perform TA100 by 10% to 20% in 12 months.
    - **Sell** – the stock is expected to under perform TA100 by 20% or more in 12 months.

2. The method used in setting our price target for Nice Systems combined a discounted cash flow model with market-to-book multiples and price-earnings ratios of other companies in the sector, which were compared with those of Nice.

3. The main risks with the potential of materially affecting the price target of Nice's shares include the following:

- Difficulties in integrating the operations of Actimize, and/or creating synergies, or similar difficulties in assimilating any future acquisitions, thereby impairing the company's ability to attain its self-declared financial objectives.
- Sector-wide technological developments that could negatively affect the company should it fail to adapt itself with sufficient alacrity to the new environment.
- The company's dependence on external suppliers, including software suppliers. Such suppliers could fail to meet the company's needs in terms of quality and/or quantity.
- Loss of its principal distributor, Avaya, which would have a materially damaging affect on the company's sales.

d. Independent Judgment

I, Tsahi Avraham, License Number 7553, declare that the opinions stated in this analysis faithfully represent my personal opinions about the shares reviewed and the corporation which issued these shares.

Tsahi Avraham

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2. Date of publication. This research report was issued on Nov. 04, 2009, following the company's Q2 earnings release.

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