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Overvalued Tech: Verint

The use of non-GAAP earnings per share can't hide Verint's worsening performance.

By VITO J. RACANELLI

July 15, 2017

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One stock riding the tech momentum but looking overvalued is Verint Systems, with a $2.5 billion market cap. It specializes in customer engagement, cybersecurity, fraud, and risk and compliance software and services for some 10,000 customers in 180 countries around the world. These can be employed on premises, in the cloud, or some combination of both.

Verint's shares have risen nearly 30% over the past 12 months, to Friday's close of $40.55. Yet its weakening track record over the past four years suggests that investor enthusiasm is misplaced. Revenue growth has dropped steadily, from 24% in fiscal 2015, which ended Jan. 31, to an 8% decline in fiscal 2017. That doesn't sound like a tech company with sustainable growth.

The sales drop has happened even as the company has spent some $765 million in that period on three major acquisitions designed to increase sales, notes David Trainer, president of New Constructs, an independent accounting research firm. Over the same period, costs for research and development, among other expenditures, have risen about twice as fast as revenue.

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Verint's net results based on generally accepted accounting principles have fared even worse, progressively deteriorating to a diluted loss of 47 cents per share in fiscal 2017, which ended in January, from net income of 99 cents in fiscal 2014.

Therein lies the rub. Bulls say the stock is cheap, at a relatively undemanding 15 times non-GAAP estimates of $2.71 per share for the current 2018 fiscal year. The *Barron's* beef is the use of non-

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GAAP numbers, which artificially flatter Verint's results. The GAAP EPS estimate is just 16 cents in fiscal 2018, for an expensive price/earnings ratio of 250 times.

The company and Wall Street prefer non-GAAP measures. Expenses that Verint strips out include stock-based compensation; acquisition expenses; restructuring expenses; amortization of acquired technology; and impairment charges. For a company that has been growing through acquisitions, these are real costs of doing business, not extraordinary expenses, Trainer adds.

The adjustments have created a wide disparity between Verint's GAAP and non-GAAP results. For example, fiscal 2017 non-GAAP EPS showed a profit of $2.51, versus that GAAP diluted loss of 47 cents. Similarly, non-GAAP EPS in fiscal 2016 was $3.04, compared with GAAP earnings of 28 cents, and in fiscal 2015 non-GAAP was $3.35, versus GAAP of 52 cents.

The Melville, N.Y.–based company did not respond to an emailed request for comment.

The use of non-GAAP EPS can't hide Verint's worsening performance, though the company has said the acquisitions would help Verint achieve scale and be accretive. While GAAP EPS fell, executives were awarded some $65 million in stock compensation in each of the past two fiscal years. Adding insult to injury, that expense was then deducted to improve non-GAAP results, Trainer notes, and "that hurts management credibility."

Verint isn't alone among tech companies in using non-GAAP numbers, but Trainer says investors shouldn't rely on them. Nor is it a startup: Verint was founded in 1994 and went public in 2002.

Verint's current valuation "is priced to perfection," adds Trainer. Its customer-engagement business, which is about two thirds of sales, and its cyber intelligence business, which is the other third, compete with the likes of Oracle, Microsoft, and Salesforce.com (CRM).

To justify the current valuation, Trainer says Verint would have to double its net operating profit after tax, or Nopat, margins to 6% and grow Nopat at 19% per year for the next 12 years. (Nopat essentially strips out nonoperating gains and losses from results.) That seems unlikely given its track record.

The caveat to our skeptical view is that Verint might be bought by a firm that is, as Trainer says, "willing to ignore prudent stewardship of capital."

The profit decline since fiscal 2014 can't be ascribed to Verint not reaching scale, and given how big Verint already is, it's hard to see how the company will raise results to meet the bullish expectations built into the stock price. If it doesn't, expect the price to drop.

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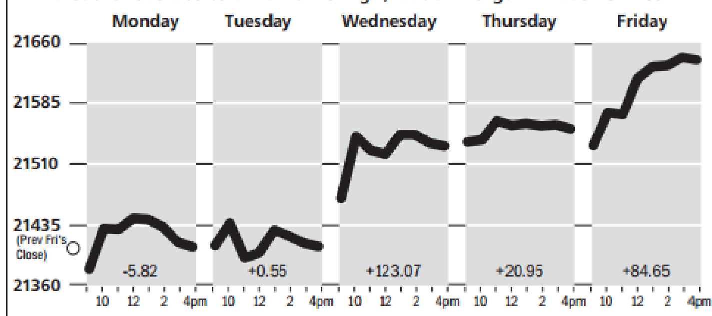

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