

NICE SYSTEMS LTD
Form 20-F
April 28, 2004

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As filed with the United States Securities and Exchange Commission on April 28, 2004

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 20-F

**Annual Report pursuant to Section 13 or 15(d) of
the Securities Exchange Act Of 1934**

For the fiscal year ended December 31, 2003

Commission file number 0-27466

NICE-SYSTEMS LTD.

(Exact name of Registrant as specified in its charter and translation of Registrant's name into English)

Israel

(Jurisdiction of incorporation or organization)

8 Hapnina Street, P.O. Box 690, Ra'anana 43107, Israel

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
----------------------------	--

None

None

Securities registered or to be registered pursuant to Section 12(g) of the Act:

**American Depositary Shares, each representing
one Ordinary Share, par value one
New Israeli Shekel per share**
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: **16,748,953 Ordinary Shares, par value NIS 1.00 Per Share**

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

Indicate by check mark which financial statements the registrant has elected to follow:

Item 17 Item 18

PRELIMINARY NOTE

This annual report contains historical information and forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995 with respect to NICE's business, financial condition and results of operations. The words "anticipate," "believe," "estimate," "expect," "intend," "may," "plan," "project" and "should" and similar expressions, as they relate to NICE or its management, are intended to identify forward-looking statements. Such statements reflect the current views and assumptions of NICE with respect to future events and are subject to risks and uncertainties. Many factors could cause the actual results, performance or achievements of NICE to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements, including, among others, changes in general economic and business conditions, changes in currency exchange rates and interest rates, difficulties or delays in absorbing and integrating acquired operations, products, technologies and personnel, changes in business strategy and various other factors, both referenced and not referenced in this annual report. These risks are more fully described under Item 3, "Key Information Risk Factors" of this annual report. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected, intended, planned or projected. NICE does not intend or assume any obligation to update these forward-looking statements.

In this annual report, all references to "NICE," "we," "us" or "our" are to NICE Systems Ltd, a company organized under the laws of the State of Israel, and its wholly owned subsidiaries, NICE Systems Inc., NICE Systems GmbH, NICE Systems Canada Ltd., NICE CTI Systems UK Ltd., STS Software Systems (1993) Ltd., NiceEye BV, NICE Systems S.A.R.L, NICE APAC Ltd., NiceEye Ltd., Racal Recorders Ltd. and NICE Interactive Solutions India Private Ltd.

In this annual report, unless otherwise specified or unless the context otherwise requires, all references to "\$" or "dollars" are to U.S. dollars and all references to "NIS" are to New Israeli Shekels. Except as otherwise indicated, the financial statements of and information regarding NICE are presented in U.S. dollars.

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PART I

Item 1. Identity of Directors, Senior Management and Advisers.

Not Applicable.

Item 2. Offer Statistics and Expected Timetable.

Not Applicable.

Item 3. Key Information.

Selected Financial Data

The following selected consolidated financial data as of December 31, 2002 and 2003 and for the years ended December 31, 2001 2002 and 2003 have been derived from our audited consolidated financial statements. These financial statements have been prepared in accordance with generally accepted accounting principles in the United States, or U.S. GAAP, and audited by Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global. The consolidated selected financial data as of December 31, 1999, 2000 and 2001 and for the years ended December 31, 1999 and 2001 have been derived from other consolidated financial statements not included in this annual report and have also been prepared in accordance with U.S. GAAP and audited by Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global. The selected consolidated financial data set forth below should be read in conjunction with and are qualified by reference to "Item 5, Operating and Financial Review and Prospects" and the consolidated financial statements and notes thereto and other financial information included elsewhere in this annual report.

On March 31, 2004 we sold the net assets of our COMINT/DF military-related business to ELTA Systems Ltd ("ELTA") for \$4 million in cash in the fourth quarter of 2003. The net assets sold include the intellectual property, fixed assets, inventory, and contracts related to the COMINT/DF product line which includes high performance spectral surveillance and direction finding systems that detect, identify, locate, monitor and record transmission sources.

Revenues for 2003 for the COMINT/DF business totaled approximately \$6.5 million compared with \$7.2 million in 2002. This activity contributed \$1.5 million to net income in 2003 and \$1.4 million in 2002. The COMINT/DF business is therefore treated as a discontinued operation in our financial statements.

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Year Ended December 31, 2003

	1999	2000	2001	2002	2003
(in thousands of U.S. dollars, except per share data)					
OPERATING DATA:					
Revenues					
Products	N/A	N/A	99,395	\$ 127,896	\$ 168,055
Services	N/A	N/A	14,474	27,445	56,203
Total revenues	108,736	144,479	113,869	155,341	224,258
Cost of revenues					
Products	N/A	N/A	47,781	55,453	64,231
Services	N/A	N/A	19,446	26,054	42,084
Total cost of revenues	44,908	69,438	67,227	81,507	106,315
Gross profit	63,828	75,041	46,642	73,834	117,943
Operating expenses:					
Research and development, net	11,853	19,002	18,843	17,122	22,833
Selling and marketing	24,393	34,048	33,719	38,743	53,701
General and administrative	18,334	27,900	26,788	23,806	29,840
Other special charges	5,415	7,646	17,862	29,092	7,082
Total operating expenses	59,995	88,596	97,212	108,763	113,456
Operating income (loss)	3,833	(13,555)	(50,570)	(34,929)	4,487
Financial income, net	4,809	6,188	4,254	3,992	2,034
Other income (expenses), net	(4)	53	(4,846)	(4,065)	292
Income (loss) before taxes on income	8,638	(7,314)	(51,162)	(35,002)	6,813
Taxes on income	74	273	198	350	1,205
Net income (loss) from continuing operations	8,564	(7,587)	(51,360)	(35,352)	5,608
Net income (loss) from discontinuing operations	2,263	2,268	4,565	1,370	1,483
Net income (loss)	\$ 10,827	\$ (5,319)	\$ (46,795)	\$ (33,982)	\$ 7,091
<i>Basic earnings (loss) per share:</i>					
Continuing operations	\$ 0.74	\$ (0.62)	\$ (3.94)	\$ (2.56)	\$ 0.35
Discontinued operations	\$ 0.20	\$ 0.19	\$ 0.35	\$ 0.10	\$ 0.09
Net income (loss)	\$ 0.94	\$ (0.43)	\$ (3.59)	\$ (2.46)	\$ 0.44
Weighted average number of shares used in computing basic earnings (loss) per share (in thousands)					
	11,559	12,317	13,047	13,795	16,038
<i>Diluted earnings (loss) per share:</i>					
Continuing operations	\$ 0.70	\$ (0.62)	\$ (3.94)	\$ (2.56)	\$ 0.33
Discontinued operations	\$ 0.18	\$ 0.19	\$ 0.35	\$ 0.10	\$ 0.09

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Year Ended December 31, 2003

Net income (loss)	\$ 0.88	\$ (0.43)	\$ (3.59)	\$ (2.46)	\$ 0.42
Weighted average number of shares used in computing diluted earnings (loss) per share (in thousands)	12,249	12,317	13,047	13,795	16,781

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At December 31,

	1999	2000	2001	2002	2003
BALANCE SHEET DATA:					
Working capital	\$ 133,398	\$ 117,837	\$ 70,572	\$ 79,583	\$ 56,174
Total assets	206,022	251,489	210,012	236,288	249,415
Total debt	3		24		
Shareholders' equity	179,070	208,577	167,018	154,536	176,831

Exchange Rate Information

The following table shows, for each of the months indicated, the high and low exchange rates between New Israeli Shekels and U.S. dollars, expressed as shekels per U.S. dollar and based upon the daily representative rate of exchange as reported by the Bank of Israel:

Month	High	Low
March 2004	NIS 4.535	NIS 4.483
February 2004	4.493	4.437
January 2004	4.483	4.371
December 2003	4.441	4.352

The following table shows, for periods indicated, the average exchange rate between New Israeli Shekels and U.S. dollars, expressed as shekels per U.S. dollar, calculated based on the average of the exchange rates on the last day of each month during the relevant period as reported by the Bank of Israel:

Year	Average
1999	4.153
2000	4.068
2001	4.203
2002	4.738
2003	4.512

On April 26, 2004 the latest practicable date, the exchange rate was 4.583 NIS per U.S. dollar as reported by the Bank of Israel.

The effect of exchange rate fluctuations on our business and operations is discussed in "Item 5. Operating and Financial Review and Prospects."

Capitalization and Indebtedness

Not applicable.

Reasons for the Offer and Use of Proceeds

Not applicable.

Risk Factors

General Business Risks Relating to Our Business Portfolio and Structure

The markets in which we operate are characterized by rapid technological changes and frequent new products and service introductions. We may not be able to keep up with these rapid technological and other changes.

We are operating in several markets, each 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 existing products obsolete and unmarketable and can exert price pressures on existing products. We anticipate that a number of existing and potential competitors will be introducing new and enhanced products that could adversely affect the competitive position of our products. Our most significant market is the market for voice recording platforms and related enhanced applications (or Voice Platforms and Applications). Voice Platforms and Applications are utilized by entities operating in the contact center, trading floor, public safety and air traffic control segments to capture, store, retrieve and analyze recorded data. The market for our Voice Platforms and Applications is, in particular, characterized by a group of highly competitive vendors that are introducing rapidly changing competitive offerings around evolving industry standards.

Our ability to anticipate changes in technology and industry standards and to successfully develop and introduce new, enhanced and competitive products, on a timely basis, in all the markets where we operate, will be a critical factor in our ability to grow and be competitive. As a result, we expect to continue to make significant expenditures on research and development, particularly with respect to new software applications, which are continuously required in all our business areas. The convergence of voice and data networks and wired and wireless communications could require substantial modification and customization of our current products and business models, as well as the introduction of new products. Further, customer acceptance of these new technologies may be slower than we anticipate. We cannot assure you that the market or demand for our products will grow as rapidly as we expect, or if at all, that we will successfully develop new products or introduce new applications for existing products, that such new products and applications will achieve market acceptance or that the introduction of new products or technological developments by others will not render our products obsolete. In addition, our products must readily integrate with major third party security, telephone, front-office and back-office systems. Any changes to these third party systems could require us to redesign our products, and any such redesign might not be possible on a timely basis or achieve market acceptance. Our inability to develop products that are competitive in technology and price and responsive to customer needs could have a material adverse effect on our business, financial condition and results of operations.

Our business could be materially adversely affected as a result of the risks associated with acquisitions and investments. In particular, we may not succeed in making additional acquisitions or be effective in integrating such acquisitions.

As part of our growth strategy, we have made a number of acquisitions and have made minority investments in complementary businesses, products or technologies. We frequently evaluate the tactical or strategic opportunity available related to complementary businesses, products or technologies. The process of integrating an acquired company's business into our operations and/or of investing in new technologies, may result in unforeseen operating difficulties and large expenditures and may absorb significant management attention that would otherwise be available for the ongoing development of our business. Other risks commonly encountered with acquisitions include the effect of the acquisition on our financial and strategic position and reputation, the failure of the acquired business to further our strategies, the inability to successfully integrate or commercialize acquired technologies or otherwise realize anticipated synergies or economies of scale on a timely basis and the potential impairment of

acquired assets. Moreover, there can be no assurance that the anticipated benefits of any acquisition or investment will be realized. Future acquisitions or investments contemplated and/or consummated could result in potentially dilutive issuances of equity securities, the incurrence of debt and contingent liabilities, and amortization expenses related to intangible assets, any of which could have a material adverse effect on our operating results and financial condition. There can be no assurance that we will be successful in making additional acquisitions or effective in integrating such acquisitions into our existing business. In addition, if we consummate one or more significant acquisitions in which the consideration consists, in whole or in part, of ordinary shares or American Depositary Shares (ADSs), representing our ordinary shares, shareholders would suffer dilution of their interests in us. We have also invested in companies which can still be considered in the start-up or development stages. These investments are inherently risky as the market for the technologies or products they have under development are typically in the early stages and may never materialize. We could lose our entire initial investment in these companies.

We have recently expanded into new markets and may not be able to manage our expansion and anticipated growth effectively.

We have recently established a sales and service infrastructure in India by recruiting sales and service personnel in order to bring about further growth in revenue in the Asia Pacific market. Also, since 2002 we have been expanding our presence in Europe (mainly in the United Kingdom) and in the Middle East and Africa (the EMEA region) through organic growth and through our acquisition of TCS. The growth in our business in the EMEA region is still in its early stage, and in particular, we are just beginning to develop our digital video business in the EMEA region. We expect continued growth, particularly in connection with the enhancement and expansion of our operations in the EMEA region, as well as in the Asia Pacific region. We may establish additional operations within these regions where growth opportunities are projected to warrant the investment. However, we cannot assure you that our revenues will increase as a result of this expansion or that we will be able to recover the expenses we incurred in effecting the expansion. Our failure to effectively manage our expansion of our sales, marketing, service and support organizations could have a negative impact on our business. To accommodate our global expansion, we are continuously implementing new or expanded business systems, procedures and controls. There can be no assurance that the implementation of such systems, procedures, controls and other internal systems can be completed successfully.

We depend upon outsourcers for the manufacture of our key products. The failure of our product manufacturers to meet our quality or delivery requirements would likely have a material adverse effect on our business, results of operations and financial condition.

We entered into a manufacturing agreement with Flextronics Israel Ltd., a subsidiary of Flextronics, a global electronics manufacturing services company in 2002. Under this agreement, Flextronics provides us with a comprehensive manufacturing solution that covers all aspects of the manufacture of our products from order receipt to product shipment, including purchasing, manufacturing, testing, configuration, and delivery services. This agreement currently covers all our products. In addition, in connection with the acquisition of Thales Contact Solutions (or TCS), we assumed a contract manufacturing agreement with Instem Technologies Ltd, a UK company, pursuant to which Instem manufactures all ex-TCS products. As a result of these arrangements, we are now fully dependent on Flextronics and Instem to process orders and manufacture our products. Consequently, the manufacturing process of our products is not in our control.

We may from time to time experience delivery delays due to the inability of Flextronics and Instem to consistently meet our quality or delivery requirements and we may experience production interruptions if either of Flextronics or Instem is for any reason unable to continue the production of our products. Should we have on-going performance issues with our contract manufacturers, the

process to move from one contractor to another is a lengthy and costly process that could affect our ability to execute customer shipment requirements and /or might negatively affect revenue and/or costs. If these manufacturers or any other manufacturer were to cancel contracts or commitments with us or fail to meet the quality or delivery requirements needed to satisfy customer orders for our products, we could lose time-sensitive customer orders and have significantly decreased quarterly revenues and earnings, which would have a material adverse effect on our business, results of operations and financial condition.

If we lose our key suppliers, our business may suffer.

Certain components and subassemblies that are used in the manufacture of our existing products are purchased from a single or a limited number of suppliers. In the event that any of these suppliers are unable to meet our requirements in a timely manner, we may experience an interruption in production until an alternative source of supply can be obtained. Any disruption, or any other interruption of a supplier's ability to provide components to us, could result in delays in making product shipments, which could have a material adverse effect on our business, financial condition and results of operations. In addition, some of our major suppliers use proprietary technology and software code that could require significant redesign of our products in the case of a change in vendor. Further, as suppliers discontinue their products, or modify them in manners incompatible with our current use, or use manufacturing processes and tools that could not be easily migrated to other vendors, we could have significant delays in product availability, which would have a significant adverse impact on our results of operations and financial condition. Although we generally maintain an inventory for some of our components and subassemblies to limit the potential for an interruption and we believe that we can obtain alternative sources of supply in the event our suppliers are unable to meet our requirements in a timely manner, we cannot assure you that our inventory and alternative sources of supply would be sufficient to avoid a material interruption or delay in production and in availability of spare parts.

If we lose our key personnel or cannot recruit additional personnel, our business may suffer.

If our growth continues, we will be required to hire and integrate new employees. Recruiting and retaining qualified engineers and computer programmers to perform research and development and to commercialize our products, as well as qualified personnel to market and sell those products, are critical to our success. As of December 31, 2003, approximately 25% of our employees were devoted to research and product development and 26% were devoted to marketing and sales. There can be no assurance that we will be able to successfully recruit and integrate new employees. Competition for highly skilled employees may again become high in the technology industry. We may also experience personnel changes as a result of our move from multimedia recording equipment towards business performance solutions. An inability to attract and retain highly qualified employees may have an adverse effect on our ability to develop new products and enhancements for existing products and to successfully market such products, all of which would likely have a material adverse effect on our results of operations and financial position. Our success also depends, to a significant extent, upon the continued service of a number of key management, sales, marketing and development employees, the loss of whom could materially adversely affect our business, financial condition and results of operations.

Operating internationally exposes us to additional and unpredictable risks.

We sell our products throughout the world and intend to continue to increase our penetration of international markets. In 1999, 2000, 2001, 2002 and 2003, approximately 99%, 97%, 98%, 98% and 99%, respectively of our total sales were derived from sales to customers outside of Israel, and approximately 52%, 55%, 48%, 52% and 50% respectively, of our total sales were made to customers in North America. A number of risks are inherent in international transactions. Our future results

could be materially adversely affected by a variety of factors including changes in exchange rates, general economic conditions, regulatory requirements, tax structures or changes in tax laws, and longer payment cycles in the countries in our geographic areas of operations. International sales and operations may be limited or disrupted by the imposition of governmental controls and regulations, export license requirements, political instability, trade restrictions, changes in tariffs and difficulties in managing international operations. We cannot assure you that one or more of these factors will not have a material adverse effect on our international operations and, consequently, on our business, financial condition and results of operations.

Inadequate intellectual property protections could prevent us from enforcing or defending our intellectual property and we may be subject to liability in the event our products infringe on the proprietary rights of third parties and we are not successful in defending such claims.

Our success is dependent, to a significant extent, upon our proprietary technology. We currently own eleven patents (including seven in the United States) to protect our technology and we have 72 applications pending in the United States and other countries. We currently rely on a combination of patent, trade secret, copyright and trademark law, together with non-disclosure and non-competition agreements, as well as third party licenses to establish and protect the technology used in our systems. However, we cannot assure you that such measures will be adequate to protect our proprietary technology, that competitors will not develop products with features based upon, or otherwise similar to our systems or that third party licenses will be available to us or that we will prevail in any proceeding instituted by us in order to enjoin competitors from selling similar products. Although we believe that our products do not infringe upon the proprietary rights of third parties, we cannot assure you that one or more third parties will not make a contrary claim or that we will be successful in defending such claim.

From time to time, we receive "cease and desist" letters alleging patent infringements. No formal claims or other actions (aside from Dictaphone) have been filed with respect to such letters. We believe that none of these allegations has merit. We cannot assure you, however, that we will be successful in defending claims if asserted. We also cannot assure you claims if asserted, will not have a material adverse effect on our business, financial condition, or operations. Defending infringement claims or other claims could involve 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 and may be required to obtain licenses which may not be available on reasonable terms.

We face potential product liability claims against us.

Our products focus specifically on organizations' business-critical operations. We may be subject to claims that our products are defective or that some function or malfunction of our products caused or contributed to property, bodily or consequential damages. We minimize this risk by incorporating provisions into our distribution and standard sales agreements that are designed to limit our exposure to potential claims of liability. We carry product liability insurance in the amount of \$15,000,000 per occurrence and \$15,000,000 overall per annum. No assurance can be given that all claims will be covered either by the contractual provisions limiting liability or by the insurance, or that the amount of any individual claim or all claims will be covered by the insurance or that the amount of any individual claim or all claims in the aggregate will not exceed policy coverage limits. A significant liability claim against us could have a material adverse effect on our results of operations and financial position.

We face risks relating to government contracts.

We sell our products to, among other customers, governments and governmental entities. These sales are subject to special risks, such as delays in funding, termination of contracts or sub-contracts at

the convenience of the government, termination, reduction or modification of contracts or sub-contracts in the event of changes in the government's policies or as a result of budgetary constraints, and increased or unexpected costs resulting in losses or reduced profits under fixed price contracts. Although to date we have not experienced any material problems in our performance of government contracts, or in the receipt of payments in full under such contracts, we cannot assure you that we will not experience problems in the future.

Risks Relating to Israel

Our business may be impacted by inflation and NIS exchange rate fluctuations.

Exchange rate fluctuations between the United States dollar and the NIS may negatively affect our earnings. A substantial majority of our revenues and a substantial portion of our expenses are denominated in U.S. dollars. However, a significant portion of the expenses associated with our Israeli operations, including personnel and facilities related expenses, are incurred in NIS. Consequently, inflation in Israel will have the effect of increasing the dollar cost of our operations in Israel, unless it is offset on a timely basis by a devaluation of the NIS relative to the U.S. dollar. We cannot predict any future trends in the rate of inflation in Israel or the rate of devaluation of the NIS against the U.S. dollar. If the U.S. dollar cost of our operations in Israel increases, our dollar-measured results of operations will be adversely affected.

We are subject to the political, economic and military conditions in Israel.

Our headquarters, research and development and main manufacturing facilities are located in the State of Israel, and we are directly affected by the political, economic and military conditions to which Israel is subject. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Since October 2000, there has been a high level of violence between Israel and the Palestinians, which has led to a crisis in the entire peace process and affected Israel's relationship with several Arab countries. Any armed conflicts or political instability in the region could negatively affect local business conditions and harm our results of operations. We cannot predict the effect on the region of the increase in the degree of violence between Israel and the Palestinians. Furthermore, several countries restrict doing business with Israel and Israeli companies, and additional companies may restrict doing business with Israel and Israeli companies as a result of the recent increase in hostilities. Our products are heavily dependent upon components imported from, and most of our sales are made to, countries outside of Israel. Accordingly, our operations could be materially adversely affected if trade between Israel and its present trading partners were interrupted or curtailed.

Some of our directors, officers and employees are currently obligated to perform annual military reserve duty. Additionally, in the event of a military conflict, including the ongoing conflict with the Palestinians, these persons could be required to serve in the military for extended periods of time. We cannot assess the full impact of these requirements on our workforce or business and we cannot predict the effect on us of any expansion or reduction of these obligations.

Service and enforcement of legal process on us and our directors and officers may be difficult to obtain.

Service of process upon our directors and officers, most of whom reside outside the United States, may be difficult to obtain within the United States. Furthermore, since the majority of our assets and most of our directors and officers are located outside the United States, any judgment obtained in the United States against us or these individuals or entities may not be collectible within the United States.

There is doubt as to the enforceability of civil liabilities under the Securities Act and the Securities Exchange Act in original actions instituted in Israel. However, subject to certain time limitations and other conditions, Israeli courts may enforce final judgments of United States courts for liquidated amounts in civil matters, including judgments based upon the civil liability provisions of those Acts.

We depend on the availability of government grants and tax benefits.

We derive and expect to continue to derive significant benefits from various programs and laws in Israel including tax benefits relating to our "Approved Enterprise" programs and certain grants from the Office of the Chief Scientist, or OCS, for research and development. To be eligible for these grants, programs and tax benefits, we must continue to meet certain conditions, including making certain specified investments in fixed assets and conducting the research, development and manufacturing of products developed with such OCS grants in Israel (unless a special approval has been granted). From time to time, the Israeli Government has discussed reducing or eliminating the availability of these grants, programs and benefits and there can be no assurance that the Israeli Government's support of grants, programs and benefits will continue. Pursuant to an amendment to Israeli regulations, income from two of our "Approved Enterprises" is exempt from income tax for only two years. Following this two-year period, the "Approved Enterprise" will be subject to corporate tax at a reduced rate of 10-25% (based on the percentage of foreign ownership in each taxable year) for the following eight years. Income from the other two "Approved Enterprises" is tax exempt for four years. Following this four-year period, the "Approved Enterprises" are subject to corporate tax at a reduced rate of 10-25% (based on the percentage of foreign ownership in each taxable year) for the following six years. If grants, programs and benefits available to us or the laws under which they were granted are eliminated or their scope is further reduced, or if we fail to meet the conditions of existing grants, programs or benefits and are required to refund grants or tax benefits already received (together with interest and certain inflation adjustments), our business, financial condition and results of operations could be materially adversely affected.

Risks Relating to Our Business

The markets in which we operate are highly competitive and we may be unable to compete successfully.

The market for our products and related services, in general, is highly competitive. Additionally, some of our principal competitors such as Witness Inc. and Verint, Inc. may have significantly greater resources and larger customer bases than do we. We have seen evidence of deep price reductions by our competitors and expect to continue to see such behavior in the future, which, if we are required to match such discounting, will adversely affect our gross margins and results of operations. To date, we have been able to manage our product design and component costs. However, there can be no assurance that we will be able to continue to achieve reductions in component and product design costs. Further, the relative and varying rates of increases or decreases in product price and cost could have a material adverse impact on our earnings.

We are expanding the scope of our Voice Platforms and Applications to Enterprise Performance Management solutions, with a focus on analytic software solutions that are based on voice and data content analysis. The market for such content analysis applications is still in its early phases. Successful positioning of our products is a critical factor in our ability to maintain growth. Furthermore, new potential entrants from the traditional enterprise business intelligence and business analytics sector may decide to develop recording and content analysis capabilities and compete with us in this emerging opportunity. As a result, we expect to continue to make significant expenditures on marketing. We cannot assure you that the market awareness or demand for our new products will grow as rapidly as we expect, or if at all, that we will successfully develop new products or introduce new applications for existing products, that such new products and applications will achieve market acceptance or that the introduction of new products or technological developments by others will not adversely impact the demand for our products.

The recent expansion of Voice over Internet Protocol (or VOIP) into contact centers and trading floors may allow one or more of our competitors to take a leadership position with respect to this new technology. Strategic partners may change their vendor preference as a result or may develop

embedded VOIP recording as part of the VOIP switch or networking infrastructure. We cannot assure you that our products or existing partnerships will ensure sustainable leadership.

With respect to the market for digital video products and applications (or Video Platforms and Applications), our Video Platforms and Applications are utilized by entities in the CCTV security, gaming and retail industries to capture, store and analyze digital video and related data. The market for our Video Platforms and Applications is highly competitive and includes products offering a broad range of features and capacities. We compete with a number of large, established manufacturers of video recording systems and distributors of similar products, as well as new emerging competitors. The price per channel of digital recording systems has decreased throughout the market in recent years, primarily due to competitive pressures. We cannot assure you that the price per channel of digital recording systems will not continue to decrease or that our gross profit will not decrease as a result.

With respect to the public safety part of our business, our ability to succeed depends on our ability to develop an effective network of distributors to the mid-low segment of the public safety market, while facing pricing pressures and low barriers to entry. We face significant competition from other well-established competitors, including Dictaphone Corporation, CVDS Inc., VoicePrint Inc. and others. Prices have decreased throughout the market in recent years, primarily due to competitive pressures. We cannot assure you that prices will not continue to decrease or that our gross profit will not decrease as a result. We believe that our ability to sell and distribute our Voice Platforms and Applications in the public safety market depends on the success of our marketing, distribution and product development initiatives. We cannot assure you that we will be successful in these initiatives.

Continuing adverse conditions in the information technology sector may lead to a decreased demand for our Voice Platforms and Applications and may harm our business, financial condition and results of operations.

Our operating results may be materially adversely affected as a result of recent unfavorable economic conditions and reduced information technology spending, particularly in the product segments in which we compete. In particular, many enterprises, telecommunications carriers and service providers have reduced spending in connection with contact centers, and many financial institutions have reduced spending related to trading floors. These trends may adversely affect the growth of sales of new applications. If these industry-wide conditions persist, they will likely have an adverse impact, which may be material, on our business, financial condition and results of operations.

We depend on certain key strategic partners for sales of our products. If our relationship with these partners is for any reason impaired, our business and results of operations will likely suffer.

We have agreements in place with many distributors, dealers and resellers to market and sell our products and services in addition to our direct sales force. We derive a significant percentage of our revenues from one or more of our channel partners. Our financial results could be materially adversely affected if our contracts with channel partners were terminated, if our relationship with channel partners were to deteriorate or if the financial condition of our channel partners were to weaken. Our top channel partner accounted for approximately 20%, 23% and 14% of our revenues in 2003, 2002 and 2001 respectively. Our competitors' ability to penetrate these strategic relationships, particularly our relationship with Avaya Inc., our largest global distribution partner and one of the leading global providers of enterprise business communication platforms in voice, e-business and data, may result in a significant reduction of sales through that partner.

In addition, as our market opportunities change, we may have increased reliance on particular channel partners, which may negatively impact gross margins. There can be no assurance that we will be successful in maintaining or expanding these channels. If we are not successful, we may lose sales

opportunities, customers and market share. In addition, there can be no assurance that our channel partners will not develop or market products or services in competition with us in the future.

We depend on the success of the NiceLog system and related products.

We are dependent on the success of the NiceLog system and related products to maintain profitability. In 2001, 2002 and 2003, approximately and respectively, 88%, 82% and 59% of our revenues were generated from sales of NiceLog systems and related products and we anticipate that such products will continue to account for a significant portion of our sales in the next several years. A significant decline in sales of NiceLog systems and related products, or a significant decrease in the profit margin on such products, could have a material adverse effect on our business, financial condition or results of operations.

We may be unable to develop strategic alliances and marketing partnerships for the global distribution of our Video Platforms and Applications, which may limit our ability to successfully market and sell these products.

We believe that developing marketing partnerships and strategic alliances is an important factor in our success in marketing our Video Platforms and Applications and in penetrating new markets for such products. However, unlike our Voice Platforms and Applications, we have only recently started to develop a number of strategic alliances for the marketing and distribution of our Video Platforms and Applications. We cannot assure you that we will be able to develop such partnerships or strategic alliances on terms that are favorable to us, if at all. Failure to develop such arrangements that are satisfactory to us may limit our ability to successfully market and sell our Video Platforms and Applications and may have a negative impact on our business and results of operations.

We may be unable to commercialize new video content analysis applications.

We are currently in the process of developing and commercializing new video content analysis applications that will enable real-time detection of security threats. The market for such video content analysis applications is still in an early phase. In addition, because this is a new opportunity for changing security procedures and represents a transition to proactive security management, we are not able to predict the pace at which security organizations will adopt this technology, if at all. Successful positioning of our products is a critical factor in our ability to maintain growth. New potential entrants to the market may decide to develop video content analysis capabilities and compete with us in this emerging opportunity. As a result, we expect to continue to make significant expenditures on marketing. We cannot assure you that a market for these products will develop as rapidly as we expect or at all, that we will successfully develop new products or introduce new applications for existing products, that new products or applications will meet market expectations and needs, that we will be successful in penetrating these markets and in marketing our products or that the introduction of new products or technological developments by others will not adversely impact the demand for our video content analysis applications.

If the pace of spending by the U.S. Department of Homeland Security is slower than anticipated, our security business will likely be adversely affected, perhaps materially.

The market for our security solutions in CCTV continuous recording, public safety and law enforcement is highly dependent on the spending cycle and spending scope of the United States Department of Homeland Security, as well as local, state and municipal governments and security organizations in international markets. We cannot be sure that the spending cycle will materialize and that we will be positioned to benefit from the potential opportunities.

Risks Related to our Ordinary Shares and ADSs

Our share price is volatile and may decline.

Numerous factors, some of which are beyond our control, may cause the market price of our ordinary shares or our ADSs, each of which represents one ordinary share, to fluctuate significantly. These factors include, among other things, announcements of technological innovations, development of or disputes concerning our intellectual property rights, customer orders or new products by us or our competitors, currency exchange rate fluctuations, earning releases by us or our competitors, market conditions in the industry and the general state of the securities markets, with particular emphasis on the technology and Israeli sectors of the securities markets.

Our operating results in one or more future periods may fluctuate significantly and may cause our share price to be volatile.

The sales cycle for our products and services is variable, typically ranging between a few weeks to several months from initial contact with the potential client to the signing of a contract. Frequently, sales orders accumulate towards the latter part of a given quarter. Looking forward, given the lead time required by our contract manufacturer, if a large portion of sales orders are received late in the quarter, we may not be able to deliver products within the quarter and thus such sales will be deferred to a future quarter. There can be no assurance that such deferrals will result in sales in the near term, or at all. Thus, delays in executing client orders may affect our revenue and cause our operating results to vary widely. Additionally, as a high percentage of our expenses, particularly employee compensation, is relatively fixed, a variation in the level of sales, especially at or near the end of any quarter, may have a material adverse impact on our quarterly operating results.

In addition, our quarterly operating results may be subject to significant fluctuations due to other factors, including the timing and size of orders and shipments to customers, variations in distribution channels, mix of products, new product introductions, competitive pressures and general economic conditions. It is difficult to predict the exact mix of products for any period between hardware, software and services as well as within the product category between audio platforms and related applications, digital video and communications intelligence. Because a significant portion of our overhead consists of fixed costs, our quarterly results may be adversely impacted if sales fall below management's expectations. In addition, the period of time from order to delivery of our Audio and Video Platforms and Applications is short, and therefore our backlog for such products is currently, and is expected to continue to be, small and substantially unrelated to the level of sales in subsequent periods. As a result, our results of operations for any quarter may not necessarily be indicative of results for any future period. Due to all of the foregoing factors, in some future quarters our sales or operating results may be below our forecasts and the expectations of public market analysts or investors. In such event, the market price of our ordinary shares and ADSs would likely be materially adversely affected.

Item 4. Information on the Company.

General

Our legal and commercial name is NICE Systems Ltd. We are a company limited by shares organized under the laws of the State of Israel. We were originally incorporated as NICE Neptun Intelligent Computer Engineering Ltd. on September 28, 1986 and renamed NICE-Systems Ltd. on October 14, 1991. Our principal executive offices are located at 8 Hapnina Street, P.O. Box 690, Ra'anana 43107, Israel and the telephone number at that location is +972-9-775-3030. Our agent for service in the United States is our subsidiary, NICE Systems Inc., 301 Route 17 North, Rutherford, New Jersey 07070.

Products/Markets Overview

1) Voice Platforms and Applications

Products

Our Voice Platforms and Applications include recording, monitoring, quality management and business performance management solutions which are designed to protect businesses and customers against risks posed by lost or misinterpreted voice or data transmissions and capture, evaluate and analyze customer interactions in order to improve contact center agent performance, business processes and the customers' experience.

Voice recorders (or loggers) are systems that capture and record large volumes of voice data transmitted over multiple telephone or other communication lines and allow users to retrieve and playback specific communication data. Traditional voice recorders were based on analog reel-to-reel technology, which limited an organization's ability to store and retrieve data efficiently, and which could not interface with digital computer and telecommunication networks. In the early 1990s, analog reel-to-reel recorders began to be replaced with analog VHS-based products and, more recently, by digital products, including those based on magnetic disk, optical disk or digital audio tapes (or DAT). Organizations' growing needs to record, process and store large amounts of voice data resulted in the introduction of digitally-based voice recording systems characterized by increased performance and improved system economics. Digital multi-channel recording systems enable simultaneous recording and logging of a large number of channels, while enabling a large number of users to process voice data simultaneously. Digital systems' advantages over traditional analog systems include the immediate random access to recorded data, open connectivity and compact size of both the recording unit and storing and archiving media. Advanced, industry-standard, digital voice recording systems employing CTI technologies allow for integration of the recording and retrieval functions with organizations' computer and telecommunications networks, thereby delivering maximum business benefits, increased user efficiency, and wider access for a larger numbers of users. The demand for sophisticated CTI digital voice recording systems is increasing as a result of the increased demand for digital recording systems, particularly in the contact center market and the conversion by the large installed base of analog systems to digital technology, specifically in the financial institutions, public safety and ATC markets.

NiceLog, our flagship digital voice recording system, is a computer telephony integrated multi-channel voice recording and retrieval system. NiceLog is an open architecture system based on PC architecture and advanced audio compression technology that performs continuous, reliable recordings of up to thousands of analog and digital telephone lines, as well as radio channels, and enables simultaneous access by multiple users. NiceLog can be used either as a stand-alone unit or as part of a highly expandable and scaleable system comprised of several seamlessly integrated units. Each NiceLog unit can simultaneously record, monitor, archive and playback. The NiceLog System includes client and web applications that enable users to access the system, these applications communicated with the voice

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servers using the TCP/IP communication protocol and can run on Windows 98/Me, Windows NT, Windows 2000 and Windows XP operating systems. The system can connect to telecommunication interfaces such as T1, E1, ISDN and analog trunks as well as other more specialized interfaces and is also capable of recording Voice over IP (VoIP) signals. The modular design of the NiceLog system makes it a powerful voice management tool that can be expanded to satisfy customers' needs by integrating it with additional NiceLog units on the same local area network, or LAN.

The NiceLog's system administrator software enables the system's supervisor to configure individual or multiple voice loggers from the central workstation and to setup passwords for individual users. The supervisor software constantly monitors the integrity of the system and displays error or warning messages when storage capacity is low or if there are any other problems with the system. The voice recorders are activated by commands received from a workstation through a LAN. NiceLog stores all information on hard disk for immediate retrieval, and on DAT for long-term archiving, through advanced compression technology. All stored information can be accessed simultaneously by any number of authorized users connected to the LAN through decompression of stored data.

NiceLog's central storage option, NICE Storage Center, can integrate with enterprise storage networks (SAN, NAS or DAS) for long term or medium term voice storage. Central storage sites can hold the entire voice recording from all the organization's different sites thus reducing management costs and redundancy. The retrieval process for voice on the central site is fully automatic.

NiceLog's playback function can be activated by any authorized user through a workstation or a standalone PC, connected via a standard network interface. Easy scanning and subsequent instantaneous random access playback of all recorded voice communications can be performed by a single or several authorized users at their desktop with the help of the NiceLog graphical user interface, which operates under a Windows platform. The playback can be routed directly through a speaker or via the private automatic branch exchange (PABX) to the user's phone extension. The playback user interface provides for full playback control, including advanced features such as random jumps, loops and optional variable speed reproduction without pitch distortion.

NiceCLS is an add-on module included in the NiceLog system. NiceCLS is a CTI server connected to the customer's switch, business data system and other NiceLog system components. It collects call details such as start and stop times, extension numbers, caller ID, routing path in the switch, agent identification, agent group, and customer and transaction identification. This information is integrated with the recorded voice, forming a comprehensive call database and enabling additional recording solutions. With this high level of integration, NiceLog provides additional advanced solutions, such as selective recording and recording on demand, and enables calls to be quickly retrieved and analyzed. The sophisticated indexing of the database enables prompt location and retrieval of recordings. Free-seating environments, such as contact centers and trading floors, where the trader or agent may log-in to any telephone station, require NiceCLS' capabilities for immediate recognition of individual users regardless of the telephone or channel accessed. NiceCLS also enables cost-effective trunk-side recording. NiceCLS can be adapted to the customer's needs based on the host environment and the size and type of database.

NiceCall Focus II is a voice recording system that records up to 32 input channels and provides up to 66,000 hours of on-line voice storage capacity (using NICE's ACA compression) and supports wide range of archiving devices for long-term storage options. NiceCall Focus II offers a wide range of connectivity to PABX and Radio systems and is built on the successful legacy of NiceCall Focus which was introduced in 2001. NiceCall Focus II provides organizations that have a relatively small number of input channels, such as public safety agencies, with a competitively priced yet technologically advanced digital recording product that offers many of the connectivity and processing features of the NiceLog. NiceCall Focus II is being targeted primarily at public safety facilities, including 911 emergency centers and utilities, as well as small bank branches, financial trading sites, and contact centers.

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NiceUniverse, introduced in February 1998, is a comprehensive quality management solution used to evaluate agent performance and to raise the level of customer service in contact centers through advanced voice and desktop screen recording technologies. The NiceUniverse system provides objective evaluation tools and helps identify training requirements for contact center agents, including real-time monitoring for instant access to live customer interactions and enhanced reporting and administration features. NiceUniverse uses a CTI that integrates with ACDs. This enables NiceUniverse to monitor and record agent sessions (voice and screen) on a user-defined schedule and store them in compressed digital format. Sessions are later retrieved by the reviewers from their network PCs or thin clients, and agent performance is graded using customized on-screen templates. From these templates and other data, NiceUniverse generates detailed reports, statistics and graphs to help identify training requirements and set relevant benchmarks for contact center agents.

NICE has also introduced a set of products complementary to the NiceUniverse Quality Management product which are aimed at improving the Contact Center's performance and the quality of the customer experience. These products include:

NiceAdvantage, introduced in 2000, is a platform that provides an integrated recording and quality monitoring solution for mid-size call centers

NICE Executive Connect, a tool that enables decision makers to keep abreast with customer needs and concerns by listening-in to customer interactions with the Contact Center from a remote location via any telephone

NICE Learning powered by Knowlagent, a complete eLearning solution used to deliver target training to Call Center agents based on the knowledge gaps identified in the quality management evaluation process

NICE Interactive Feedback enables organizations to collect customer feedback upon completion of their interaction with a customer, on topics of their choice, using an interactive voice response platform. The data collected is associated with the call and vast reporting options enable the organization to gain insight into their customers' satisfaction from the products and services they provide. Since this information is closely linked to the interaction with the customer, the organization can also use it to benchmark their own evaluation of the service rendered.

NICE Analyzer is a product developed fro