

SEACHANGE INTERNATIONAL INC  
Form 10-Q  
June 09, 2009

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**SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**FORM 10-Q**

(Mark One)

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

For the quarterly period ended April 30, 2009

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-21393

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**SEACHANGE INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of incorporation or organization)

**04-3197974**  
(IRS Employer Identification No.)

**50 Nagog Park, Acton, MA 01720**  
(Address of principal executive offices, including zip code)

**Registrant's telephone number, including area code: (978) 897-0100**

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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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and

post such files). YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.): YES  NO

The number of shares outstanding of the registrant's Common Stock on June 5, 2009 was 30,790,889.

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**PART I FINANCIAL INFORMATION**

**ITEM 1. Financial Statements**

**SEACHANGE INTERNATIONAL, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(in thousands, except share data)**

	<b>April 30, 2009 (unaudited)</b>	<b>January 31, 2009</b>
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<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 66,860	\$ 62,458
Restricted cash	1,472	1,431
Marketable securities	8,954	9,447
Accounts receivable, net of allowance for doubtful accounts of \$900 and \$853, respectively	43,792	41,513
Income taxes receivable	565	771
Unbilled receivables	3,834	4,595
Inventories, net	17,730	17,251
Prepaid expenses and other current assets	4,153	3,348
Total current assets	147,360	140,814
Property and equipment, net	37,266	35,217
Marketable securities, long-term	13,403	12,415
Investments in affiliates	13,043	13,043
Intangible assets, net	4,106	4,621
Goodwill	28,633	27,422
Other assets	512	451
Total assets	\$ 244,323	\$ 233,983
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 13,765	\$ 11,951
Income taxes payable	699	519
Other accrued expenses	8,939	10,592
Customer deposits	9,339	1,966
Deferred revenues	25,533	26,237
Total current liabilities	58,275	51,265
Deferred revenue, long-term	9,122	6,737
Distribution and losses in excess of investment	1,785	1,745
Deferred tax liabilities and taxes payable, long-term	2,072	2,000
Total liabilities	71,254	61,747
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Convertible preferred stock, \$0.01 par value; 5,000,000 shares authorized, none issued or outstanding	-	-
Common stock, \$0.01 par value, 100,000,000 shares authorized; 31,869,837 and 31,822,838 shares issued; 30,698,041 and 30,949,457 outstanding, respectively	318	318
Additional paid-in capital	207,172	206,411
Treasury stock, at cost 1,171,796 and 873,381 common shares, respectively	(7,709)	(5,989)
Accumulated deficit	(17,775)	(18,773)
Accumulated other comprehensive loss	(8,937)	(9,731)
Total stockholders' equity	173,069	172,236
Total liabilities and stockholders' equity	\$ 244,323	\$ 233,983

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

**SEACHANGE INTERNATIONAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
*(in thousands, except share data)*  
*(unaudited)*

	Three Months Ended April 30,	
	2009	2008
<b>Revenues:</b>		
Products	\$ 26,370	\$ 26,994
Services	22,506	18,390
	48,876	45,384
<b>Cost of revenues:</b>		
Products	9,969	10,725

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Services	13,889	11,897
	23,858	22,622
Gross profit	25,018	22,762
Operating expenses:		
Research and development	12,104	10,476
Selling and marketing	6,264	6,423
General and administrative	4,867	5,285
Amortization of intangibles	479	396
	23,714	22,580
Income from operations	1,304	182
Interest and other income, net	135	869
Income before income taxes and equity loss in earnings of affiliates	1,439	1,051
Income tax expense	(244)	(425)
Equity loss in earnings of affiliates, net of tax	(197)	(283)
Net income	\$ 998	\$ 343
Earnings per share:		
Basic	\$ 0.03	\$ 0.01
Diluted	\$ 0.03	\$ 0.01
Weighted average common shares outstanding:		
Basic	30,847	30,477
Diluted	31,220	30,817

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

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**SEACHANGE INTERNATIONAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(in thousands)*  
*(unaudited)*

	<b>Three Months Ended April 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 998	\$ 343
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	1,784	1,728
Amortization of intangibles and capitalized software	530	588
Inventory valuation charge	120	260
Provision for doubtful accounts receivable	50	70
Discounts earned and amortization of premiums on marketable securities	27	15
Equity loss in earnings of affiliates	197	283
Stock-based compensation expense	761	869
Deferred income taxes	(98)	121
Changes in operating assets and liabilities:		
Accounts receivable	(2,233)	(14,676)
Unbilled receivables	761	1,417
Inventories	(1,784)	(3,011)
Income taxes receivable	206	35
Prepaid expenses and other assets	(778)	(789)
Accounts payable	1,784	(384)
Income taxes payable	212	713
Accrued expenses	(1,680)	(372)
Customer deposits	7,373	(107)
Deferred revenues	1,671	5,583
Other	26	21
Net cash provided by (used in) operating activities	9,927	(7,293)
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(2,434)	(715)
Purchases of marketable securities	(11,118)	(11,355)
Proceeds from sale and maturity of marketable securities	10,555	9,974

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Acquisition of businesses and payment of contingent consideration	(723)	-
Investment in Affiliates	(212)	(227)
Net cash used in investing activities	(3,932)	(2,323)
<b>Cash flows from financing activities:</b>		
Purchase of treasury stock	(1,720)	(1,823)
Proceeds from issuance of common stock relating to the stock plans	-	330
Net cash used in financing activities	(1,720)	(1,493)
Effect of exchange rates on cash	127	(103)
Net increase (decrease) in cash and cash equivalents	4,402	(11,212)
Cash and cash equivalents, beginning of period	62,458	63,359
Cash and cash equivalents, end of period	\$ 66,860	\$ 52,147
Supplemental disclosure of non-cash activities:		
Transfer of items originally classified as inventories to equipment	\$ 1,185	\$ 440
Issuance of equity for ODG contingent consideration	-	8,150
Conversion of accounts receivable to equity related to investment in affiliate	-	332

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

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**SEACHANGE INTERNATIONAL, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements as of April 30, 2009 and for the three months ended April 30, 2009 and 2008, respectively, include the accounts of SeaChange International, Inc. and its subsidiaries (the "SeaChange" or the "Company") in accordance with generally accepted accounting principles for interim financial reports and the instructions for Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared under generally accepted accounting principles have been condensed or omitted pursuant to such regulations. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K as filed with the SEC for the fiscal year ended January 31, 2009. In the opinion of management, the accompanying financial statements include all adjustments necessary to present a fair statement of financial position as of April 30, 2009 and results of operations and cash flows for the three months ended April 30, 2009 and 2008. The results of operations and cash flows for the period ended April 30, 2009 are not necessarily indicative of the operating results and cash flows for the full fiscal year or any future periods.

The preparation of these financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates these estimates and judgments, including those related to revenue recognition, valuation of inventory and accounts receivable, valuation of investments and income taxes, stock-based compensation, goodwill, intangible assets and related amortization. The Company bases these estimates on historical and anticipated results and trends and on various other assumptions that the Company believes are reasonable under the circumstances, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results may differ from management's estimates. Additionally, the statement of operations for the quarter ended April 30, 2008 has been recast to reflect the reclassification of foreign currency gain (loss) from operating expenses to interest and other income, net below operating income. These reclassifications had no impact on the Company's results of operations or financial position.

**2. Fair Value Measurements**

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The Company adopted the provisions of Statement of Financial Account Standard No. 157 and FASB Staff Position FAS 157-2, *Fair Value Measurements* (□SFAS 157□ and □FSP FAS 157-2□) on February 1, 2008. The adoption of these pronouncements did not have a material effect on the Company□s financial position or results of operations. Accordingly, the Company is continuing to apply Statement of Financial Accounting Standard No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (□SFAS 115□) for its available for sale securities with offsetting unrealized gains and losses reported in other comprehensive income or loss. Per SFAS 157, the Company is providing fair value measurement disclosures of its available for sale securities in accordance with one of three levels of fair value measurement.

SFAS 157 defines fair value to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and emphasizes that fair value is a market-based measurement, not an entity-specific measurement. It establishes a fair value hierarchy and expands disclosures about fair value measurements in both interim and annual periods. SFAS 157 enables the reader of the financial statements to assess the inputs used to develop fair value measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. SFAS 157 requires that assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

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The Company□s financial assets and liabilities that are measured at fair value on a recurring basis as of April 30, 2009 are as follows:

	April 30, 2009	Fair Value Measurements Using		
		Level 1	Level 2 (in thousands)	Level 3
Financial assets:				
Available for sale marketable securities:				
Current marketable securities	\$ 8,954	\$ 8,954	\$ -	\$ -
Non-current marketable securities	13,403	12,403	-	1,000
<b>Total</b>	<b>\$ 22,357</b>	<b>\$ 21,357</b>	<b>\$ -</b>	<b>\$ 1,000</b>

The following table sets forth a reconciliation of assets measured at fair value on a recurring basis with the use of significant unobservable inputs (Level 3) from January 31, 2009 to April 30, 2009 (in thousands):

	Investment in Marketable Securities
Balance at January 31, 2009	\$ 1,000
Purchases	-
<b>Balance at April 30, 2009</b>	<b>\$ 1,000</b>

The Company relies on mark to market valuations to record the fair value of the Company□s available for sale security assets which are measured under a Level 1 input. These assets are publicly traded equity securities for which market prices are readily observable and recorded under the guidelines of SFAS 115. At April 30, 2009, we had \$9.0 million in short-term marketable securities and \$13.4 million in long-term marketable securities. Of the \$22.4 million in available-for-sale securities at April 30, 2009, the Company holds \$1.0 million in auction rate securities ("ARS") that were intended to provide liquidity via an auction process that resets the applicable interest rate in the event there is no new investment in these securities. Due to the uncertainty in the credit markets, this \$1.0 million ARS holding in our investment portfolio has failed to settle on its respective settlement

date resulting in illiquidity in this investment. Consequently, we have not been able to access these funds and do not expect to do so until a future auction of these investments is successful or a buyer is found outside the auction process. Although the maturity date of the underlying security of our ARS investment is twenty-three years, we currently have sufficient cash and cash equivalents, cash from operations and access to unused credit facilities to meet our short term liquidity requirements and do not anticipate that we will need to access our ARS investment. Accordingly, the Company has classified this investment at par value which approximates fair value.

### 3. Inventories

Inventories consist of the following:

	April 30, 2009	January 31, 2009
	(in thousands)	
Components and assemblies	\$ 9,458	\$ 8,501
Finished products	8,272	8,750
Total inventory, net	\$ 17,730	\$ 17,251

### 4. Investments in Affiliates

#### *On Demand Deutschland GmbH & Co. KG*

On February 27, 2007, the On Demand Group Limited (["ODG"]), a wholly-owned U.K. subsidiary of SeaChange, entered into an agreement with Tele-Munchen Fernseh GmbH & Co. Produktionsgesellschaft (TMG) to create a joint venture named On Demand Deutschland GmbH & Co. KG. On Demand Deutschland specializes in establishing on-demand and pay-per-view services on multiple platforms in German-speaking Europe. ODG contributed \$2.8 million to acquire its 50% ownership interest in the joint venture of which \$2.6 million consisted of the fair value of customer contracts and content license agreements contributed by ODG and \$154,000 represented a cash contribution. The customer contracts and licensed content had no book value. SeaChange determined that this investment is an operating joint venture and does not require consolidation under the accounting guidance of FIN No. 46R. Consequently, SeaChange accounts for this investment under the equity method of accounting.

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ODG's original investment in the joint venture was recorded at \$154,000 representing the US dollar equivalent of the initial cash contribution. The difference between the book and fair value of the customer contracts and content license agreements is being accreted over the expected five year life of the contracts and recorded as a gain and an increase in the investment. This gain will be partially offset by ODG's 50% share of the joint venture's amortization expense over the same period related to the acquired contracts and content license agreements. ODG also recorded a net payable amount to the joint venture of \$337,000 as of the joint venture formation date (February 27, 2007) reflecting the transfer of net liabilities incurred by ODG related to the joint venture as well as the joint venture's reimbursement of previously incurred costs by ODG of \$787,000 related to joint venture activities prior to its formation. Consistent with EITF 89-7, *Exchange of Assets or Interest in a Subsidiary for a Noncontrolling Equity Interest in a New Entity*, ODG did not record other income in connection with the reimbursement of these costs or any other gains as ODG is deemed to have a commitment to support the operations of the joint venture. ODG treated the reimbursement and other gain for a total of \$869,000 as a capital distribution in excess of the carrying value of its investment in the joint venture. This capital distribution will be accreted over the expected five year life of the customer contracts and recorded as a gain and an increase in the investment in the joint venture.

ODG entered into a Service Agreement with the joint venture whereby ODG provides content aggregation, distribution, marketing and administration services to the joint venture under an arm's length fee structure. In the three months ended April 30, 2009 and 2008, ODG recorded revenues of \$344,000 and \$581,000 (USD equivalent) respectively, related to the Service Agreement. ODG's share of profits from this agreement in proportion to its equity ownership interest is eliminated in consolidation.

The Shareholder's Agreement requires ODG to provide cash contributions up to \$4.2 million (USD equivalent) upon the request of the joint venture's management and approval by the shareholders of the joint venture. In February 2009, ODG made an additional cash contribution of \$212,000 to the joint venture.

ODG recorded its proportionate share of the joint venture's losses for the three months ending April 30 2009 and April 30, 2008 of \$197,000 and \$283,000 respectively. Due to the capital distribution and ODG's share of the joint venture's net loss exceeding the book value of its investment in the joint venture, the investment is recorded as a long-term liability of \$1.6 million at April 30, 2009 and 2008.

## 5. Acquisitions and Dispositions

On November 19, 2008, ODG entered into a Share Purchase Agreement (the "Share Purchase Agreement") providing for the purchase by ODG of all the outstanding capital stock (the "Mobix Shares") of Mobix Interactive Limited ("Mobix"). Mobix is a London, England based company that provides software and content services related to the deployment of mobile video services for wireless network operators.

At the closing, ODG paid the shareholders of Mobix approximately £2 million (approximately \$3 million USD) in cash for the Mobix Shares, with an additional £1 million (approximately \$1.5 million USD) deposited in escrow which was subsequently released back to ODG on May 27, 2009 due to Mobix failing to meet certain performance goals within the Share Purchase Agreement. Previously, on March 16, 2009, ODG paid £500,000 in cash (approximately \$700,000 USD) to the former shareholders of Mobix due to Mobix meeting a performance goal within the Share Purchase Agreement. This payment was recorded as goodwill on the Company's balance sheet as of April 30, 2009.

In addition, under the earnout provisions in the Share Purchase Agreement, if Mobix meets certain performance goals over the three year period ending November 19, 2011, primarily related to the financial performance of Mobix, SeaChange will be obligated to make additional cash payments aggregating £8.3 million (approximately \$12.4 million USD). The contingent consideration will be reduced or increased based upon Mobix's actual performance relative to the performance goals. Any payout of contingent consideration will be recorded as additional goodwill.

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The acquisition was accounted for under the purchase method of accounting. Accordingly, the financial position and results of operations of Mobix's business have been consolidated subsequent to the acquisition date. The Company is currently undergoing a valuation of the assets and liabilities acquired and it is expected to finalize the purchase price allocation by the fourth quarter of fiscal 2010. The allocation of the purchase price is preliminarily based on the Company's best estimates of fair values as of November 19, 2008 and is as follows, subject to the final valuation results (in thousands):

<b>Consideration:</b>	
Cash paid, net of cash acquired of \$209	\$ 3,514
Transaction costs	413
Total consideration	\$ 3,927
<b>Preliminary allocation of the purchase consideration:</b>	
Liabilities assumed	\$ (898)
Tangible assets acquired	592
Goodwill	4,233
	<u>\$ 3,927</u>

SeaChange determined that the goodwill included the value of the Mobix work force and expected synergies in global sales and marketing, especially within the European market, and in content services related to the deployment of mobile video services for wireless network operators. The goodwill generated from the acquisition is not tax deductible. The acquired assets, including goodwill, have been assigned to the Media Services operating segment.

## 6. Commitments and Contingencies



SeaChange provides indemnification, to the extent permitted by law, to its officers, directors, employees and agents for liabilities arising from certain events or occurrences while the officer, director, employee, or agent is or was serving at SeaChange's request in such capacity. With respect to acquisitions, SeaChange provides indemnification to or assumes indemnification obligations for the current and former directors, officers and employees of the acquired companies in accordance with the acquired companies' bylaws and charter. As a matter of practice, SeaChange has maintained directors and officers' liability insurance including coverage for directors and officers of acquired companies.

SeaChange enters into agreements in the ordinary course of business with customers, resellers, distributors, integrators and suppliers. Most of these agreements require SeaChange to defend and/or indemnify the other party against intellectual property infringement claims brought by a third party with respect to SeaChange's products. From time to time, SeaChange also indemnifies customers and business partners for damages, losses and liabilities they may suffer or incur relating to personal injury, personal property damage, product liability, and environmental claims relating to the use of SeaChange's products and services or resulting from the acts or omissions of SeaChange, its employees, authorized agents or subcontractors. For example, SeaChange has received requests from several of its customers for indemnification of patent litigation claims asserted by Acacia Media Technologies, USA Video Technology Corporation, Multimedia Patent Trust, and VTran Media Technologies. Management performed an analysis of these requests under Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* (SFAS 5) as interpreted by FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others* (FIN45).

SeaChange warrants that its products, including software products, will substantially perform in accordance with its standard published specifications in effect at the time of delivery. Most warranties have at least a one year duration that generally commence upon installation. In addition, SeaChange provides maintenance support to customers and therefore allocates a portion of the product purchase price to the initial warranty period and recognizes revenue on a straight line basis over that warranty period related to both the warranty obligation and the maintenance support agreement. When SeaChange receives revenue for extended warranties beyond the standard duration, it is deferred and recognized on a straight line basis over the contract period. Related costs are expensed as incurred.

In the ordinary course of business, SeaChange provides minimum purchase guarantees to certain of its vendors to ensure continuity of supply against the market demand. Although some of these guarantees provide penalties for cancellations and/or modifications to the purchase commitments as the market demand decreases, most of the guarantees do not. Therefore, as the market demand decreases, SeaChange re-evaluates the accounting implications of guarantees and determines what charges, if any, should be recorded.

With respect to its agreements covering product, business or entity divestitures and acquisitions, SeaChange provides certain representations and warranties and agrees to indemnify and hold such purchasers harmless against breaches of such representations, warranties and covenants. With respect to its acquisitions, SeaChange may, from time to time, assume the liability for certain events or occurrences that took place prior to the date of acquisition.

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SeaChange provides such guarantees and indemnification obligations after considering the economics of the transaction and other factors including but not limited to the liquidity and credit risk of the other party in the transaction. SeaChange believes that the likelihood is remote that any such arrangement could have a material adverse effect on its financial position, results of operation or liquidity. SeaChange records liabilities, as disclosed above, for such guarantees based on the Company's best estimate of probable losses which considers amounts recoverable under any recourse provisions.

## 7. Treasury Stock

On March 11, 2009, SeaChange's Board of Directors authorized the repurchase of up to \$20.0 million of its common stock, par value \$.01 per share, through a share repurchase program. As authorized by the program, shares may be purchased in the open market or through privately negotiated transactions in a manner consistent with applicable securities laws and regulations, including pursuant to a Rule 10b5-1 plan maintained by the Company. This share repurchase program does not obligate the Company to acquire any specific number of

shares and may be suspended or discontinued at any time. All repurchases are expected to be funded from the Company's current cash and investment balances. The timing and amount of the shares to be repurchased will be based on market conditions and other factors, including price, corporate and regulatory requirements and alternative investment opportunities. The repurchase program is scheduled to terminate on January 31, 2010. During the three months ended April 30, 2009, the Company repurchased 298,415 shares at a cost of \$1.7 million.

## 8. Segment Information

The Company is managed and operated as three segments, Software, Servers and Storage, and Media Services, as defined by SFAS No. 131, *Disclosure about Segments of an Enterprise and Related Information*. A description of the three reporting segments is as follows:

- Software segment includes product revenues from the Company's Advertising, VOD, Middleware and Broadcast software, related services such as professional services, installation, training, project management, product maintenance, technical support and software development for those software products, and operating expenses relating to the Software segment such as research and development, selling and marketing and amortization of intangibles.
- Servers and Storage segment includes product revenues from the VOD and Broadcast server product lines and related services such as professional services, installation, training, project management, product maintenance, and technical support for those products and operating expenses relating to the Servers and Storage segment, such as research and development and selling and marketing.
- Media Services segment includes the operations of ODG, including the acquisition of Mobix on November 19, 2008, activities which include content acquisition and preparation services for television service providers and related operating expenses.

Under this reporting structure, the Company further determined that there are significant functions, and therefore costs, that are considered corporate expenses and are not allocated to the reportable segments for the purposes of assessing performance and making operating decisions. These unallocated costs include general and administrative expenses, other than general and administrative expenses related to ODG and Mobix, interest and other income, net, taxes and equity losses in affiliates, which are managed separately at the corporate level.

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The basis of the assumptions for all such revenues, costs and expenses includes significant judgments and estimations. There are no inter-segment revenues for the periods shown below. The Company does not separately track all assets by operating segments nor are the segments evaluated under this criterion. The following summarizes the revenues, gross profit, operating expenses and income from operations by reportable segment:

	Three Months Ended April 30,	
	2009	2008
	(in thousands)	
<b>Software</b>		
Revenue:		
Products	\$ 16,285	\$ 19,153
Services	14,333	10,910
Total revenue	30,618	30,063
Gross profit	17,730	16,496
Operating expenses:		
Research and development	9,478	8,187
Selling and marketing	3,678	3,720
Amortization of intangibles	385	364
	13,541	12,271
<b>Income from operations</b>	<b>\$ 4,189</b>	<b>\$ 4,225</b>
<b>Servers and Storage</b>		
Revenue:		

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Products	\$ 10,085	\$ 7,841
Services	3,968	3,466
<b>Total revenue</b>	<b>14,053</b>	<b>11,307</b>
Gross profit	6,898	5,599
<b>Operating expenses:</b>		
Research and development	2,626	2,289
Selling and marketing	2,586	2,673
	5,212	4,962
<b>Income from operations</b>	<b>\$ 1,686</b>	<b>\$ 637</b>
<b>Media Services</b>		
Service revenue	\$ 4,205	\$ 4,014
Gross profit	390	667
<b>Operating expenses:</b>		
Selling and marketing	-	30
General and administrative	819	815
Amortization of intangibles	94	32
	913	877
<b>Loss from operations</b>	<b>\$ (523)</b>	<b>\$ (210)</b>
<b>Unallocated Corporate</b>		
<b>Operating expenses:</b>		
General and administrative	\$ 4,048	\$ 4,470
<b>Total unallocated corporate expenses</b>	<b>\$ 4,048</b>	<b>\$ 4,470</b>
<b>Consolidated income from operations</b>	<b>\$ 1,304</b>	<b>\$ 182</b>

For the period ended April 30, 2008, The Company has reclassified revenue originated in Canada from Latin American revenue to North American revenue and added the United Kingdom revenue to Europe and Middle East to conform to the April 30, 2009 presentation.

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The following table summarizes revenues by geographic locations:

	Three Months Ended April 30,			
	2009		2008	
	Amount	%	Amount	%
Revenues by customers' geographic locations:	<b>(in thousands, except percentages)</b>			
North America	\$ 37,124	76%	\$ 31,484	70%
Europe and Middle East	9,061	19%	9,587	21%
Latin America	1,572	3%	957	2%
Asia Pacific and other international locations	1,119	2%	3,356	7%
<b>Total</b>	<b>\$ 48,876</b>		<b>\$ 45,384</b>	

The following summarizes revenues by significant customer where such revenue exceeded 10% of total revenues for the indicated period:

Three Months  
Ended  
April 30,

	2009	2008
Customer A	24%	27%
Customer B	10%	13%
Customer C	18%	- *

\* Denotes a percentage less than 10%

International sales accounted for approximately 26% and 31% of total revenues in the three months ended April 30, 2009 and 2008, respectively. In light of the high proportion of revenues derived from our international businesses, we expect that any adverse movements in foreign currency exchange rates could have an impact on our future translated results within the Condensed Consolidated Statements of Operations.

At April 30, 2009, three different customers accounted for approximately 25%, 23% and 12%, respectively, of the accounts receivable and unbilled receivables balances, and at January 31, 2009, two customers accounted for 27% and 14%, respectively, of SeaChange's accounts receivable and unbilled receivables balances.

Goodwill allocated to the Company's reportable segments and changes in the carrying amount of goodwill for the first three months of fiscal 2010 were as follows:

	Goodwill			Total
	Software	Servers & Storage (in thousands)	Media Services	
Balance at January 31, 2009	\$ 10,162	\$ 754	\$ 16,506	\$ 27,422
Mobix acquisition (Note 5)	-	-	723	723
Cumulative translation adjustment	-	-	488	488
Balance at April 30, 2009	\$ 10,162	\$ 754	\$ 17,717	\$ 28,633

## 9. Income Taxes

For the three months ended April 30, 2009, the Company recorded an income tax provision of \$244,000 on income before taxes and equity loss in earnings of affiliates of \$1.4 million, resulting in an effective income tax provision rate of 17%. For the three months ended April 30, 2008, the Company recorded an income tax provision of \$425,000 on income before income taxes and equity losses in earnings of affiliates of \$1.1 million, resulting in an effective income tax provision rate of 40%.

As of April 30, 2009, the Company has maintained the full valuation allowance against its net U.S. deferred tax assets primarily due to the uncertainties related to the Company's ability to generate sufficient pre-tax income for fiscal 2010 and thereafter. If SeaChange generates sufficient pre-tax income in the future, some portion or all of the valuation allowance could be reversed and a corresponding increase in net income would be reported in future periods.

## 10. Comprehensive Income

During the first quarter of fiscal year 2010, the U.S. dollar weakened against foreign currencies held by our subsidiaries. The Company's Media Services operations in the United Kingdom generated a foreign currency gain of \$835,000 which was recorded as accumulated other comprehensive income increasing the Company's equity section of the balance sheet over the prior period.

The components of comprehensive income consisted of the following:

	<b>Three Months Ended April 30, 2009                      2008 (in thousands)</b>	
Net income	\$ 998	\$ 343
Other comprehensive income (loss):		
Foreign currency translation adjustment	835	(176)
Unrealized loss on marketable securities, net of tax	(41)	(114)
Other comprehensive income (loss), net of tax	794	(290)
Comprehensive income	\$ 1,792	\$ 53

## 11. Earnings Per Share

Earnings per share are presented in accordance with SFAS No. 128, *Earnings Per Share*, which requires the presentation of "basic" earnings per share and "diluted" earnings per share. Basic earnings per share are computed by dividing earnings available to common shareholders by the weighted-average shares of common stock outstanding during the period. For the purposes of calculating diluted earnings per share, the denominator includes both the weighted average number of shares of common stock outstanding during the period and the weighted average number of shares of potential common stock, such as stock options and restricted stock units and warrants, calculated using the treasury stock method.

For the three months ended April 30, 2009 and 2008, respectively, 4,405,291 and 4,565,799 common stock equivalents respectively were anti-dilutive based on the Company's stock price being lower than the option exercise price.

Below is a summary of the shares used in calculating basic and diluted income per share for the periods indicated:

	<b>Three Months Ended April 30, 2009                      2008 (in thousands)</b>	
Weighted average shares used in calculating earnings per share—Basic	30,847	30,477
Dilutive common stock options	373	340
Weighted average shares used in calculating earnings per share—Diluted	31,220	30,817

## 12. Recently Issued Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board issued FASB Staff Position (FSP) SFAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, to provide additional guidance on estimating fair value when the volume and level of activity for an asset or liability have significantly decreased. The FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. The FSP emphasizes that, regardless of whether the volume and level of activity for an asset or liability have decreased significantly and regardless of which valuation technique was used, the objective of a fair value measurement under FASB Statement 157, *Fair Value Measurements*, remains the same—to estimate the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. The FSP also requires expanded disclosures. FSP SFAS 157-4 is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, and must be applied prospectively. If an entity adopts either FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, or FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, for periods ending after March 15, 2009, then it must

adopt this FSP at the same time. The Company intends to adopt FSP SFAS 157-4 effective July 31, 2009 and apply its provisions prospectively. The Company is in the process of evaluating the impact FSP SFAS 157-4 will have on valuing its financial assets and liabilities.

In April 2009, the Financial Accounting Standards Board issued FASB Staff Position (FSP) SFAS 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, to make the guidance on other-than-temporary impairments of debt securities more operational and improve the financial statement disclosures related to other-than-temporary impairments for debt and equity securities. The FSP clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. To evaluate whether a debt security is other-than-temporarily impaired, an entity must first determine whether the fair value of the debt security is less than its amortized cost basis at the balance sheet date. If the fair value is less than the amortized cost basis, then the entity must assess whether it intends to sell the security and whether it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. If an entity determines that it will sell a debt security or that it more likely than not will be required to sell a debt security before recovery of its amortized cost basis, then it must recognize the difference between the fair value and the amortized cost basis of the debt security in earnings. Otherwise, the other-than-temporary impairment must be separated into two components: the amount related to the credit loss and the amount related to all other factors. The amount related to the credit loss must be recognized in earnings, while the other component must be recognized in other comprehensive income, net of tax. The portion of other-than-temporary impairment recognized in earnings would decrease the amortized cost basis of the debt security, and subsequent recoveries in the fair value of the debt security would not result in a write-up of the amortized cost basis. FSP SFAS 115-2 and SFAS 124-2 is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. If an entity adopts either FSP SFAS 157-4 or FSP SFAS 107-1 and APB 28-1 for periods ending after March 15, 2009, then it must adopt this FSP at the same time. The Company intends to adopt FSP FAS 115-2 and FAS 124-2 effective July 31, 2009. The Company is in the process of evaluating the impact FSP FAS 115-2 and FAS 124-2 will have on its financial statements.

In April 2009, the Financial Accounting Standards Board issued FASB Staff Position (FSP) SFAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, to require, on an interim basis, disclosures about the fair value of financial instruments for public entities. FSP SFAS 107-1 and APB 28-1 is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity may early adopt this FSP only if it concurrently adopts both FSP SFAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, and FSP SFAS 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairment*. The Company intends to adopt FSP SFAS 107-1 and APB 28-1 effective July 31, 2009.

### ***Impact of the Recently Adopted Accounting Pronouncements***

In December 2007, the Financial Accounting Standards Board issued Statement 141 (□FASB 141□ revised 2007), *Business Combinations* (□SFAS 141R□), to change how an entity accounts for the acquisition of a business. SFAS 141R replaces existing SFAS 141 in its entirety for business combinations. SFAS 141R carries forward the existing requirements to account for all business combinations using the acquisition method (formerly called the purchase method). In general, SFAS 141R requires acquisition-date fair value measurement of identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree. SFAS 141R eliminates the current cost-based purchase method under SFAS 141.

The new measurement requirements result in the recognition of the full amount of acquisition-date goodwill, which includes amounts attributable to noncontrolling interests. The acquirer recognizes in income any gain or loss on the remeasurement to acquisition-date fair value of consideration transferred or of previously acquired equity interests in the acquiree. Neither the direct costs incurred to effect a business combination nor the costs the acquirer expects to incur under a plan to restructure an acquired business may be included as part of the business combination accounting. As a result, those costs are charged to expense when incurred, except for debt or equity issuance costs, which are accounted for in accordance with other generally accepted accounting principles. SFAS 141R also changes the accounting for contingent consideration, in process research and development, and restructuring costs. In addition, after SFAS 141R is adopted, changes in uncertain tax positions or valuation allowances for deferred tax assets acquired in a business combination are recognized as adjustments

to income tax expense or contributed capital, as appropriate, even if the deferred tax asset or tax position was initially acquired prior to the effective date of SFAS 141R. The Company adopted SFAS 141R as of the required effective date of February 1, 2009 and applies its provisions prospectively to business combinations that occur after adoption. The Company did not have any business combinations during the three months ended April 30, 2009 and thus the adoption of SFAS 141R did not have a significant effect on the Company's financial statements. Additionally, there were no changes in the Company's previously acquired deferred tax assets or uncertain tax positions.

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On December 12, 2007, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 07-01, *Accounting for Collaborative Arrangements* (EITF 07-01). EITF 07-01 defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. EITF 07-01 also establishes the appropriate income statement presentation and classification for joint operating activities and payments between participants, as well as the sufficiency of the disclosures related to these arrangements. EITF 07-01 became effective for the Company beginning February 1, 2009. Companies are required to apply EITF 07-01 using a modified version of retrospective transition for those arrangements in place at the effective date. In addition, companies are required to report the effects of the application of EITF 07-01 as a change in accounting principle through retrospective application to all prior periods presented for all arrangements existing as of the effective date, unless it is impracticable to apply the effects of the change retrospectively. The Company does not currently have any collaborative arrangements. The adoption of EITF 07-01 did not have a material impact on the Company's results of operations and financial position.

In April 2008, the Financial Accounting Standards Board issued FASB Staff Position (FSP) SFAS 142-3, *Determination of the Useful Life of Intangible Assets*, to provide guidance for determining the useful life of recognized intangible assets and to improve consistency between the period of expected cash flows used to measure the fair value of a recognized intangible asset and the useful life of the intangible asset as determined under FASB Statement 142 (SFAS 142), *Goodwill and Other Intangible Assets*. The FSP requires that an entity consider its own historical experience in renewing or extending similar arrangements. However, the entity must adjust that experience based on entity-specific factors included in SFAS 142. If the company lacks historical experience to consider for similar arrangements, it would consider assumptions that market participants would use about renewal or extension, as adjusted for the entity-specific factors under SFAS 142. The Company adopted FSP SFAS 142-3 as of the required effective date of February 1, 2009. The Company did not acquire any intangible assets during the three months ended April 30, 2009 nor did it have intangible assets with implicit or explicit renewal or extension terms. As a result, the adoption of FSP SFAS 142-3 did not have a significant effect on the Company's results of operations and financial position.

## **ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following information should be read in conjunction with the unaudited condensed consolidated financial information and the notes thereto included in this Quarterly Report on Form 10-Q. In addition to historical information, the following discussion and other parts of this Quarterly Report contain forward-looking statements, as that term is defined in the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties. You should not place undue reliance on these forward-looking statements. Actual events or results may differ materially due to competitive factors and other factors referred to in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for our fiscal year ended January 31, 2009 and elsewhere in this Quarterly Report. These factors may cause our actual results to differ materially from any forward-looking statement.

### **Overview**

We are a leading developer, manufacturer and marketer of digital video systems and services including the management, aggregation, licensing, storage, and distribution of video, television, gaming and advertisement content to cable system operators, telecommunications companies and broadcast television companies.

The Company is managed and operated as three segments, Software, Servers and Storage, and Media Services, as defined by SFAS No. 131, *Disclosure about Segments of an Enterprise and Related Information*. A description of the three reporting segments is as follows:

- Software segment includes product revenues from the Company's Advertising, VOD, Middleware and Broadcast software, related services such as professional services, installation, training, project management, product maintenance, technical support and software development for those software products, and operating expenses relating to the Software segment such as research and development, selling and marketing and amortization of intangibles.
- Servers and Storage segment includes product revenues from VOD and Broadcast server product lines and related services such as professional services, installation, training, project management, product maintenance, and technical support for those products and operating expenses relating to the Servers and Storage segment, such as research and development and selling and marketing.
- Media Services segment includes the operations of ODG, including the acquisition of Mobix on November 19, 2008, activities which include content acquisition and preparation services for television service providers and related operating expenses.

The Company determined there are significant functions, and therefore costs, that are considered corporate expenses and are not allocated to the reportable segments for the purposes of assessing performance and making operating decisions. These unallocated costs include general and administrative expenses, other than general and administrative expenses related to ODG and Mobix, interest and other income, net, taxes and equity losses in earnings of affiliates, which are managed separately at the corporate level.

The basis of the assumptions for all such revenues, costs and expenses includes significant judgments and estimations. There are no inter-segment revenues for the periods shown below. The Company does not separately track all assets by operating segments nor are the segments evaluated under this criterion.

We have experienced fluctuations in our product revenues from quarter to quarter due to the timing of the receipt of customer orders and the shipment of those orders. The factors that impact the timing of the receipt of customer orders include among other factors:

- the customer's receipt of authorized signatures on their purchase orders;
- the budgetary approvals within the customer's company for capital purchases; and
- the ability to process the purchase order within the customer's organization in a timely manner.

Factors that may impact the shipment of customer orders include:

- the availability of material to produce the product;
- the time required to produce and test the product before delivery; and
- the customer's required delivery date.

The delay in the timing of receipt and shipment of any one customer order can result in significant fluctuations in our revenue reported on a quarterly basis.

Our operating results are significantly influenced by a number of factors, including the mix of products sold and services provided, pricing, costs of materials used in our products and the expansion of our operations during the fiscal year. We price our products and services based upon our costs and consideration of the prices of competitive products and services in the marketplace. The costs of our products primarily consist of the costs of components and subassemblies that have generally declined from product introduction to product maturity. As a result of the growth of our business, our operating expenses have historically increased in the areas of research and development, selling and marketing and administration. In the current state of the economy, we currently expect that customers may still have limited capital spending budgets as we believe they are dependent on advertising revenues to fund their capital equipment purchases. Accordingly, we expect our financial results to vary from quarter to quarter and our historical financial results are not necessarily indicative of future performance. In light of the higher proportion of our international business, we expect movements in foreign exchange rates to have a greater impact on our operating results and the equity section of our balance sheet in the future.



Our ability to continue to generate revenues within the markets that our products are sold and to generate cash from operations and net income is dependent on several factors which include:

- market acceptance of the products and services offered by our customers and increased subscriber usage and demand for these products and services;
- selection by our customers of our products and services versus the products and services being offered by our competitors;
- our ability to introduce new products to the market in a timely manner and to meet the demands of the market for new products and product enhancements;
- our ability to maintain gross margins from the sale of our products and services at a level that will provide us with cash to fund our operations given the pricing pressures within the market and the costs of materials to manufacture our products; and
- our ability to control operating costs given the fluctuations that we have experienced with revenues from quarter to quarter.

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### Three Months ended April 30, 2009 Compared to the Three Months Ended April 30, 2008

The following table sets forth statement of operations data for the three months ended April 30, 2009 compared to the three months ended April 30, 2008.

	<b>Three Months Ended April 30,</b>	
	<b>2009</b>	<b>2008</b>
	<b>(in thousands)</b>	
<b>Revenues:</b>		
Products	\$ 26,370	\$ 26,994
Services	22,506	18,390
	48,876	45,384
<b>Costs and expenses:</b>		
Cost of product revenues	9,969	10,725
Cost of service revenues	13,889	11,897
Research and development	12,104	10,476
Selling and marketing	6,264	6,423
General and administrative	4,867	5,285
Amortization of intangibles	479	396
Income from operations	1,304	182
Interest and other income, net	135	869
Income before income taxes and equity loss in earnings of affiliates	1,439	1,051
Income tax expense	(244)	(425)
Equity loss in earnings of affiliates, net of tax	(197)	(283)
Net income	\$ 998	\$ 343

### Revenues

The following table summarizes information about the Company's reportable segment revenues for the three months ended April 30, 2009 and 2008.

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	<b>Three Months Ended</b>			
	<b>April 30,</b>			
	<b>2009</b>	<b>2008</b>		<b>%</b>
	<b>(in thousands, except for percentage data)</b>			
<b>Software revenues:</b>				
Products	\$ 16,285	\$ 19,153		-15%
Services	14,333	10,910		31%
Total Software revenues	\$ 30,618	\$ 30,063		2%
<b>Servers and Storage revenues:</b>				
Products	\$ 10,085	\$ 7,841		29%
Services	3,968	3,466		14%
Total Servers and Storage revenues	\$ 14,053	\$ 11,307		24%
<b>Media Services:</b>				
Services	\$ 4,205	\$ 4,014		5%
<b>Total consolidated revenue:</b>				
Products	\$ 26,370	\$ 26,994		-2%